BULGARIAN DEVELOPMENT BANK AD

ANNAUL MANAGEMENT REPORT
INDEPENDENT AUDITORS' REPORT AND
SEPARATE FINANCIAL STATEMENTS

31 December 2012

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INDEPENDENT AUDITORS' REPORT

To the shareholders of
Bulgarian Development Bank AD

Report on the Separate Financial Statements

We have audited the accompanying separate financial statements of Bulgarian Development Bank AD ("the Bank") which comprise the separate statement of financial position as at 31 December 2012, the separate statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Separate Financial Statements

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

Auditor's Responsibility

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

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

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

KPMG

Opinion

In our opinion, the separate financial statements give a true and fair view of the unconsolidated financial position of the Bank as at 31 December 2012, and of its unconsolidated financial performance and its unconsolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Report on Other Legal and Regulatory Requirements

Annual report of the activities of the Bank prepared in accordance with the requirements of article 33 of the Accountancy Act

As required under the Accountancy Act, we report that the historical financial information disclosed in the separate annual report of the activities of the Bank, prepared by Management as required under article 33 of the Accountancy Act, is consistent, in all material aspects, with the unconsolidated financial information disclosed in the audited separate financial statements of the Bank as of and for the year ended 31 December 2012. Management is responsible for the preparation of the separate annual report of the activities of the Bank which was approved by the Management Board of the Bank on 14 March 2013.

Tsvetelinka Koleva
Authorised representative

Margarita Goleva
Registered auditor

Специализирано одиторско предприятие
София
Рег. №045
"КПМГ - България" ООД

KPMG Bulgaria OOD

Sofia, 5 April 2013

BULGARIAN DEVELOPMENT BANK AD

SEPARATE STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2012

In thousand of BGN	*Note*	**As at 31.12.2012**	**As at 31.12.2011**
Assets			
Cash and balances with the Central Bank	16	51,606	70,335
Loans and advances to banks	17	858,249	858,948
Loans and advances to customers	18	511,141	477,871
Receivables from the State Budget	19	12,666	335,395
Available-for-sale securities	20	125,401	16,560
Financial assets held-for-trading	21	3,191	2,995
Investments in subsidiaries	22	87,643	84,562
Property, plant and equipment, intangible assets	23	15,014	14,523
Deferred tax assets	14	1,403	1,284
Current tax assets		1,511	636
Other assets	25	6,753	4,038
Assets classified as held for sale	24	4,802	3,244
Total assets		1,679,380	1,870,391
Liabilities			
Deposits from banks	26	113,564	120,432
Deposits from customers	27	443,030	466,826
Borrowings from international institutions	28	337,209	327,963
Other borrowings	29	21,396	195,378
Debt securities issued	30	78,489	78,499
Financial liabilities held-for-trading	31	3,082	3,081
Other liabilities	32	14,115	12,609
Total liabilities		1,010,885	1,204,788
Equity			
Share capital	33	601,774	601,774
Retained earnings	34	7,491	6,218
Revaluation reserves	34	(526)	(403)
Reserves	34	59,756	58,014
Total equity		668,495	665,603
Total liabilities and equity		1,679,380	1,870,391

The notes on pages 8 to 69 are an integral part of these financial statements.

Assen Yagodin
Executive Director

Iliya Karanikolov
Executive Director

Ivan Lichev
Chief accountant

In accordance with an independent auditors' report:

Tsvetelinka Koleva
Authorised representative
KPMG Bulgaria OOD

СПЕЦИАЛИЗИРАНО ОДИТОРСКО ПРЕДПРИЯТИЕ
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Registered auditor

BULGARIAN DEVELOPMENT BANK

SEPARATE STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2012

In thousand of BGN	*Note*	2012	2011
Interest income	6	78,954	82,188
Interest expense	6	(21,480)	(20,751)
Net interest income	6	57,474	61,437
Fee and commission income	7	1,819	1,878
Fee and commission expense	7	(69)	(76)
Net fee and commission income	7	1,750	1,802
Net gains from foreign exchange deals	8	718	340
Net losses from available-for-sale securities	9	(303)	(176)
Net gains/(losses) from financial instruments held-for-trading	10	(6)	979
Other operating gains/(losses)	11	2,284	(335)
Operating income		61,917	64,047
General and administrative expenses	13	(10,699)	(8,636)
Depreciation and amortisation	23	(287)	(213)
Net impairment loss on financial assets and provision expense	12	(42,946)	(48,276)
Profit before income tax		7,985	6,922
Income tax expense	14	(494)	(704)
Profit for the year		7,491	6,218
Other comprehensive income			
Items that may be reclassified to profit or loss in the future:			
Net change in fair value of available-for-sale securities	15	(123)	(99)
Other comprehensive income for the year		(123)	(99)
Total comprehensive income for the year		7,368	6,119

The notes on pages 8 to 69 are an integral part of these financial statements.

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BULGARIAN DEVELOPMENT BANK

SEPARATE STATEMENT OF CHANGES IN EQUITY
AS AT 31 DECEMBER 2012

In thousand of BGN	Share capital	Statutory reserves	Additional reserves	Available-for-sale financial assets Revaluation reserve	Retained earnings	Total
Balance at 1 January 2011	601,774	25,941	6,190	(304)	25,883	659,484
Total comprehensive income for the year						
Profit for the year	-	-	-	-	6,218	6,218
Other comprehensive income	-	-	-	(99)	-	(99)
Total comprehensive income for the year	-	-	-	(99)	6,218	6,119
Transactions with owners, recognised directly in equity						
Transfer to Reserves based on a decision of the owners	-	25,883	-	-	(25,883)	-
Total transactions with owners	-	25,883	-	-	(25,883)	-
Balance at 31 December 2011	601,774	51,824	6,190	(403)	6,218	665,603

SEPARATE STATEMENT OF CHANGES IN EQUITY (CONTINUED)
AS AT 31 DECEMBER 2012

In thousand of BGN	Share capital	Statutory reserves	Additional reserves	Available-for-sale financial assets Revaluation reserve	Retained earnings	Total
Balance at 1 January 2012	601,774	51,824	6,190	(403)	6,218	665,603
Total comprehensive income for the year						
Profit for the year	-	-	-	-	7,491	7,491
Other comprehensive income	-	-	-	(123)	-	(123)
Total comprehensive income for the year	-	-	-	(123)	7,491	7,368
Transactions with owners, recognised directly in equity						
Dividends to equity holders	-	-	-	-	(4,476)	(4,476)
Transfer to Reserves based on a decision of the owners	-	623	1,119	-	(1,742)	-
Total transactions with owners	-	623	1,119	-	(6,218)	-
Balance at 31 December 2012	601,774	52,447	7,309	(526)	7,491	668,495

The notes on pages 8 to 69 are an integral part of these financial statements.

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Registered auditor

BULGARIAN DEVELOPMENT BANK

SEPARATE STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2012

In thousand of BGN	*Note*	2012	2011
Cash flows from operating activities			
Profit for the year		7,491	6,218
Adjustments for:			
Dividends	11	(3,096)	(21)
Net impairment loss on loans and advances	12	38,748	31,150
Net impairment loss and provision expense on bank portfolio guarantees	12	4,161	14,994
Impairment loss on available-for-sale securities	9	6	153
Impairment loss and net loss on sale of other assets		331	2,304
Net (gain)/loss on revaluation of financial instruments classified as held-for-trading		578	(918)
Depreciation and amortisation	23	287	213
Loss from written-off tangible assets	23	26	3
Tax expense	14	494	704
		49,026	54,800
Changes in:			
Reserve Guarantee Fund with the Central Bank	16	(21)	17
Loans and advances to banks		(289,269)	23,681
Loans and advances to customers		(72,018)	(141,431)
Receivables from the State Budget	19	322,729	(69,205)
Available-for-sale securities		(108,970)	1,110
Financial instruments classified as held-for-trading		(773)	1,004
Assets classified as held for sale		(1,558)	47
Other assets		(3,046)	(3,742)
Deposits from banks	26	(6,868)	28,894
Deposits from customers	27	(23,796)	402,542
Other liabilities		(2,655)	(5,708)
Cash flows from operating activities		(137,219)	292,009
Dividends received		15	21
Income taxes paid		(1,488)	(3,046)
Net cash used in operating activities		(138,692)	288,984
Cash flows from investing activities			
Acquisition of property and equipment, and intangible assets		(863)	(554)
Proceeds from the sale of property and equipment, and intangible assets		59	5
Dividends received from investments in subsidiaries		3,081	-
Acquisition of shares in subsidiaries		(3,081)	(52,500)
Net cash used in investing activities		(804)	(53,049)
Cash flows from financing activities			
Dividends paid		(4,476)	-
Repayments on other borrowings		(173,808)	-
Proceeds from other borrowings		-	51,187
Proceeds from borrowings from international institutions		57,163	67,401
Repayments on borrowings from international institutions		(48,101)	(71,905)
Net cash used in financing activities		(169,222)	46,683

BULGARIAN DEVELOPMENT BANK

SEPARATE STATEMENT OF CASH FLOWS (CONTINUED)
FOR THE YEAR ENDED 31 DECEMBER 2012

Net (decrease)/increase in cash and cash equivalents		(308,718)	282,618
Cash and cash equivalents at 1 January	36	480,183	197,565
Cash and cash equivalents at 31 December	36	171,465	480,183

The notes on pages 8 to 69 are an integral part of these financial statements.

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Margarita Goleva
Registered auditor

1. REPORTING ENTITY AND OPERATING POLICIES

Bulgarian Development Bank AD (BDB/the Bank) was initially established on 11 March 1999 as a joint-stock company in Bulgaria under the name Encouragement Bank AD.

The Bulgarian Development Bank Act was adopted on 23 April 2008 (SG 43/29.04.2008) and the structure and the scope of Bank's activities including those for its envisaged subsidiaries were provided for therein. By virtue of that law all rights and obligations were applied to Encouragement Bank AD. Following a requirement of the law, a General Meeting of the Shareholders was held (26 June 2008) at which the name of the Bank was changed to Bulgarian Development Bank and its Articles of Incorporation were amended in line with the new legal requirements thereto.

The registered address of the Bank is 10, Stefan Karadzha, Sofia.

The Bank holds a general banking licence, issued by the Central Bank of Bulgaria (BNB) on 25 February 1999 with latest update of 16 November 2009 (due to the new Credit Institutions Act) and is allowed to conduct all banking transactions permitted by the Bulgarian legislation. Nevertheless, its Articles of Incorporation prohibit the following types of operations: accepting deposits from individuals (except for deposits from the employees), transactions with precious metals, issuance and management of bank cards, and provision of safe-deposit boxes. The Bank is also a licensed financial intermediary and a broker.

The Bank was established with a special purpose – to support the implementation of the economic policies of the State by financing the business development of small and medium-sized enterprises (SME) by maintaining their investment and export abilities and initiatives. With the adoption of the Bulgarian Development Bank Act in 2008 this objective was further incorporated in the principles and scope of the Bank's activities as set by law.

These include:

a) pre-export and export financing of SME;

b) SME financing by investing in equity from its subsidiary the Capital Investment Fund (still not incorporated);

c) financing SME operations and projects either through local intermediary banks or directly;

d) guarantees issuance to SME to serve to local and foreign banks either directly or through its subsidiary the National Guarantee Fund (already established - 2008);

e) refinancing banks that grant loans to SME;

f) financing SME investments abroad;

g) EU financial resources management and support of activities under state, municipal and international projects directed towards the development of the economy of the country, including with regard to the utilisation of funds/subsidies for such projects;

h) other activities relevant to this scope and state objectives.

1. REPORTING ENTITY AND OPERATING POLICIES (CONTINUED)

In early 2012, Bulgarian Development Bank has negotiated with commercial banks credit lines amounting BGN 100 million, which will provide lending to Bulgarian small and medium enterprises (SMEs). It is provided that the funds under the credit lines will be utilized by the partner-banks in two tranches, each amounting BGN 50 million. Partner-banks will be lending the funds to small and medium enterprises (SMEs) at preferential terms. As at 31.12.2012 the utilized credit lines under this program amount to BGN 53,500 thousand.

In mid-September 2012, The Bank signed a Memorandum for lending on preferential terms and providing consultations with the Association of Meat Processors in Bulgaria (AMB). The Memorandum is part of the broad initiative of Bulgarian Development Bank called "Partners" supporting the Bulgarian business. Under the same initiative, in November 2012, the Bank signed cooperation agreements – Memorandum for privileged partnership - with Bulgarian Industrial Capital Association (BICA), Bulgarian Association of Diary Processors, Food Industry Union, National vine and wine chamber, Federation of Bread Producers and Confectioner in Bulgaria and Bulgarian Soft Drinks Association.

In 2012, the commercial banking activity continued as well, including provision of loans to private companies (with priority on long-term and investment loans), special-purpose financing of banks (on-lending), transactions with treasury bonds, deposit and REPO transactions on interbank market, attraction of long-term credit lines and loans from international financial institutions, issuance of bank guarantees – directly to customers (companies) and in favor of lending banks (under the transferred to BDB project of the MLSP "Microcredit guarantee fund"), as well as other financial services in Bulgaria.

At 31.12.2012 the Bank has 124 employees (31.12.2011: 111).

The Bulgarian Development Bank Act (2008) envisages the establishment of two Bank subsidiaries - the Capital Investment Fund and the National Guarantee Fund.

The Capital Investment Fund is at project level and has not been established as at 31 December 2012.

The National Guarantee Fund (the NGF) was established on 12 August 2008 as a sole owner joint-stock company with 100% ownership of BDB. The registered office of the Fund is 10 Stefan Karadzha, Sofia. At 31.12.2012 the registered share capital is 800 000 registered nominal shares with par value of BGN 100 each (31.12.2011: 800 000 registered nominal shares with par value of BGN 100 each), the paid-in capital of which amounts to BGN 80,000,000. (31.12.2011: BGN 80,000,000) (Note № 22).

1. REPORTING ENTITY AND OPERATING POLICIES (CONTINUED)

The scope of NGF's principal activities is defined by the Bulgarian Development Bank Act. It includes:
a) issue of guarantees to supplement the collaterals for SME loans;
b) provide other guarantee products to serve as security for participation in tenders, for good performance;
c) guarantees for advance payments and for payment of loans to exporters;
d) other similar services.
The guarantees shall cover up to 50% of the respective liability to which they refer.
The National Guarantee Fund is managed by a Board of Directors (BD) with a mandate ending 12.08.2016. The members of the BD are: Samuil Shiderov, Dimitar Mitev and Andrey Genev.
At 31 December 2012 the NGF has 14 employees (31.12.2011: 12).

A micro-financing institution JOBS EAD (MFI) was registered on 14.01.2011 as sole proprietorship joint stock company, 100% owned by BDB. The registered address of the MFI is: 1 Angel Kanchev str., Sofia. As of 31.12.2012 the registered shareholder's equity comprises of 76 430 nominal shares with par value of BGN 100 each, and the paid-in capital as at 31.12.2012 is BGN 7,643,000. (31.12.2011: the registered shareholder's equity comprises 45 618 nominal shares with par value of BGN 100 each, and the paid-in capital as at 31.12.2011 is BGN 4,561,800) (Note № 22).

MFI' scope of activities includes:

a) micro-financing /with a maximum equivalent per product per customer – EUR 25,000 /including, but not limited to:
- provision of microloans;
- purchase from third parties and leasing of industrial equipment, automobiles and other vehicles, as well as other assets (financial leasing);
- sale and purchase of such items;
- consultancy.

JOBS MFI is managed by a Board of Directors (BD) with mandate ending 23 December 2013. Members of the board are: Martin Genchev, Ilia Karanikolov and Hristo Karamfilov.
The registration of the company is dated 14.01.2011. As of 31.12.2012 the entity has 11 employees (31.12.2011: 9).

As at 31.12.2012 Bulgarian Development Bank does not have branches.

The separate financial statements have been adopted by the Bank's Management board on 14 March 2013.

2. BASIS OF PREPARATION

Statement of compliance

The separate financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union.

These financial statements have been prepared on an individual basis. The Bank prepares consolidated financial statements as per the Accounting law. These separate financial statements shall be read together with the consolidated financial statements.

Basis of preparation

These financial statements have been prepared on the historical cost basis except for the following items:

- Derivative financial instruments, measured at fair value;
- Trade instruments and other instruments, designated at fair value through profit and loss, as long as the fair value can be appropriately measured;
- Available-for-sale instruments, designated at fair value through profit and loss, as long as the fair value can be appropriately measured;
- Present value of pension liabilities.

Functional and presentation currency

These financial statements are presented in Bulgarian leva (BGN) rounded to the nearest thousand, which is the Bank's functional currency.

Use of estimates and judgments

The preparation of these financial statements requires management to make judgments, estimates and assumptions that affect the application the Bank's accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates and judgments.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 5.

3. SIGNIFICANT ACCOUNTING POLICIES

Financial instruments

The Bank initially recognises loans, receivables and deposits on the date that they have initially originated. All other financial instruments (including assets and liabilities designated at fair value through profit or loss) are recognised initially on the trade date, which is the date that the Bank becomes a party to the contractual provisions of the instrument.

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or the Bank transfers the rights to receive the contractual cash flows in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in such transferred financial asset that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Bank has a legal right to set off the amounts and it intends either to settle them on a net basis or to realize the asset and settle the liability simultaneously.

The Bank has the following non-derivative financial assets: financial assets designated at fair value through profit or loss, loans and advances, assets available-for-sale.

Financial assets classified at fair value through profit or loss

A financial asset is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial assets are designated at fair value trough profit or loss when the Bank manages them, evaluates their performance and makes decisions for purchases and sales on a fair value basis, in accordance with a documented risk management strategy of the Bank. Attributable transaction costs are recognised in profit or loss as incurred.
Financial assets at fair value through profit or loss are measured at fair value and any related changes, including income from dividends are recognised in profit or loss.

Financial assets classified as held for trading include short-term government debt securities that are actively managed by the Bank in order to cover short-term liquidity needs.

Financial assets classified by the entity at fair value through profit or loss comprise equity securities that would otherwise be classified as held for sale.

A derivative is a financial instrument:

- Whose value changes in response to changes in interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable;
- That requires no initial investment, or one that is smaller than would be required for a contract with similar response to changes in market factors;
- That is settled at a future date.

When entering a specific derivative transaction the Bank defines a position to be hedged and have met all the requirements of accounting standards, the corresponding derivative is recognised as such hedging. Derivatives that do not meet the criteria for hedge accounting are classified as held for trading.
Initially, the derivative financial instruments are measured at cost (including transaction costs) and subsequently, they are measured at fair value. Derivatives are accounted for as assets when their fair value is positive and as liabilities when it is negative.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial instruments (continued)

Loans and advances

Loans and advances are financial assets with fixed or determinable payments, that are not quoted in an active market. Loans and advances are initially measured at fair value plus incremental direct transaction costs. Subsequently, loans and advances are measured at their amortised cost using the effective interest rate, less any allowance for impairment. (Note 3: Impairment of financial assets).
Loans and advances include cash and cash equivalents, trade and other receivables.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or are not classified as other category financial assets. Securities are initially recognised at fair value of the consideration given including acquisition costs associated with the investment. After initial recognition, they are measured at fair value and any fair value changes, other than impairment losses (Note 3: Impairment of financial assets) and foreign exchange gains or losses, are recognised in other comprehensive income and presented in the fair value reserve in equity. When an investment classified as available-for sale is derecognised, the accumulated gains or losses in other comprehensive income are reclassified to profit or loss.

The available-for-sale financial assets include securities and investments in other entity shares.

Non-derivative financial liabilities

The Bank initially recognises debt securities and subordinated liabilities at the time of their origination. All other financial liabilities (including such recognised at fair value through profit or loss) are recognised initially on the trade date, which is the date that the Bank becomes a party to the contractual provisions of the instrument.

The financial liabilities are written off when its contractual obligations are discharged, cancelled or expire.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Bank has a legal right to set off the amounts and it intends either to settle them on a net basis or to realize the asset and settle the liability simultaneously.

The Bank classifies the non-derivative financial liabilities as "other financial liabilities". They are initially recognised at fair value with all of the directly attributable transaction costs included and are subsequently measured at amortised cost using the effective interest method.

Other financial liabilities include borrowings, bank overdrafts and trade and other liabilities.
Bank overdrafts that are repayable on demand and form an integral part of the cash management of the Bank are included as a component of cash and cash equivalents for the purposes of the statement of cash flows.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Impairment of financial instruments

At each reporting date the Bank assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset is impaired when there is any objective evidence that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows of the asset that can be estimated reliably.

Objective evidence that financial assets are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, adverse changes in the payment status of a borrower or issuer, economic conditions that lead to failures, the disappearance of an active market for a security.

Financial assets measured at amortised cost

The Bank considers evidence for impairment of financial assets measured at amortised cost (loans and advances and held-to-maturity investment securities) at both a specific asset and collective level. All individually significant assets are assessed for specific impairment. Those found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Those assets that are not individually significant are collectively assessed for impairment by grouping together assets with similar risk characteristics.

In assessing collective impairment the Bank uses statistical modeling of historical trends of the probability of default, the timing of recoveries and the amount of loss incurred, adjusted for management' judgments as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

Impairment losses on assets measured at amortised cost are calculated as the difference between the carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Impairment losses are recognised in profit or loss and reflected in an allowance account against loans and advances or held-to-maturity investment securities. When an event occurring after the impairment was recognised causes the amount of impairment losses to decrease, the decrease in impairment loss is reversed through profit or loss.

Available-for-sale financial assets

Impairment losses on available-for-sale financial assets are recognised by reclassification of the losses accumulated in the fair value reserve in equity to profit or loss. The cumulative loss that is reclassified from equity to profit or loss is the difference between the acquisition cost, net of any principal repayments and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment provisions attributable to the application of the effective interest method are reflected as a component of interest income. If, in a subsequent period, the fair value of an impaired available-for sale debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, then the impairment loss is reversed, with the amount of the reversal recognised in profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised in other comprehensive income.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investments in subsidiaries

Long-term investments representing shares in subsidiaries are recognised in the statement of financial position at cost, which is the fair value of the payments, including direct acquisition costs of the investment. These investments are not traded on stock exchanges.

The investments in subsidiaries are reviewed for impairment. If there are indicators that impairment has occurred, the impairment loss is recognised in the profit and loss.

For acquisition or disposal of investments in subsidiaries the date of the contract is applied. Investments are derecognised when the rights are transferred and thus the control over the economic benefits of investment is lost. Income from their sale are presented separately in "Other income / (loss) from operations" of the statement of comprehensive income (profit or loss for the year).

Property, plant and equipment

Property, plant and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses.

Initial recognition

Upon their initial acquisition, property, plant and equipment are valued at acquisition cost, which comprises the purchase price, including customs charges and any directly attributable costs of bringing the asset to working condition. The directly attributable costs include: costs for site preparation, initial delivery and handling costs, installation costs, professional fees for people involved in the project, non-refundable taxes etc.

Subsequent measurement

The approach chosen by the Bank for subsequent measurement of property, plant and equipment, is the cost model under IAS 16 - acquisition cost less any accumulated depreciation and any accumulated impairment losses.

Any gain or loss on disposal of an item of property, plant and equipment (calculated as the difference between the net proceeds from disposal and the carrying amount of the item) is recognised within other income in profit or loss.

Depreciation

The Bank applies the straight-line depreciation method for property, plant and equipment. The useful life per group of assets is as follows:

- buildings – 50 years
- bank equipment and computers – 5 years
- motor vehicles – 5 years
- fixtures and fittings – 6.7 years

The useful life of the individual group of assets is determined by the management considering: their physical wear, the characteristic features of the equipment, the intentions for future use and the expected obsolescence. The useful life, set for any equipment, is reviewed at each year-end and is adjusted prospectively in case that any material deviations from future expectations concerning the terms of use are determined.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property, plant and equipment (continued)

Subsequent costs
Repair and maintenance costs are recognised as current expenses at the moment they are incurred. Subsequent costs incurred in relation to property, plant and equipment having the nature of replacement of certain significant parts or improvements and restructuring, are capitalized in the carrying amount of the respective asset whereas its residual useful life is reviewed at the date of capitalization. At the same time, the non-depreciated part of the replaced components is derecognised from the carrying amount of the assets and is recognised in the current expenses for the period of the restructuring.

Intangible assets

Intangible assets are measured at cost less accumulated amortisation and any accumulated impairment losses. They include software programs and license for their use.

The Bank applies the straight-line depreciation method for the intangible assets with a determined useful life of 5 years.

The carrying amount of the intangible assets is subject to review for impairment when events or changes in the circumstances indicate that the carrying amount might exceed their recoverable amount. Impairment losses are included in the statement of comprehensive income.

Intangible assets are written-off from the statement of financial position when they are permanently disposed and no future economic benefits are expected from their use or when they are sold. The gains or losses arising from the sale of separate assets from the group of the intangible assets are determined by comparing the proceeds from sale and the carrying amount of the asset at the date of sale.

Impairment of non-financial assets

The carrying amounts of the Bank's non-financial assets, other than investment property, inventory and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indications exist, then the asset's recoverable amount is estimated. For intangible assets with indefinite life or not yet brought into use assets, the recoverable amount is estimated annually. An impairment loss is recognised if the carrying amount of an asset or cash-generating unit (CGU) exceeds its recoverable amount.

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using the pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU. For impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or CGUs.

Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of CGUs are allocated to reduce the carrying amount of the assets in the CGU on a pro rata basis.
An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of amortisation or depreciation, if no impairment loss had been recognised.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Interest income and expense

Interest income and expenses are recognised in the statement of comprehensive income on accrual basis for all interest-bearing instruments using the effective yield method based on the actual price of acquisition or the applicable floating rate. Interest income and expenses include the amortisation of any discount or premium or other differences between the initial carrying amount of an interest-bearing instrument and its amount at maturity calculated on an effective interest rate basis.

Interest income includes coupons earned on available-for-sale debt securities, interest on deposits with other banks, interest on loans and advances to customers, and fees and commissions on loans and advances to customers, which are an integral part of the effective yield of the financial instrument.

Interest expense is recognised on accrual basis and includes the interest accrued on the deposits of customers and banks, as well as on loans received and other borrowed funds, fees and commissions under loans received, which represent an integral part of the effective interest expense.

Fees and commissions

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

Trust management fees are recognised on accrual basis throughout the period of providing the service.

Fee and commission expenses related to servicing nostro accounts with other banks or to the provision of another bank service are recognised at the time of provision of the underlying service and attaining the result from it.

Transactions in foreign currency

Foreign currency transactions are transformed into BGN by applying the daily exchange rate as quoted by the Bulgarian National Bank (BNB) as of the day of the transaction. The receivables and liabilities in foreign currency are revalued on a daily basis. At the end of the year they are revalued in BGN according to closing official rate of BNB, which for the main currencies as of the dates of the financial position are the following:

Foreign currency	31 December 2012	31 December 2011
US dollars	1.48360	1.51158
Euro	1.95583	1.95583

Since 1999 the Bulgarian Lev is pegged to the Euro, the official currency of the European Union, at ratio of EUR 1: BGN 1.95583.

The net gains or losses from changes in the exchange rates incurred from revaluation of receivables, liabilities and from transactions with foreign currencies are included in the statement of comprehensive income, for the period in which they have occurred.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Provisions and contingent liabilities

Provisions are recognised when the Bank has a current constructive or legal obligation as a result of a past event and it is probable that an outflow of resources will be required to repay/settle this obligation. The provisions are measured based on the best estimate, made by the management at the end of reporting period, concerning the expenses that will be incurred for the settlement of the particular obligation. The estimate is discounted if the obligation is long-term. For the measurement of the portfolio provisions statistical methods are applied, based on historical experience and gathered data regarding behavior and events under the guarantee commitments.

Contingent liabilities are obligations arising from past events, the existence of which can be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not entirely within the control of the Bank, or it is not probable that an outflow of resources will be required to settle the obligation. They are not recognised in the statement of financial position but are subject to special disclosure.

Pensions and other payables to personnel under the social security and labour legislation

According to the Bulgarian legislation, the Bank is obliged to pay contributions to social security health insurance funds. The employment relations of the employees with the Bank, in its capacity of an employer, are based on the provisions of the Labour Code.

Short-term employee benefits

Short-term income of the employees of the Bank in the form of remunerations, bonuses and social payments and benefits are recognised as an expense in the statement of comprehensive income in the period when the service thereon has been rendered or the requirements for their receipt have been met and as a current liability at their undiscounted amount. The Bank's payables for social security and health insurance are recognised as a current expense and liability at their undiscounted amount together with the respective benefits they relate to and within the period of their accrual.
At the end of each reporting period the Bank assesses and reports the amount of expected costs on the accumulating paid leaves, which amount is expected to be paid as a result of the unused entitlement. The assessment includes the estimated expenses on the employee's remunerations and the statutory social security and health insurance contributions due by the employer thereon.

Long-term retirement benefits

In accordance with the requirements of the Labour Code, the employer is obliged to pay to its personnel upon retirement an indemnity, which depending on the length of service with an entity varies between two and six gross monthly salaries as at the termination date of the employment. In their nature these are defined benefit plans.
The calculation of the amount of these liabilities requires the participation of qualified actuaries in order to determine their present value at the date of the financial statements, at which they are included in the statement of financial position, adjusted with the amount of the unrecognised actuarial gains and losses, and respectively, the change in their value including the recognised actuarial gains and losses is included in the statement of comprehensive income (profit or loss for the year).

Past service costs are recognised immediately in the statement of comprehensive income.
At the date of issue of each set of annual financial statements, the Bank assigns certified actuaries who provide their report with calculations regarding the long-term retirement benefit obligations. For this purpose, they apply the Projected Unit Credit Method. The present value of the defined benefit obligation is determined by discounting the estimated future cash flows, which are expected to be paid within the maturity of this obligation, and using the interest rates of long-term government bonds, denominated in Bulgarian leva.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Pensions and other payables to personnel under the social security and labour legislation (continued)

Actuarial gains and losses arise from changes in the actuarial assumptions and experience adjustments. Those exceeding the 10% corridor against the present value of the defined benefit obligations at the end of the prior year, are recognised immediately in the statement of comprehensive income (within the profit or loss for the year). The changes in the amount of the liabilities to personnel for indemnities upon retirement, including the interest from unwinding of the present value and the recognised actuarial gains or losses, are recognised as expenses on personnel in the statement of comprehensive income.

Termination benefits

In accordance with the provisions of the Labour Code, the employer is obliged, upon termination of the employment contracts prior to retirement, to pay indemnities as follows:

- for non-observed preliminary notice: one gross monthly salary;
- due to closing down of the enterprise or part of it, staff cuts, reduction of the volume of work and work stoppage for more than 15 days, etc.: one gross monthly salary;
- upon termination of the employment contract due to illness: two gross monthly salaries;
- for unused annual paid leave: for the respective years of the time recognised as service period.

The Bank recognises employee income obligations in the event of employment termination before the normal retirement date when it is demonstrably committed, based on announced plan, to terminating the employment contract with the respective individuals without possibility of withdrawal or in case of formal issuance of documents for voluntary redundancy. Termination benefits due more than 12 months are discounted and presented in the statement of financial position at their present value.

Taxation

Current income taxes are determined in accordance with the requirements of the Bulgarian tax legislation. Current tax comprises tax payable calculated on the basis of the expected taxable income for the year, using the tax rates enacted by the date of preparation of the statement of financial position.

The tax effect, related to transactions and other events, reported in the statement of comprehensive income are recognised as well in the statement of comprehensive income and the tax effect related to transactions and other events, reported directly in the equity, is also recognised directly in the equity.

Deferred tax liabilities are reported for all temporary differences, subject to taxation, except in the events when they arise from the initial recognition of assets and liabilities for a transaction, which at the time of being concluded is not reflected in the accounting or the tax income (tax loss).

Deferred tax assets are recognised for all temporary differences, subject to deduction, to the extent that it is probable that there might be an available taxable profit, against which the relevant deductions under the deferred tax receivables can be made. This is not applicable for the cases when they arise from the initial recognition of assets and liabilities for a transaction, which at the time of being concluded is not reflected in the accounting or the tax income (tax loss).

The deferred taxes are recognised as income or expenses and are included in the net profit for the period, except in cases, when these taxes arise from transactions or events, reported for the same or another period directly in the equity. Deferred taxes are charged or deducted directly from the equity, when these taxes refer to positions, which are charged or deducted during the same or a different period directly in the equity.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and cash equivalents

For the purposes of the cash flow statement cash equivalents comprise cash on hand, cash at current accounts with other banks, demand deposits and placements with other banks – payable at sight and/or with original maturity up to 3 months, including repo deals with original maturity up to 3 months, as well as unrestricted (not blocked) balances with the Central Bank (BNB).
They are presented in the statement of financial position at amortised cost.

Assets classified as held for sale

Assets are classified as held for sale, if their carrying amount will be recovered through a sale and not through a continuing use in the operations of the Bank. Usually, these assets have been initially accepted by the Bank as collaterals and subsequently acquired thereby as a result of a "debt against property" exchange by borrowers that do not perform their obligations as per the agreed terms of loans.
Assets classified in this group are available for immediate sale in their present condition. The management is engaged actively and performs events to realize a sale within at least one year after the date on which the asset has been classified in this group.
Assets classified as held for sale are presented in the statement of financial position separately and are measured at the lower of their carrying amount and their fair value less the direct expected costs to sell.
The assets within this classification group are not depreciated.

Segment reporting

The Bank does not report operating segments, because its major source of risks and returns is the corporate business sector, there isn't a single external customer the revenues from which to form more than 10% percent of the total revenue, and the Bank operates throughout the country. If in the future these factors change and the Bank reports operating segments they will be determined and reported in accordance with the requirements of IFRS 8 Operating segments.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations, endorsed by the EC, are available for early adoption in the annual period ended 31 December 2012, although they are not yet mandatory until a later period. These changes to IFRS have not been applied in preparing these financial statements. The Bank does not plan to adopt these standards early.

Standards, Interpretations and amendments to published Standards that have not been early adopted – endorsed by the EC:

- Amendments to IFRS 7 Disclosures – Offsetting Financial Assets and Financial Liabilities shall be applied, at latest, as from the beginning of the first financial year starting on or after 1 January 2013. The Bank does not expect the Amendments to have any impact on the financial statements since the Bank does not apply offsetting to any of its financial assets and financial liabilities and it has not entered into master netting arrangements.

- IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IFRS 12 Disclosures of Interests in Other Entities, IAS 27 Separate Financial Statements (2011) which supersedes IAS 27 (2008) and IAS 28 Investments in Associates and Joint Ventures (2011) which supersedes IAS 28(2008) shall be applied, at latest, as from the beginning of the first financial year starting on or after 1 January 2014.

  The Bank does not expect IAS 27 (2011) to have material impact on the financial statements, since it does not results in a change in the entity's accounting policy.

- IFRS 13 Fair Value Measurement provides a single source of guidance on how fair value is measured, and replaces the fair value measurement guidance that is currently dispersed throughout IFRS. Subject to limited exceptions, IFRS 13 is applied when fair value measurements or disclosures are required or permitted by other IFRSs. The Bank is currently reviewing its methodologies in determining fair values. IFRS 13 shall be applied, at latest, as from the beginning of the first financial year starting on or after 1 January 2013.

- Amendments to IAS 1 Presentation of Items of Other Comprehensive Income are shall be applied, at latest, as from the beginning of the first financial year starting on or after 1 July 2012. The impact of the initial application of the amendments will depend on the specific items of other comprehensive income at the date of initial application. The amendments are not relevant to the Bank's financial statements, since the Bank does not have other comprehensive income.

- Amended IAS 19 Employee Benefits shall be applied, at latest, as from the beginning of the first financial year starting on or after 1 January 2013. If the Bank were to adopt the amendments earlier than 1 January 2013, the impact would be a debit to other comprehensive income for the year ending 31 December 2012 of the BGN 5 thousand, debit to deferred tax asset of BGN 1 thousand and a credit to defined benefit obligation of BGN 6 thousand.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

New standards and interpretations not yet adopted (continued)

- Amendments to IAS 12 Deferred Tax: Recovery of Underlying Assets is effective shall be applied, at latest, as from the beginning of the first financial year starting on or after 1 January 2013. The Bank does not expect the amendments to have any impact on the financial statements, since they do not result in a change in the Bank's accounting policy.

- Amendments to IAS 32 Offsetting Financial Assets and Financial Liabilities i shall be applied, at latest, as from the beginning of the first financial year starting on or after 1 January 2014. The Bank does not expect the Amendments to have any impact on the financial statements since the Bank does not apply offsetting to any of its financial assets and financial liabilities and it has not entered into master netting arrangements.

- IFRIC Interpretation 20: Stripping Costs in the Production Phase of a Surface Mine shall be applied, at latest, as from the beginning of the first financial year starting on or after 1 January 2013. The Bank does not expect the Interpretation to have any impact on the financial statements since the Bank does not have any stripping activities.

- Amendments to IFRS 1 Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters shall be applied, at latest, as from the beginning of the first financial year starting on or after 1 January 2013. The Bank does not expect the Amendments to have any impact on the financial statements.

IASB/IFRIC documents not yet endorsed by EC:

Management believes that it is appropriate to disclose that the following new or revised standards, new interpretations and amendments to current standards, which are already issued by the International Accounting Standards Board (IASB), are not yet endorsed for adoption by the European Commission, and therefore are not taken into account in preparing these financial statements. The actual effective dates for them will depend on the endorsement decision by the EC.

- IFRS 9 *Financial Instruments (issued November 2009 and Additions to IFRS 9 issued October 2010)* has an effective date 1 January 2015 and could change the classification and measurement of financial instruments.
- Amendments to IFRS 1 *Government Loans* with an effective date of 1 January 2013.
- Improvements to IFRSs 2009-2011 with an effective date of 1 January 2013.
- Amendments to IFRS 10, IFRS 11 and IFRS 12 *Transition Guidance* with an effective date of 1 January 2013.
- Amendments to IFRS 10, IFRS 12 and IAS 27 *Investment Entities* with an effective date of 1 January 2014.

4. FINANCIAL RISK MANAGEMENT

4.1. Credit risk

Credit risk is the risk that the customers/counterparties will fail to discharge their contractual obligations in full and on time to the Bank.

The credit risk is the main risk for the Bank and its management is fundamental in the Bank's activity. Credit risk management is performed in accordance with the law for BDB AD and with the operative laws and regulations of Republic of Bulgaria related to credit activity as long as with the international regulations and bank best practices.

At portfolio level, the Bank have established units for current monitoring and control of the quality of the credit portfolio – Working group for overdue credits, Working group for current control of the credit portfolio, Provisions Committee.

The management of specific credit risk is performed by the Provisions Committee of the Bank and is supervised by both the Management Board and the Supervisory Board. The credit risk management function ensures that appropriate policies are established and its compliance with the related credit monitoring procedures and controls for current supervision of the credits. Exposure to credit portfolio risk is managed through regular analysis of the ability of the borrowers to meet interest and capital repayment obligations and by establishing lending limits as appropriate. Exposure to credit risk is also reduced in part by obtaining different types of collateral.

Based on a Guarantee letter from year 2003 and the subsequent annexes signed with the European Investment Fund (EIF), the Bank participates in the EU SME Guarantee Facility under conditions determined by the long-term EU Program on SMEs. EIF is committed to provide a direct guarantee covering 50% of the remaining loss on the principal and interest of each loan, included in the sub-portfolio of the Bank, formed on the basis of the conditions of the agreement, but not exceeding EUR 2,520 thousand. The Bank has applied reduced requirements in accepting collaterals for the EIF-guaranteed portfolio of loans.

The volume of the loans with EIF guarantee amounts to BGN 10,855 thousand as of 31.12.2012. (As of 31.12.2011: BGN 13,304 thousand). This amount includes the drawn but not paid portion of loans and the engagements undertaken by the Bank under unutilised loans. The payment engagements of EIF at this date amount to BGN 4,929 thousand (31.12.2011: BGN 4,929 thousand), whereas the losses covered by EIF amount to BGN 3,333 thousand (31.12.2011: BGN 3,285 thousand).

Letters of guarantee and letters of credit represent another source of the credit risk. The main purpose of the instruments in form of letters of guarantee and letters of credit is to ensure funds for the customer in case of need. Letters of guarantee and letters of credit, representing irrevocable commitment of the Bank to make a payment in case the customer is not able to meet his/her obligations to a third party. These instruments bear the same credit risk as the loans. Documentary and trade letters of credit, representing written commitment of the Bank on behalf of a customer, authorize a third person to draw funds up to a certain amount under certain conditions. Usually, they are secured with cash deposits, and so they are less risky than direct financing.

The unutilised portion of authorized loan agreements in form of loans, letters of guarantee or letters of credit represents commitments of the Bank. In relation to the credit risk the Bank is potentially exposed to loss to the amount of the total unutilised commitments. However, the likely amount of loss is less than the total unutilised funds since most commitments to extend credits are contingent upon customers maintaining specific credit standards. The Bank monitors on current basis the utilization periods of the loans because longer-term commitments generally have a greater degree of credit risk than the short-term commitments.

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

Maximum exposure of the credit risk

The exposure to the credit risk attributable to financial assets recognised in the statement of financial position is as follows:

In thousand of BGN	**2012**	**2011**
Financial assets		
Cash and balances with the Central Bank	51,606	70,335
Loans and advances to banks	858,249	858,948
Loans and advances to customers	511,141	477,871
Receivables from the State Budget	12,666	335,395
Available-for-sale securities	125,401	16,560
Financial assets held-for-trading	3,191	2,995
	1,562,254	1,762,104

The exposure to credit risk attributable to off-balance sheet contingent commitments not recognised in the statement of financial position is as follows:

In thousand of BGN	**2012**	**2011**
Bank guarantees and letters of credit	47,970	65,825
Unutilised amount of authorized loans	43,966	40,490
	91,936	106,315
Maximum exposure to credit risk	1,654,190	1,868,419

Credit risk - concentration

The Management of the Bank currently monitors the credit risk of concentration of financial assets both by industry sector and by individual counterparty. Limits for maximum exposures are established and periodically analyzed and measured. Due to its major objectives, the Bank has risk exposure of concentration of loans to small- and medium sized enterprises and of long-term investment loans – with maturity of 3 to 10 years (Notes № 18 and 19).

Each variance from the set limits for concentration is approved by the Management Board of the Bank.

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

The financial assets of the Bank (loans and receivables), classified by industry sectors, are presented in the table below:

In thousands of BGN	2012	%	2011	%
Sectors				
Financial services	910,716	61.65	883,298	50.81
Manufacturing	182,139	12.33	160,390	9.23
Transport	87,673	5.94	106,424	6.12
Trade	69,596	4.71	47,174	2.71
Construction	68,053	4.61	78,238	4.50
Collection and disposal of garbage	36,047	2.44	40,783	2.35
Tourist services	31,223	2.11	29,818	1.72
Agriculture	17,532	1.19	19,029	1.09
Operations with real estate	16,165	1.09	3,511	0.20
Receivables from the State Budget	12,666	0.86	335,395	19.29
Other industry sectors	45,314	3.07	34,360	1.98
	1,477,124		1,738,420	

Quality of the loans and receivables

The Bank has implemented internal regulations for risk assessment of every counterparty. The risk assessment is made according to a methodology based on current financial information, forecasts, investments projects execution and targeted use of funds, manner of exposure servicing and information on the state of accepted collaterals. Loans and receivables are classified in four risk groups (2011.: four risk group) depending on the result of the assessment. The adopted classification groups are as follows: **"standard"**, **"watch"**, **"non-performing"** and **"loss"**. The classification of risk exposures is within the competence of the Provisions Committee and is made on monthly basis. In addition, current financial information is required from customers quarterly and is subject to analysis under an internal methodology of Risk and Regulations Department. The investment projects execution and, respectively, loan withdrawal and utilization are currently monitored. The provided collaterals, which are subject to approval by the Credit Committee, are reviewed and revaluated periodically, but not less than once per year. All decisions of the Provisions Committee are controlled and approved by the Management Board of the Bank.

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

The structure of the financial assets of the Bank by risk classification groups is as follows:

In thousand of BGN *As at 31 December 2012*	Standard	Watch	Non-performing	Loss	Total
Loans and advances to banks	858,249	-	-	-	858,249
Receivables from the State Budget	12,666	-	-	-	12,666
Loans for commercial property and construction	368,630	16,505	8,769	46,537	440,441
Trade loans	111,442	8,890	2,346	37,327	160,005
Agricultural loans	-	-	-	2,000	2,000
Consumer loans	682	-	-	-	682
Residential mortgage loans to individuals	2,042	-	-	-	2,042
Other loans and receivables	1,039	-	-	-	1,039
Total financial assets	1,354,750	25,395	11,115	85,864	1,477,124

In thousand of BGN *As at 31 December 2011*	Standard	Watch	Non-performing	Loss	Total
Loans and advances to banks	858,948	-	-	-	858,948
Receivables from the State Budget	335,395	-	-	-	335,395
Loans for commercial property and construction	351,391	37,477	3,687	21,831	414,386
Trade loans	82,339	14,905	906	26,558	124,708
Agricultural loans	-	-	-	2,000	2,000
Consumer loans	756	-	-	-	756
Residential mortgage loans to individuals	1,240	-	-	-	1,240
Other loans and receivables	987	-	-	-	987
Total financial assets	1,631,056	52,382	4,593	50,389	1,738,420

All loans granted to non-financial institutions and individuals are secured. The accepted collaterals are mainly mortgages of land and industrial property, hotels, trade and residential buildings. Additional collaterals are also accepted in the form of pledge on machinery, equipment and inventories, securities, cash deposits, corporate shares, promissory notes, avals and guarantees from third parties. The common practice of the Bank is to require from loan applicants a collateral at least 100% of the contracted loan amount.

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

The table below presents the types of collaterals held by the Bank at updated fair value, determined with the assistance of an internal certified appraiser:

In thousand of BGN	2012	2011
Type of collateral	**Fair value**	**Fair value**
Mortgages	388,534	323,328
Pledge on a ships	79,249	130,997
Pledges on machinery, equipment, installations and inventories	100,983	41,160
Blocked deposits	3,276	1,425
Total collaterals	572,042	496,910

Percentage of exposure that is subject to an arrangement that requires collateralisation:

In thousand of BGN

Type of credit exposure	Principal type of collateral	Percentage of exposure that is subject to an arrangement that requires collateralisation 2012	2011
Loans and advances	1. Mortgages	100	100
	2. Pledge on a ship	100	100
	3. Pledges on machinery, equipment, installations and inventories	61	35
	4. Blocked deposits	11	17
Reverse sale and repurchase agreements	1. Securities	100	100

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

The table below presents data on the portfolio amount of the bank's financial assets by type of instrument at amortised costs and the accumulated impairment losses:

In thousand of BGN	Loans and advances to non-financial institutions		Receivables from the State Budget		Loans and advances to financial institutions		Loans and advances to individuals	
	2012	2011	2012	2011	2012	2011	2012	2011
Impaired on individual basis								
-------watch	25,395	52,382	-	-	-	-	-	-
-------non-performing	11,115	4,593	-	-	-	-	-	-
-------loss	82,755	49,325	-	-	-	-	-	-
Gross value	119,265	106,300	-	-	-	-	-	-
Accumulated impairment loss	(83,801)	(58,874)	-	-	-	-	-	-
Book value	35,464	47,426	-	-	-	-	-	-
Incl. re-negotiated loans	22,895	40,502	-	-	-	-	-	-
Impaired on portfolio basis								
-------standard	411,548	403,012	-	-	-	-	-	-
Gross value	411,548	403,012	-	-	-	-	-	-
Accumulated impairment loss	(11,267)	(7,332)	-	-	-	-	-	-
Book value	400,281	395,680	-	-	-	-	-	-
Incl. re-negotiated loans	219,631	150,679	-	-	-	-	-	-
Past due but not impaired								
-------up to 30 days	260	5,429	-	-	-	-	-	-
-------from 90 to 360 days	489	49	-	-	-	-	-	-
-------over 360 days	2,359	185	-	-	-	-	-	-
Book value	3,108	5,663	-	-	-	-	-	-
Incl. re-negotiated loans	1,227	-	-	-	-	-	-	-
Neither past due nor impaired								
-------standard	69,564	26,276	12,666	335,395	858,249	858,948	2,724	1,996
-------loss	-	830	-	-	-	-	-	-
Book value	69,564	27,106	12,666	335,395	858,249	858,948	2,724	1,996
Incl. re-negotiated loans	29,088	1,920	-	-	49,243	23,464	1,413	1,658
Book value	508,417	475,875	12,666	335,395	885,249	858,948	2,724	1,996
Incl. re-negotiated loans	272,841	193,107	-	-	49,243	23,464	1,413	1,658

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

The Bank may re-negotiate the initial conditions under the signed contacts in case of a request by the contacting parties. Usually these conditions are the terms for disbursement of the loans, loan amounts, interest rates and/or repayment schedules with regard to the amounts of the repaid installments. This is often observed in the case of changes of the projects' original parameters, objectives and scope, including the time schedule for their completion.

The re-negotiated loans and receivables, presented at amortised cost, are as follows:

In thousand of BGN	**2012**	**2011**
Loans for commercial property and construction	237,112	161,857
Trade loans	103,345	66,272
Loans and advances to banks	49,243	23,464
Residential mortgage loans to individuals	937	1,010
Consumer loans	476	648
Other loans and receivables	690	636
	391,803	253,887

The restructured loans and receivables, presented at amortised cost, are as follows:

In thousand of BGN	**2012**	**2011**
Loans for commercial property and construction	14,209	-
Other loans and receivables	386	-
	14,595	-

The Bank's exposure to national debt as at 31.12.2012 and 31.12.2011 is presented in the table below.

In thousand of BGN ***As at 31 December 2012***	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Unstated maturity**	**Total**
Government bonds							
Bulgaria	60,048	-	-	-	-	-	60,048
Total	60,048	-	-	-	-	-	60,048

In thousand of BGN ***As at 31 December 2011***	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Unstated maturity**	**Total**
Government bonds							
Bulgaria	-	-	12	-	989	-	1,001
Total	-	-	12	-	989	-	1,001

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.2. Market risk

Market risk is the risk of adverse movements in interest rates, exchange rates between currencies, liquidity and other factors affecting the price of securities and other financial assets. These movements affect the Bank's profitability and financial position.

Interest risk

Interest risk is the probability for potential change of the net interest income or the net interest margin and the market value of the equity due to the changes in the total market interest levels.

The interest risk is related to the overall activity of the Bank. Tables with the financial assets and liabilities grouped in time intervals depending on their sensitivity to changes in the interest rates, are prepared on regular basis. Where period inconsistencies exist, changes in the interest curve are made to measure the potential risk for the interest income of the Bank. Besides the interest rate sensitivity analyses made, for the interest risk management main sources related to the change in the net interest spread of the Bank are also identified. This helps decision making on the interest rates policies of the Bank, in particular the development of specific products and providing sources of financing with the respective characteristics.

In order to determine the interest rates on loans and amounts due from non-financial institutions, the Bank has implemented internal base levels, which are related to the used financial resources for funding these loans – equity, special-purpose long-term credit facilities and other which are periodically reviewed.

Assets and Liabilities Committee currently monitors the interest risk to which the Bank is exposed and develops measures for its coverage and maintenance within the bank's permitted levels and limits.

The table below summarizes the interest exposure and risk of the Bank. It includes information on Bank's assets and liabilities at their book value in accordance with interest-related clauses, set in the contracts, their maturity structure and sensitivity to the behavior of the interest rates.

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.2. Market risk (continued)

In thousand of BGN *As at 31 December 2012*	*With floating interest rate*	*With fixed interest rate*	*Interest-free*	*Total*
Financial assets				
Cash and balances with the Central Bank	-	-	51,606	51,606
Loans and advances to banks	29,713	828,536	-	858,249
Loans and advances to customers	379,860	131,281	-	511,141
Receivables from the State Budget	-	12,666	-	12,666
Available-for-sale securities	-	123,394	2,007	125,401
Financial assets held-for-trading	2,771	-	420	3,191
Total financial assets	412,344	1,095,877	54,033	1,562,254
Financial liabilities				
Deposits from banks	39,272	74,292	-	113,564
Deposits from customers	303,176	139,854	-	443,030
Borrowings from international institutions	337,209	-	-	337,209
Other borrowings	11,071	10,325	-	21,396
Debt securities issued	-	78,489	-	78,489
Financial liabilities held-for-trading	-	2,618	464	3,082
Total financial liabilities	690,728	305,578	464	996,770
Total interest exposure	(278,384)	790,299	53,569	565,484

In thousand of BGN *As at 31 December 2011*	*With floating interest rate*	*With fixed interest rate*	*Interest-free*	*Total*
Financial assets				
Cash and balances with the Central Bank	-	-	70,335	70,335
Loans and advances to banks	31,272	827,676	-	858,948
Loans and advances to customers	352,934	124,937	-	477,871
Receivables from the State Budget	-	335,395	-	335,395
Available-for-sale securities	5,076	9,461	2,023	16,560
Financial assets held-for-trading	2,995	-	-	2,995
Total financial assets	392,277	1,297,469	72,358	1,762,104
Financial liabilities				
Deposits from banks	54,608	65,824	-	120,432
Deposits from customers	393,958	72,868	-	466,826
Borrowings from international institutions	327,963	-	-	327,963
Other borrowings	10,954	184,424	-	195,378
Debt securities issued	-	78,499	-	78,499
Financial liabilities held-for-trading	-	2,082	999	3,081
Total financial liabilities	787,483	403,697	999	1,192,179
Total interest exposure	(395,206)	893,772	71,359	569,925

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.2. Market risk (continued)

Analysis of interest rate sensitivity

The table below includes the financial instruments of the Bank at book value, categorized by the earlier of interest rate change in the contract or maturity dates.

In thousand of BGN	*Up to 1 month*	*1-3 months*	*3-6 months*	*6-12 months*	*1-5 years*	*Over 5 years*	*Non-interest bearing*	*Total*
As at 31 December 2012								
Financial assets								
Cash and balances with the Central Bank	-	-	-	-	-	-	51,606	51,606
Loans and advances to banks	210,226	80,783	71,906	48,296	141,386	305,652	-	858,249
Loans and advances to customers	379,860	131,281	-	-	-	-	-	511,141
Receivables from the State Budget	-	12,666	-	-	-	-	-	12,666
Available-for-sale securities	60,048	24,925	124	30,537	7,760	-	2,007	125,401
Financial assets held-for-trading	-	2,771	-	-	-	-	420	3,191
Total financial assets	650,134	252,426	72,030	78,833	149,146	305,652	54,033	1,562,254
Financial liabilities								
Deposits from banks	65,854	47,710	-	-	-	-	-	113,564
Deposits from customers	304,114	77,592	963	60,361	-	-	-	443,030
Borrowings from international institutions	45,682	215,112	72,485	3,930	-	-	-	337,209
Other borrowings	-	11,071	-	-	3,134	7,191	-	21,396
Debt securities issued	-	-	-	-	78,489	-	-	78,489
Financial liabilities held-for-trading	-	2,618	-	-	-	-	464	3,082
Total financial liabilities	415,650	354,103	73,448	64,291	81,623	7,191	464	996,770
Total exposure to interest rate sensitivity	234,484	(101,677)	(1,418)	14,542	67,523	298,461	53,569	565,484

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.2. Market risk (continued)

In thousand of BGN	*Up to 1 month*	*1-3 months*	*3-6 months*	*6-12 months*	*1-5 years*	*Over 5 years*	*Non-interest bearing*	*Total*
As at 31 December 2011								
Financial assets								
Cash and balances with the Central Bank	-	-	-	-	-	-	70,335	70,335
Loans and advances to banks	409,897	433	1,938	995	87,900	357,785	-	858,948
Loans and advances to customers	352,934	124,937	-	-	-	-	-	477,871
Receivables from the State Budget	-	335,395	-	-	-	-	-	335,395
Available-for-sale securities	-	75	7,690	1,103	4,680	989	2,023	16,560
Financial assets held-for-trading	-	2,995	-	-	-	-	-	2,995
Total financial assets	762,831	463,835	9,628	2,098	92,580	358,774	72,358	1,762,104
Financial liabilities								
Deposits from banks	81,305	39,127	-	-	-	-	-	120,432
Deposits from customers	395,261	10,655	2,153	120	58,637	-	-	466,826
Borrowings from international institutions	48,147	191,000	79,146	9,670	-	-	-	327,963
Other borrowings	-	10,954	171,206	-	5,839	7,379	-	195,378
Debt securities issued	-	-	-	-	78,499	-	-	78,499
Financial liabilities held-for-trading	-	2,082	999	-	-	-	-	3,081
Total financial liabilities	524,713	253,818	253,504	9,790	142,975	7,379	-	1,192,179
Total exposure to interest rate sensitivity	238,118	210,017	(243,876)	(7,692)	(50,395)	351,395	72,358	569,925

Sensitivity of the interest assets and liabilities with floating interest rate

The table below represents the sensitivity of the Bank on possible changes in the interest rate based on the structure of assets and liabilities as of 31 December with floating interest rate and with the assumption that the influence of the other variables is ignored. The effect is measured and presented as an impact on the financial results after tax. The actual effect of changes in the market interest rates could be different, as a significant portion of the loans and receivables from customers are accumulated at a floating interest rate, based on the determined by the Bank's variable portion, which is influenced by numerous factors.

In thousand of BGN	**2012**		**2011**	
Currency	*Increase in percentage points*	*Sensitivity of the financial result*	*Increase in percentage points*	*Sensitivity of the financial result*
BGN	0.50%	(999)	0.50%	(1,255)
EUR	0.50%	25	0.50%	(274)
BGN	-0.50%	999	-0.50%	1,255
EUR	-0.50%	(25)	-0.50%	274

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.2. Market risk (continued)

Currency risk

The currency risk is a risk with a negative impact of fluctuations in the prevailing currency exchange rates on the financial position and cash flows of the Bank as a result of open currency positions. In the currency risk management the Bank follows the principle of maintaining a minimal open currency positions according to set limits. The currency positions are not formed with speculative purposes but after transactions in foreign currencies related to the normal operating activities. Policy of the Bank is that the main part of the assets and liabilities, and respectively the bank operations, are denominated in EUR or BGN. The Bank does not carry out significant transactions and does not hold significant open positions in currencies other than EUR and BGN. As the Bulgarian lev is pegged to the euro, there is no significant open currency risk for the Bank.

The following table summarizes the Bank's exposure to currency risk. The table includes the financial instruments and the contingent liabilities and commitments of the bank at book value, categorized by type of currency.

In thousand of BGN

As at 31 December 2012	In USD	In EUR	In other foreign currency	In BGN	Total
Financial assets					
Cash and balances with the Central Bank	13	1,717	-	49,876	51,606
Loans and advances to banks	48,791	270,506	80	538,872	858,249
Loans and advances to customers	23,821	352,065	12,849	122,406	511,141
Receivables from the State Budget	-	-	-	12,666	12,666
Available-for-sale securities	-	125,160	-	241	125,401
Financial assets held-for-trading	-	2,771	-	420	3,191
Total financial assets	72,625	752,219	12,929	724,481	1,562,254
Financial liabilities					
Deposits from banks	17,689	58,867	-	37,008	113,564
Deposits from customers	76,350	75,453	-	291,227	443,030
Borrowings from international institutions	-	324,012	13,197	-	337,209
Other borrowings	-	18,262	-	3,134	21,396
Debt securities issued	-	78,489	-	-	78,489
Financial liabilities held-for-trading	-	3,082	-	-	3,082
Total financial liabilities	94,039	558,165	13,197	331,369	996,770
Net balance sheet currency position	(21,414)	194,054	(268)	393,112	565,484
Contingent liabilities and commitments	45	36,620	-	55,271	91,936

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.2. Market risk (continued)

In thousand of BGN *As at 31 December 2011*	In USD	In EUR	In other foreign currency	In BGN	Total
Financial assets					
Cash and balances with the Central Bank	9	623	-	69,703	70,335
Loans and advances to banks	10,880	396,796	108	451,164	858,948
Loans and advances to customers	25,858	321,269	17,387	113,357	477,871
Receivables from the State Budget	-	-	-	335,395	335,395
Available-for-sale securities	-	11,887	-	4,673	16,560
Financial assets held-for-trading	-	2,995	-	-	2,995
Total financial assets	36,747	733,570	17,495	974,292	1,762,104
Financial liabilities					
Deposits from banks	15,274	76,598	-	28,560	120,432
Deposits from customers	4,016	88,653	1	374,156	466,826
Borrowings from international institutions	-	310,263	17,700	-	327,963
Other borrowings	-	18,333	-	177,045	195,378
Debt securities issued	-	78,499	-	-	78,499
Financial liabilities held-for-trading	999	2,082	-	-	3,081
Total financial liabilities	20,289	574,428	17,701	579,761	1,192,179
Net balance sheet currency position	16,458	159,142	(206)	394,531	569,925
Contingent liabilities and commitments	1,133	54,520	-	50,662	106,315

Price risk of shares quoted on the Stock Exchange

The Bank is exposed to price risk in respect to the shares it holds, classified as investments available-for-sale. The management of the Bank monitors and analyzes all changes in the securities market, as well as uses the advisory services of authoritative investment intermediaries in the country. In addition, at this stage, due to the economic and financial crisis, the management of the Bank has decided to greatly reduce the operations on the stock markets, the hold of the purchased shares in the longer horizon for ongoing monitoring of the reported from the respective issuer financial and business indicators, as well as the development of its activities under the circumstances of a crisis.

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.3. Liquidity risk

Liquidity risk is the risk that the bank is unable to meet its current and potential payment obligations as and when they fall due without unacceptable losses.

The business of the Bank requires a stable flow of funds both to replace existing deposits and received loans as they mature and to satisfy demands of customers for additional borrowing. Undrawn borrowing facility commitments and the level of all outstanding contingent obligations are taken into consideration in managing the liquidity risk in the Bank.

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the liquidity management of the Bank. It is unusual for banks ever to be completely matched. An unmatched position potentially enhances profitability, but also increases the risk of losses. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature are important factors in assessing the liquidity of the Bank and its exposure to changes in interest rates and exchange rates. To manage this risk, the Bank maintains at all times highly liquid assets depending on the currency of its liabilities. The overall liquidity control and monitoring are performed by the Assets and Liabilities (Liquidity) Committee and is based on maturity tables with scenarios for measuring the net cash flows by periods and normatively enacted by Bulgarian National Bank ratios. Additionally varieties of correlations are monitored to indicate the liquid position by periods. Liquidity risk is also measured through application of additional tree scenarios for the cash flows from the operations and monitoring of the liquidity buffers of the Bank and the additional sources of financing in case of market and idiosincraty shocks.

The table below presents the amounts in percentage of the ratio of liquid assets to liabilities of the Bank:

	2012	2011
	%	%
As at December 31-st	30.19%	14.32%
Average for the period	19.22%	26.56%
Highest for the period	35.67%	37.90%
Lowest for the period	10.98%	14.32%

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.3. Liquidity risk (continued)

The table below provides an analysis of the financial assets and liabilities of the Bank grouped by remaining maturity:

In thousand of BGN ***As at 31 December 2012***	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Maturity not defined**	**Total**
Financial assets							
Cash and balances with the Central Bank	51,606	-	-	-	-	-	51,606
Loans and advances to banks	210,226	80,783	120,202	141,386	305,652	-	858,249
Loans and advances to customers	6,942	21,855	95,700	287,760	98,884	-	511,141
Receivables from the State Budget	-	12,666	-	-	-	-	12,666
Available-for-sale securities	60,048	25,033	30,553	7,760	-	2,007	125,401
Financial assets held-for-trading	-	2,771	420	-	-	-	3,191
Total financial assets	328,822	143,108	246,875	436,906	404,536	2,007	1,562,254
Financial liabilities							
Deposits from banks	54,723	19,725	9,779	29,337	-	-	113,564
Deposits from customers	304,114	77,592	61,324	-	-	-	443,030
Borrowings from international institutions	3,057	6,686	56,559	189,975	80,932	-	337,209
Other borrowings	174	170	974	13,954	6,124	-	21,396
Debt securities issued	-	256	-	78,233	-	-	78,489
Financial liabilities held-for-trading	-	3,082	-	-	-	-	3,082
Total financial liabilities	362,068	107,511	128,636	311,499	87,056	-	996,770
Difference in maturity thresholds of assets and liabilities	(33,246)	35,597	118,239	125,407	317,480	2,007	565,484
Contingent liabilities and commitments	1,652	25,503	39,741	25,038	2	4,694	96,630

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.3. Liquidity risk (continued)

In thousand of BGN ***As at 31 December 2011***	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Maturity not defined**	**Total**
Financial assets							
Cash and balances with the Central Bank	70,335	-	-	-	-	-	70,335
Loans and advances to banks	409,897	1,770	2,933	87,000	357,348	-	858,948
Loans and advances to customers	14,198	15,830	75,428	249,347	123,068	-	477,871
Receivables from the State Budget	-	335,395	-	-	-	-	335,395
Available-for-sale securities	-	75	8,793	4,680	989	2,023	16,560
Financial assets held-for-trading	-	2,995	-	-	-	-	2,995
Total financial assets	494,430	356,065	87,154	341,027	481,405	2,023	1,762,104
Financial liabilities							
Deposits from banks	65,854	10	15,451	39,117	-	-	120,432
Deposits from customers	395,261	10,655	2,273	58,637	-	-	466,826
Borrowings from international institutions	1,424	9,094	33,148	183,240	101,057	-	327,963
Other borrowings	225	171,462	5,367	7,379	10,945	-	195,378
Debt securities issued	-	266	-	78,233	-	-	78,499
Financial liabilities held-for-trading	-	2,082	999	-	-	-	3,081
Total financial liabilities	462,764	193,569	57,238	366,606	112,002	-	1,192,179
Difference in maturity thresholds of assets and liabilities	31,666	162,496	29,916	(25,579)	369,403	2,023	569,925
Contingent liabilities and commitments	2,762	16,730	40,892	45,925	6	4,694	111,009

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.3. Liquidity risk (continued)

The liquidity requirements to support calls under guarantees and letters of credit are considerably lower than the amount of the commitment because the Bank does not generally expect the third party to draw funds under these agreements.

The table below presents the gross undiscounted cash flows related to the Bank's liabilities as of 31 December:

In thousand of BGN *As at 31 December 2012*	Carrying amount	Gross nominal outflow	Less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years
Financial liabilities							
Deposits from banks	113,564	117,430	54,948	21,429	10,070	30,983	-
Deposits from customers	443,030	444,869	304,115	77,761	936	62,057	-
Borrowings from international institutions	337,209	356,831	2,986	6,954	57,664	199,696	89,531
Other borrowings	21,396	24,053	174	206	1,090	14,807	7,776
Debt securities issued	78,489	88,921	-	255	-	88,666	-
Financial liabilities held-for-trading	3,082	4,888	-	-	811	4,077	-
	996,770	1,036,992	362,223	106,605	70,571	400,286	97,307
Provisions on bank guarantees	12,400	12,400	300	600	3,978	7,522	-
Undrawn credit commitments	43,966	43,966	42	18,958	21,664	3,302	-

In thousand of BGN *As at 31 December 2011*	Carrying amount	Gross nominal outflow	Less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years
Financial liabilities							
Deposits from banks	120,432	125,028	65,880	10	15,847	43,291	-
Deposits from customers	466,826	471,140	395,261	10,741	2,293	62,845	-
Borrowings from international institutions	327,963	364,352	1,152	8,256	33,471	199,487	121,986
Other borrowings	195,378	248,399	223	171,464	17,016	47,713	11,983
Debt securities issued	78,499	96,417	-	980	2,875	92,562	-
Financial liabilities held-for-trading	3,081	4,975	-	-	999	3,976	-
	1,192,179	1,310,311	462,516	191,451	72,501	449,874	133,969
Provisions on bank guarantees	10,942	10,942	600	1,200	4,200	4,942	-
Undrawn credit commitments	40,490	40,490	777	14,521	24,408	784	-

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.4. Equity management

The main objectives of the Bank's capital management is to maintain its level at amounts sufficient for activities development and achieving the general objectives set at its foundation – support of the economic policy of the country and the development of small- and medium-sized businesses.

In its activities the Bank should observe the regulatory requirements for capital adequacy, as well as continue operating as a going concern.

The table below shows the main equity components following the regulatory requirements and ratios achieved by the Bank:

In thousand of BGN	2012	2011
Tier 1 capital		
Ordinary shares	601.774	601.774
Statutory reserves	52.447	51.824
Additional reserves	7.309	6.190
Total Tier 1 capital	661.530	659.788
Tier 2 capital	-	-
Total equity	661.530	659.788
Investments	(88.022)	(84.736)
Incl. Intangible assets	(379)	(174)
Other deductions		
Specific provisions for credit risk using standardized approach	11.667	5.613
Revaluation differences, included in Tier 1 capital	526	403
Tier 1 capital base	*561.315*	*569.036*
Tier 2 capital base	*561.315*	*569.036*
Credit risk		
Risk-weighted assets	1 021 381	963.289
Incl. Risk-weighted assets for credit risk	955.212	881.282
Incl. Off-balance sheet equivalents of risk-weighted assets for credit risk	62.569	78.937
Incl. Derivatives	3.600	3.070
Risk component	1.021.381	963.289

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.4. Equity management (continued)

Total capital requirements for operating risk	8,077	5,559
Reconciliation of the risk component for operating risk (operating risk * 12.5)	100,963	69,488
Total risk component	*1,122,344*	*1,032,777*
Tier 1 capital adequacy	*50.01%*	*55.10%*
Total capital adequacy	*50.01%*	*55.10%*
Regulatory required levels		
Tier 1 capital adequacy	*10.00%*	*10.00%*
Total capital adequacy	*12.00%*	*12.00%*

5. USE OF ACCOUNTING ESTIMATES AND JUDGEMENTS

Accounting estimates

The presentation of the financial statements in accordance with the International Financial Reporting Standards requires the management to make the best estimates, accruals and reasonable assumptions, which affect the reported amounts of assets and liabilities, revenues and expenses and disclosure of contingent claims and liabilities as of the reporting date. These estimates, accruals and assumptions are based on the information available as of the date of the financial statements and this may lead to differences in the future actual results. The items, that require a higher degree of discretion or complexity or where the assumptions and accounting estimates are essential for the financial statements, are disclosed below.

Key estimates and assumptions with high uncertainty

a) Impairment losses on loans and advances

At the date of each financial statement the Bank reviews its loan portfolio in order to detect the availability and calculates the losses from such impairment. When determining whether to include the impairment loss in the statements for the comprehensive income, the Bank's management considers whether there are and what are the visible indicators and data, which indicate that there is a measurable reduction in the expected cash flows of the loan portfolio as a whole, or respectively – a decrease associated with a particular loan/component from this portfolio. Such indicators and data are those that indicate the existence of an adverse change in the payment options by the borrowers from a particular group or by a particular borrower, or the presence of national, economic or other conditions that are associated with a particular risk for a given group/type of loans.

5. USE OF ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

Key estimates and assumptions with high uncertainty (continued)

a) Impairment losses on loans and advances (continued)

When analyzing the risks of impairment losses and uncollectability, the loans are grouped into four risk classification groups: "standard", "watch", "non-performing" and "loss". The main indicators for determining the risk groups are financial condition of the debtor and project implementation, funded by the loan, problems with servicing, including interest in arrears and maturing principal, sources of repayment and granted collateral, as a type and opportunity for realization. Additionally, for loans, guaranteed by the EIF, the impairment loss is recognised after deduction of the part, borne by the Fund (Note № 4.1).
In determining the future cash flows pattern, the management of the Bank uses estimates, judgments and assumptions based on its historical loss experience for assets with similar credit risk characteristics, as well as an objective evidence for impairment of the portfolio from non-crystallized loss in a particular component thereof. Analogous approach is used also for assessments at individual loan level taking into account the quality of collaterals as well. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly so as to minimize the discrepancies between loss estimates and actual loss experienced (Note № 12, 18).
In 2012, the management has made a retrospective analysis of actual losses experienced on loans for a ten year period (2001 to 2011 incl.) in order to update the applicable rates for loan impairment on a portfolio basis.
As a result of this analysis, the applied rate of impairment on a portfolio basis has been increased from 1.83% to 2.75%.

b) Measurement of available-for-sale financial instruments non-quoted on the active stock market

The Bank classifies its investments as share participation in other non-public companies/entities (below 20% of their capital) as available-for-sale financial assets that have been acquired for the purpose of establishing and development of business relations of importance for the bank. The management has judged and accepted that they should be measured at cost because sufficiently reliable sources and methods to determine their fair value are not available at present and due to the specific closed manner of their trading until the time when new circumstances occur that allow the formation of reasonable assumptions and reliable valuation.
Analysis and assessment is performed at each end of reporting period as to whether indicators for impairment of the Bank's investments are present. The significant and continuous decrease in the equity, including below the level of the registered share capital of the company/entity, subject to the investment, is regarded as a main indicator. In such cases impairment is determined with the assistance of a certified appraiser but at least at the level of the difference between the acquisition cost (cost) and the assessment of participation under the equity method including with additional adjustments of net assets, if necessary. In the cases of partial sales of similar shares in the reporting period, those from the same issuer but remaining in the Bank's statement of financial position are revalued at the price of the sale (Note № 9, 20).

5. USE OF ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

Key estimates and assumptions with high uncertainty (continued)

c) Impairment of available-for-sale financial instruments quoted on stock market

As at 31.12.2012 the Bank has made a detailed comparative analysis of the changes in the stock market prices of public companies shares held by the bank on the national fund market.
For investments in companies, whose shares are listed for the Bulgarian Stock Exchange of dealing the management has carried out investigation and analysis and is in position to assess further on fair value, determined directly on realized transactions in the stock market in the last month of the financial year (Level 1). In addition, the applied prices are analyzed for trends in the behavior in stock exchange prices of the respective securities at least for the last three months of the year and respectively to for the date of issuing of the financial statements. (Notes № 9, 15, 20).
The management has used compulsory and alternative valuation methods for further confirmation of the applicable assessment as fair value for both reporting years.
For all investment securities available for sale, held by the Bank more than one year after the date of acquisition, has performed a special analysis of monitored graphics of the stock exchange prices and fair values, defined by alternative methods of valuation for a period of 18 months to 31 December, in order to define if there are conditions of permanent and material impairment.

d) Provisions for issued bank guarantees

At the end of each reporting period the Bank reviews its contingent liabilities for the purpose of establishing whether any events have occur, that would confirm with a high probability outflow of resources might take place for the settlement of an obligation. If such events occur, the Bank provides its liability up to the amount of its future costs (losses) related to the outflows from economic benefits (payments). These costs (losses) are determined on the basis of the present value of the future net cash flows, representing the difference between the payment obligation and the possible inflows from subsequent resources to third parties (Notes № 12, 35).

With regard to portfolio guarantees related to the implementation of the Micro-credits Guarantee Fund Project of the Ministry of Labor and Social Policy (as per the BDB Act), in 2012 a retrospective analysis was made of the actual losses from loans granted (for which guarantees had been issued) for a seven-year period by partner-bank. An average percentage of losses were determined for the whole period under assessment by partner-bank and in general for the whole portfolio of such type of loans, using appropriate statistical instruments. As a result of the analysis the management has determined the average percent of loss for the whole portfolio to be 32.50% (2011: 32.50%) as minimum level for calculation of provisions for losses by partner-bank and when the average rate for a particular bank is higher than that minimum level, the respective percent for that is applied. The obtained average percent of the provision against the whole guarantee portfolio under this project is 32.50 % (2011: 32.50 %).

e) Actuarial calculations

For assessing the present value of the long-term liabilities to employees upon retirement are used actuarial methods and calculations based on assumptions for mortality rate, staff turnover rate, future level of salaries and discount factor considered by the management as reasonable and relevant to the Bank (Note № 32).

5. USE OF ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

Fair value of financial assets and liabilities

The fair value is defined as the value compared to which an asset could be changed or a liability could be settled between informed and willing parties in a fair transaction. The Bank publishes information for the fair value of those financial assets and liabilities for which there is available market information and whose fair value is materially different from the one reported in the statement of financial position.

The fair values of financial assets and liabilities dealing on active markets and for which there is available market information are based on declared market prices or prices closing. The use of real market prices and information reduce the need for information of management assessment and assumptions, as well as the uncertainty related to determination of the fair values. The availability of real market prices and information varies depending on products and markets and changes according to the specific events and the general financial market conditions. For some of the other financial instruments the Bank determines the fair values by using of assessment method based on net present value. The net present value calculation is provided by market yield curves and credit spreads, where necessary for the respective instrument. The purpose of evaluation techniques is to determine fair value, which would be précised by direct market participants. For investments in subsidiaries and associated companies and equity investments for which there are no observable market prices, the Bank accepts, that the fair value is the price of acquisition. The Bank has established control environment under assessment of fair values.

The fair value of financial instruments not traded in active markets that are the subject of a transaction between the parties are determined using valuation techniques (such instruments as derivatives not traded on the market). These valuation techniques adhere to the use of market data when available and as less as possible to the use of specific assessments of the company. If there is significant increase in requirements for fair value of the reference financial instrument, it is included in Level 2.

Fair Value Hierarchy

The Bank determines the following hierarchy for disclosing the fair value of financial instruments using valuation techniques:

- Level 1: quoted (not adjusted) prices on active markets for identical assets or liabilities;
- Level 2: other techniques for which all of the incoming information, which has a material effect on the reported fair value is subject to monitoring, either directly or indirectly;
- Level 3: techniques that use an incoming information, which has a material effect on the reflected fair value not based on the observed market data. In addition, this level includes investments valued at cost, for which no reliable market value exists.

5. USE OF ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

Fair value of financial assets and liabilities (continued)

The following charts summarize information on the assets and liabilities at fair value for 2012 and 2011:

In thousand of BGN	Carrying amount	Level 1 - quoted market price	Level 2 - Evaluation technique - monitored market levels	Level 3 - Evaluation technique – not monitored market levels
2012				
Available for sale securities	119,771	119,771	-	-
Financial assets held-for-trading	3,191	-	3,191	-
Total assets	122,962	119,771	3,191	-
Financial liabilities held-for-trading	3,082	-	3,082	-
Total liabilities	3,082	-	3,082	-

In thousand of BGN	Carrying amount	Level 1 - quoted market price	Level 2 - Evaluation technique - monitored market levels	Level 3 - Evaluation technique – not monitored market levels
2011				
Available for sale securities	11,385	11,385	-	-
Financial assets held-for-trading	2,995	-	2,995	-
Total assets	14,380	11,385	2,995	-
Financial liabilities held-for-trading	3,081	-	3,081	-
Total liabilities	3,081	-	3,081	-

6. NET INTEREST INCOME

In thousand of BGN	**2012**	**2011**
Interest income		
Loans and advances to customers	46,097	43,470
Loans and advances to banks	22,546	22,822
Receivables from the State Budget	5,652	11,530
Available-for-sale securities	2,164	973
Deposits in banks	2,495	3,393
	78,954	82,188
Interest expense		
Borrowings from international institutions	8,788	9,624
Deposits from customers	4,264	1,862
Debt securities issued	3,909	3,903
Other borrowings	2,964	3,956
Deposits from banks	1,555	1,406
	21,480	20,751
Net interest income	57,474	61,437

7. NET FEE AND COMMISSION INCOME

In thousand of BGN	**2012**	**2011**
Fee and commission income		
Guarantees and letters of credit	1,023	1,140
Customers' accounts, bank transfers, cash operations of customers	454	371
Servicing of debenture loans	269	292
Trust management of borrowings	73	75
	1,819	1,878
Fee and commission expense		
Agency commissions	25	52
Current accounts due from other banks	18	15
Bank transfers and cash operations with other banks	26	9
	69	76
Net fee and commission income	1,750	1,802

8. NET GAINS FROM FOREIGN EXCHANGE DEALS

In thousand of BGN	2012	2011
Net gain from dealing in foreign currencies	725	326
Net gain/(loss) from foreign currency translation of assets and liabilities	(7)	14
	718	340

9. NET LOSSES FROM AVAILABLE-FOR-SALE SECURITIES

In thousand of BGN	2012	2011
Net losses on transactions with available-for-sale securities, incl. realised revaluation reserve	(297)	(23)
Impairment loss on available-for-sale securities	(6)	(153)
	(303)	(176)

10. NET GAINS/(LOSSES) FROM FINANCIAL INSTRUMENTS HELD-FOR-TRADING

In thousand of BGN	2012	2011
Net interest income from financial instruments held-for-trading	572	61
Net gains/(losses) from revaluation of financial instruments held-for-trading	(578)	918
	(6)	979

11. OTHER OPERATING GAINS/(LOSSES)

In thousand of BGN	2012	2011
Rentals, net	6	24
Dividends received	3,096	21
Legal fees and expenses, net	(543)	(188)
Net (losses) from assets classified as held for sale	(294)	(172)
Withholding tax	(56)	(119)
Other income, net	75	99
	2,284	(335)

12. NET IMPAIRMENT LOSS ON FINANCIAL ASSETS AND PROVISION EXPENSE

In thousand of BGN	2012	2011
Individual allowance for impairment loss, net	34,813	30,060
Collective allowances for impairment loss on portfolio basis, net	3,935	1,090
Letters of guarantee provision expense, net	4,161	14,994
Impairment loss on assets classified as held for sale	37	2,132
	42,946	48,276

13. GENERAL AND ADMINISTRATIVE EXPENSES

In thousand of BGN	2012	2011
Personnel costs and social security contributions	4,739	3,920
Remuneration of Managing Board and Supervisory Board members	1,522	1,790
Rentals	1,152	784
Contribution to the Deposit Insurance Fund	1,017	266
Advertising and entertainment expenses	560	215
Communications and IT services	490	390
Office and office equipment maintenance	452	492
Audit, legal and consulting services	328	328
Hired services	184	127
Government taxes and charges	161	255
Business trips	94	69
	10,699	8,636

In thousand of BGN	2012	2011
Personnel costs and social security contributions include:		
Salaries	4,026	3,313
Social security contributions	547	452
Social benefits	131	120
Accruals for indemnities upon retirement	35	35
	4,739	3,920

The average number of the personnel for 2012 is 119 (2011: 111)

14. INCOME TAX EXPENSE

In thousand of BGN	**2012**	**2011**
Current tax expense	613	1,931
Deferred tax expense/(income) as a result of temporary differences	(119)	(1,227)
Total income tax expense	494	704

In thousand of BGN	**2012**	**2011**
Profit before income tax	7,985	6,922
Income tax, calculated on standard tax rate (10% for 2012, 10% for 2011)	799	692
Tax effect from permanent differences	(305)	12
Total income tax expense	494	704
Effective tax rate	6.19%	10.17%

Outstanding amounts of deferred income taxes on income related to the following items from the statement of financial position:

In thousand of BGN	Assets		Liabilities		Net (Assets)/Liabilities	
	2012	**2011**	**2012**	**2011**	**2012**	**2011**
Property and equipment	(4)	(4)	-	-	(4)	(4)
Other assets	(195)	(213)	-	-	(195)	(213)
Guarantees portfolio	(1,240)	(1,094)	-	-	(1,240)	(1,094)
Other liabilities	(26)	(22)			(26)	(22)
Available-for-sale securities	-	-	62	49	62	49
Net deferred tax assets/liabilities	(1,465)	(1,333)	62	49	(1,403)	(1,284)

14. INCOME TAX EXPENSE (CONTINUED)

The changes in the temporary differences during the year are recognised in the statement of comprehensive income and in the statement of changes in equity as follows:

In thousand of BGN	**2012**	**Changes in statement of comprehensive income**	**2011**
Property and equipment	(4)	-	(4)
Other assets	(195)	18	(213)
Guarantees portfolio	(1,240)	(146)	(1,094)
Other liabilities	(26)	(4)	(22)
Available-for-sale securities	62	13	49
	(1,403)	(119)	(1,284)

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

15. NET CHANGE IN FAIR VALUE OF AVAILABLE-FOR-SALE SECURITIES

In thousand of BGN	**2012**	**2011**
Change in fair value of available-for-sale securities		
Loss for the year	(123)	(38)
Less: Correction from reclassification of profit/(loss), included in current year profit and loss	-	(61)
Other comprehensive income for the year, net of tax	(123)	(99)

16. CASH AND BALANCES WITH THE CENTRAL BANK

In thousand of BGN	**2012**	**2011**
Cash on hand	119	124
Balances with the Central Bank:		
Current accounts	51,417	70,162
Security fund	70	49
	51,487	70,211
Total cash and balances with the Central Bank	51,606	70,335

Deposits with the Central Bank are not interest-bearing.

17. LOANS AND ADVANCES TO BANKS

In thousand of BGN	2012	2011
Current accounts and deposits		
Current accounts with local banks	251	166
Current accounts with foreign banks	2,003	1,821
Term deposits with local banks	250,626	306,749
Term deposits with foreign banks	113,937	101,161
Loans granted to local banks	491,432	445,685
Loans granted to foreign banks	-	3,366
	858,249	858,948

As at 31.12.2012 there are loans granted to local banks with nominal value of EUR 14,750 thousand and BGN equivalent 28,848 thousand (31.12.2011: EUR 14,750 thousand and BGN equivalent – 28,848 thousand), with original maturity of nine years and repayment in bullet at the end of the loans period. These are special-purpose loans and are granted to banks for direct crediting of customers with the objective of SME development under funding from the Ministry of Finance with KfW funds. Loans are charged with interest equal to BIR plus 3.25% margin, payable every 3 or 6 months. Loans are secured up to 50% of their nominal amount through a pledge of government securities. The carrying amount of those loans as at 31.12.2012 is BGN 27,460 thousand (2011: BGN 29,285 thousand).

As at 31.12.2012 the receivables from foreign banks under agreement signed for serving export deals are fully repaid. (2011: BGN 3,366 thousand equivalent EUR 1,721 thousand).

As at 31.12.2012 there are loans granted to banks in BGN with nominal value of 447,000 thousand (31.12.201: BGN 415,500 thousand) under two programs. The loans are with a special purpose under the first program (BGN 375,000 thousand of nominal value), and are granted to banks with the objective of direct lending of clients for the purpose of SME development, with original maturity from 5 to 10 years and repayment in bullet at the end of loan period or according to repayment schedule with 5 years grace period. Under the second program (BGN 80,000 thousand – nominal value) the loans are with special purpose and are granted to banks with the objective of direct lending to agricultural producers with original maturity of 5 years and repayment in bullet to maturity or according to repayment schedule with 3 or 4 years grace period. Loans are charged with fixed interest rate equal to 5.00%, payable every 6 months. Loans are secured up to 100% of their nominal amount through a pledge of government securities or through a pledge on receivables.

In early 2012, Bulgarian Development Bank has negotiated with commercial banks credit lines amounting BGN 100 million, which will provide lending to Bulgarian small and medium enterprises (SMEs). It is provided that the funds under the credit lines will be utilized by the partner-banks in two tranches, each amounting BGN 50 million. Partner-banks will be lending the funds to small and medium enterprises (SMEs) at preferential terms – annual interest rate up to 7%, up to BGN 2 million and up to 5 years repayment. As at 31.12.2012 the utilized credit lines under this program amount to BGN 53,500 thousand. Loans are charged with fixed interest rate equal to 4.00%, payable every 6 months.

As at 31.12.2012 the Bank has term deposits receivables denominated in BGN, USD or EUR from eight local banks and four foreign banks, representing 42.48 % of the carrying value of the deposits due from banks (31.12.2011: ten local banks and four foreign banks– with 47.49 %). The term deposits are with original maturity up to one year (31.12.2011: up to three months).

As at 31.12.2012 the Bank has three repo deals receivable denominated in BGN and USD with amortised amount of BGN 28,364 thousand, with maturity up to 08.05.2013 and contracted interest rate from 0.1% to 0.6 % (31.12.2011: BGN 17,606 thousand).

18. LOANS AND ADVANCES TO CUSTOMERS

In thousand of BGN	2012	2011
Loans and advances to customers	606,209	544,077
Less allowance for loan impairment loss	(95,068)	(66,206)
	511,141	477,871

In thousand of BGN	2012	2011
A. Analysis by customer type		
Corporate and sole traders	585,223	531,985
Municipalities	18,262	10,096
Individuals	2,724	1,996
	606,209	544,077

In thousand of BGN	2012	2011
B. Analysis by industry sector		
Manufacturing	182,139	160,390
Transport	87,673	106,424
Trade	69,596	47,174
Construction	68,053	78,238
Financial services	52,467	24,350
Collection and disposal of wastes	36,047	40,783
Tourist services	31,233	29,818
Agriculture	17,532	19,029
Real estate operations	16,165	3,511
Other industry sectors	45,314	34,360
	606,209	544,077

The Bank provides funds mainly for activities of small and medium-sized enterprises as well as investment projects with 5 to 10 years return on investment.

18. LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

C. Movement in the allowances for loan impairment loss and uncollectability

In thousand of BGN	2012			2011		
	Individually impaired	Collectively impaired	Total	Individually impaired	Collectively impaired	Total
As at January 01	58,874	7,332	66,206	29,450	6,242	35,692
Net increase/(decrease) for the year	34,813	3,935	38,748	30,060	1,090	31,150
Written-off against impairment	(9,886)	-	(9,886)	(636)	-	(636)
As at December 31	83,801	11,267	95,068	58,874	7,332	66,206

19. RECEIVABLES FROM THE STATE BUDGET

In thousand of BGN	2012	2011
Loans and advances	12,666	335,395
	12,666	335,395

As at 31.12.2012 the loans and advances classified as receivables from the State Budget represent purchased receivables through cession with debtor Road Infrastructure Agency.

In December of 2011 Bulgarian Development Bank AD has granted BGN 335 million to the Ministry of Agriculture and Food of Republic of Bulgaria the funds of which will be utilized under the Rural Development Programme of the European Union. As at 31.12.2012 the loan is repaid in full.

The loan provided by BDB is the first step of the project for establishing a Guarantee Fund in the amount of BGN 335 million, financed jointly by the EU and the Bulgarian Government. The gurantee fund will be governed by National Guarantee Fund EAD, a subsidiary ot Bulgarian Development Bank AD. As part of its full capacity the guarantee fund will be able to take guarantees bank loans to over BGN 1.2 billion allocated to beneficiaries in rural areas of the country.

In the mean time, the Ministry of Finance submits a deposit amounting BGN 171,000 thousand for the period up to 30.03.2012, but not before the date of full repayment of the loan extended by the Bulgarian Development Bank signed on 20.12.2011. As at 31.12.2012 the liability has been settled. (Note 29).

20. AVAILABLE-FOR-SALE SECURITIES

In thousand of BGN	2012	2011
Corporate bonds	63,346	13,536
Government bonds	60,048	1,001
Non-public companies' shares	1,903	1,903
Public companies' shares	104	120
	125,401	16,560

Movement in available-for-sale securities

In thousand of BGN	2012	2011
As at January 01	16,560	17,922
Additions (purchases)	134,820	4,784
Disposals (sale and/or redemption)	(25,856)	(6,047)
Net decrease from revaluation of available-for-sale securities to fair value	(123)	(99)
As at December 31	125,401	16,560

The non-public companies' shares held by the Bank represent shares of the capital of the European Investment Fund (EIF). The portion of the nominal value of the acquired shares of EIF, which has not been paid, is due after a decision to be taken on the General meeting of the EIF shareholders (Note № 35).

The rest of the non-public companies' shares represent shares in the company licensed as payment system operator under the Bulgarian law – BORICA - Bankservice AD. Only banks can be shareholders in this company and they acquire its shares following a specific procedure whereas the value per share is determined using a formula stated in the company's statute. The shares are presented at cost (acquisition price) due to their specific closed way of trading (except where sufficiently reliable information is available on a particular company so that the actual fair value could be determined).

The shares in public companies in BGN have been acquired mainly for the purpose of investments in companies in which the Bank is interested. They are presented at average stock exchange prices at the end of the financial year.

The reserve formed of the available-for-sale financial assets as at 31.12.2012 is at the amount of BGN 526 thousand – negative value (31.12.2011: BGN 403 thousand negative value) (Note № 34).

In 2012 impairment allowance of available-for-sale securities is transferred and reported on the statement of comprehensive income (as part of the current profit or loss for the year) amounting to BGN 6 thousand (Note № 9) (2011: BGN 153 thousand).

21. FINANCIAL ASSETS HELD-FOR-TRADING

In thousand of BGN	**2012**	**2011**
Interest rate swaps	2,771	2,995
Currency swaps	420	-
	3,191	2,995

As at 31.12.2012, the financial assets held for trading include derivative financial instruments – interest rate swaps and currency swaps. They represent marketable instruments with positive fair value as at 31.12.2012. These instruments are traded for its own account, including the netting of transactions in foreign currency, interest rate and credit risk, and to cover transactions with customers of the Bank.

22. INVESTMENTS IN SUBSIDIARIES

The Bank is sole owner of National Guarantee Fund EAD, a company established according to the Trade register on 22 August 2008. As at 31.12.2012 the registered share capital is 800,000 registered nominal shares with par value of BGN 100 each (31.12.2011: 800,000 registered nominal shares with par value of BGN 100 each). As at 31.12.2012 the paid-in capital amounts to BGN 80,000 thousand. (31.12.2011: BGN 80,000 thousand)
As at 31.12.2012 the value of the investment in the subsidiary amounts to BGN 80,000 thousand (31.12.2011: BGN 80,000 thousand), valuated on a historical cost of acquisition basis.

A micro-financing institution JOBS EAD (MFI) was registered on 14 January 2011 as sole proprietorship joint stock company, 100% owned by Bulgarian Development Bank AD. The registered shareholder's equity of the company amounts to BGN 7,643 thousand comprised of 76,430 nominal shares with par value of BGN 100 each. As at 31.12.2012 the value of the investment in the subsidiary amounts to BGN 7,643 thousand (31.12.2011: BGN 4,562 thousand), valuated on a historical cost of acquisition basis.

23. PROPERTY, PLANT AND EQUIPMENT, INTANGIBLE ASSETS

In thousand of BGN	Land and buildings	Bank equipment and computers	Fixtures and fittings	Motor vehicles	Licenses and software	Total
Book value						
As at 1 January 2011	14,143	615	271	426	313	15,768
Additions	31	287	34	14	183	549
Disposals	-	(45)	-	(52)	(67)	(164)
As at 31 December 2011	14,174	857	305	388	429	16,153
Additions	190	330	1	-	283	804
Disposals	-	(156)	(4)	(288)	(93)	(541)
As at 31 December 2012	14,364	1,031	302	100	619	16,416
Accumulated depreciation						
As at 1 January 2011	361	405	152	388	272	1,578
Charge for the year	38	72	30	23	50	213
Written off	-	(42)	-	(52)	(67)	(161)
As at 31 December 2011	399	435	182	359	255	1,630
Charge for the year	38	134	31	6	78	287
Written off	-	(153)	(4)	(265)	(93)	(515)
As at 31 December 2012	437	416	209	100	240	1,402
Carrying amount						
As at 31 December 2012	13,927	615	93	-	379	15,014
As at 31 December 2011	13,775	422	123	29	174	14,523
As at 1 January 2011	13,782	210	119	38	41	14,190

As at 31.12.2012 the book value of fully depreciated property, plant and equipment, which are still in use by the Bank, amount to BGN 413 thousand (31.12.2011: BGN 648 thousand).

The Bank provides rental space from the owned building under two rental agreements (operating lease). The term of the rent agreements is not determined as they have a clause for one-month preliminary notification in case of termination by any of the parties, without subsequent penalties. The amount of the annual rental income for the year ended 31.12.2012 is BGN 49 thousand (for 2011: BGN 46 thousand).

The license represents the right for identification and participation in the system for international settlement - SWIFT.

As at 31.12.2012 the book value of fully amortised intangible assets, which are still in use by the Bank, amounts to BGN 111 thousand (31.12.2011: BGN 189 thousand).

24. ASSETS CLASSIFIED AS HELD FOR SALE

The available assets classified as held for sale as at 31.12.2012 with book value of BGN 4,802 thousand, include property (land and buildings) at the amount of BGN 4,802 thousand (31.12.2011: BGN 2,404 thousand) and machinery and equipment at the amount of BGN 0 thousand (31.12.2011: BGN 840 thousand), acquired by the Bank in 2012 against a settlement of the liabilities under problematic loans of its borrowers.

The assets are not used and are not intended to be used in the activities of the Bank. The management actively searches buyers for them with the aim to sell them by the end of 2013.

25. OTHER ASSETS

In thousand of BGN	2012	2011
Other assets	6,421	3,899
Other receivables	154	48
VAT refundable	111	9
Prepayments and advances	67	82
	6,753	4,038

Other assets includes assets classified as held for sale, but not realized within the stipulated 12-month period and were reclassified in other assets.

26. DEPOSITS FROM BANKS

In thousand of BGN	2012	2011
Deposits from local banks	93,968	100,787
Deposits from foreign banks	19,596	19,645
	113,564	120,432

The average interest rates on term deposits in BGN are from 0.01% to 0.2% (2011 - from 0.3% to 1.45%), and for term deposits in EUR are from 0.04% to 0.72% (2011- from 0.20% to 4.10%).

On 31.08.2011 Bulgarian Development Bank AD signed a second short-term loan contract amounting EUR 7,900 thousand with Citibank – Bulgaria branch. The loan is for financing international or local trades. As at 31.12.2012 the loan is fully repaid.
On 16.09.2011 Bulgarian Development Bank AD signed a long-term loan contract with Citibank amounting EUR 20,000 thousand. The funds from this loan are intended for direct and indirect funding of SME. As at 31.12.2012 the loan is utilized in full.
As at31.12.2012 the outstanding principal is EUR 20,000 thousand with BGN equivalent of 39,117 thousand. The interest rate is fixed using a standard interest rate swap.

27. DEPOSITS FROM CUSTOMERS

In thousand of BGN	2012	2011
Individuals	985	771
Companies and sole traders	174,500	121,864
Budget companies	267,545	344,191
	443,030	466,826

The amounts due to individuals represent deposits of employees of the bank.
The amounts due to budget companies represent deposits of National Guarantee Fund EAD (subsidiary of BDB) related to the projects of the establishment of Guarantee Fund supporting the rural regions in the country under the Rural Development Program of the Ministry of Agriculture and Food (2007-2013) and under Operational program fisheries sector development (2007-2013) of the National Agency for Fisheries and Agriculture.

28. BORROWINGS FROM INTERNATIONAL INSTITUTIONS

In thousand of BGN	2012	2011
Long-term framework loan agreement with the Council of Europe Development Bank	76,337	78,410
Long-term loans from Black See Trade and Development Bank	68,101	30,796
Long-term loans from the European Investment Bank	50,543	52,199
Long-term loans from the Nordic investment bank	47,828	38,397
Long-term loans from Kreditanstalt für Wiederaufbau	46,157	49,219
Long-term loan from DEXIA Kommunalkredit	17,556	19,543
Long-term loan from DEPFA Investment Bank - Fms Wertmanagement Aor	13,560	17,472
Long-term loans from JBIC Japan Bank for International Cooperation	13,197	17,700
Long-term loan from China Development Bank	3,930	5,906
Short-term loan Sumitomo Mitsui – Banking Corporation Europe	-	18,321
	337,209	327,963

Interest rates on borrowed funds from international institutions at 31.12.2012 ranged from 0.433 % to 3.2925% (31.12.2011: from 1.676 % to 5.255%).

Council of Europe Development Bank

On 2 January 2003 between the Council of Europe Development Bank (CEB), the Republic of Bulgaria represented by the Minister of Finance and Encouragement Bank AD (being at present Bulgarian Development Bank AD) are signed two Framework Loan Agreements for EUR 10,000 thousand and EUR 5,000 thousand for the financing of micro-, small and medium-sized enterprises in Bulgaria. The loan agreement at the amount of EUR 10,000 thousand is secured with state guarantee from the Republic of Bulgaria. As at 31.12.2012 the 2003 Loans are fully utilized.
As at 31.12.2012 the outstanding principal under the facility amounts to EUR 15,000 thousand equivalent to BGN 29,337 thousand (31.12.2011: EUR 15,000 thousand equivalent to BGN 29,337 thousand). The interest rate is floating, based on 3-month EURIBOR plus margin.
On 18 November 2009 a third Loan agreement is signed between Bulgarian Development Bank AD and the Council of Europe Development Bank (CEB) in the amount of EUR 15,000 thousand. The loan is unsecured. As at 31.12.2012 the loan is fully utilized.
As at 31.12.2012 the outstanding principal under the facility amounts to EUR 15,000 thousand equivalent to BGN 29,337 thousand (31.12.2011: EUR 15,000 thousand equivalent to BGN 29,337 thousand). The interest rate is floating, based on 3-month EURIBOR plus margin.

28. BORROWINGS FROM INTERNATIONAL INSTITUTIONS (CONTINUED)

Council of Europe Development Bank (continued)

On 25 March 2011 a fourth Loan Agreement is signed between the Bulgarian Development Bank AD and the Council of Europe Development Bank for the amount of EUR 20,000 thousand. The loan is unsecured.
As at 31.12.2012 the utilized amount under the loan agreement is EUR 10,000 thousand equivalent to BGN 19,558 thousand, whereas the outstanding principal as at 31.12.2012 is EUR 9,000 thousand equivalent to BGN 17,602 thousand (2011: 10,000 thousand equivalent to BGN 19,558 thousand). The interest rate under the loan is floating, based on 3-month EURIBOR plus margin.

European Investment Bank

On 4/6 October 2000 BDB signed a financial contract (Global Loan Bulgaria – Encouragement Bank) with the European Investment Bank in the amount of EUR 10,000 thousand for the financing of small and medium sized enterprises. The loan is based on signed Agreement between European Investment Bank and Republic of Bulgaria on 14.07.1997. The loan is secured with state guarantee from the Republic of Bulgaria and is fully utilized.
As at 31.12.2012 the outstanding principal under the facility amounts to EUR 842 thousand equivalent to BGN 1,647 thousand (31.12.2011: EUR 1,684 thousand equivalent to BGN 3,294 thousand). The interest rate under the loan is based on the EIB Reference Interest Rate and is determined quarterly.

On 30 December 2009 a second finance contract is signed between EIB and BDB in the amount of EUR 25,000 thousand for financing of SMEs and priority projects in the fields of infrastructure, energy, environmental protection, industry, health and education. The loan is unsecured and has been fully utilized.
As at 31.12.2012 the outstanding principal under the loan amounts to EUR 25,000 thousand equivalent to BGN 48,896 thousand (31.12.2011: EUR 25,000 thousand equivalent to BGN 48,896 thousand). The interest rate is floating, based on 3-month EURIBOR plus margin.

Kreditanstalt für Wiederaufbau

On the 27 July 2010 Bulgarian Development Bank AD signed a direct loan agreement for EUR 25,000 thousand with the German development bank Kreditanstalt für Wiederaufbau. The financial resource is intended for direct lending to small and medium sized enterprises and/or for providing credit lines to commercial banks for special-purpose financing for the business. The loan is unsecured and as at 31.12.2012 is fully utilized.

As at 31.12.2012 the outstanding principal under the loan amounts to EUR 23,529 thousand equivalent to BGN 46,020 thousand. The interest rate is floating, on the basis of 6-month EURIBOR plus margin.

Nordic Investment Bank

On 16 November 2004 a Loan Agreement was signed with the Nordic Investment Bank for a credit facility amounting to EUR 10,000 thousand for the financing of projects of small- and medium-sized enterprises, which are of mutual interest for Bulgaria and the Nordic Investment Bank member states. The Loan is secured with a Letter of intent. As at 31.12.2011 the loan is fully utilized.

As at 31.12.2012 the outstanding principal under the loan amounts to EUR 5,059 thousand equivalent to BGN 9,894 thousand (31.12.2011: EUR 6,235 thousand equivalent to BGN 12,195 thousand). The interest rate is floating, on the basis of 6-month EURIBOR plus margin.

28. BORROWINGS FROM INTERNATIONAL INSTITUTIONS (CONTINUED)

Nordic Investment Bank (continued)

On 15.12.2010 a second credit line has been signed between the Nordic Investment Bank and Bulgarian Development Bank AD in the amount of EUR 20,000 thousand. The funds are intended for the financing of investment projects with participation of the Nordic Investment Bank member states and ecological projects, as the financing may be provided directly from BDB of through bank-partners. The loan is unsecured.

Към 31.12.2012 г. three tranches are utilized under the Loan, amounting to EUR 19,484 thousand equivalent to BGN 38,108 thousand. The term of the Loan is 10 years with 2 years grace period. The interest rate is floating, on the basis of 6-month EURIBOR plus margin.

Black Sea Trade and Development Bank (BSTDB)

On 9 October 2009 Bulgarian Development Bank and Black Sea Trade and Development Bank signed a Loan Agreement in the amount of EUR 8,000 thousand. The resources are intended for the financing of Bulgarian small and medium-sized enterprises. The loan is unsecured. As at 31.12.2012 the loan is fully utilized.
As at 31.12.2012 the outstanding loan amount is EUR 4,000 thousand equivalent to BGN 7,823 thousand (as at 31.12.2011: the outstanding loan amount is EUR 6,000 thousand equivalent to BGN 11,735 thousand). The interest rate is floating, on the basis of 6-month EURIBOR plus margin.

On the 9 September 2011 a second Loan Agreement is signed between Bulgarian Development Bank and Black Sea Trade And Development Bank in the amount of EUR 31,000 thousand. The loan is intended for the financing of investment projects, working capital, export and pre-export financing of SMEs. The loan is unsecured. As at 31.12.2011 the loan is fully utilized.

As at 31.12.2012 the outstanding principal amounts to EUR 31,000 thousand equivalent to BGN 60,631 thousand (as at 31.12.2011 the outstanding principal amounts to EUR 10,000 thousand equivalent to BGN 19,558 thousand) The interest rate is floating, on the basis of 3-month EURIBOR plus margin.

DEXIA Kommunalkredit Bank

On 23 May 2007 the Bank has signed a Loan agreement with DEXIA Kommunalkredit Bank for EUR 10,000 thousand. loan is intended for the financing of investment projects of small and medium sized enterprises in Bulgaria. As at 31.12.2012 the loan is fully utilized. The loan is secured with a Letter of intent, signed by the Minister of Finance.

As at 31.12.2012 the outstanding principal under the facility amounts to EUR 9,000 thousand equivalent to BGN 17,602 thousand (31.12.2011: EUR 10,000 thousand equivalent to BGN 19,558 thousand). The interest rate is floating, on the basis of 3-month EURIBOR plus margin.

Sumitomo Mitsui – Banking Corporation Europe

On 13 May 2010 Bulgarian Development Bank AD and Sumitomo Mitsui – Banking Corporation Europe signed a bilateral commercial financial facility. According to the facility Sumitomo Mitsui – Banking Corporation Europe may provide short-term financing to BDB AD for commercial transactions for period of up to 1 year and limit of up to USD 5,000 thousand. On 19 May 2011 an amendment to the commercial financial facility was signed, providing an additional limit in the amount of EUR 9,450 thousand.

As at 31.12.2012 the facility is repaid (31.12.2011: the outstanding principal under the facility amounts to EUR 9,138 thousand equivalent to BGN 17,872 thousand). The interest rate is on the basis of 12-month EURIBOR plus a margin.

28. BORROWINGS FROM INTERNATIONAL INSTITUTIONS (CONTINUED)

Japan Bank for International Cooperation (JBIC)

On 19 July 2006 a Loan Agreement was signed between Bulgarian Development Bank AD and the Japanese Bank for International Cooperation in the amount of EUR 10,000 thousand. The purpose of the loan is financing of the import of Japanese investment goods and part of the local expenses of Bulgarian companies. The Loan is secured with a Letter of intent. As at 31.12.2012 the loan is fully repaid.

On 17 December 2009 a second Loan agreement is signed between Bulgarian Development Bank AD and Japan Bank for International Cooperation for the amount of EUR 20,000 thousand. The loan can be utilized both in EUR and in JPY. For a loan in EUR the applicable interest rate will be formed as fixed (CIRR plus risk margin) for 60% of the amount and floating (6-month EURIBOR + margin) for the rest 40% of the amount. For a loan in JPY the applicable interest rate is fixed (CIRR plus risk margin). The loan is unsecured. As at 31.12.2012 the utilized amount under the Loan is JPY 1,122,594 thousand equivalent to BGN 19,812 thousand.

As at 31.12.2012 the outstanding principal amount of the loan is JPY 771,779 thousand equivalent to BGN 13,299 thousand.

DEPFA Investment Bank - Fms Wertmanagement Aor

On 18 May 2007 an Agreement is signed with DEPFA Investment Bank for EUR 15,000 thousand for general corporate purposes. The Loan is unsecured. As at 31.12.2012 the Loan is fully utilized.
As at 31.12.2012 the outstanding principal under the loan agreement amounts to EUR 7,000 thousand equivalent to BGN 13,691 thousand (31.12.2011: EUR 9,000 thousand equivalent to BGN 17,602 thousand). The interest rate is floating, on the basis of 6-month EURIBOR plus margin.

China Development Bank (CDB)

On the 15 October 2009, Bulgarian Development Bank and China Development Bank signed a credit agreement in the amount EUR 5,000 thousand. The funds under the loan are intended for direct lending to small and medium sized enterprises. The loan is unsecured. As of 31.12.2012 the credit line is fully utilized.
As at 31.12.2012 the outstanding principal under the loan amounts to EUR 2,000 thousand equivalent to BGN 3,912 thousand (as at 31.12.2011 the outstanding principal under the loan amounts to EUR 3,000 thousand equivalent to BGN 5,867 thousand). The interest rate is floating on the basis of 6-month EURIBOR plus margin.

29. OTHER BORROWINGS

In thousand of BGN	**2012**	**2011**
Borrowed financing from the Ministry of Finance with funds from KfW	11,071	10,954
KfW funds provided by the Ministry of Finance for trust management	7,191	7,379
Attracted special purpose deposit from the Ministry of Finance	-	171,206
Long-term refunding agreement with the State Fund Agriculture	3,134	5,839
	21,396	195,378

29. OTHER BORROWINGS (CONTINUED)

Borrowed financing from the Ministry of Finance with funds from KfW

On 18 April 2007 the Bank concluded a loan agreement with the government of the Republic of Bulgaria, represented by the Minister of Finance. This agreement is based on the Treaty between Bulgaria and Germany for financial collaboration from year 2001 and an agreement between the Republic of Bulgaria and KfW. By virtue of this agreement, the amount of EUR 4,929 thousand is granted to the Bank designated as Project Provider for the purpose of financing micro, small and medium-sized enterprises. The term of the agreement is 10 years as from the date of fund receipt while the latter along with the due interest is repaid bullet at the end of the period. The loan interest is capitalized quarterly and is based on 3-month EURIBOR plus margin.

As at 31.12.2012 the amount of the loan is EUR 5,659 thousand equivalent to BGN 11,069 thousand (31.12.2011: EUR 5,600 thousand equivalent to BGN 10,954 thousand).

KfW funds provided by the Ministry of Finance for trust management

The Bank concluded an agreement with the Ministry of Finance (MF) for management of funds granted by Kreditanstalt fur Wiederaufbau (KfW) pursuant to an agreement between the Governments of Bulgaria and Germany. These funds are provided for the purpose of financing small and medium-sized enterprises. The Ministry of Finance retains the risk for the advanced provided to the partner – banks.

The main responsibilities of the Bank in respect of the funds management include the following: selection of the banks – intermediaries, and transferring the funds to those approved; gathering of information and performance of periodic reviews regarding the funds utilization. Also monitoring of the timely payments of the interest and principal due and their repayment to the special account of the Ministry of Finance.

As at 31.12.2012 the balance of the loan with the Bank amounts to EUR 3,676 thousand equivalent to BGN 7,190 thousand (31.12.2011: EUR 3,773 thousand equivalent to BGN 7,379 thousand).
The Bank receives a management fee of 1% per annum. The calculation of the management fee is based on the total of funds advanced to the partner-banks plus the balance on the current account of the Fund with the Bank. The balance bears quarterly interest of 2% per annum.

Attracted special purpose deposit from the Ministry of Finance

On 20 December 2011 the Bank concluded a deposit agreement with the Ministry of Finance for the provision of deposit in the amount of BGN 171,000 thousand up to 30.03.2012, but not before the date of full repayment of the loan granted by the Bank under the state loan from 20.12.2011 year. (Note 19).
As at 31.12.2012 the deposit has matured and the BDB AD liability has been settled.

Long-term refinancing agreement with the State Fund Agriculture

Under a Contract, signed in 2002, with the State Fund Agriculture for re-financing special-purpose loans provided to farmers, the Fund has refinanced the Bank with its own funds for granting such loans in relation to investment projects and disclosed investment programs. The interest due by the Bank on the Borrowings is 2% p.a. Since 18.05.2011 the Bank provided loans to farmers at 7% annual pursuant in accordance with Annex 1 (before 18.05.2011 loans granted by the Bank to the farmers are at 9% annual interest rate).
As at 31.12.2012 the amounts received for refinancing from the Fund is BGN 3,129 thousand (31.12.2011: BGN 5,712 thousand).

On 21.07.2011 the Bank signed a new Refinancing agreement with funds of the State Agricultural Fund for providing loans to applicants with approved projects under measures of the Rural Development Program (RDP) for the period 2007 – 2013. The interest due by the Bank to State Agricultural Fund is 2% p.a. The Bank provides loans to approved projects under measures of RDP at 7% p.a.

As at 31.12.2012 there are no amounts received for refinancing from the Fund for refinancing projects under the Rural Development Program (RDP). (31.12.2011: BGN 117 thousand).

30. DEBT SECURITIES ISSUED

In May 2010 the Bank has issued second ordinary, corporate, interest bearing, non-cash, registers, freely transferable, non-convertible, unsecured bonds ISIN code BG 2100005201 with a total nominal value EUR 20,000 thousand and par value of bond - EUR 1,000 each. The term of bond loan is 60 months, until 15 May 2015. The agreed interest is paid quarterly by applying interest rate of 5% p.a. The principal is payable on a single installment on maturity.

In December 2010 the Bank issued third registered, non-cash, freely transferable, ordinary, non-convertible, unsecured, interest bearing bonds with a total nominal value EUR 20,000 thousand and par value of bond – EUR 1,000 each. The term of bond loan is 60 months, until 30 December 2015. The contracted interest is paid quarterly by applying interest rate of 4,8 % p.a. The principal is payable on a single installment on maturity.

Debt securities issued are presented in the statement of financial position at amortised cost.

31. FINANCIAL LIABILITIES HELD-FOR-TRADING

In thousand of BGN	2012	2011
Interest rate swaps	2,618	2,082
Currency swaps	464	999
	3,082	3,081

32. OTHER LIABILITIES

	2012	2011
Provisions on bank guarantees	12,400	10,942
Charges on debenture loans	974	1,173
Accruals for expenses	474	250
Payables to personnel and for social security	258	227
Tax payables	9	17
	14,115	12,609

Provisions on bank guarantees represent the amount expected to be actually paid to third parties by the Bank under issued thereby guarantees. It is comprised of two components: a) individual provisions – when at 31 December (the reporting date) there are already sufficiently clear evidence as to the individual guarantees that they will be enforced and the beneficiaries there under will have undeniable right and may submit request for payment – BGN 6 973 thousand (31.12.2011: BGN 2 300 thousand), as well as (b) portfolio provisions – determined as at 31 December (the reporting date) based on the assessment of the risk of loss for each guaranteed credit portfolio of a partner-bank under the Micro-credits Guarantee Fund Project of the Ministry of Labor and Social Policy – BGN 5 427 thousand (31.12.2011: BGN 8 642 thousand).

Payables to personnel include: accruals on compensated leaves and social security contributions thereon as well as the present value of the Bank's liability due on retirement benefit obligations as at 31.12.2012.

32. OTHER LIABILITIES (CONTINUED)

In accordance with the Labor Code each employee is entitled to indemnity on retirement at the amount of two gross monthly salaries, and if he or she has worked for more than 10 years for the Bank – six gross monthly salaries at the time of retirement. The Bank has estimated the amount of these liabilities by using mathematical models and the services of a certified actuary. On the basis of the calculations made, the amount of BGN 168 thousand is included in the balance at 31 December 2012 (31.12. 2011: BGN 142 thousand).

In thousand of BGN	**2012**	**2011**
Present value of the liability at 1 January	117	106
Unrecognised actuarial gain/ loss at 1 January	25	9
Liability recognised in the balance sheet at 1 January	142	115
Expenses for the period	35	35
Amounts paid in the period	(9)	(8)
Liability recognised in the balance sheet at 31 December	168	142
Unrecognised actuarial gain/(loss) at 31 December	(1)	(25)
Present value of the liability at 31 December	167	117

The change in Bank's liability to personnel for indemnities on retirement for the reporting year is presented in the statement of comprehensive income and includes:

In thousand of BGN	**Amounts on retirement for old age and service**	**Amounts on retirements due to illness**	**Total**
Interest expense	7	1	8
Current service costs	21	1	22
Net actuarial (gain) loss recognised for the period	1	4	5
Expense recognised in the statement of comprehensive income (as current profit or loss for the period)	29	6	35

The following actuarial assumptions are used in calculating the present value of the liabilities as at 31 December 2012:

- mortality rate – in accordance with the table, on basis of statistics issued by the National Statistical Institute for the total mortality rate of the population in Bulgaria for the period 2009 – 2011;
- staff turnover rate – from 0% to 10% depending of the five age groups formed;
- effective annual interest rate for discounting – 4.5% (2011: – 5.7%);
- The assumptions for the future level of working salaries in the Bank is based on the plan for development of the company and verified by the Bank with confirmation letter: for 2013 – 5 % compared to level in 2012 and for 2014 and subsequent years – 5 % compared to the previous year level.

33. SHARE CAPITAL

In thousand of BGN	2012	2011
Share capital		
Ordinary shares issued for cash fully paid	587,964	587,964
Issued ordinary shares – in-kind contribution (land for the building of the bank)	12,200	12,200
Issued ordinary shares – in-kind contribution (building of the bank)	1,610	1,610
	601,774	601,774

The capital of the Bank is composed by 6,017,735 ordinary registered voting shares with par value of BGN 100 each.

The new Bulgarian Development Bank Act provides that not less than 51% of the shares - should be owned by the State whereas shares of the State amounting to not less than 51% of the registered share capital, are non-transferable. Also, a specific limit is established with regard to the remaining shareholders, other than the Bulgarian State, through the Ministry of Finance. They may be: the Council of Europe Development Bank, the European Investment Bank, the European Investment Fund as well as other banks for development in EU member states.

The Bank's shares may not be pledged and the rights thereon may not be subject to transfer deals.

34. RESERVES

In accordance with the general provisions of the Commercial Act and the Bulgaria Development Law from 2008, the Bank shall allocate to General Reserves at least 1/10 of its profit for the year until the reserves reach 10% of the share capital.

The Bank can use the money from the Reserve Fund to cover its current or prior period losses, but cannot use it for distribution of dividends without permission by Bulgarian National Bank.

In addition, under the Credit Institutions Act, the banks may not distribute dividends before reaching the minimum reserves (mainly General Reserves) required by law or by the Articles of Association, or in case the distribution of dividends results in violating the regulatory capital adequacy ratios. The requirement under the Bulgarian Development Bank Act is analogous

As at 31.12.2012 the General Reserves of the Bank amount to BGN 52,447 thousand (31.12.2011: BGN 51,824 thousand).

As at 31.12.2012 the Addiotional reserves of the Bank amount to BGN 7,309 thousand (31.12.2011: BGN 6,190 thousand) and are formed as result of distribution of profits of the Bank from previous periods, according to decisions of the General Meeting of shareholders.

In 2012 after a General Shereholders's Meeting took place in July 2012 and in accordance with article 26 from Decree 367/29.12.2011 of the Council of Ministers of the Republic of Bulgaria, a decision for distribution of dividends has been taken, amounting 80% of the profit for the year after deduction of the distribution to reserves. The dividend paid was BGN 4,476 thousand (in 2011 there are no dividends paid).

In accordance with the Bulgarian Development Bank Act, each shareholder of the Bank may refuse the dividend due thereto and then the dividend amount is transferred to additional reserves.

All unrealized gains and losses from fair value revaluation of the available-for-sale securities are recognised in equity in the Available-for-sale Revaluation Reserve. When securities classified as available-for-sale are sold, therefore derecognised or are impaired, the fair value adjustments accumulated in equity are recognised in the statement of comprehensive income (in profit ot loss). The revaluation reserve is presented net of deferred taxes. As at 31.12.2012 the AFS revaluation reserve equals to BGN 526 thousand negative value. (31.12.2011: BGN 403 thousand – negative value).

35. CONTINGENT LIABILITIES AND COMMITMENTS

In thousand of BGN	2012	2011
Contingent liabilities		
Bank guarantees and letters of credit	78,987	98,980
Incl. letters of credit with cash collateral	(5,214)	(8,430)
letters of credit with borrowed funds, accounted as undrawn authorized loans	(13,403)	(13,783)
Recognised in the statement of financial position (provided)	(12,400)	(10,942)
	47,970	65,825
Irrevocable commitments		
Undrawn authorized loans	43,966	40,490
Incl. letters of credit with borrowed funds	*13,403*	*13,783*
Uncalled nominal portion of held EIF shares	4,694	4,694
	48,660	45,184
	96,630	111,009

The table below presents the movement in the provisions for bank guarantees:

In thousand of BGN	2012	2011
As at 1 January	10,942	676
Charge for the year	7,177	15,064
Utilized during the year	(2,703)	(4,728)
Reversed for the year	(3,016)	(70)
As at 31 December	12,400	10,942

By virtue of the Bulgarian Development Bank Act, the transfers of the activities under the Micro-credits Guarantee Fund Project from the Ministry of Labor and Social Policy (MLSP) to the National Guarantee Fund EAD – subsidiary of the Bank were started in the last quarter of 2008. Based on this law and on Council of Ministers Decision No. 309/3 May 2007, re-negotiations were carried out within one year (until May 2009) with each of the partner-banks under the Micro-credits Guarantee Fund Project of MLSP for replacing the security of MLSP deposits with bank guarantees of the Bulgarian Development Bank AD. The capital of the Bulgarian Development Bank AD and respectively, of the National Guarantee Fund, was increased with the amount of the released government funds under the project.

As at 31.12.2012 agreements with eight partner-banks were concluded and the issued bank guarantees amount to BGN 16,697 thousand (31.12.2011: eight partner-banks and the issued bank guarantees amount to BGN 26,590 thousand).

Nature of instruments and credit risk

These commitments of contingent nature bear an off-balance sheet credit risk because only fees are recognised in the financial statements until the commitments are fulfilled or expire. The amounts reflected in the above table for guarantees represent the maximum accounting loss that would be recognised at the reporting date if counterparties failed to perform in full their obligations as contracted. Many of the contingent liabilities and commitments will expire without being advanced fully or partially. Therefore, the amounts do not represent expected future cash flows. The collateral coverage ratio for common bank guarantees is over 100% and represents deposits blocked at the Bank, mortgages of real estate and insurance policies issued in favor of the Bank. When conditions for enforcement of an issued guarantee occur, the Bank judges the possibilities for recourse to the counterparty and eventual realization of the provided securities.

35. CONTINGENT LIABILITIES AND COMMITMENTS (CONTINUED)

The guarantees of the Bank issued under the Micro-credits Guarantee Fund Project are not secured. In case of activation of a guarantee of the Bank component, the payment is not assessed as ultimate loss because the partner-bank is obliged to undertake all necessary measures for realizing the received collaterals of the non-performing loan and to reimburse the respective amount to the Bank.

The non-paid portion of the nominal value of European Investment Fund shares, held by the Bank shall become due for payment after a special decision for this purpose taken by fund's General Meeting of Shareholders. By the issue date of this financial statement no such a decision has been taken.

36. CASH AND CASH EQUIVALENTS

	2012	2011
Cash on hand (Note 16)	119	124
Current account with the Central Bank (Note 16)	51,417	70,162
Amounts due from other banks, with up to 90 days maturity	119,929	409,897
	171,465	480,183

37. TRANSACTIONS WITH RELATED PARTIES AND COMPANIES UNDER JOINT CONTROL WITH THE STATE

Entity	*Type of control*
Ministry of Finance	Majority shareholder of the capital of the BDB AD representing the State
National Guarantee Fund EAD	Subsidiary
Microfinancing Institution JOBS EAD	Subsidiary
Holding Bulgarian State Railways EAD	Company under joint control with the State
National Electricity Company EAD	Company under joint control with the State
BULGARGAS EAD	Company under joint control with the State
Bulgarian Institute for Standardization	Company under joint control with the State
State-owned Enterprise "Communicative Construction and Rehabilitation"	Company under joint control with the State
South Stream Bulgaria AD	Company under joint control with the State
State-owned Enterprise "Transport Construction and Rehabilitation"	Company under joint control with the State
"I C J B" AD	Company under joint control with the State
Road Infrastructure Agency	Company under joint control with the State
Ministry of Agriculture and Food	Company under joint control with the State
State Fund Agriculture	Company under joint control with the State
Ministry of Environment and Water	Company under joint control with the State
Bulgarian State Railways EAD	Company under joint control with the State

37. TRANSACTIONS WITH RELATED PARTIES AND COMPANIES UNDER JOINT CONTROL WITH THE STATE (CONTINUED)

Balances with related parties and companies under joint control with the State (in thousand of BGN):

Assets

Entity	*Type of balance*	2012	2011
Ministry of Finance	Available-for-sale securities	60,048	1,001
Microfinancing Institution JOBS EAD	Loans and advances to customers	29,088	24,000
National Guarantee Fund EAD	Loans and advances to customers	23,029	-
Road Infrastructure Agency	Receivables from the State Budget	12,666	-
Ministry of Agriculture and Food	Receivables from the State Budget	-	335,395

Liabilities

Entity	*Type of balance*	2012	2011
National Guarantee Fund EAD	Deposits from customers	269,390	345,762
Ministry of Finance	Other borrowings	18,262	189,539
South Stream Bulgaria AD	Deposits from customers	5,852	5,851
State Fund Agriculture	Other borrowings	3,134	5,839
Microfinancing Institution JOBS EAD	Deposits from customers	382	534
"I C J B" AD	Deposits from customers	1,445	389
Bulgarian Institute for Standardization	Deposits from customers	27	37
BULGARGAS EAD	Deposits from customers	7	13
National Electricity Company EAD	Deposits from customers	1	2
State-owned Enterprise "Transport Construction and Rehabilitation"	Deposits from customers	1	2

Transactions with related parties and companies under joint control with the State (in thousand of BGN):

Entity	*Type of transaction*	2012	2011
Ministry of Finance	Fee and commission income	73	75
	Interest income	2,189	11,016
	Interest expense	(2,834)	(3,811)
National Guarantee Fund EAD	Fee and commission income	1	1
	Fee and commission expense	(25)	(52)
	Interest income	46	-
	Interest expense	(8)	(6)
	Rental income	35	42
Microfinancing Institution JOBS EAD	Fee and commission income	2	1
	Interest income	1,009	309
	Interest expense	-	(1)
	Rental income	13	16
Holding Bulgarian State Railways EAD	Fee and commission income	70	70
Ministry of Agriculture and Food	Interest income	5,497	395
Road Infrastructure Agency	Interest income	156	-
State Fund Agriculture	Interest expense	(94)	(124)
Ministry of Environment and Water	Interest income	-	173
South Stream Bulgaria AD	Interest expense	(5)	(3)
"I C J B" AD	Interest expense	(1)	(5)

37. TRANSACTIONS WITH RELATED PARTIES AND COMPANIES UNDER JOINT CONTROL WITH THE STATE (CONTINUED)

Contingent liabilities and commitments with related parties (in thousand of BGN):

Entity	*Type*	**2012**	**2011**
Microfinancing Institution JOBS EAD	Bank guarantees issued	2	2
Microfinancing Institution JOBS EAD	Undrawn authorized loans	912	6,000

Relations with key management personnel (in thousand of BGN):

Balances with key management personnel	**2012**	**2011**
Deposits from customers	154	124
Remunerations payable	36	29
Loans and advances to customers	185	-

Transactions with key management personnel	**2012**	**2011**
Remunerations and social security contributions	1,522	1,790
Interest expense	(2)	(1)
Interest income	6	-

38. SUBSEQUENT EVENTS

No adjusting and/or non-adjusting events have occurred after the reporting period that require additional disclosures in the financial statements.

BULGARIAN DEVELOPMENT BANK AD

ACTIVITY REPORT
2012

Information on the Bank

Bulgarian Development Bank AD (BDB AD) was established on 11.03.1999 as a joint stock company under the Bulgarian Law with the name of Encouragement Bank AD.

On 23.04.2008 the Law on the Bulgarian Development Bank was adopted. It regulates the bank's structure and scope of activities, including those of the subsidiaries provided for establishment.

The mission of Bulgarian Development Bank is to be a contemporary banking institution, which utilizes its unique position on the Bulgarian banking market for implementation of the state's economic policy. Main focus for the Bank are local SME's, project finance for export orientated companies, as well as investment banking for public projects with national importance.

As at 31.12.2012 the paid-in share capital amounts to BGN 601,774 thousand (31.12.2011: BGN 601,774 thousand), consisting of 6,017,735 ordinary registered shares with nominal value of BGN 100 each. The Bank has complied with the requirements of BNB for minimum share capital for banking activity, as well as the capital requirements of the Law on BDB. The ownership of the capital is as follows: 99,9999% is owned by the Republic of Bulgaria represented by the Ministry of Finance; 0,0001% is owned by DSK Bank.

For the implementation of its goals the Bank forms a financial group together with two subsidiaries – National Guarantee Fund and Microfinance Institution JOBS.

On 24.01.2012 in the Commercial Register at the Registry Agency were entered additions and amendments in the Statute of BDB, including actualization of the scope of activity of the Bank. According to the Statute of the Bank, it shall perform the activities stipulated in Art. 2 paragraph 1 and 2 of the Law on Credit Institutions, in compliance with the license issued by the Bulgarian National Bank. The Bank may conduct the following activities:

1. public attraction of deposits or other repayable funds and extending loans or other financing for its own account and at its own risk;
2. payment services within the meaning of the Law on Payment Services and Payment Systems, except of issuance of bank payment cards and electronic money, as well as execution of payment transactions with bank payment cards and electronic money instruments;
3. issuance and administration of other means of payment such as traveler's checks and letters of credit, as much as such activity is not covered by p. 2;
4. acting as depository or custodian institution;
5. financial leasing;
6. guarantee transactions;
7. trading for its own account or for customers' accounts with:
    - Money market instruments – checks, bills of exchange, deposit certificates and others not covered under p. 8;
    - Foreign currency and precious metals;
    - Financial futures, options, exchange rate and interest rate instruments and other derivative instruments not covered under p. 8;
8. trading for its own account or for customers' accounts with transferable securities, participation in issuance of securities, as well as other services and activities under article 5, paragraph 2 and 3 of the Law on Markets of Financial Instruments;
9. money brokerage;
10. advising companies on their capital structure, strategy and related matters as well as advices and services concerning company transformations and mergers and acquisitions transactions;
11. acquisition of receivables and other form of financing, resulting from sale of goods or services /factoring/;
12. equity acquisition and management;

13. collection and distribution of information and references on customers' creditworthiness;
14. other similar activities defined with a Regulation of the Bulgarian National Bank

The Bank may not perform as a core activity other activities, except the above and the activities provided by the Law on the Bulgarian Development Bank, except when this may prove necessary for the performance of its activity or in the process of collection of receivables and extended credits. The Bank may establish or acquire legal entities for performance of ancilliary services. The Bank may participate in companies, consortiums and other forms of association in conformity with the relevant requirements of the effective legislation.

The seat of Bulgarian Development Bank AD is: 10 Stefan Karadhza Str., Sredets District, Sofia 1000. As at 31.12.2012 the headcount of the Bank is 124 employees.

Characteristics of the environment - Macroeconomic environment and banking system

The development of the Bulgarian economy in 2012 was influenced by the problems in the countries from the EU, which are Bulgaria's main trading partners. In 2012 Bulgaria registered growth of 0,8% in the physical volume of GDP. While in 2011 the growth was mainly driven by the increase in net exports, in 2012 the main growth driver of the Bulgarian economy was domestic demand. In 2012 final consumption increased by 18%, whereas gross fixed capital formation increased by 0,8% YoY (in real terms).

The recovery in domestic demand contributed to the growth of the Bulgarian economy, and hence to an increase of the current account deficit in the Balance of payments. According to preliminary data for 2012 from the Bulgarian National Bank, the current account was negative,amounting to EUR 528.2 mln (-1.3% from GDP). According to the preliminary data for the Balance of payments, the foreign direct investments in the country amounted to EUR 1,478.3 mln.

Despite the growth of the economy in 2012, the dynamics in the labor market continued to be influenced by the ongoing restructuring processes in the economy. The level of employment continued to decrease and the unemployment rate in 2012 increased to 12,3% (according to data from NSI). Average annual inflation (Harmonized Index of Consumer Prices) for 2012 remained low at 2,4%.

In 2012 assets of the banking system grew by 7.3% and as of 31.12.2012 amounted to BGN 82.4 billion. Attracted funds followed a similar dynamic and reached BGN 70.7 billion. Loans (excluding loans to financial institutions) amounted to BGN 57.8 billion or increase of 3.2% YoY. Loans to enterprises increased by 5.7%, while loans to individuals and households decreased by 0.5%.

The banking system retained its capacity to resist unfavorable changes in the environment. As of the end of the year, non-performing loans of over 90 days reached 16.7% of the aggregate loan portfolio (2011: 14.9%). In the last quarter of 2012 there were signs that the dynamic in the indicator has reached its maximum and a reverse in the trend can be expected. The amount and quality of the capital position of the banking system remained at level that ensures the stability of the banking business. Total capital adequacy ratio of the banking sector at the end of 2012 stood at 16.66% (2011: 17.53%).

Review of activities

In 2012 continued the process of modernization and upgrade of BDB. Simultaneously, the Bank continued to rapidly expand its business.

Following the structural reorganization in 2011 the process of comprehensive review of the internal regulations was finalized in 2012. The upgraded procedures regarding the organization of the bank's core business – lending activity were consistently applied. A new partnership program was developed aiming to improve the access of SMEs to the loan products of the bank. Within this program agreements were concluded with more than 20 branch and regional unions of the business.

The management of the Bank adheres to a consistent conservative risk assessment policy, in line with the economic environment and the specific characteristics of the loan portfolio of the bank. In 2012 impairment coverage of exposures to non-financial institutions was raised from 12.2% to 15.7%, thus the risk to loans granted before 2011 was adequately covered.

As at 31.12.2012 the financial result of Bulgarian Development Bank after taxes is a profit amounted to BGN 7,491 thousand (2011: BGN 6,218 thousand). The financial result in 2012 was significantly influenced by the higher impairment loan portfolio formed before 2011 as the net costs for impairment of loans are at a total amount of BGN 38,748 thousand (2011: 31,150 thousand). Provisions for guarantee commitments were allocated for the amount of BGN 4,161 thousands. The increase in the impairment and provisions is due to the conservative approach in credit risk assessment and the necessity of additional impairment of particular credit exposures. The coverage of loans classified in category "Standard" was increased.

The realized operating income of the bank in 2012 reached BGN 61,917 thousand (2011: BGN 64,047 thousand). The decline in the operating income is due to a lower net interest income for 2012 in the amount of BGN 57,474 thousand (2011: BGN 61,437 thousand). The decrease is due to the lack of one-off positive effect from 2011 for the amount of BGN 5,000 thousand (the initiative according to Decree 197 of the Council of Ministers (CM) dated 08.04.2010 on "Adoption of a mechanism for settlement of State budget liabilities").

The general and administrative expenses in 2012 amount to BGN 10,699 thousand (2011: BGN 8,636 thousand). Significant contribution for the increase has the installment for Deposit Insurance Fund. In 2012 the necessary expenses and investments for upgrade of the information and communication systems in the bank were done, while as at the same time BDB maintained the lowest cost to income ratio for the Bulgarian banking system in 2012 - 17.3%.

As at 31.12.2012 the assets of Bulgarian Development Bank reached BGN 1,679 mln, which is 10% decrease (BGN 191 mln) in comparison with the end of 2011. The amount of the assets and liabilities of the bank in 2012 was significantly influenced by the following financial operation: in December 2011 BDB signed a contract for granting a loan to the Ministry of Agriculture and Food (MAF) for the amount of BGN 335,022 thousand as part of the initiative Rural Areas Development Program of the European Union. As at the end of 2011 these funds were deposited in BDB and within the same initiative The Ministry of Finance deposited BGN 171,000 thousand in BDB. As a result the volume of the assets of the bank increased with BGN 506 mln. In May 2012 structuring of the initiative was finalized, and as a result the volume of the funds related to it in BDB was BGN 237 mln. (effect: decrease of the assets of the bank with the amount of BGN 269 mln.). Eliminating this one-off effect, the assets of the bank would have increased with BGN 78 mln.

In 2012, the Bank continued to actively develop its activities supporting the Bulgarian business in a difficult economic environment. The loan portfolio increased by 11% to BGN 606,209 thousands, as BDB continued to maintain a diversified sectoral structure of its loan portfolio. Significantly decreased the relative shares of transport services (minus 5.1 pp) and construction (minus 3.2 pp). There was an increase in the shares of financial services (+ 4.2 pp) and trade (+ 2.8 pp).

The volume of indirect lending through commercial banks (on-lending) as of 31.12.2012 amounted to BGN 491,432 thousands (BGN 445,685 thousands at the end of 2011).

The securities portfolio of BDB increased up to BGN 125,401 thousand (2011: BGN 16,560 thousand) and is equally split between government and corporate bonds. Investments in securities were not among the priority temporary activities of BDB. The increase in the portfolio at the end of 2012 was due to the temporary availability of significant volume of liquid funds.

As at 31.12.2012 the amount of utilized funds from international financial institutions is BGN 337,209 thousand (2011: BGN 327,963 thousand). The cooperation with key international partners continued. In 2012 funds for the amount of BGN 53,863 thousand were utilized. The loan granted to BDB in 2011 by one of the strategic key partners of the bank-Black Sea Trade and Development Bank was fully utilized. The resources under these loans are aimed at supporting the SME sector in Bulgaria by financing new projects to final borrowers – SMEs. Fully utilized were also the funds under the loan from Nordic Investment Bank, used to finance projects for renewable energy and environment.

Except its traditional sources of funding, in 2012 BDB initiated negotiations for additional financial facilities with six more new and existing partners for extension to BDB of export financing and financing of projects of mutual interest.

Risk management

In the usual course of business, the Bank is exposed to a variety of financial risks. These risks are identified, measured and monitored through various control mechanisms in order to be managed and to prevent undue risk concentration. The process of risk management is essential for the Bank's profitability and existence. The main risks, to which the Bank is exposed, are credit risk, market risk and operating risk.

Credit risk

Credit risk is the main risk to which the bank is exposed, hence its management is essential for the business. Credit risk management is carried out in accordance with the Law on BDB and the laws and regulations of the Republic of Bulgaria regulating lending activity, as well as in accordance with established international standards and good banking practices.

The Bank uses a model to generate internal ratings for assessing and managing credit risk exposures. These ratings indicate the credit quality of the borrower for each loan transaction. Within BDB are created and function bodies for current monitoring and controlling of the quality of loan portfolio, namely a Work group on overdue loans, Work group for current control on the loan portfolio, Provisions committee and Work group on the legal cases. The Bank also conducts ongoing monitoring of the loan portfolio by establishing periodic reports (twice a year) on the activities of each borrower and after an detailed examination of the information in the report each case is sent for consideration by the Working Group for monitoring and / Committee or provisions in the event that there is new information that would lead to a risk for the Bank.

For the management of the credit risk in the BDB, a system of interbank limits for economic sectors is observed, as well as other credit and concentration limits, and the results of compliance monitoring are reported to competent authorities. The system of limits is revised and updated periodically.

Market risks

When managing the foreign currency risk, the BDB follows the principle of maintaining a minimal open currency positions within the specified limits. Foreign exchange positions are not formed for speculative purposes, but are due to foreign currency transactions arising in the ordinary course of a banking business. The Bank does not carry out significant transactions and does not hold significant open positions in currencies other than Euro and Bulgarian Leva. Until the exchange rate of the Bulgarian Lev is fixed to the Euro, the Euro is not considered a currency bearing currency risk for the cash flows and the financial position of the Bank.

As a part of the management of interest rate risk, regular reports on financial assets and liabilities are prepared, divided in time intervals depending on their sensitivity to changes in interest rates. In case of discrepancies in periods, an assessment of expected changes in interest curve is applied and potential risk for the interest income of the Bank is measured.

Risks in operations on money and capital markets are managed by a system of limits reflecting the risk profile of investments and certain parameters of the portfolio, such as counterparty, financial instrument, maturity, etc. The system of limits is reviewed periodically, and implementation of the limits is subject to daily monitoring. The securities portfolio formed by BDB is below the specified regulatory threshold requiring an allocation of capital for price risk and price risk is negligible compared to the size of business. As there is no trading portfolio in accordance to the regulatory provisions there is no capital allocated for market risk.

Liquidity of BDB is managed by closely monitored ratios indicating liquidity position by periods. Liquidity risk is measured by applying additional scenarios for cash flows from operations. Measured and monitored are also the liquidity buffers of the Bank and the additional sources of funding in case of market and idiosyncratic shocks.

Operational risk

Operational risk management is implemented through close observation and recording of all operational events. Events, characterized by greater frequency, are the basis of scenario analysis on operational risk. With the relatively small headcount in the BDB, the operational risk is easily measurable and controllable. In the course of business a register of operational events is created, serving as a basis for analysis and improvement of work processes and minimizes factors that potentially could lead to operational events and loss for the Bank.

Banking regulators under the Bulgarian legislation

In accordance with the requirements of laws and regulations governing the banking in the country, Bulgarian Development Bank should comply with restrictions related to certain ratios. As at 31.12.2012 the Bank has complied with all regulatory requirements of the BNB and the Bulgarian legislation.

The capital adequacy ratio on individual basis as of 31.12.2012 is 50.01% (31.12.2011: 55.10%), which manyfold exceeds the minimum required capital adequacy ratio of 12%. The decrease registered in 2012 is associated with more intensive utilization of the Bank's capital in its business development.

Credit rating and international activities

On 14.11.2012 the rating agency "Fitch Ratings" affirmed the long-term rating "BBB-" of BDB AD as an issuer of long-term foreign currency debt. The rating's perspective is stable. The short-term rating of the bank is affirmed at "F3". The investment community considers these ratings as an investment grade and it is among the highest in the Bulgarian banking system - evidence of the sound financial position BDB amid the ongoing processes in Europe.

BDB continues to successfully develop fruitful partnership with major European and International financial institutions. These relations enable the Bank to be preferred business partner, to benefit from the best banking practices and to participate in their development and implementation.

BDB is a shareholder in the European Investment Fund, holding 0.10% of its equity, and participates regularly in the Committee of the minority shareholders of the financial institution where the guidelines for development of the activity and policy of the EIF are discussed. The Bank is an active member of the European Association of Public Banks (EAPB) since 2005. At the end of 2012 on a general assembly of the association in Brussels, a representative of BDB was elected as a member of the Administrative Board of the prestigious European banking organization.

In 2012 BDB continued to take an active participation in the workshops and seminars organized by EAPB, related to the development of the European banking and financial legislation. The membership in EAPB facilitates the exchange of experiences and best practices between BDB and the European public banks.

The Bank is also a member and the Network of European Financial Institutions (NEFI), participated by 15 European countries. The objectives of NEFI are to improve the exchange of information, know-how and experience in SME financing between banks, as well as to engage in constructive dialogue with the EU institutions regarding the financing problems of SMEs in the EU.

BDB retains its status as member and takes part in the activities of "Club of Institutions of the European Union Specializing in Long-Term Credit", jointly with the EIB, the EBRD, Caisse des depots et consignations (CDC), Cassa depositi i prestiti (CDP) and others.

Management of the Bank

Bulgarian Development Bank has a two-tier management structure consisting of Supervisory Board and Management Board. In 2012, there were no changes in the composition or the structure of management bodies. As at 31.12.2012 the Supervisory Board and the Management Board have the following structure:

Supervisory Board

Dorothea Ivanova Pandova - Chairperson of the Supervisory Board
Rumen Andonov Porozhanov - Member of the Supervisory Board
Diana Toneva Dragneva-Ivanova - Member of the Supervisory Board

Management Board

Assen Vassilev Yagodin - Chairman and Chief Executive Officer
Vladimir Vladimirov Gyulev - Deputy Chairman and Executive Director
Iliya Zapryanov Karanikolov - Member of the Management Board and Executive Director
Andrey Ivanov Genev – Member of the Management Board,
Hristo Vangelov Karamfilov - Member of the Management Board

The Bank is represented jointly by any two of the three Executive Directors.
Remuneration paid to persons managing the Bank in 2012 amounted to BGN 1,522 thousand.
No contracts within the meaning of Art. 240 "b" of the Commercial Law are concluded between members of the SB, MB or related persons on one side, and the Bank on the other side, falling beyond the ordinary course of business or significantly deviating from market conditions.

The participation within the meaning of Art.247, paragraph 2, item 4 of the Commercial Law of members of the SB and MB in commercial companies as general partners, holding more than 25 percent of the capital of another company, as well as participation in the management of other companies or associations as procurators, managers or Board members is as follows:

- The members of the SB and MB of BDB do not participate in the capital of other companies.
- Mrs. Dorothea Pandova is a member of the Board of Directors of the European Investment Bank. The other members of the SB do not participate in the management of other companies.
- Members of the MB have the following participation in the management of other companies:
  - Assen Vassilev Yagodin participates in the management of BULGARIAN STOCK EXCHANGE - SOFIA, ID - 030412611 as Chairman of the Board of Directors and in the Association of Banks in Bulgaria as Vice Chairman of the MB.
  - Vladimir Vladimirov Gyulev does not participate in the management of other companies.
  - Iliya Zapryanov Karanikolov participates in the management of Microfinance Institution JOBS EAD, UIC 201390740 as Chairman of the Board of Directors. Mr. Karanikolov is a member of the Administrative Board of the European Association of Public Banks.
  - Andrey Ivanov Genev participates the management of National Guarantee Fund EAD, UIC 200321435 as Chairman of the Board of Directors
  - Christo Vangelov Karamfilov is a member of the Board of Directors of Microfinance Institutions Jobs EAD, UIC 201390740.

Transactions with related persons and companies under joint control of the state

Owner of BDB is the Bulgarian state, hence the Bank is a related party to the state authorities of the Republic of Bulgaria and the companies in which it exercises control. In note № 37 to the individual financial statements of BDB for 2012 are presented transactions with related parties and companies under common control of the state.

Development strategy and business objectives. Financial goals and objectives

In 2011 and 2012 BDB managed to cover expenses related to the financial impact of inherited risks from previous periods. This allows it to focus on the implementation of the Strategy for development of BDB in the period until 2014 and until 2016, approved on 14.11.2012 by the Council of Ministers of the Republic of Bulgaria. The strategy establishes a framework for the modernization of the Bank's activity and accelerated growth in support of the Bulgarian business. It envisages returning the focus to the main priority of the Bank – SMEs, export-oriented business and public projects. BDB's objective is to become one of the leading financial institutions in the Bulgarian banking market, reaching a scale, that would allow it to be an important instrument of the state policy in support of the Bulgarian economy. This way the capacity of the Bank will be used efficiently and on the basis of its stable foundation (100% state-owned, large as per the local standards capital, highest possible rating for Bulgaria) the Bank will attract resources under favorable terms and will transfer this price advantage to Bulgarian SMEs.

Within the horizon of the strategy the Bank will aim towards achieving an adequate ratio "equity - loan portfolio" of about "1 to 4", compared to "1 to 1.2" at the end of 2010.
BDB will continue to be an important partner of Bulgarian banks in lending to SMEs – by using its competitive advantages to attract external resources at attractive price levels, the

bank will expand the so-called "on-lending" portfolio, credit lines to other local banks to provide loans to SMEs under better conditions.
The Bank takes an active position in the absorption of EU funds. BDB will assist in the future both the beneficiaries (SMEs and agricultural producers) in the implementation of their investment projects, and if necessary, using its previous experience, the state administration. BDB is willing to play a leading role in the implementation of projects of national importance, based on its unique position on the local market. Considering its relatively limited resources, the bank will seek the role of lead advisor / organizer and co-lender in the implementation of large transactions in the field of project financing.
The business development in 2013 will focus on the development of lending and profitability. The Bank will continue to pursue its conservative approach to risk-taking and assets impairment, taking into account the general level of credit risk in the banking system and the specific characteristics of the loan portfolio formed by the end of 2010. Also envisaged is the development of the lending activity, both directly and indirectly. The pace of this development will be tailored to the risk characteristics of the environment, in order not to be undertaken additional risks. In order to finance its assets BDB will continue to rely mainly on its equity and attracted funding from international financial institutions.
In February 2013 the reconstruction of the office building of the Bank started. The major investments under the project will take place during 2013 and 2014.

Subsequent events

In the period between the balance sheet closing date and the preparation of this report no events have occurred, which have a significant impact on the facts in the report.

Declaration of the management

The management of the Bank declares that the attached annual financial statements fairly reflect the assets and financial status of the Bank at the end of 2012 and the calculation of the financial result for the year in accordance with the applicable law. Appropriate accounting policies are used and applied consistently. The necessary judgments are made in accordance with the prudential principle in preparation of the annual financial accounting statement at the end of the year. The management consistently uses the applicable accounting standards and the annual financial statements are prepared on a going concern basis.
The management of the Bank endeavors to maintain an adequate accounting system that complies with the applicable accounting standards. The annual financial statements disclose the standing of the bank with a reasonable degree of accuracy.
All measures are taken to protect the Bank's assets, to prevent fraud and violations of laws in the country and regulations of BNB on the banking activity.
This Activity report was adopted on 14.03.2013 by the Management Board of the Bank and signed by:

EXECUTIVE DIRECTORS:

Assen Yagodin

Iliya Karanikolov