Bulgarian National Bank

ANNUAL REPORT • 2010

BANQUE NATIONALE DE BULGARIE

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The cover shows an engraving of the BNB building
from the 1938 banknote with a nominal value of 5000 levs.

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Honourable Chairman of the National Assembly,
Honourable People's Representatives,

Under the provisions of Article 1, paragraph 2 and Article 51 of the Law on the Bulgarian National Bank, I have the honour of presenting the Bank's 2010 Annual Report.

Ivan Iskrov
Governor
of the Bulgarian National Bank

BNB Governing Council

Sitting from left to right: Kalin Hristov, Ivan Iskrov, Rumen Simeonov, Dimitar Kostov.
Standing from left to right: Oleg Nedyalkov, Penka Kratunova, Statty Stattev.

Governing Council

Ivan Iskrov
Governor

Dimitar Kostov
Deputy Governor
Banking Department

Rumen Simeonov
Deputy Governor
Banking Supervision Department

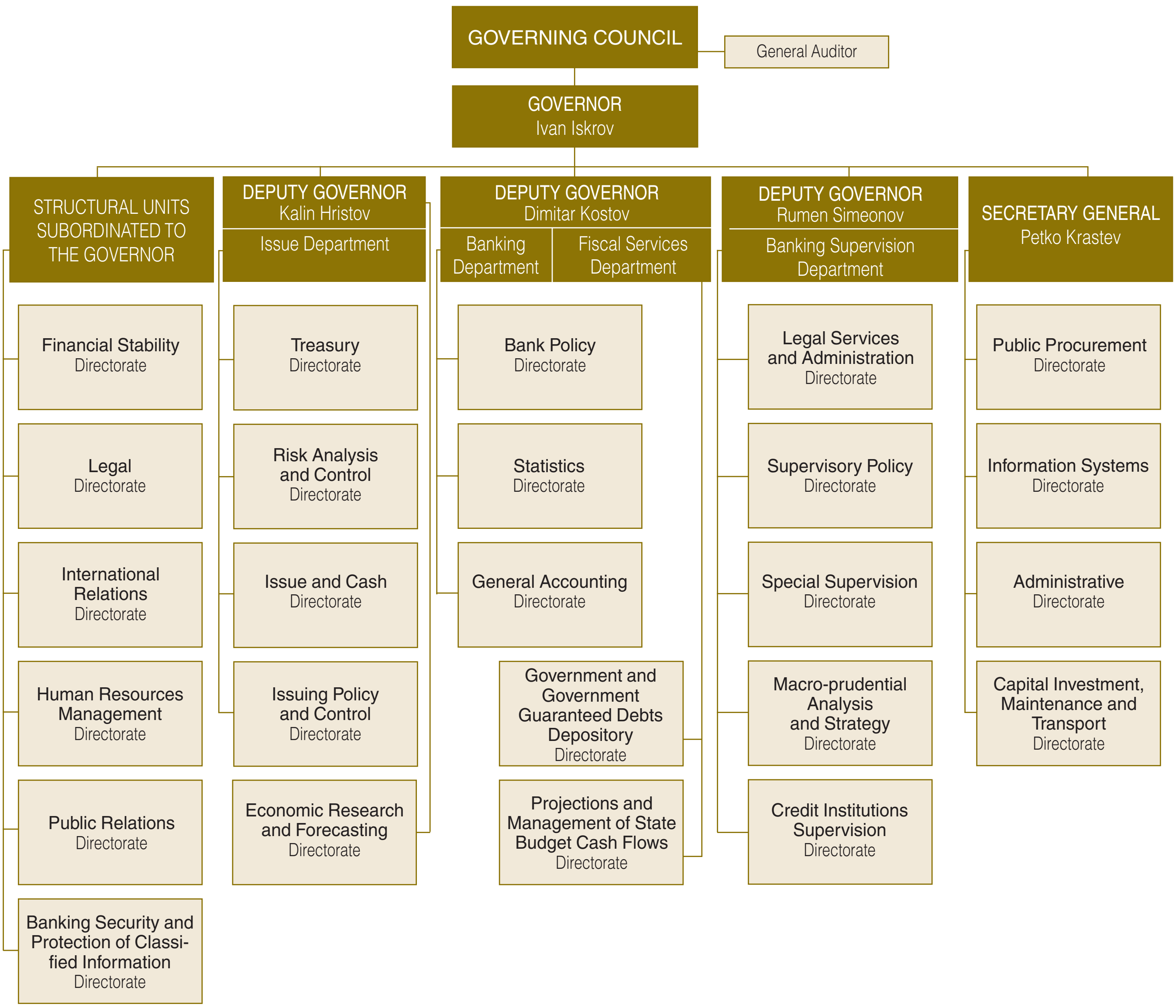
Kalin Hristov
Deputy Governor
Issue Department

Oleg Nedyalkov

Penka Kratunova

Statty Stattev

Organisational Structure of the BNB



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Abbreviations

BIR	Base interest rate
BIS	Bank for International Settlements, Basle, Switzerland
BISERA	System for servicing customer payments initiated for execution at a designated time
BNB	Bulgarian National Bank
BORICA	Banking Organization for Payments Initiated by Cards
BSE	Bulgarian Stock Exchange
BTC	Bulgarian Telecommunication Company
CEFTA	Central European Free Trade Association
CIF	Cost, Insurance, Freight
CM	Council of Ministers
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
ECOFIN	Economic and Financial Council
EFTA	European Free Trade Association
EMU	Economic and Monetary Union
ESCB	European System of Central Banks
EU	European Union
FLIRBs	Front-loaded Interest Reduction Bonds
FOB	Free on Board
FSC	Financial Supervision Commission
GDDS	General Data Dissemination System
GDP	Gross Domestic Product
HICP	Harmonized Index of Consumer Prices
IFO	Institute of Economic Research, Germany
IMF	International Monetary Fund
MF	Ministry of Finance
MFIs	Monetary financial institutions
NLO	National Labour Office
NSI	National Statistical Institute
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of Petroleum Exporting Countries
RINGS	Real-time Interbank Gross Settlement System
SBL	State Budget Law
SDR	Special Drawing Rights
TFP	Transitional and Final Provisions
VAT	Value Added Tax
ZUNK	Bulgarian abbreviation of the Law on Settlement of Non-performing Credits Negotiated prior to 31 December 1990 (LSNC)

Summary

In 2010 global economic recovery intensified, but at different rates in different regions. Growing demand pushed up the international prices of major commodities, particularly crude oil and metals. Over the second half of the year agricultural produce prices increased rapidly due to bad weather in major producer countries. Average global inflation went up to 3.4 per cent (against 2.2 per cent in 2009), at relatively high rates in emerging and some advanced economies. As growth and inflation returned, most central banks pursuing autonomous monetary policies started raising interest rates on refinancing operations. Inflation was not a problem in the euro area and the USA, being lower than targets. Yet, growth being relatively slow and unstable, the ECB and the US Federal Reserve System kept interest rates unchanged. In mid-2010 the ECB clearly signalled it was starting to soak up the additional liquidity injected into the money market by discontinuing six-month and one-year refinancing operations and setting a floating interest rate on three-month operations. The US Federal Reserve System, however, launched a new programme of direct government securities purchases to inject additional liquidity into banks.

In 2010 the Bulgarian economy started a gradual recovery. GDP increased by 0.2 per cent, goods and services exports contributing most, while domestic consumer and investment demand continued falling. The balance of payments current and capital account deficit went down to 0.2 per cent of GDP. Net foreign direct investment remained comparatively high at 4.0 per cent of GDP. It went mainly into manufacturing, power and heating generation, and distribution and transport, storage and communications. Bulgaria's gross external debt fell by EUR 1045 million to 101.8 per cent of GDP. As businesses sought increased efficiency and cost competitiveness, the rate of employment contraction accelerated to 5.9 against 2.6 per cent in 2009, while productivity rose 6.4 per cent.

The BNB performed its functions based on a comprehensive analysis of international conditions and developments in the national economy. The BNB directed attentions to managing Bulgaria's international reserves, maintaining the stability of the banking system, ensuring smooth payment systems and currency circulation, acting as the government's fiscal agent and official depository, and participating in the work of the European System of Central Banks (the ESCB).

Periodic world financial market tension over fiscal and debt problems in some euro area countries brought new constraints to BNB gross international reserve investment to mitigate risk. At the end of April 2010 the purchase of debt instruments issued or guaranteed by countries with worsened fiscal positions and high public debt was suspended across the Bank's portfolio, including the externally managed portion. Exposure to banks in these countries was also limited. In mid-2010 government debt instruments into which gross international reserves could be invested were divided into three inherent risk groups, with constraints on each. Reinvested maturing funds and new gross reserve receipts were directed mainly into German government and government-guaranteed debt and short-term deposits, mitigating credit risk and maintaining liquidity. Funds invested into assets with the highest long-term credit rating (AAA) averaged 52 per cent over the year. Given these constraints and opportunities on international financial markets, BNB income from international reserve investment in 2010 was EUR 64.69 million. Net earnings from international reserve management came to EUR 441.14 million or 3.99 per cent profit.

Maintaining banking system stability is a top BNB priority. Stability was assessed by early risk identification and analyses of risk sharpening scenarios. Regular publications of macro-prudential analyses advised the public of the state of the banking system.

Since the change of bank strategies at the outset of the global economic crisis in late 2008, bank financing has depended on residents' deposits. As households saved and cut spending, confidence in banks boosted deposits despite falling deposit rates. By the end of 2010 annual broad money growth amounted to 6.2 per cent, quasi-money contributing most at 9.4 per cent. Credit demand was weak due to the uncertain pace of recovery, relatively low investment demand, and low capacity utilisation. The annual growth of claims on the non-government sector slowed to 1.3 per cent. Slow growth of banks' credit portfolios reflected sluggish corporate demand and cautiousness about credit by both households and banks. Coupled with low credit demand, the growth of residents' funds provided significant liquidity, used by banks to cut gross external debt by EUR 1516.8 million.

Slow recovery and unstable international markets continued to depress Bulgarian banking indicators. Credit portfolio quality continued to worsen, mainly through non-performing corporate loans. At the same time, the consistent anti-cyclic policy of the BNB has seen the accumulation of capital and provision buffers which, along with the excess of operating revenue over impairment costs and current profits, will help institutions cope. Classified loans were impaired and provisioned to conservative BNB standards. High-liquid security adequately covered the extent of net classified loans (after impairment). Over the year the capital position of the banking system remained stable and system capital adequacy ratio reached 17.39 per cent, with 15.16 per cent for tier one capital. Limited credit and the need to allocate provisions against worsened loans hampered profitability. Banking system profit in 2010 was BGN 600 million, ROA was 0.84 per cent and ROE 6.55 per cent.

In 2010 the intensity and efficiency of bank supervision remained high. Periodical stress-testing assessed sustainability and the capacity of individual institutions to retain stability in case of diverse shocks. The results enabled supervisory measures and helped shape the BNB's anti-cyclic policy.

The 1 February 2010 accession by the BNB and the national banking community to the Trans-European Automated Real-time Gross Settlement Express Transfer System (TARGET2) was a solid step to integration into European financial market and payment infrastructures. EU central banks in TARGET2 now number 23, including six outside the euro area. Participation provides for stability and business continuity, enhances security, and speeds euro transfers to European Economic Area banks. TARGET2 makes retail payment systems more competitive and broadens their scope through services tailored to banks' and consumers' needs.

Commissioning of the BNB's new Cash Centre in Sofia in early April 2010 provided Bulgarian cash circulation with up-to-date storage and processing. The Centre is among the most modern and secure in the ESCB, with strictest security requirements being applied during its construction. Its operation will be in line with BNB responsibilities in the area of cash distribution, including processing, storing, and destroying banknotes and coins in a manner guaranteeing the reliability of individual operating procedures. The newly established Cash Centre continues to provide standard cash services to its customers and to service payments of individuals in national and reserve currency (euro).

The BNB enjoyed particularly intensive international relations over the year. A series of EU initiatives addressed economic governance, policy coordination, and competitiveness in areas where the global crisis highlighted shortcomings. The European Semester package, the Integrated Guidelines, the Stability and Growth Pact reforms, and the draft regulations on macroeconomic imbalances were widely debated. The BNB helped formulate Bulgarian positions through representatives on 82 ESCB, European Commission, and EU Council committees and working groups, and in the Council for European Affairs. Following the principles of cooperation and the national interest, the Bank consistently upheld a position shared by the government: that Bulgaria would pursue national goals through flexible economic, financial, and stabilisation policies. The new initiatives and regulations, including the Euro-plus Competitiveness Pact or the Competitiveness Pact and the future European Stability Mechanism, should take into account national specifics, and in particular macroeconomic indicator convergence in countries such as Bulgaria, so as not to hinder growth and retain Bulgaria's competitive tax advantage.

The Bank helped draft the new EU financial sector supervisory architecture. November 2010 regulations established the European Systemic Risk Board and the European Authorities for the supervision of banks, markets and securities, insurance, and pensions, these bodies starting work in early 2011.

Growing expert capacity and recent experience helped the BNB expand and deepen international cooperation and render technical assistance to neighbouring central banks.

I. Economic Development in 2010

1. The External Environment

In 2010 global economic activity accelerated on 2009. Fiscal and monetary measures by the leading economies greatly contributed to recovery, yet also caused inflation and fiscal instability. Asian economies posted high growth. Real growth in China accelerated to 10.3 per cent against 1.7 and 2.8 per cent in the euro area and the USA respectively. The industry sector reported the highest growth, with production increasing globally by around 6.3 per cent[1] over the year. World trade rose 7.1 per cent on an annual basis.

Major Macroeconomic Indicators
(average annual change)

(per cent)

	Growth of real GDP			Inflation			Unemployment		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
EU-27	0.5	-4.2	1.8	3.7	1.0	2.1	7.0	8.9	9.6
Euro area-16	0.4	-4.1	1.7	3.3	0.3	1.6	7.5	9.4	10.0
EU-8	3.8	-3.0	2.3	6.9	3.7	3.2	6.3	9.9	11.5
EU-3	-0.2	-5.0	1.9	3.6	2.1	3.1	5.1	7.3	7.9
USA	0.0	-2.6	2.8	3.8	-0.3	1.7	5.8	9.3	9.6
Japan	-1.2	-6.3	3.9	1.4	-1.4	-0.7	4.0	5.1	5.1
China	9.6	9.2	10.3	5.9	-0.7	3.3	4.2	4.3	4.1

Note: The EU-8 are the post-2004 EU entrants less those now in the euro area. The EU-3 are Denmark, Sweden, and the United Kingdom. EU-8 and EU-3 indicators are calculated by weighing the time series, growth derived from the weights of individual countries in group GDP, and inflation derived from the weights of the EU-27 in HICP calculated by Eurostat.

Sources: Eurostat, Bureau of Labor Statistics, Bureau of Economic Analysis, Statistics Bureau of Japan, the National Bureau of Statistics of China, BNB estimates

In 2010 euro area economic indicators improved significantly. Despite mid-year concerns that some euro area countries would have difficulties financing budget deficits and servicing sovereign debt, the area posted 1.7 per cent growth because of increasing goods exports and industrial output. Germany's economy contributed most, growing by 3.6 per cent on 2009. Despite the recovery in economic activity, unemployment increased slightly from 9.4 to 10 per cent.

The US recovery begun in mid-2009 continued in 2010. Economic activity accelerated, real GDP rising 2.8 per cent. Unemployment remained high at 9.6 per cent, with a downward trend by the close of the year. Household consumption began improving by mid-year, while household debt continued falling. The housing market remained comparatively unchanged amid a surplus of dwellings and low demand following the end of tax relief on house purchases in April.

In 2010 average global annual inflation grew to 3.4 per cent[2] from 2.2 per cent in 2009, with developing economies contributing most. Main drivers were energy and commodity price rises on international markets. Average annual euro area inflation was 1.6 per cent, up from 0.3 per cent in 2009, core inflation declining from 1.4 per cent to 1.0 per cent. Average US inflation increased from -0.3 per cent in 2009 to 1.7 per cent in 2010, core inflation falling from 1.7 per cent to 1.0 per cent.

In 2010 Brent crude followed an upward trend between USD 76.3 (EUR 54) a barrel in January and USD 91.8 (EUR 69.6) in December. The food price index rose 15.4 per cent. Low interest rates supporting economic activity and industrial output led to higher commodity prices. Metal prices grew most at 62 per cent on 2009; at 57 per cent, steel contributed most.

[1] Based on 21 March 2011 data by the CPB Netherlands Bureau for Economic Policy Analysis.
[2] International Monetary Fund data as of 21 March 2011.

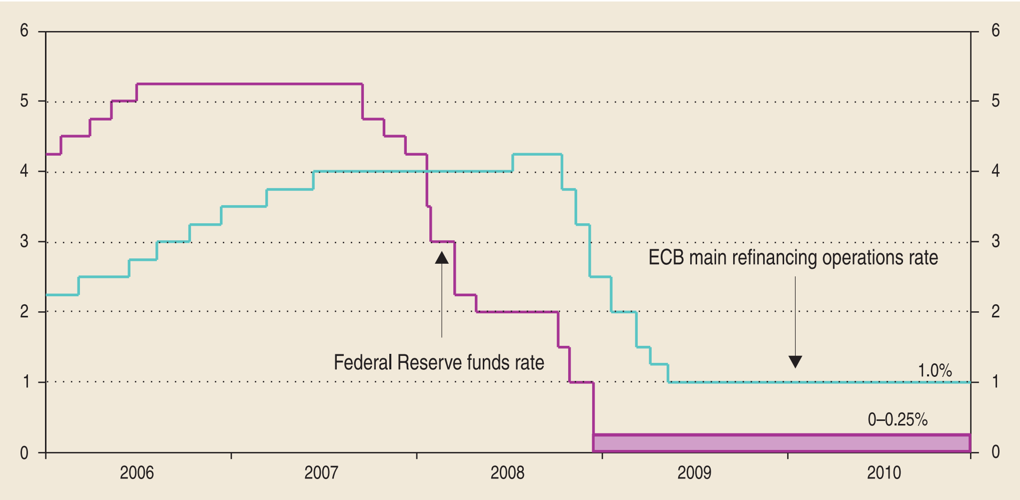
In 2010 world financial markets remained unstable, tensions exacerbated in May and November by the Greek and Irish debt crises. As these countries' government bond yields rose, they sought aid from the European Union and the International Monetary Fund. Help for Greece comprised bilateral loans from euro area countries and the IMF. The Irish support package launched the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF).

In an unstable market, the European Central Bank continued to conduct its main and one-month money market refinancing at fixed 1 per cent interest and full allotment of submitted bids. The ECB repeatedly postponed a return to variable rate refinancing until December, when its Governing Council decided to revert to pre-crisis open market operations in March 2011.

The US reference interest rate stayed unchanged at between 0.00 and 0.25 per cent until the close of 2010. From the second half of the year, US and euro area monetary policies began diverging. The ECB began soaking up the additional liquidity injected into the money market, stopped six-month and one-year refinancing operations, and set a floating rate on three-month operations at an average value of main refinancing operations. US concerns about slowing growth and continuing high unemployment led the Federal Reserve System to start direct bond purchases in a second round of quantitative easing (QE2), providing additional banking liquidity to depress interest rates at the long end of the yield curve. The Federal Reserve System also gave a clear sign it would not sell securities bought as part of non-conventional monetary measures to provide liquidity, protecting capital markets from further volatility.

Federal Reserve System and ECB Interest Rates

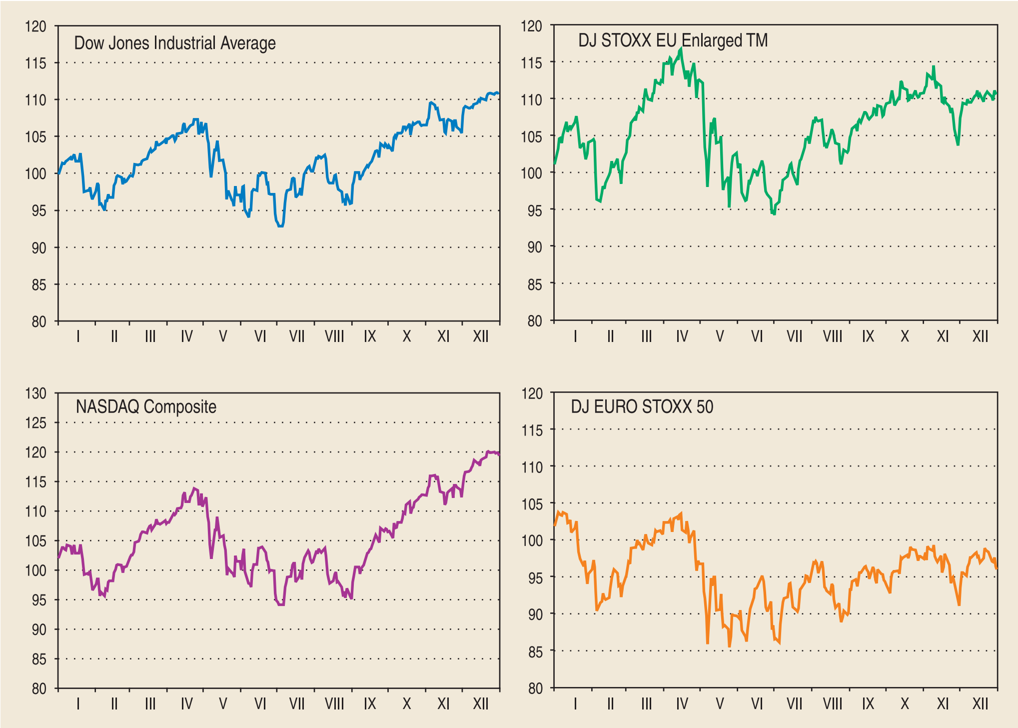
(per cent)



Sources: ECB, Federal Reserve System.

In 2010 leading stock market indices rose, reaching highs at the end of the year. Greek and then Irish fiscal tensions dented mid-year optimism which returned at the close of the year. By December the Dow Jones EURO STOXX 50 and Dow Jones STOXX EU Enlarged TM had risen 10.3 and 29.6 per cent respectively in a year, while in the US, the Dow Jones Industrial and NASDAQ Composite increased by 20.0 and 27.4 per cent respectively.

Major Stock Market Index Dynamics in 2010



Note: Indices in US dollars, December 2009 = 100.

Source: Bloomberg.

2. The Bulgarian Economy

Following the 2009 decline, real Bulgarian GDP started a gradual recovery, posting 0.2 per cent growth in 2010. Goods and services exports which had grown since mid-2009 with the first signs of world economy recovery contributed most. In 2010 exports rose 16.2 per cent, exceeding pre-crisis levels in real terms. In the last quarter higher domestic demand pushed goods and services imports, whose real growth came to 4.5 per cent.

Real GDP Growth Rate

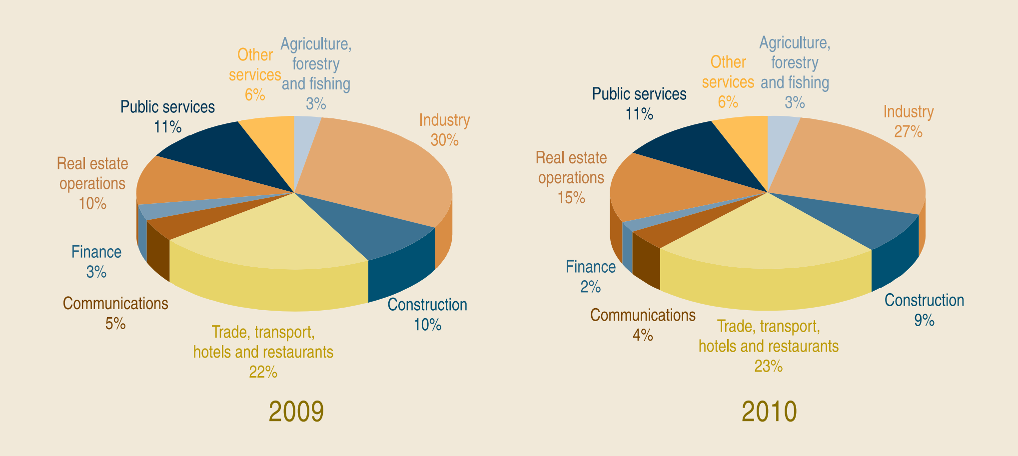
	2009		2010	
	Change (%)	Contribution (p.p.)	Change (%)	Contribution (p.p.)
Produced GDP	-5.5	-5.5	0.2	0.2
Final consumption	-7.3	-6.1	-1.1	-0.9
Household consumption	-7.5	-5.0	-1.3	-0.8
Final consumption expenditure of General Government*	-8.4	-0.6	3.8	0.3
Collective consumption	-4.9	-0.4	-5.0	-0.4
Gross fixed capital formation	-17.6	-5.9	-16.5	-4.8
Physical changes in inventories	0.7*	-3.4	1.5*	0.6
Exports (goods and services)	-11.2	-6.5	16.2	7.7
Imports (goods and services)	-21.0	16.5	4.5	-2.6

* Share of GDP at 2000 prices.

Source: NSI.

Uncertainty about world economic recovery curbed fixed asset investment by 16.5 per cent in 2010. Slowing foreign direct investment, restructuring of sectors with high pre-crisis growth, weak domestic demand, and cautious bank lending constricted investment additionally. Capacity utilisation nevertheless gradually recovered and, with economic situation improvement, brought investment growth by the fourth quarter. The decline in nominal expenditure on fixed assets slowed to -5.8 per cent in 2010 from -28.2 per cent in 2009, that in industry being -16.1 per cent. After significant drops in 2009, fixed asset expenditure in real estate operations and agriculture grew 34.5 and 9.2 per cent respectively in the year.

Structure of Expenditure on Acquisition of Fixed Assets by Economic Sector

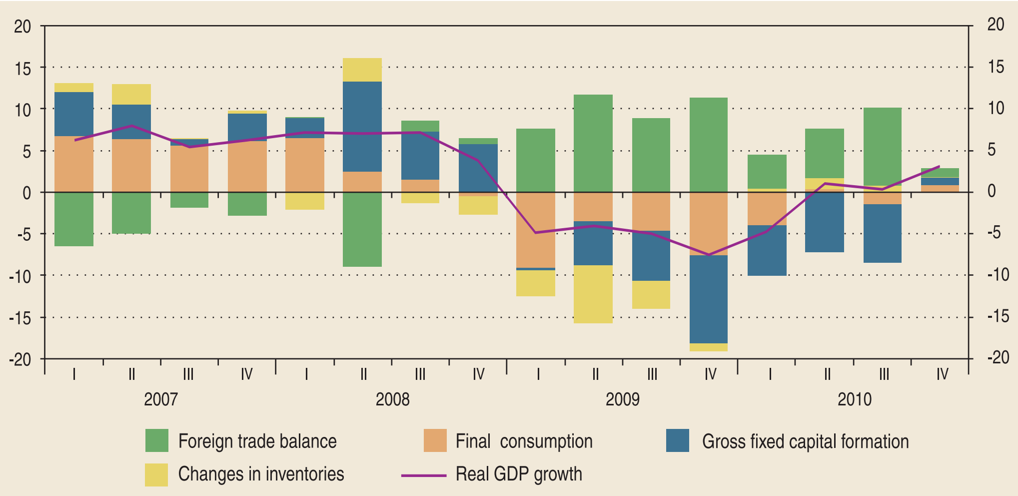


Source: NSI.

In 2010 final household consumption declined 1.3 per cent. The consumer confidence index was on the rise over the year but uncertainty about labour market and household income improvement held back consumer expenditure.

Contribution to Real GDP Growth by Component of Final Consumption

(per cent, percentage points on corresponding quarters of prior year)



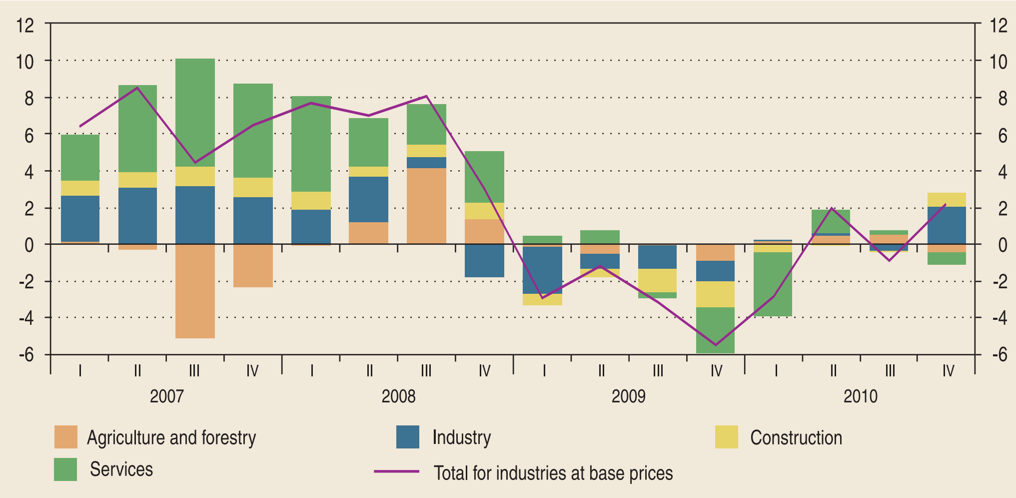
Source: NSI.

Gross value added in 2010 rose 0.2 per cent, having dipped 3.3 per cent in 2009. Sectors differed greatly. Industry, worst hit by external demand falls in 2008, optimised spending and boosted efficiency[3] in 2009. As external demand began recovering, real value added growth there reached 2.3 per cent in 2010. Services were hit by lower domestic demand, some subsectors in continuing difficulties in 2010. Gross value added in the sector fell by 0.9 per cent against a decline of 0.8 per cent in 2009. Gross value added in trade fell by 3.5 per cent in 2010, while foreign trade and growing industrial turnover led to 0.7 per cent growth in transport.

[3] Measured by the *value added to gross output* ratio.

Value Added Change in Real Terms and Contribution by Industry

(per cent, percentage points on corresponding quarters of prior year)



Source: NSI.

Real Growth Rate of Gross Value Added

	2009		2010	
	Change (%)	Contribution (p.p.)	Change (%)	Contribution (p.p.)
Gross value added	-3.3	-3.3	0.2	0.2
Agriculture and forestry	-6.1	-0.4	3.9	0.2
Industry	-7.8	-2.4	1.9	0.6
Services	-0.8	-0.5	-0.9	-0.6

Source: NSI.

The labour market did not improve in 2010 despite the gradual recovery in economic activity. In 2009 employment fell 2.6 per cent, mainly through staff cuts in manufacturing. In 2010 employment fell 5.9 per cent, mainly through cuts in services. The rate of employment decline in industry slowed from -7.1 per cent in 2009 to -6.7 per cent in 2010.

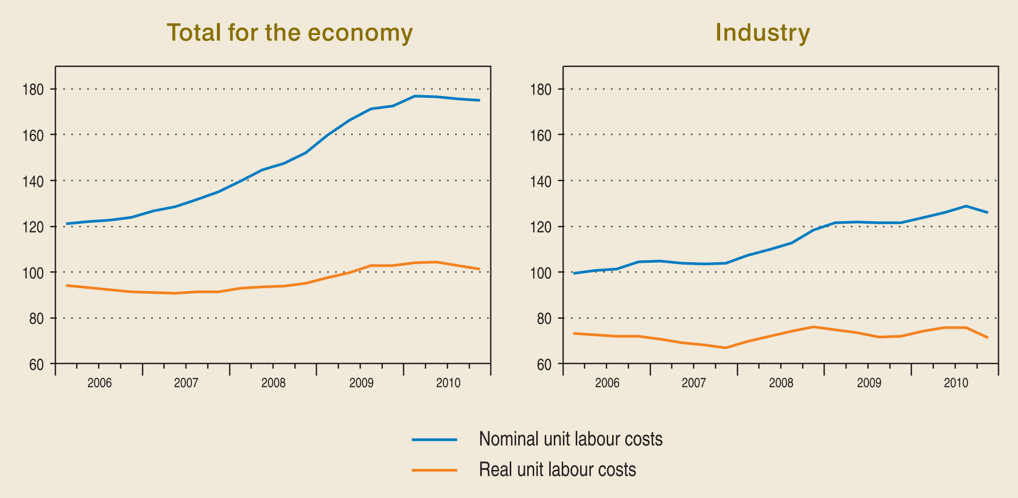
Unemployment continued rising, reaching 11.2 per cent at the end of 2010 according to the Labour Force Survey. Weaker labour demand and scarce new jobs continued to keep people of working age out of work. The number of unemployed registered with the Employment Agency remained relatively constant at 342,000 (9.2 per cent) in December. In contrast to 2009, those unemployed for over 12 months (35.2 per cent of the total) contributed most to this number in 2010. The number of discouraged persons remained comparatively constant over the year after a rise in 2009, and the economic activity ratio of 15 to 64-year-olds dropped from 67.2 per cent in 2009 to 66.5 per cent in 2010.

Nominal wage growth slowed to 7.2 per cent in 2010 (from 9.4 per cent in 2009) as companies sought to cut labour costs. Amid significant unemployment and continuing weak production activity, nominal wage growth (compensation *per* employee) halved to 4.7 per cent on an annual basis in the second half of the year, from 9.7 per cent in the first. The wage fund rose by just 1 per cent in the first half of the year, to fall by the same amount in the second half on the corresponding periods of 2009.

After falling 2.9 per cent in 2009, labour productivity increased 6.4 per cent in 2010 due to fewer employees and some economic activity recovery. Industry contributed most to value added growth which, with falling employment, boosted its productivity by 9.7 per cent. Significant cuts in trade retained productivity growth at 2.2 per cent on an annual basis despite value added declines.

In 2010 nominal unit labour cost rises in the economy slowed significantly to 0.8 per cent on 12.7 per cent in 2009. Real unit labour costs in the entire economy fell 2.1 per cent on 8.1 per cent growth in 2009. Staff cuts and slower income growth in 2010 made the growth of productivity overtake that of compensation *per* employee, improving cost competitiveness of enterprises. In the fourth quarter of 2010 unit labour costs fell 1.9 per cent in nominal and 6.7 per cent in real terms.

Unit Labour Costs
(moving average, 2000 = 100)



Sources: NSI, BNB.

Rising global commodity prices were the major driver of Bulgarian inflation.[4] By the end of 2010 cumulative inflation reached 4.4 per cent (2.8 percentage points higher than in December 2009) and average annual inflation 3 per cent. High world prices of oil and farm produce hiked domestic transport and food prices by 20.5 per cent and 3.9 per cent respectively. Excise rises hiked tobacco prices 34 per cent, with adjustments to the administratively controlled prices of some services adding to inflation. Transport fuels, tobacco products, food, and administratively controlled prices were top contributors to inflation accumulated by December 2010.

Cumulative Inflation over the Year and Contributions by Major Goods and Services Groups to it

	2009		2010	
Inflation	1.6%		4.4%	
	Rate of inflation by group (%)	Contribution (p.p.)	Rate of inflation by group (%)	Contribution (p.p.)
Food	-3.0	-0.73	3.9	0.84
Processed food	-2.6	-0.39	5.7	0.74
Unprocessed food	-3.6	-0.33	1.1	0.10
Services	2.9	0.88	0.2	0.07
Catering services	4.4	0.52	2.2	0.27
Transport services	-1.2	-0.06	-0.8	-0.04
Telecommunication services	-1.0	-0.04	-1.3	-0.05
Other services	4.9	0.46	-1.1	-0.11
Energy products	6.4	0.49	18.7	1.74
Transport fuels	8.2	0.54	20.5	1.71
Industrial goods	0.0	-0.01	-1.0	-0.19
Administratively controlled prices and services	2.0	0.31	4.3	0.65
Tobacco products	23.9	0.69	33.9	1.33

Note: The above structure corresponds to the Eurostat classification. Tobacco products and goods and services with administratively controlled prices are presented separately. Administratively controlled prices are calculated using simple consumer basket aggregates.

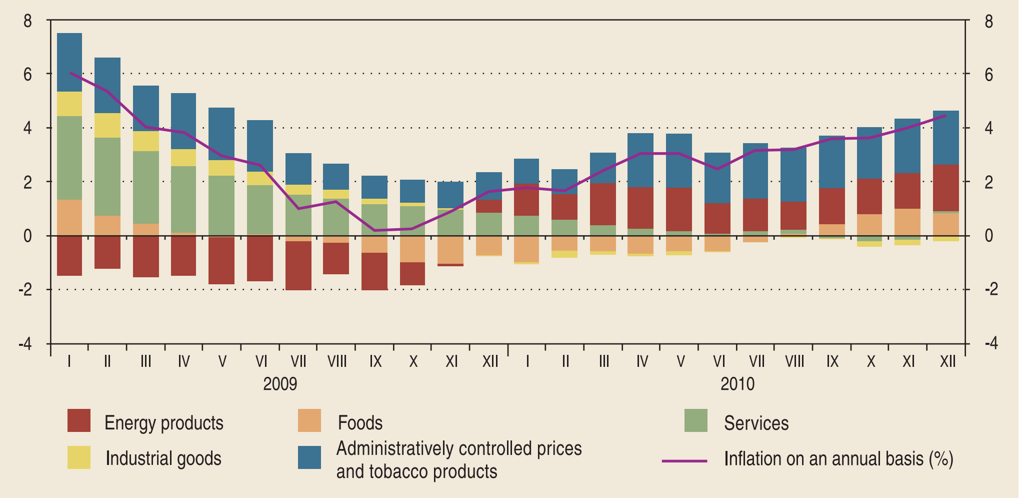
Sources: NSI, BNB.

[4] The analysis employs HICP data.

Core inflation, including non-food (fuels excluded) and service prices, had no significant effect on consumer prices at -0.1 percentage points by the end of 2010 and a 0.1 percentage point contribution to average annual inflation. The industrial goods price index (fuels excluded) declined by 1 per cent on an annual basis by December, car prices contributing most. Services inflation fell by 2.7 percentage points to 0.2 per cent on the end of 2009. Non-food goods and services prices reflected lower consumption and business cost-cutting (e.g. wage spending), displaying no significant indirect effect due to energy and food price rises.

Annual Inflation and Contributions by Major Goods and Services Groups

(p.p., per cent)



Sources: NSI, BNB.

Balance of payments current, capital, and financial account flows reduced BNB foreign exchange reserves by EUR 383.9 million in 2010 (valuation adjustments excluded). Issue Department assets (foreign exchange reserves including revaluation adjustments) rose by EUR 57.8 million.

The overall current and capital account deficit in 2010 contracted to EUR 65.4 million (0.2 per cent of GDP) against EUR 2640.6 million (7.6 per cent of GDP) in 2009. This stemmed mainly from the trade deficit drop by EUR 1761.1 million in 2009 to EUR 2412.5 million in 2010. The services balance also improved by EUR 602.0 million, as did net transfers (by EUR 590.5 million). The income balance declined by EUR 192.2 million to a deficit of EUR 1392.4 million, with higher income payments on direct investment (up EUR 182.8 million on the previous year). The capital account surplus fell by EUR 186.4 million because of lower net receipts from EU funds.

The balance of payments trade deficit fell due to the 33.2 per cent positive nominal growth of goods exports in 2010 and the significantly lower 13.4 per cent nominal growth of goods imports. Major contributors to export growth were base metals and their products (8.3 percentage points), machines, vehicles, and appliances (6.7 percentage points), and mineral products and fuels (5.4 percentage points). This reflected recovering external demand and higher metal and energy prices. Commodities and mineral products, and fuels played a major role in import growth (6.3 and 5.1 percentage points respectively) due to higher world prices. The negative growth rate of investment goods slowed to -0.2 per cent over the year.

Net direct investment inflow into Bulgaria was positive at EUR 1458.9 million (4 per cent of GDP) in 2010. It went mainly into manufacturing (35.9 per cent), electricity and heating generation and distribution (16.5 per cent), transport, storage and communications (15.4 per cent), real estate operations, lessors activities and business services (11.1 per cent), and financial intermediation (9.84 per cent).

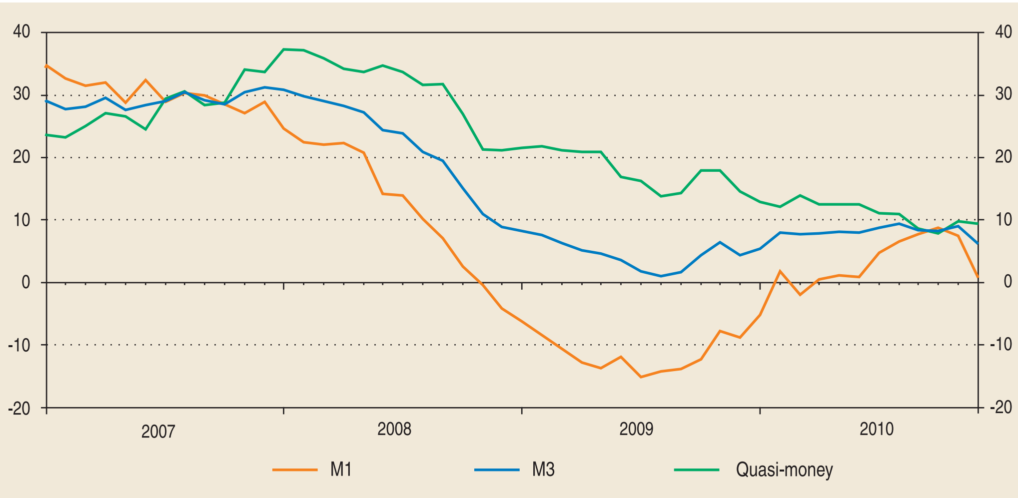
The balance of payments financial account balance fell to EUR -0.9 million. The inflow of foreign direct investment was insufficient to offset the repayment of EUR 917.8 million of bank loans and the withdrawal of EUR 642.0 million from non-resident deposits with local banks. Since the last quarter of 2008 banks have relied for financing on residents' deposits. These have been boosted by households' propensity to save and cut spending, and by confidence in the banking system. At the same time, credit demand was weak. This gave banks liquidity, allowing them to cut their gross external debt by EUR 1516.8 million in 2010, their share in gross external debt falling to 18.7 from 22.2 per cent in 2009.

Between January and December 2010 gross external debt dropped by EUR 1045 million to EUR 36.7 billion (101.8 per cent of GDP), decreased bank debt contributing most. Over the year, loans and deposits of EUR 5630.6 million[5] were taken, and principal obligations of EUR 6554.9 million were serviced. Public and publicly guaranteed debt rose by EUR 108.8 million, mainly because of a loan from the European Investment Bank and USD/EUR rate movements.

In 2010 monetary aggregates followed an upward pattern reflecting a gradual economic activity recovery and resident bank deposit growth. By the year's end, the annual growth rate of broad money came to 6.2 per cent from 4.2 per cent in December 2009. Quasi-money made a major contribution to broad money growth at 9.4 per cent. The narrow monetary aggregate M1 also helped liquidity, mainly due to overnight depositing. Resources accumulated by the National Health Insurance Fund reserve increased local government and social insurance funds, significantly boosting overnight depositing in 2010. The 2011 State Budget Law transferred the National Health Insurance Fund's deposit accounts into the central budget, greatly cutting overnight depositing and curbing M1 annual basis growth to 0.8 per cent in December. The downward trend in currency outside banks was reversed, growing positively on an annual basis since August to 3.4 per cent by the year's close. Determinants of cash in circulation dynamics relate to the gradual economic activity recovery, end-of-year inflation, and stabilising private consumption.

Monetary Aggregates
(annual change)

(per cent)



Source: BNB

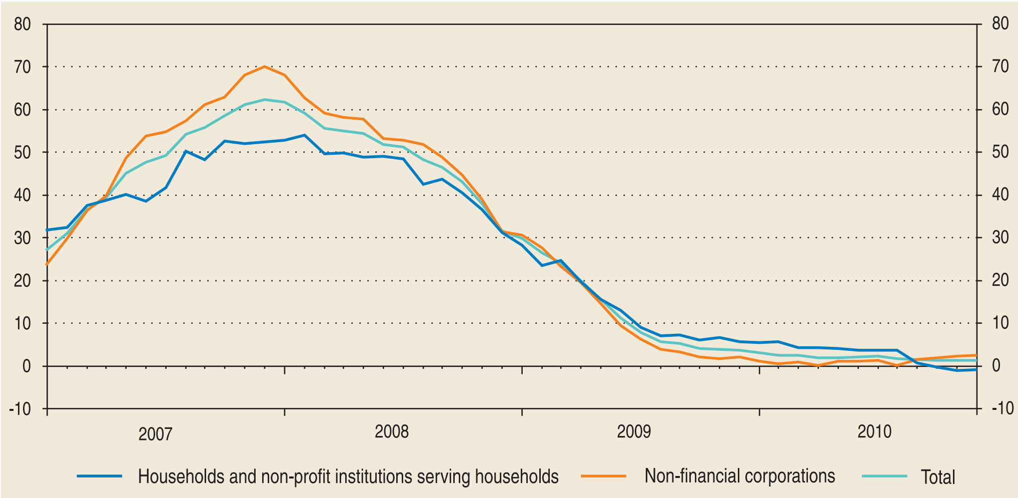
Uncertainty about the rate of macroeconomic recovery continued restraining credit. Banks continued cautious lending and serviced their external obligations. Lower demand and continuing tight lending curbed credit growth. By the end of 2010 the annual growth of claims on the non-government sector declined to 1.3 per cent from 3.8 per cent a year earlier. Moderating 2010 credit growth cut the volume of new corporate and household lending to BGN 12.6 billion, down 6 per cent on 2009. The growth rate of corporate lending remained low throughout 2010, accelerating somewhat only in the last quarter. By December the annual growth of claims on non-financial corporations came to 2.5 per cent. Lending to households was also weak, with a negative growth of -0.8 per cent on an an-

[5] Revolving and trade credit excluded.

nual basis. The slower growth of claims *vis-à-vis* nominal GDP for 2010 depressed the *claims on the non-government sector to GDP* ratio to 74.7 per cent by December, down 0.6 percentage points on 2009.

Claims on the Non-government Sector
(annual change)

(per cent)



Source: BNB.

Banks operating in Bulgaria continued to finance lending by residents' deposits. Household deposits grew by BGN 3 billion in 2010. The overall growth in resident deposits was BGN 4.4 billion, while non-resident deposits fell by BGN 2 billion.

Foreign currency trading with the BNB was the banks' main lev liquidity management tool. It performed the currency board's main function of buying and selling on demand national currency against euro at the fixed rate set by the Law on the Bulgarian National Bank. Over the year the BNB was a net seller of currency to the amount of EUR 463 million, net sales to banks totalling EUR 306 million.[6]

Total foreign currency market turnover came to EUR 356 billion[7] in 2010 (down 28.7 per cent for the year) reflecting ample banking liquidity. Main market segments (BNB trading with banks and bank and BNB trading with final customers) also declined. Only interbank trading (excluding the BNB) increased, with euro transactions there rising almost 8.0 per cent at the expense of USD transactions.

The highly liquid interbank money market over the year forced interest rates dramatically down, especially in the overnight segment. Weak credit demand and growth in resident deposit taking boosted free bank resources. The average interest rate on interbank deposits and repos was 0.29 per cent, while the average monthly rate halved from 0.50 per cent in January to 0.24 per cent in December. The spread between LEONIA and EONIA remained negative, expanding from -11 basis points in January to -31 in December. This was almost entirely due to rising euro area interest rates, especially in the second half of the year. Unlike euro area interest rates, those in Bulgaria were marked by low volatility, signalling confidence among market participants. The total volume of interbank money market transactions increased some 63 per cent in a year to BGN 8 billion. Deposits comprised 72.8 per cent of the turnover and government securities repos 27.2 per cent. Overnight transactions dominated deposits, their share reaching 83.7 per cent.

In 2010 the cash balance on the consolidated fiscal programme ended in a deficit of BGN 2780.8 million (3.9 per cent of GDP). In 2010 the ECOFIN Council found for the first time that Bulgaria had an excessive deficit under ESA95 methodology, the reference value of 3 per cent of GDP being exceeded.

[6] See Section II.
[7] This comprises bank and BNB foreign currency transactions against levs with a spot value date of up to two business days and includes the double volume of trade between the BNB and banks, as well as interbank trading.

Average Interbank Money Market Interest Rate

(per cent)

Source: BNB.

Key challenges to fiscal policy in 2010 were weaker tax revenue, rising social expenditure after several pension increases in 2009, and prior years' liabilities. Total revenue and grants fell 4.4 per cent on 2009 to BGN 23,932.6 million. Following some recovery in VAT income over the second half of the year, indirect taxes came to BGN 9954.1 million for 2010, down 4.3 per cent on an annual basis. Corporate tax revenue declined 23.2 per cent on 2009 to BGN 1353.3 million. Receipts from social and health insurance went down 5.9 per cent, mostly because of a 2 percentage point cut in Pension Fund contributions and decreased employment. Consolidated fiscal programme spending for 2010 (including the EU budget contribution) was 4.1 per cent higher on an annual basis at BGN 26,713.4 million. Actual budget expenditure in 2010 was 3.9 per cent lower than projected in the amended State Budget Law. Social and health insurance spending grew 8.7 per cent over the year, contributing most to current expenditure growth. Though rising significantly in December, capital expenditure[8] declined 2.2 per cent on 2009. By the end of the year, the fiscal reserve came to BGN 6011.8 million: down BGN 1661.1 million in a year.

Investor interest in government securities and consequent declining average yields attained at primary auctions enabled government to increase budget deficit funding significantly through positive net bond issuance. In 2010 net government bond financing reached BGN 864.3 million, while in 2009 it was negative at BGN -71.5 million. The total nominal value of government securities bids approved by the Ministry of Finance in the primary market was BGN 1508.1 million: over three times more than in 2009. In 2010 there were 25 successful primary auctions for BGN- and EUR-denominated treasury bonds and bills. The maturity structure of BGN government securities issues included one-year treasury bills, three-year (3 years and 6 months), seven-year and ten-year (10 years and 6 months) treasury bonds at a fixed rate, with several openings of the 2009 five-year issue. All fixed-rate issues were tap. In 2010 the total nominal value of BGN-denominated issues came to BGN 753.9 million: up 54.3 per cent on 2009 (BGN 488.7 million). The volume of newly issued one-year discount securities was BGN 150.8 million. At the other end of the maturity spectrum, there were seven openings of the new ten-year bond issue, worth BGN 313.1 million.

In 2010 the MF offered another two EUR issues on the domestic market at six auctions. The total nominal value of bids approved by the Ministry during the fifth opening of the EUR-denominated two-year (2 years and 6 months) issue was EUR 151.5 million (BGN 96.3 million). At the auction for 15-year government bonds, the MF approved EUR 234.1 million (BGN 457.9 million) of bids. The total nominal value of EUR issues came to BGN 754.2 million: half of the year's total issues.

[8] Including government reserve growth.

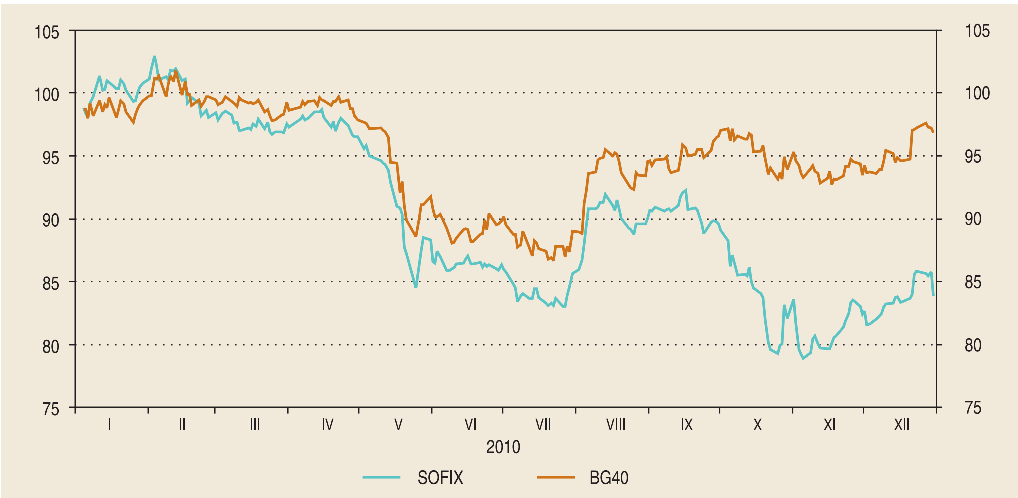
Participation by a comparatively broad range of investors in the auctions, their confidence in government debt instruments, and broadly favourable national credit ratings had a positive effect on the yield curve. Average yield in the primary market fell on 2009 at the five- and ten-year maturity end. Demand for government securities exceeded supply healthily, with the average weighted bid-to-cover ratio at MF auctions increasing from 2.01 in 2009 to 3.31 in 2010.[9]

Outright transactions in domestic government securities between banks in the secondary market totalled BGN 1134.1 million at market value[10]: 89.8 per cent more than in 2009. Higher secondary market activity reflected active MF issuing and the diversified maturity and currency structure of instruments offered which broadened investor appeal. At the same time, persistent high uncertainty in global markets and a weaker Bulgarian capital market reduced investment alternatives. In 2010 trade in BGN-denominated bonds increased to BGN 1045.6 million on BGN 564.7 million in 2009 and that in EUR-denominated bonds more than tripled to BGN 88.4 million on BGN 28.4 million in 2009. Transactions in USD-denominated bonds came to BGN 29,000 on BGN 4.4 million in 2009.[11]

By the end of the year EUR-denominated global bonds maturing in 2013 were quoted at 108.6 (a yield of 3.06 per cent) against 109.07 (a yield of 4.24 per cent) a year earlier. USD-denominated global bonds maturing in 2015 were quoted at 117.25 (a yield of 3.61 per cent) against 116.43 (a yield of 4.56 per cent) a year earlier.[12] As in 2009, the price of USD-denominated ZUNK bonds hovered around nominal.

In 2010 the SOFIX and BG40 indices fluctuated greatly. In the first quarter they retained their late 2009 levels, dipping in the second and beginning of the third quarter to reflect the Greek debt crisis. August and September saw some recovery followed by a new fall coupled with high index volatility. SOFIX and BG40 annual declines came to 15.2 per cent and 2.1 per cent respectively, in line with leading markets. In 2010 the volume of secondary market shares fell to BGN 549.3 million or almost 18 per cent, while the volume of *bourse* trade in bonds decreased by 26 per cent to BGN 124.3 million. Over-the-counter bond transactions totalled BGN 7.5 million. By the end of the year capitalisation of the Bulgarian Stock Exchange, Sofia, market was BGN 10.8 billion or 15.3 per cent of GDP, against 17.3 per cent of GDP at the close of 2009.

Bulgarian Stock Exchange Indices
(December 2009 = 100)



Sources: BNB, BSE.

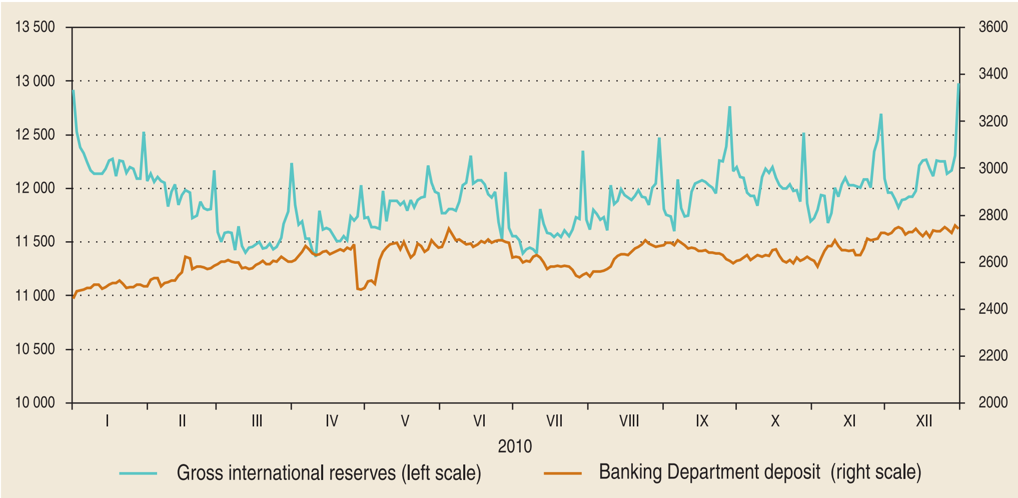
[9] Also see Section VIII.
[10] Based on statistics of operations with a flow on current accounts with the BNB.
[11] Also see Section VIII.
[12] Reuters data.

II. Gross International Reserves

Gross international reserves are managed in line with the requirements and constraints of the Law on the Bulgarian National Bank and opportunities offered by world financial markets.[1] They comprise the assets on the Issue Department's balance sheet and their role is to provide complete cover for monetary liabilities under the fixed exchange rate of the lev to the euro[2]. The excess of gross international reserves over monetary liabilities forms the Banking Department deposit item or the net value of the Issue Department's balance sheet[3].

Gross International Reserves and Banking Department Deposit

(million EUR)



Note: The chart shows daily movements of the Issue Department balance sheet figure and the Banking Department Deposit in the Issue Department balance sheet, including the two tranches of Special Drawing Rights totalling SDR 610.9 million received by the BNB in August and September 2009 from IMF general SDR allocation.

Source: BNB.

1. The Amount and Structure of Gross International Reserves

By the end of 2010 the market value of gross international reserves was EUR 12,977 million: an increase of EUR 57.8 million on the end of 2009. In the first half of 2010 international reserves fell by 6 per cent due to prevailing foreign currency outflows. In the second half of the year the significant positive market revaluation of gold and foreign currency inflows, mainly from large purchases of reserve currency from banks, offset the decrease. By the year's close, reserves registered a net increase on 2009. Foreign currency revaluation led to a significant increase in assets of EUR 388.53 million resulting from the

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[1] In 2010 there were no amendments to the Law on the BNB concerning gross international reserves.

[2] Pursuant to Article 28, paragraph 2 of the Law on the BNB, the Bank's monetary obligations include all circulating banknotes and coins issued by the BNB, and all BNB account balances held by other persons with the Bank except those of the IMF. Article 28, paragraph 3 of the Law on the BNB comprehensively lists assets which are included in gross international reserves: monetary gold; Special Drawing Rights; banknotes and coins in freely convertible foreign currency; funds in freely convertible foreign currency held by the BNB on accounts with foreign central banks or other financial institutions with one of the two highest ratings by two internationally recognized credit rating agencies; securities, issued by foreign countries, central banks, other foreign financial institutions, or international financial organizations assigned one of the two highest ratings by two internationally recognized credit rating agencies; the balance on accounts receivable and payable on BNB forward or repo agreements with (or guaranteed by) foreign central banks, public international financial organizations or other foreign financial institutions with one of the two highest ratings from two internationally recognized credit agencies; and BNB futures and options which bind non-residents and which are payable in freely convertible foreign currency. The Law stipulates that these assets are estimated at market value.

[3] Under Article 28, paragraph 1 of the Law on the BNB 'the aggregate amount of the monetary liabilities of the BNB shall not exceed the lev equivalent of gross international reserves,' the latter set by the fixed exchange rate to the euro.

appreciation of gold. Compared to 2009, the contribution of foreign currency revaluation was EUR 170.52 million.

External cash flows in foreign currency reduced reserves by EUR 463 million, mainly due to operations with banks. Net sales to the amount of EUR 305.61 million dominated BNB reserve currency trading with banks: far below 2009's EUR 1247 million net sales. Banks' minimum reserve accounts with the BNB in euro decreased by EUR 384.73 million[4], while in 2009 the flow was positive, the BNB reporting EUR 158.67 million net receipts on banks' minimum reserve accounts in euro. External foreign currency cash flows to the government and budget organisations partly offset negative foreign currency flows with banks.

External Cash Flows in Foreign Currency

(million EUR)

	2010	2009
I. Purchases and sales of euro		
at tills	-16	-35
banks	-306	-1 247
bank's purchases	57 241	112 527
bank's sales	-57 547	-113 774
Total I	-322	-1 282
II. Currency outflows with banks, the MF, *etc.*		
Minimum required reserves	-385	159
Government and other depositors	243	859
Total II	-142	1 018
Total I+II	-464	-264

Note: The two tranches of some SDR 610.9 million (EUR 665 million) from the IMF's last general SDR allocation are shown in the Government and Other Depositors item for 2009.

Source: BNB.

The SDR 610.9 million received by the BNB in August and September 2009 after the IMF's general SDR allocation were not shown under BNB international reserves[5].

The structure of international reserves changed, with an increased share of gold following world gold price rises. In 2010 the average share of euro-denominated assets fell to 88.5 per cent from 91 per cent in 2009, while gold rose to 10.6 from 7.7 per cent in 2009.

Currency Structure of Gross International Reserves

(per cent)

Currency	2010	2009
EUR	88.52	90.99
USD	0.53	0.95
XAU	10.60	7.69
XDR	0.34	0.36
CHF	0.01	0.01

Note: Average data for the period.

Source: BNB.

There was no significant change in the structure of assets by financial instrument, with the relative share of investment in securities decreasing slightly to 76 per cent on average in 2010 from 81.5 per cent in 2009. The share of investment in money market instruments – mostly short-term deposits and funds with first-rate foreign banks – increased slightly.

[4] Banks' minimum required reserves with the BNB increased in 2010 in line with rising deposit taking. Managing minimum required reserves, banks change the currency structure of their reserve assets. In 2010 banks decreased their minimum reserves in euro and increased those in levs. See also Section IV on the change in the currency structure of minimum required reserves.

[5] For further details on these tranches, see the 2009 BNB Annual Report, p. 26.

Gross International Reserves by Financial Instrument

(per cent)

Financial instruments	2010	2009
Vault cash*	3.37	1.72
Deposits**	16.45	13.73
Securities**	75.94	81.48
Gold in the vault	4.24	3.07

* Account balances and payments.
** Including instruments in foreign currency and gold.
Note: Period averages.
Source: BNB.

The structure of international reserves by residual term did not change significantly compared to the 2009 average. The main portion of assets continued to be concentrated in the up to one year sector (current accounts, short-term deposits in foreign currency and gold and short-term securities), its share averaging 64.2 per cent of assets – almost unchanged from 2009 levels. The first half-year's relative reduction in securities with maturity of up to a year in favour of those with maturities of one to three years changed in the second half as investment preference switched to short-term instruments with the lowest risk.

Gross International Reserves by Residual Term to Maturity

(per cent)

Maturity sectors	2010	2009
Up to 1 year	64.24	64.38
From 1 to 3 years	23.95	23.39
From 3 to 5 years	9.14	8.30
From 5 to 10 years	2.15	3.32
From 10 to 30 years	0.52	0.61

Note: Average data for the period.
Source: BNB.

2. Gross International Reserve Risk and Yield

The year saw world growth recover after stimuli from central banks and governments in some countries[6]. The business climate continued improving, with industry and services optimistic about output, employment, and orders. In the second half of 2010 the US and euro area economies continued growing moderately.

Despite improved macroeconomic indicators in the euro area and in the United States, international financial markets fluctuated and avoided risk. This was more pronounced in the euro area, with little market confidence that countries such as Greece, Ireland, Portugal, and Spain could achieve fiscal consolidation and service their government debts. Government securities market tension increased markedly in May and November as Greek and Irish government debt yield reached unstable levels. Investors fled to the safety of German, French, and Dutch government securities, with sizeable appreciations of such paper over the year.

Government Securities Yield Curve

The yield of the benchmark German bonds declined, falling on 8 June 2010 to 0.455 per cent in the two-year maturity sector: the lowest since 2008. Only in the last quarter of 2010, when more favourable inflation expectations ended the surge in German bonds, did the yield in that maturity sector begin recovering its past levels of 0.8 to 1.1 per cent. At the same time, higher credit risk fuelled a flight from peripheral euro area government securities, their bond yields increasing. The bid-offer spread of these securities also widened, reflecting falling liquidity.

The euro area yield curve declined for most of the year due to the strong decrease in yield in the long rather than short end of the curve. By the close of 2010 this trend was

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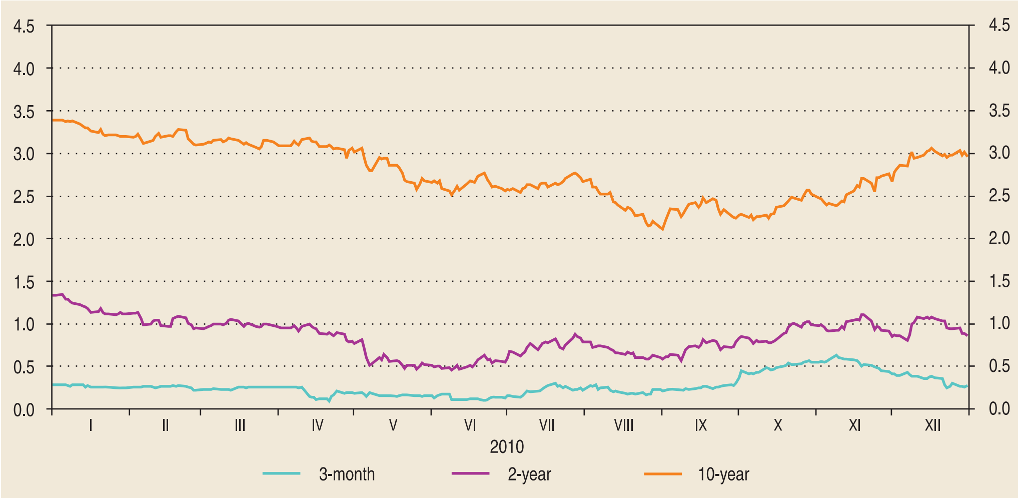
[6] For more details, see Section I.

interrupted, the yields of long-term US and euro area government securities beginning to rise. The change reflected global inflation expectations based on rises in fuel, metal, and food prices on international markets.

EUR Government Securities Yield to Maturity

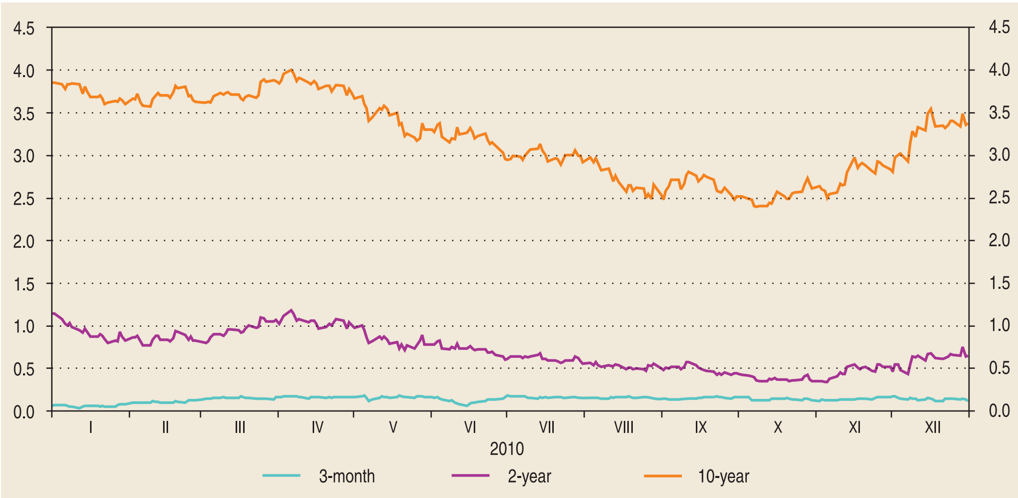
(per cent)



Source: BNB.

US Government Securities Yield to Maturity

(per cent)



Source: BNB.

Exchange Rate and Gold Price

In 2010 the US dollar appreciated 7.1 per cent on the euro, with a broad fluctuation range of 0.69 to 0.82. The main drivers of the rate were declining investor risk appetites, the relative safety of USD-denominated assets, and concerns about public finances in some euro area countries. In the second half of the year, interest rates and the differential between US government securities and benchmark German bonds also influenced the rate. A factor was the round of Federal Reserve direct bond purchasing (quantitative easing or QE2) to the amount of USD 600 billion, which led to expectations of a dollar depreciation.

In 2010 gold prices in US dollars and euro continued to rise as gold was perceived a safer alternative to securities. Varying within the relatively wide band of USD 1062 to 1423 *per* troy ounce, the price ended the year at USD 1420.8 and EUR 1063: 29.6 and 38.6 per cent up.

USD/EUR Exchange Rate

(EUR)

Source: BNB.

US Dollar Gold Price per Troy Ounce

(USD)

Source: BNB.

Euro Gold Price per Troy Ounce

(EUR)

Source: BNB.

Major Types of Risk

Over the year BNB gross international reserves were invested in line with the long-term risk tolerance set by the Governing Council as regards the net value[7] in the Issue Department balance sheet: $-2.5\% \leq VaR \leq 0\%$ in the first half year and $-5\% \leq VaR \leq 0\%$ in the second half of the year at 95 per cent confidence level[8].

In 2010 gross international reserve **interest rate risk** measured by reserves' average modified duration in years was 0.78, while in 2009 it was 0.83. By the end of the year asset duration shortened to 0.70 as expectations of rate rises led to a strategy change favouring the short-term sector.

Gross international reserve **currency risk** was constrained by the Law on the BNB provision that the sum of the absolute values of open foreign currency positions[9] in currencies other than euro, SDR, and monetary gold, should not exceed 2 per cent of the market value of monetary liabilities in these currencies. In the reporting period minimal open currency positions in currencies other than the euro were maintained, the open gold position posing the major currency risk.

Credit risk reflected recurrent financial market tension related to Greek fiscal and debt problems. Significant market turbulence instigated additional measures in international reserve management: new or revived investment constraints, methodological changes to benchmark choice, and a change in the latter's structure. The measures aimed at an overall moderate decline in credit risk to the BNB. After April 2010 debt issued or guaranteed by Portugal, Spain, Italy, and Ireland was banned. In the middle of the year new constraints and rules divided eligible issuing countries into three credit risk groups, with at least 30 per cent of international reserve invested in the least risky group and at most 20 per cent in the riskiest group. Some easing of market tensions after mid-year allowed new investment into Italian government debt subject to stricter maxima. At the beginning of the third quarter Portugal left the list of approved issuers, Irish government debt following in the fourth quarter. Both measures anticipated credit rating downgrades for the two countries; these duly came, long-term credit ratings falling below the minimum of AA- (Aa3) set in the Law on the BNB. Liquidity restrictions also changed, further constraining exposures in securities from countries in debt crises. Temporary constraints affected operations with some BNB Group I counterparty banks[10]. Investment into assets with the highest long-term credit rating (AAA) averaged 52 per cent over the year[11].

Strict control of investment restrictions and business procedures tackled operational risk.

Profitability and Efficiency

Net income from assets in euro comprised income from investing gross international reserves, plus income from foreign currency revaluation of euro denominated assets and liabilities (currency imbalance yield[12]), and expenditure on liabilities. Over the year BNB investing gross international reserves yielded EUR 64.68 million (0.6 per cent). Currency imbalance yielded EUR 382.05 million, primarily due to the open position in monetary gold. Interest on Issue Department balance sheet liabilities was EUR 5.59 million. The three components gave net earnings of EUR 441.14 million, or around 4 per cent net profitability.

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[7] 'Net value' means the Issue Department balance sheet item 'Banking Department Deposit'.

[8] Net value risk measured by VaR=-X% (X>0) at 95 per cent confidence level and allowing for normal yield allocation means that 95 per cent of the time maximum net value loss would not exceed X per cent.

[9] An open foreign currency position is the difference between the value of assets and liabilities in any currency other than the euro.

[10] Group I counterparties are first-rate foreign banks with long-term credit ratings of at least AA- (Aa3) set by at least two internationally recognised credit rating agencies. The BNB may deposit foreign currency and gold for short terms at such banks.

[11] Under investment restrictions, the Bank may only invest into financial instruments rated at least AA- (Aa3) by at least two internationally recognised credit rating agencies and issued by counterparties with the same minimum ratings.

[12] Currency imbalance yield is the sum total of the effects of exchange rate movements on assets and liabilities open foreign currency positions.

Earnings and Profitability of International Reserves in 2010

(million EUR)

Quarters	Net earnings (1)+(2)+(3)	Earnings from investment (1)	Earnings from currency revaluation of assets and liabilities (2)	Expenditure (interest) on liabilities (3)
I	132.03	57.55	75.47	-0.99
II	225.89	-18.76	245.36	-0.72
III	-42.99	28.66	-70.53	-1.12
IV	126.21	-2.76	131.73	-2.76
Total income, million EUR	441.14	64.69	382.03	-5.59
Total earnings, per cent	3.99	0.58	3.45	-0.06

Source: BNB.

International reserves are split operationally into portfolios depending on currency and investment goal, each with a benchmark, goals, and limits.

Profitability and Risk of Portfolios in 2010

Portfolio	Base portfolio currency	Profitability		Risk (Volatility)		Information ratio***
		Absolute (per cent)	Relative* (b.p.)	Absolute (b.p.)	Relative** (b.p.)	
Investment 1	EUR	0.61	-34	61	44	-3.05
Investment 2	EUR	0.64	-32	70	52	-2.44
External Manager A	EUR	1.33	-5	110	47	-1.28
External Manager B	EUR	1.29	-11	100	34	-2.53
Liquidity	EUR	0.38	12	2	2	
Liquidity	USD	0.28	15	7	7	

* The positive relative yield of a given portfolio is the profit attained against the benchmark yield. When relative yield is negative, it is interpreted as an opportunity cost. The relative yield has been rounded to 1 basis point; within the -0.5 to 0 band it is marked with -0, and within the 0 to 0.5 band with +0.
** The relative risk against the benchmark indicates the deviation degree of the risk characteristics of the portfolio from those of the benchmark because of active portfolio management (on an annual basis).
*** The information ratio is the ratio of the expected portfolio relative yield to relative risk (on an annual basis).

Source: BNB.

By 31 December 2010, 5.9 per cent of international reserves were managed by external managers at international financial institutions. Beside achieving additional diversification, using external managers helped exchange expertise of investing on international markets. Liquid portfolios were formed to assist immediate payment needs. To diversify management styles and reduce operational risk, most EUR-denominated assets continued to be split into two investment portfolios with identical benchmarks and investment limits, managed by different BNB teams.

III. The National Payment System

Organising, supporting, and developing national payment systems by implementing and overseeing efficient payment mechanisms is a duty of the Bank under the Law on the Bulgarian National Bank. The Bank's major goals were to curb systemic risk and facilitate Bulgarian integration into the euro area payment infrastructure.

Bulgaria's lev settlement payment systems are:

- RINGS, a real-time gross settlement system operated by the BNB;
- Ancillary systems:
  - BISERA, a designated time customer transfer settlement system operated by BORICA–Bankservice AD;
  - BORICA, Bulgaria's bank card settlement system operated by BORICA–Bankservice AD, also a Member Service Provider of MasterCard Europe, and a Processor Company of Visa International;
  - SEP, a mobile telephone electronic payment system operated by SEP Bulgaria AD.

Euro settlement payment systems in Bulgaria are:

- the TARGET2 national system component (TARGET2-BNB) operated by the BNB;
- Ancillary systems:
  - BISERA7-EUR, a designated time customer transfer settlement system operated by BORICA–Bankservice AD;

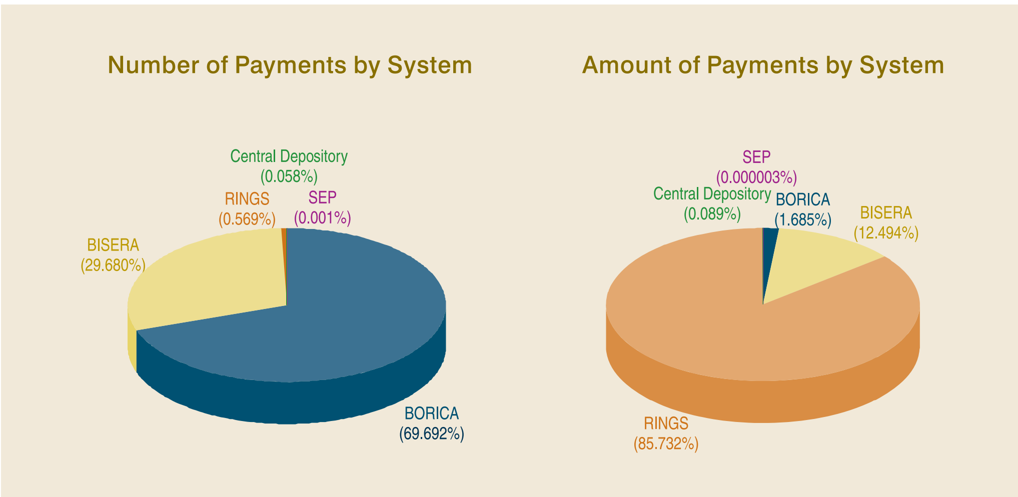
Securities settlement systems in Bulgaria are:

- the book-entry government securities settlement system run by the BNB.
- the system for registering and servicing book-entry security transaction payments run by the Central Depository.

1. Payment Systems for Settlement in Levs and Securities Settlement Systems

In 2010 RINGS processed over 86 per cent of Bulgarian payments; values of around 80 per cent are optimum for the operation of real-time gross settlement systems. RINGS processed 0.6 per cent of non-cash payments.

Bulgarian Payments by System



Source: BNB.

In 2010 payments through BORICA rose by 3.9 per cent in number and 3.8 per cent in value on 2009. The increase reflected growing consumer propensity to use bank cards for easy access to bank accounts in payments and cash withdrawals. The upward trend in the number of transactions effected *via* POS terminals was sustained. The increase suggests that card holders used cards more frequently to pay for goods and services.

The value of BISERA transactions rose by 0.15 per cent on 2009, the number of transactions dropping by 3.56 per cent on the prior year.

Equity market declines in 2010 eroded 44.6 per cent of the value and 46.3 per cent of the number of Central Depository transactions on 2009.

The SEP share of Bulgarian payments remained minor in 2010. This reflects the fact that currently only several banks operating in Bulgaria are SEP participants. Mobile payments, a new way of making non-cash transfers in Bulgaria, allow the handful of banks in the system to broaden the range of payment options for final customers. Given high security, mobile payments should obtain an increasing share in overall Bulgarian payments.

RINGS Real Time Gross Settlement System

In 2010, 31 banks participated in RINGS. Processing most payments by value through this system cuts payment system risks: a major BNB payment system goal. Over the year RINGS processed 994,254 payments worth BGN 591,993 million. The daily average number of payments rose by 0.5 per cent on 2009, while the daily average value went down by 14.9 per cent, reflecting the decrease in average daily values in interbank payments. The daily average value of customer payments rose by 1.7 per cent.

Over the year 47.9 per cent of payments were processed by noon and 78.5 per cent by 2:30 pm; 86.3 per cent of payments were effected by 2:30 pm.

In 2010 no payments were rejected by the close of a RINGS system day due to insufficient funds on participants' accounts, indicating good liquidity management by banks. The Bank took no radical steps to provide liquidity. There was no recourse to the Reserve Collateral Pool: an interbank mechanism guaranteeing settlement of payment and securities' system orders. RINGS offered 99.99 per cent availability.[1]

2. Payment Systems for Settlement in Euro

On 1 February 2010 the Bulgarian banking community joined the Trans-European Automated Real-time Gross Settlement Express Transfer system (TARGET2). The BISERA7-EUR ancillary system for designated time servicing of customer transfers in euro was launched the same day. This great step to Bulgarian integration into European financial market and payment infrastructures was made possible by the success of the TARGET2 accession project.

As a central bank, the BNB operates a National Service Bureau for the TARGET2-BNB national system component and is responsible for the business relations of participants in the component and for coordination with the ECB.

TARGET2 membership facilitates convergence with the European payment systems and payment market in line with BNB policy on reducing system risk and integrating Bulgaria into the euro area payment infrastructure. Participation in TARGET2 provides mechanisms for business processes' stability and continuation. Bulgarian banks in the TARGET2 national system component can opt for real-time euro settlement, improving security and cutting settlement times within the European Economic Area. Participation offers effective settlement and liquidity management. TARGET2 makes retail payment systems more competitive and broadens their scope through services in euro in line with the needs of banks and their customers.

Bulgarian banks and payment systems may participate on equal price terms in a modern payment system with up-to-date infrastructure, functionality and organisation, and exceptional security and efficiency. Through access to European payment mechanisms, TARGET2 accession on 1 February 2010 sets the direction of future Bulgarian payment systems development.

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[1] The ratio between fully operational time and overall operating time.

TARGET2 National System Component

TARGET2-BNB includes the BNB and 17 participating banks, as well as the BISERA7-EUR ancillary system for designated time transfers. By the close of 2010, TARGET2-BNB processed 65,343 payments worth EUR 181,161 million. Over the period 85.6 per cent of payments worth 92.1 per cent in value were directed to banks by other system components. The daily average number of payments in 2010 was 275 and daily average value was EUR 761 million. During the same period the BISERA7-EUR ancillary system processed 4096 payments worth EUR 32 million.

3. Regulatory Changes

In December 2010 amendments to the Law on Payment Services and Payment Systems transposed Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims, as well as Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC.

Amendments to Directive 98/26/EC on settlement finality introduced the concepts of interoperability and system operator, and clarified system operator responsibilities. As to the requirement competent authorities to ensure that the rules on the moment of entry into an interoperable system are coordinated and legal uncertainty will be avoided in the event of default of a participating system, the amendments to the Law on Payment Services and Payment Systems stipulates that in the event of interoperable systems, each system determines in its own moment-of-entry rules, in a manner as to ensure that the rules of the respective interoperable systems are coordinated. With a view to limiting systemic risk which may arise in interoperable systems due to non-coordinated moment-of-irrevocability rules, each of the systems is required to set its own moment-of-irrevocability rules in a manner as to ensure that the rules of all interoperable systems are coordinated.

With the review of Directive 2000/46/EC of the European Parliament and of the Council of 18 September 2000 on the taking up, pursuit of and prudential supervision of the business of electronic money institutions, the European Commission stresses the need of revising the Directive on the issue of electronic money since some of its provisions are considered as impeding the establishment of a single services market, related to electronic money, as well as the development of user-friendly services. To this end, the purpose of Directive 2009/110/EC is to set a clear legal framework for the activities of electronic money issuers and at the same time to provide an adequate level of macro-prudential oversight over these activities.

Amendments to the legal framework of electronic money provide primarily for a clear technically neutral definition of electronic money. This definition encompasses electronic money no matter whether it is kept in a payment device owned by an electronic money holder or is distantly stored in a server and is managed by the electronic money holder *via* a special electronic money account. An option of electronic money repurchase is provided. The repurchase option does not mean that funds received in exchange for the electronic money should be considered as deposits or other recoverable funds within the meaning of Directive 2006/48/EC. Repurchase is allowed at any time and at a nominal value with no option for negotiating a minimum threshold.

In December 2010 the BNB Governing Council approved amendments to BNB Ordinance No 16 of 16 July 2009 on Payment Institutions and Payment System Operators Licensing. Amendments to BNB Ordinance No 16 are intended to supplement and detail the set of documents which provide information on the professional experience, qualification and good name of the persons owning a share in company who wish to carry out transactions as a payment institution. According to the amendments which comply with the requirements of the Law on Payment Services and Payment Systems, the persons having directly or indirectly a qualified holding within the meaning of § 1, paragraph 1, item 6 of the Additional Provisions of the Law on Credit Institutions in the capital of the companies and applying for a license for a payment institution, shall prove their reliability, implying sound and prudent governance of the companies managed by them.

4. Payment System Developments in Bulgaria

In the context of outlined trends in the European payment market and to preserve the competitiveness of Bulgarian systems in 2010 the merger of Bankservice payment system operator for processing of small payments in Bulgaria and BORICA payment system operator for card payments was completed. Both companies at their regular general shareholder meetings took decisions on transformation of the companies through a merger into a new BORICA–Bankservice company.

Based on a decision, the BNB issued a licence to BORICA–Bankservice as a payment system operator. The newly established company operates three settlement finality payment systems: BORICA for card payments, BISERA6 for payments in levs and BISERA7-EUR for payments in euro.

To ensure banks' availability in EUR-payments to and from banks of other countries that joined SEPA as of 13 December 2010, a bilateral interconnection is established between BISERA-EUR7 system and SEPA-Clearer operated by Deutsche Bundesbank.

The link between BISERA-EUR7 and SEPA-Clearer allows to reciprocally exchange SEPA credit transfers between bank communities in Bulgaria and Germany in a reliable, fast and effective manner. The implementation of the connection between the two systems is based on the technical Interoperability framework established by the European Automated Clearing House Association, EACHA.

The bilateral interoperability arrangement ensures banks participating in BISERA7-EUR availability to and from banks participating in SEPA-Clearer, with no need for using any other transfer execution methods. The transactions exchanged between the two clearing and settlement mechanisms are routed *via* SWIFT, whilst the settlement is effected in TARGET2.

Payment System Oversight

Limiting system risk and improving Bulgarian payment systems' reliability and efficiency were the major goals of payment systems supervisors. They monitored observance of Bank for International Settlements, International Organization of Securities Commissions, European Central Bank, and ESCB standards and recommendations.

After the Law on Payment Services and Payment Systems came into force on 1 November 2009, the BNB updated the licences of money remitters Coinstar Money Transfer (Bulgaria) EOOD, Choice Money Transfer Bulgaria EOOD, M Securd OOD, and Change Centre Bulgaria EOOD and payment systems operators Bankservice AD, BORICA AD, and SEP Bulgaria AD.

In 2010 the BNB issued licences for conducting bank transactions as a payment institution under the Law on Payment Services and Payment Systems to Diners Club Bulgaria AD, Transcard Financial services EAD, Intercard Finance AD, TBI Credit EAD, Easypay AD.

IV. Bank Reserves at the BNB

In 2010 the minimum required reserve rate and banks' deposit base underlying this rate did not change. Launching the TARGET2 national system component in February entailed a change to Ordinance No 21 on Minimum Required Reserves Maintained by Banks with the BNB Article 4, paragraph 2 recognising as reserves funds on banks' settlement accounts in the TARGET2 national system component equal to 10 per cent of the average daily amount of successfully settled payment orders for the period under Article 7.[1]

In 2010 attracted bank funds for reserve calculation purposes increased by 1.7 per cent, including 7.5 per cent growth in lev liabilities and a 1.8 decrease in foreign currency liabilities. Funds from residents (excluding central and local government accounts) rose 6.1 per cent; central and local government liabilities fell 17.4 per cent, and non-resident funds fell 16.1 per cent. These changes increased the effective rate of minimum required reserves to 8.7 per cent from 8.4 per cent in the prior year.[2] Reserve assets covering this ratio include funds on bank accounts with the BNB (7.4 percentage points) and 50 per cent of cash balances recognised as reserves (1.3 percentage points). The foreign currency structure of reserves changed in 2010, with the BGN element increasing 26.4 per cent in the year and its absolute amount doubling the funds required to cover payments. Foreign currency reserve assets fell 20.7 per cent over the year, their share varying between 52 and 24.3 per cent in individual months. Reflecting high bank liquidity, the share of excess reserves in total reserves maintained by banks reached 4.4 per cent.

[1] Since 1 October 2008 the BNB has recognised as reserve assets 50 per cent of cash in vaults, including bank ATM terminals.

[2] According to Ordinance No 21, minimum reserves maintained by banks comprised 10 per cent of their deposit base except on funds attracted from abroad (5 per cent) and on government and local government funds (0 per cent).

V. Cash in Circulation

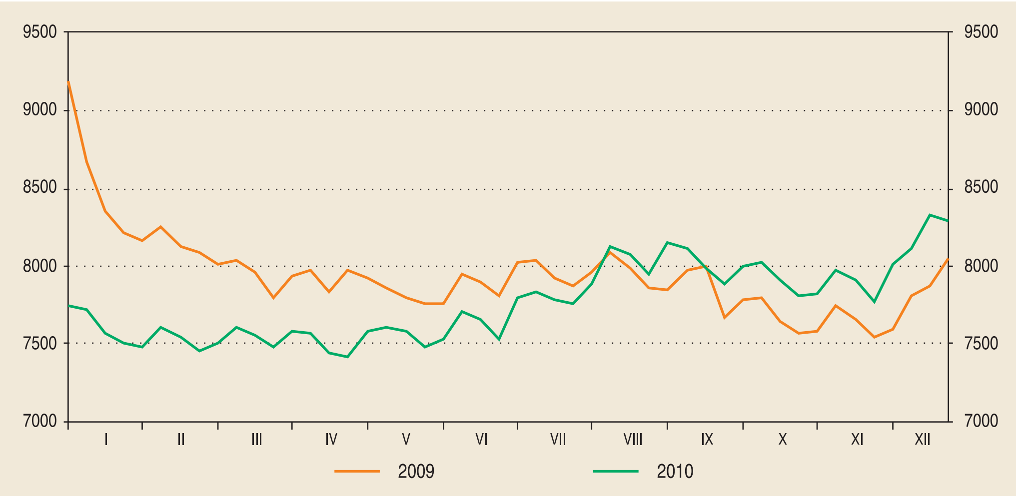
The Bulgarian National Bank has a monopoly on Bulgarian cash issuance.[1] The Bank's cash is legal tender mandatorily acceptable as payment at full face value without restriction. The BNB prints banknotes, mints coins, and safeguards uncirculated and withdrawn cash.

Banknotes and Coins in Circulation (Outside BNB Vaults)

By the end of 2010 circulating cash[2] came to BGN 8302.5 million in value, up BGN 253.4 million or 3.15 per cent in a year. By the close of the year banknotes accounted for 97.97 per cent of this: a 0.08 percentage point decrease in favour of coins.

Circulating Banknotes and Coins

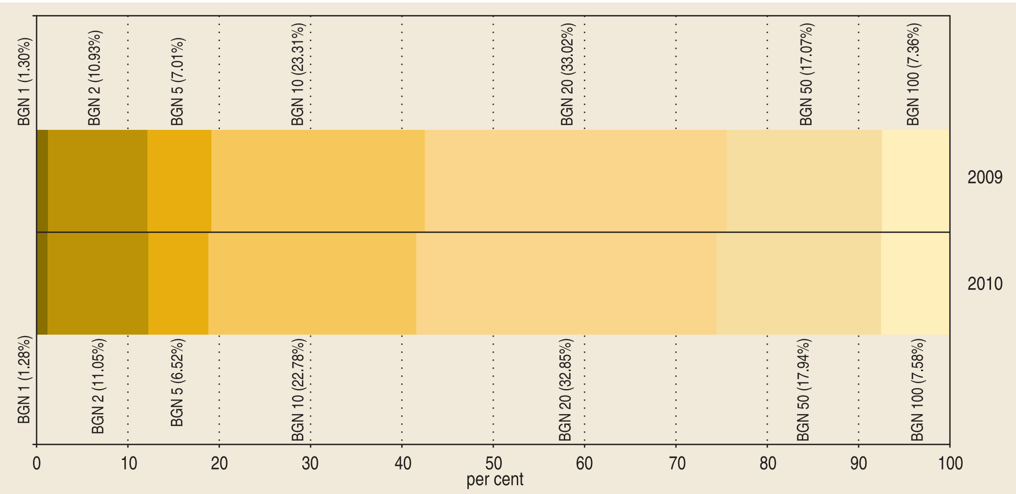
(million BGN)



Source: BNB.

Denomination Composition of Circulating Banknotes by Number

(share of total number)



Source: BNB.

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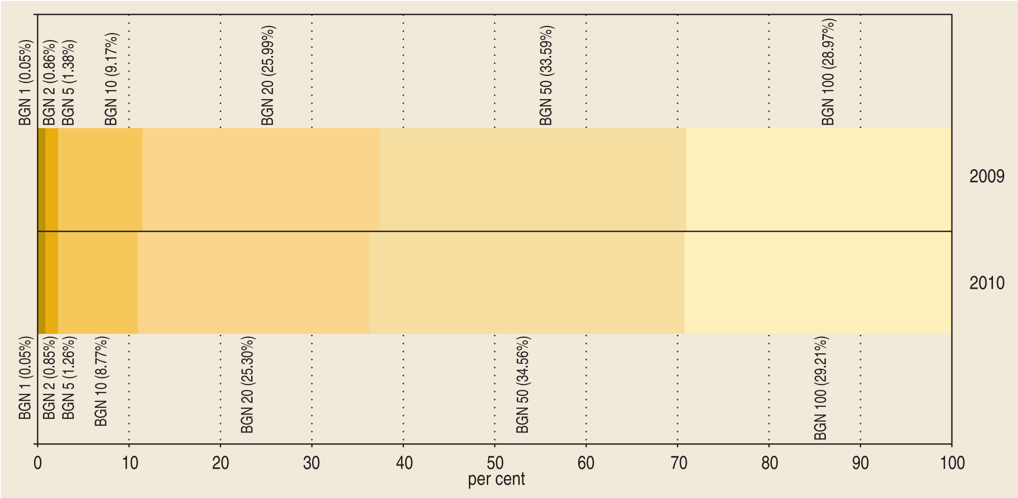
[1] Law on the Bulgarian National Bank Article 2, paragraph 5 and Article 25.
[2] Banknotes and circulating and commemorative coins issued after 5 July 1999.

Over the year the number of circulating banknotes increased moderately to 313.3 million, up 2.8 million (0.90 per cent) in a year. Their nominal value grew by BGN 241.8 million by end-2010 (3.06 per cent).

By the end of 2010 the BGN 20 banknote was most common in circulation at 32.85 per cent of all banknotes or 102.9 million pieces. The shares of BGN 100, BGN 50 and BGN 2 banknotes increased by 0.22, 0.87, and 0.12 percentage points respectively.

Denomination Composition of Circulating Banknotes by Value

(share of total value)

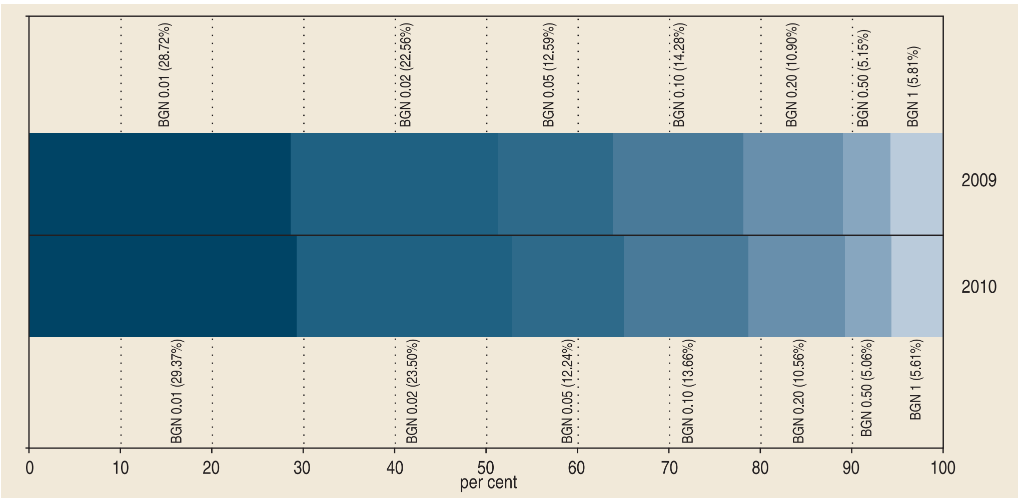


Source: BNB.

By the end of 2010 the nominal value of BGN 50 banknotes was BGN 2810.7 million, giving them a lead at 34.56 per cent of the value of circulating banknotes, followed by BGN 100 and BGN 20 banknotes at 29.21 and 25.30 per cent. The average value of a circulating banknote was BGN 25.96, up BGN 0.54 or 2.12 per cent, mainly due to the growing shares of BGN 100 and BGN 50 banknotes.

Denomination Composition of Circulating Coins by Number

(share of total number)



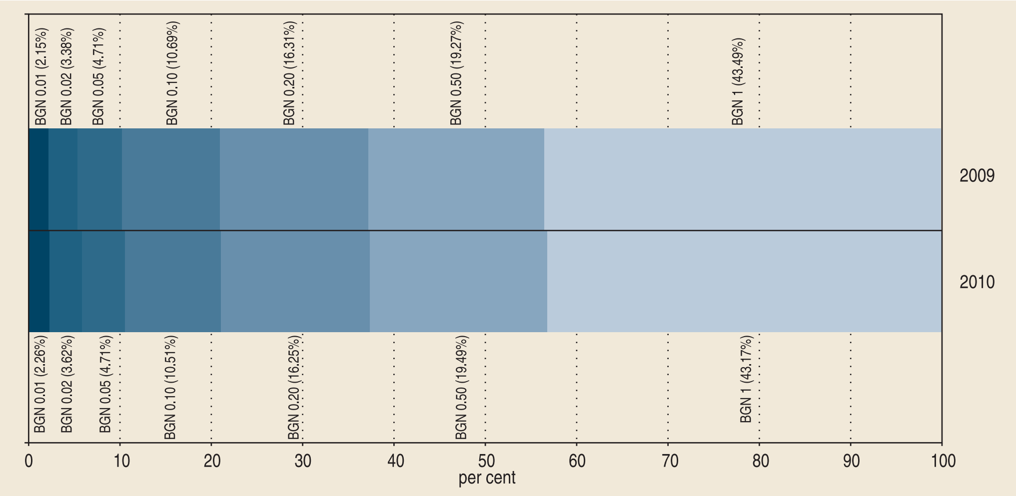
Source: BNB.

By the end of 2010 the relative share of circulating coins accounted for 1.97 per cent of the value of circulating cash. The 1255.6 million coins had a value of BGN 163.2 million. Within a year, the number increased by 117.6 million (10.34 per cent) and its value by BGN 11.1 million (7.32 per cent). These relatively big increases reflect demand for low value coins. The changes in the structure of circulating coins show a two-year trend towards increasing shares of BGN 0.01 and BGN 0.02 coins. The share of low-value coins (BGN 0.01, BGN 0.02, and BGN 0.05) was 65.11 per cent.

In a year, the share of BGN 0.01 and BGN 0.02 coins among circulating coins rose 0.66 and 0.94 percentage points, while that of BGN 0.05, 0.10, 0.20, 0.50, and BGN 1 declined 0.34, 0.62, 0.34, 0.09 and 0.20 percentage points. At the end of 2010 BGN 1 coins had the largest share at 43.17 per cent of the value of circulating coins, followed by BGN 0.50 and BGN 0.20 coins at 19.49 and 16.25 per cent.

Denomination Composition of Circulating Coins by Value

(share of total value)



Source: BNB.

At the end of 2010 the average value of a circulating coin held its level of a year earlier at BGN 0.13. Commemorative coins also held their value share in circulating cash at the 0.06 per cent level of 2009.

Non-genuine Banknotes and Coins

The total number of non-genuine Bulgarian banknotes retained by the BNB National Analysis Centre in 2010 was 10,329, of which 7537 had entered circulation: 4455 fewer retained banknotes than last year. The share of retained non-genuine Bulgarian banknotes remained very low for the year at 0.0033 per cent of circulating banknotes; by end-2009 it was 0.00476 per cent.

The BGN 20 banknote had the largest share of all retained non-genuine banknotes at 55.63 per cent, followed by BGN 50 (42.56 per cent). Reported non-genuine BGN 2, BGN 5, BGN 10, and BGN 100 banknotes numbered 187 (1.81 per cent). The year saw authenticity evaluations of 559 non-genuine coins, including 555 BGN 0.50 and four BGN 1 coins. The National Analysis Centre also retained 3048 euro banknotes, 3124 US dollar banknotes, and 290 assorted foreign non-genuine banknotes. The Bank regularly advised the public and cash handlers of newly-identified non-genuine Bulgarian coins and banknotes and ways to spot them.

BNB Issue and Cash Activities

BNB issue and cash operations include printing banknotes; accepting, delivering, repaying, processing and physical monitoring of banknotes, coins, and foreign currency; exchanging damaged cash; and destroying unfit Bulgarian banknotes and coins.

Commissioning of the new BNB Cash Centre in early April 2010 marked an important stage of the BNB Development Strategy. The Centre discharges BNB duties in cash distribution, processing, storing, and destruction under the General Terms for Supplying Banknotes and Coins at an Announced Value and services retail customers in levs and the euro reserve currency.

In 2010 the Bank supplied 100.4 million new banknotes and 142 million new coins worth BGN 1282.3 million under contracts with producers. The BNB launched the five commemorative coins planned in its 2010 minting programme under Article 25, paragraph 1 of the Law on the BNB.[3]

Banknote and coin deposits and withdrawals from the BNB totalled BGN 21,547.6 million in 2010. Banks deposited BGN 10,647.3 million of cash: down BGN 1365.9 million or 11.37 per cent on 2009. Banknotes and coins worth BGN 10,900.3 million were issued by the BNB: up BGN 17.9 million or 0.16 per cent on the prior year.

In 2010 banknotes recirculated through BNB tills an average of 2.14 times a year. This indicator remained at the levels of euro area countries. High-value banknotes return less often, while the BNB 10 and BGN 20 banknotes dispensed by ATM terminals return more often alongside the BGN 5 and BGN 2 banknotes used for retail payments.

The BNB strives to maintain banknote and coin quality. In 2010 sorting machines tested 594.6 million banknotes and 112.5 million circulating coins: 70.6 million (10.62 per cent) fewer banknotes and 4.9 million (4.55 per cent) more coins in a year. BGN 10 and BGN 20 banknotes and BGN 0.10, BGN 0.20 and BGN 1 coins were most frequently processed. The customary 15 per cent of banknotes retained as unfit numbered 95.6 million: down 5.2 million (5.13 per cent) on 2009. There were 0.2 million unfit coins, down 23.50 per cent in a year.

In 2010 BNB reserve currency purchases came to EUR 0.7 million, including EUR 0.3 million from budget organisations and EUR 0.4 million from individuals. BNB reserve currency sales were EUR 16.3 million, including EUR 6.7 million to budget organisations and EUR 9.7 million to individuals.

The Bank continuously controlled regulations on banknote and coin quality. This involved on-site checks into how credit institutions and service providers which handle cash professionally follow Ordinance No 18 on the Control over Quality of Banknotes and Coins in Cash Circulation and of their sorting machines. It is a BNB duty to keep a list of approved sorting machines and the Bank publishes this on its website.

[3] For information on new banknote, circulating, and commemorative coin issues, see the BNB website.

VI. Maintaining Banking System Stability

1. State of the Banking System

The slow recovery in 2010 continued to affect adversely banks' balance sheets. Company and household difficulties in servicing loans hit credit portfolio quality. The corporate sector contributed more to the increase in non-performing loans, while the quality of household loans worsened comparatively slower. The banking system's capital buffers endured despite growing non-performing loans and associated impairment costs. Despite unfavourable economic developments, the system managed to generate profit but its 2010 level was lower than a year ago. The significant profitability drop at individual banks and the sector as a whole resulted from weak growth in new loans, mainly due to low demand. Expectations of a fall in the cost of credit during the year failed to come true because of higher impairment costs, low interest income, and relatively high deposit rates. Coupled with inflationary pressure pushing annual deposit rates above annual inflation, any decrease in the cost of financing was limited.

Low lending and steady deposit growth gave banks stable liquidity. This reflected continuing public confidence in them, as well as the fact that foreign parent banks kept significant resources with their Bulgarian subsidiaries. The share of funds attracted from non-residents remained significant, despite repayments of obligations to parent companies in 2010.

Banks' strategy over the reporting year involved boosting deposits from residents wanting low-income low-risk investment, increasing non-interest revenue, and improving flexibility to cut administrative costs. The sector managed to increase its assets. In the second half of the year lending picked up, while non-performing loans declined.

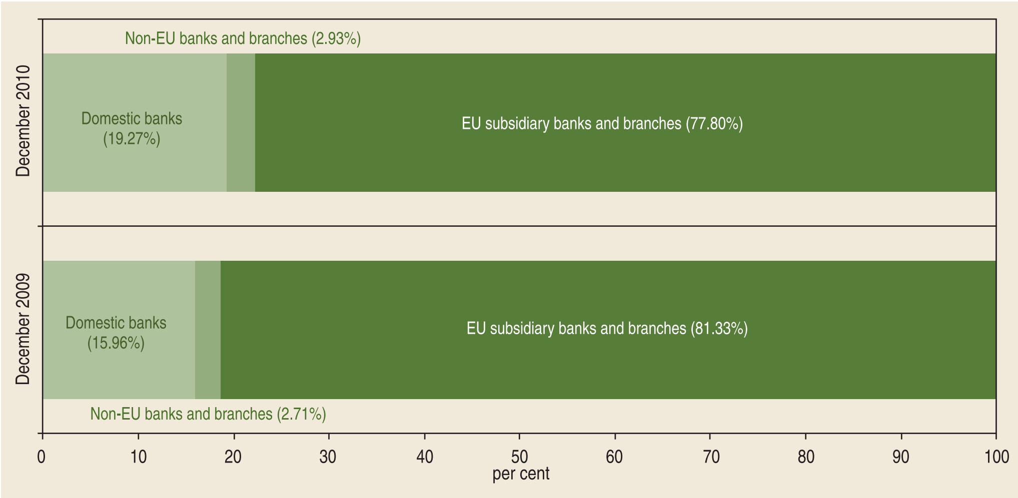
Structural Changes in the Banking System Balance Sheet

Banking sector total assets came to BGN 73.7 billion: an increase of 4.1 per cent (BGN 2.9 billion) for the year. There were no essential changes in the balance sheet structures of individual institutions or the system. The banking market over the year witnessed a progressively increasing significance of funds attracted from residents, mostly individuals and households. By the end of 2010 cash made up 9.9 per cent of the system's assets and securities portfolios 7.4 per cent (9 and 6.3 per cent respectively a year earlier). Free resource and more intensive investing in securities greatly improved liquidity. Lending remained low both due to lower demand (particularly by households) and tighter criteria in assessing credit worthiness. This, added to more impaired receivables, cut the share of loans and advances by 2.3 percentage points to 79.2 per cent of system assets by the end of the year.

The big five banks' share of banking assets dropped 3.5 percentage points to 54.5 per cent, while that of small and medium institutions reached 40.7 per cent. The share of EU subsidiary banks fell to 73.7 per cent and that of EU bank branches to 4.1 per cent. Domestic institutions increased their share by 3.3 percentage points to 19.3 per cent, while that of banks and branches from outside the EU was 2.9 per cent of the system's assets. The number of banks in Bulgaria in 2010 remained unchanged at 30.

Market Shares of Domestic and Foreign Banks

(per cent)



Source: BNB.

Lending

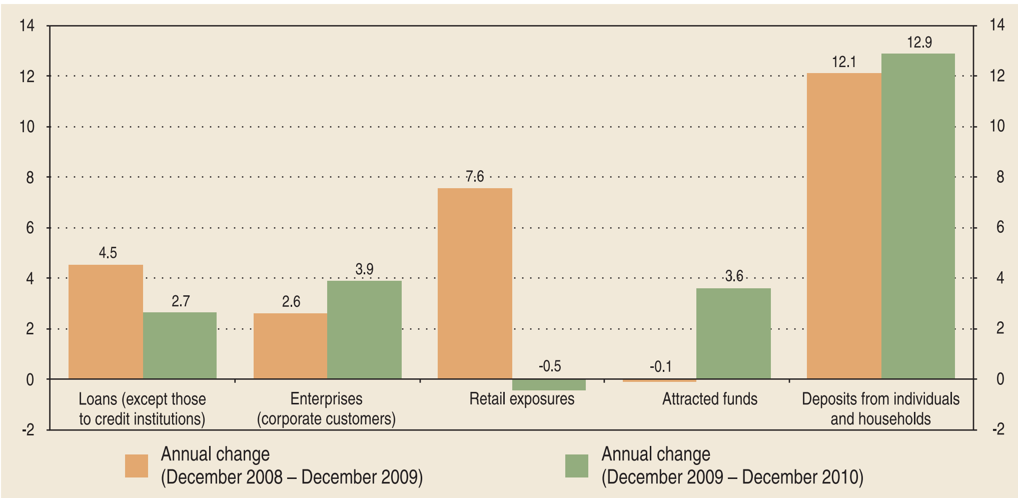
Despite continuing economic problems, banks reported an annual nominal increase in lending (except to other banks) of 2.7 per cent, or BGN 1.4 billion[1]. On an annual basis, the medium and small bank group increased corporate lending by BGN 1.6 billion against the BGN 1.3 billion increase posted by the system as a whole. The big five's market positions within the segment contracted 2.4 percentage points.

Despite intensive marketing of household credit, retail exposures went down by 0.5 per cent (BGN 86 million) on an annual basis. Households preferred to trim spending and repay debt. Consumer lending continued its downward trend with an annual decrease of 4.1 per cent or BGN 401 million. Mortgage lending, however, increased 3.5 per cent (BGN 315 million).

The lev component of the credit portfolio continued to decrease gradually (except that of credit institutions) to 38.7 per cent by the end of 2010, while loans and advances in euro stood at 58.9 per cent and that of other currencies at 2.4 per cent.

Dynamics of Selected Financial Indicators

(per cent)



Source: BNB.

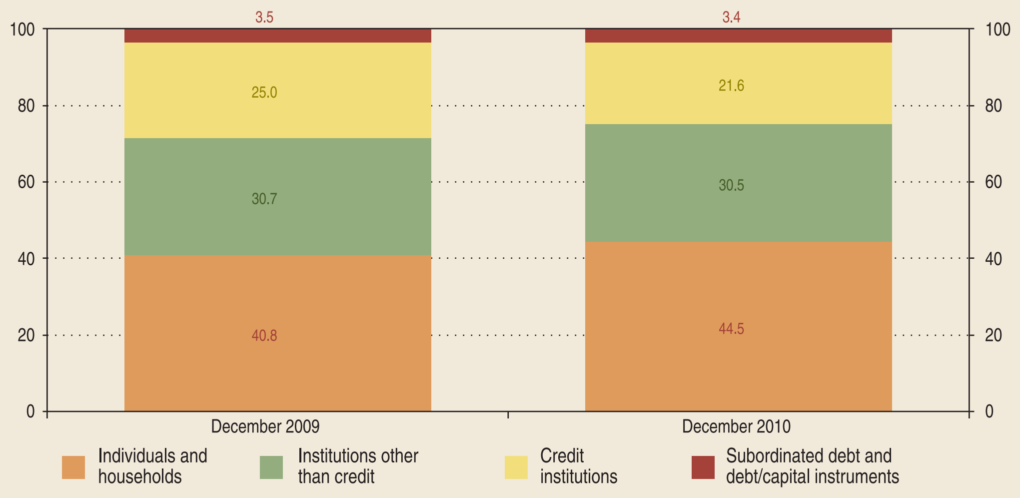
[1] The net worth of repurchased loans was BGN 549 million. Differences in credit data here and in monetary statistics in Part I are due to methodological differences.

Attracted Funds

Over the year funds attracted by the system rose 3.6 per cent to BGN 63 billion. Resource from credit institutions decreased by BGN 1.6 billion (10.5 per cent), mostly by non-residents, while funds from institutions other than credit grew 2.9 per cent (BGN 549 million) and subordinated liabilities grew 3 per cent (BGN 52 million). Individual and household deposits continued growing steadily, rising by BGN 3.2 billion (12.9 per cent). On an annual basis, the share of household deposits increased by 3.7 percentage points to 44.5 per cent of total attracted funds, while financing from credit institutions and institutions other than credit went down to 21.6 per cent and 30.5 per cent respectively. As a result of household deposit growth and the structural changes in attracted funds compared with 2009, the total amount of deposits guaranteed under the Deposit Insurance Fund scheme rose[2]. The guaranteed proportion of individual, household, and corporate deposits was 62.1 per cent at the end of 2010 against 59.2 per cent a year earlier.

Structure of Attracted Funds

(per cent)



Source: BNB.

Dynamics of Funds Attracted from Residents and Non-residents

(per cent)

Source: BNB.

Fixed-interest funds increased to 78.7 per cent of attracted resource, while variable-interest funds accounted for 69.1 per cent of loans and advances. Resource from non-

[2] The guaranteed amount of deposits with interest accrued which would be paid to depositors by the cut-off date of the respective reporting period.

residents decreased by BGN 2.4 billion in 2010, its share of attracted funds dropping from 28.5 to 23.6 per cent. This was offset by the steady growth of funds from residents. By the end of the year lev resource accounted for 41.3 per cent against 35.4 per cent at the end of 2009. Euro resource comprised 52 per cent of the total against 58.7 per cent a year earlier, and other currencies comprised 6.7 per cent.

Balance Sheet Equity

Compared with 2009, the banking system balance sheet equity increased 6.2 per cent to BGN 10 billion, its growth exceeding that of assets (4.1 per cent) and credit (2.7 per cent). The faster growth of balance sheet equity improved system shock resistance. The amount of the balance sheet equity at the end of the year is indicative of buffers adequate to risk. Issued capital picked up BGN 132 million and premium reserves by BGN 69 million.

Despite growing impairment costs, at the end of 2010 the banking system's net profit (audited) was BGN 600 million: down BGN 152 million on 2009. The big five continued generating most of this at 72 per cent. The system's financial results show that banks managed to overcome the worsened credit portfolio and unfavourable economic environment through resilience and efficiency.

System Risk Profile

Credit risk continued to dominate at banks. They faced the challenge of coping with worsened loans and allocating the required provisions without threatening their stability. Available data indicate that:

- Despite the increase in problem loans, their proportion did not threaten revenue stability and the capacity to generate additional buffers;
- The proportion of performing assets (standard loans, prime-rate government securities, deposits with credit institutions with high ratings) remained significant, guaranteeing normal functioning and support for balance sheets if necessary;
- Capital position sustainability was retained and 2010 saw an improvement in its stability indicators: capital adequacy and leverage;
- Classified loans were impaired and provisioned in line with BNB prudent standards, with the amount of net classified loans (after impairment) adequately covered by highly liquid security;
- The system and banks additionally improved liquidity, with liquid assets covering approximately a quarter of attracted funds;
- The substitution of non-resident funds by domestic depositor funds continued, improving the maturity structure of liabilities;
- Asset growth indicated continuing confidence and laid the grounds for a future intensification of work with the real economy and customers;
- Risk areas in the balance sheets of individual credit institutions and the system as a whole was subject to continuous supervisory monitoring, with a readiness for measures to counter high-intensity risk;
- Shock resilience simulations of the system and individual banks allowed the BNB and banks to define contingency measures.

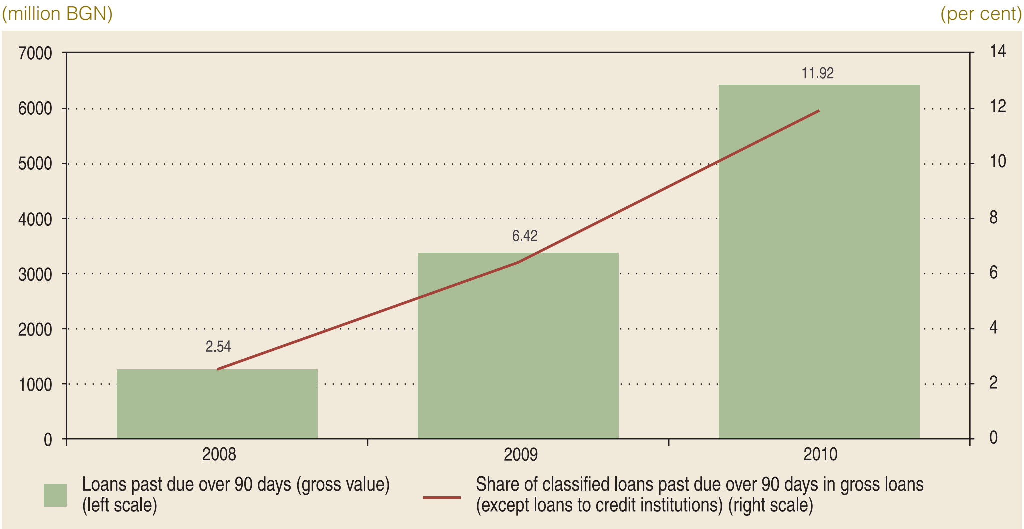
Asset Quality

Worsening credit portfolio quality was the major challenge to banks in 2010. Nevertheless, they continued to enjoy a significant volume of performing loans: BGN 42.4 billion or 55 per cent of banking sector's gross assets. Over the last 12 months the volume of classified assets (BGN 4.2 billion) was similar to that of 2008 and 2009, yet its growth declined from 147 to 59 per cent. The share of loans past due over 90 days continued rising to 11.92 per cent.[3] The level of non-performing loans (over 90 days) in retail exposures almost matched that of late 2009, while the corporate sector's indicator doubled. Total provisions for impairment and specific credit risk covered 75 per cent of loans past due over 90 days and all loans past due over 180 days. Banks also hold security of sufficiently high value despite the property price fall. High-liquid security covered 37 per cent of the

[3] The level shown refers to gross loans and includes risk already reported in the income statement through impairment. If the gross amount of loans were reduced by impairment, by the end of 2010 the share of net non-performing loans (over 90 days) in total net loans would be 8 per cent.

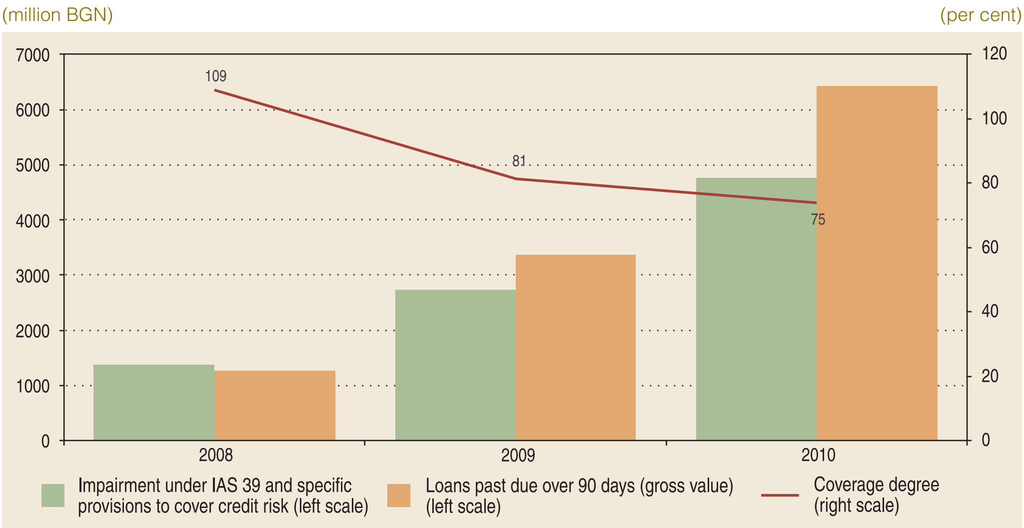
total volume of corporate loans, while housing loans account for 63 per cent of mortgages established in favour of banks.

Classified Loans Past Due over 90 Days



Source: BNB.

Cover of Non-performing Loans Past Due over 90 Days



Source: BNB.

In 2010 the quality of banks' assets (other than loans and advances) representing 21 per cent of banking assets remained good. To reduce risk in their balance sheets credit institutions invested free resource mainly in low-risk debt instruments. By the end of the year approximately two-thirds of investments were in Bulgarian government securities, half of them denominated in levs.

Profitability

The two main factors for banks' profitability in 2010 were poor credit growth opportunities (primarily by extending loans) and the need of allocating provisions to cover the deteriorated loans in portfolios. To restore earnings, institutions began promoting credit, especially in the second half of the year.

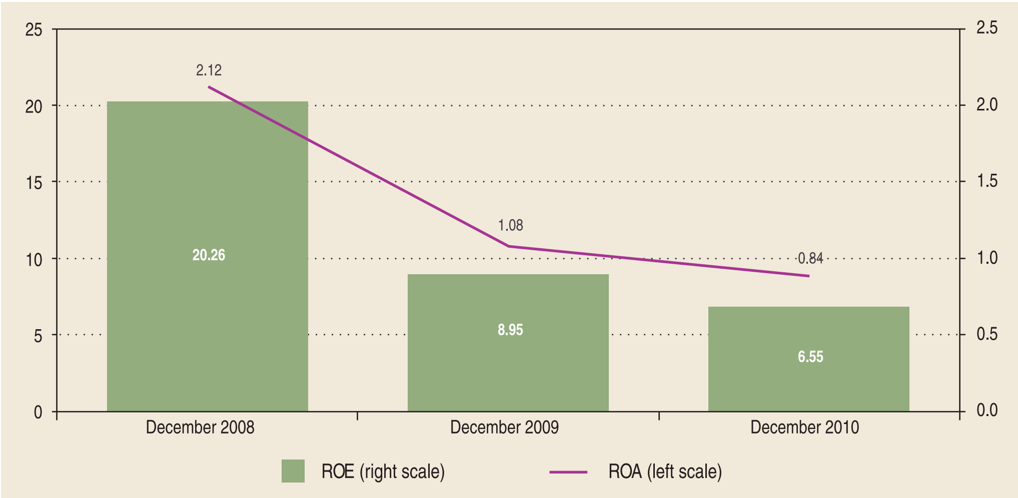
Interest income by the end of the year was lower than in 2009 as revenue from problem loans fell; yet, the falling price of asset financing had a positive effect on net interest income. Loan deterioration entailed rising impairment costs which reached BGN 1.3 billion by the end of 2010 but at significantly slower rates than in 2009 (24 against 210 per cent). Fees and commissions helped generate some limited revenue.

Banks' 2010 gross operating income was 3.9 billion, exceeding by BGN 143 million (3.8 per cent) that of 2009. Institutions tried to offset lower core operation revenue by reducing administrative costs. This income level allowed banks not only to cope with non-performing loans, but also to generate sufficient capital support.

The 2010 profit amounted to BGN 600 million, down BGN 152 million on 2009. As a result, ROA went down from 1.08 to 0.84 per cent and ROE from 8.95 to 6.55 per cent. Though declining, profitability indicators remained above the average in the 27 EU Member States and in other Central and Eastern European countries, where recovery rates were similar to those in Bulgaria.

Return on Assets and Return on Equity

(per cent) (per cent)



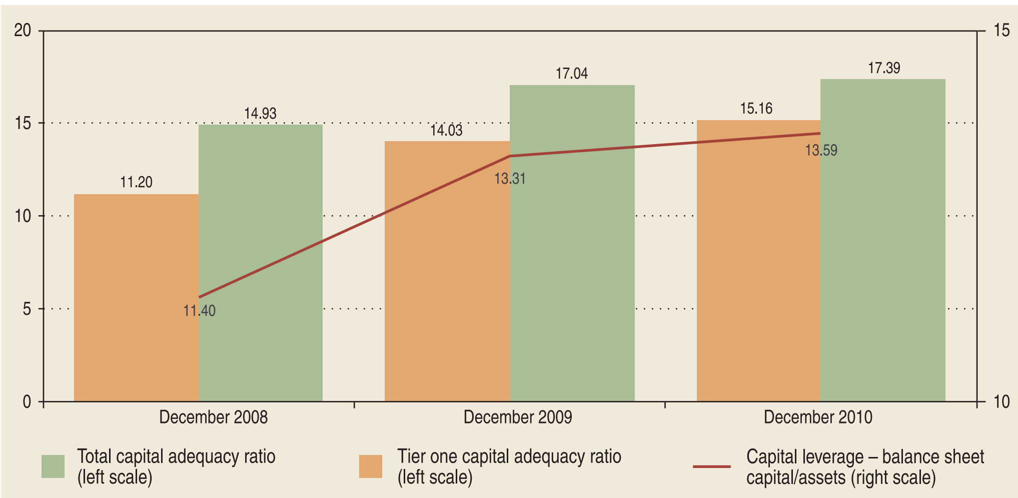
Source: BNB.

Equity

The banking sector capital position remained stable over the reporting year. At the close of 2010 banks had reliable capacity for offsetting new risks under relatively unfavourable conditions. Accumulated buffers endured thanks to consistent efforts to maintain capital indicators adequate to risk profiles and external shocks. Total banking system capital adequacy rose to a six-year high of 17.39 per cent by the end of 2010. The capital surplus (the excess of capital over regulatory minima) remained at its December 2009 level at BGN 2.74 billion. The 2010 audited financial results showed an additional potential support for capital.

Selected Capital Indicators

(per cent)



Source: BNB.

Several factors influenced banking system regulatory capital over the reporting year. Specific credit risk provisions reduced own funds[4]. At the same time, the strengthening of Tier 1 capital had a favourable effect. The increase in registered and paid-up capital and reserves boosted Tier 1 capital adequacy from 14.03 to 15.16 per cent (against the 10 per cent floor recommended by the BNB). As a result primary capital — that best component of own funds — continued increasing to exceed 87 per cent of the total capital base by the end of 2010. Capital leverage suggested low Bulgarian banking debt.

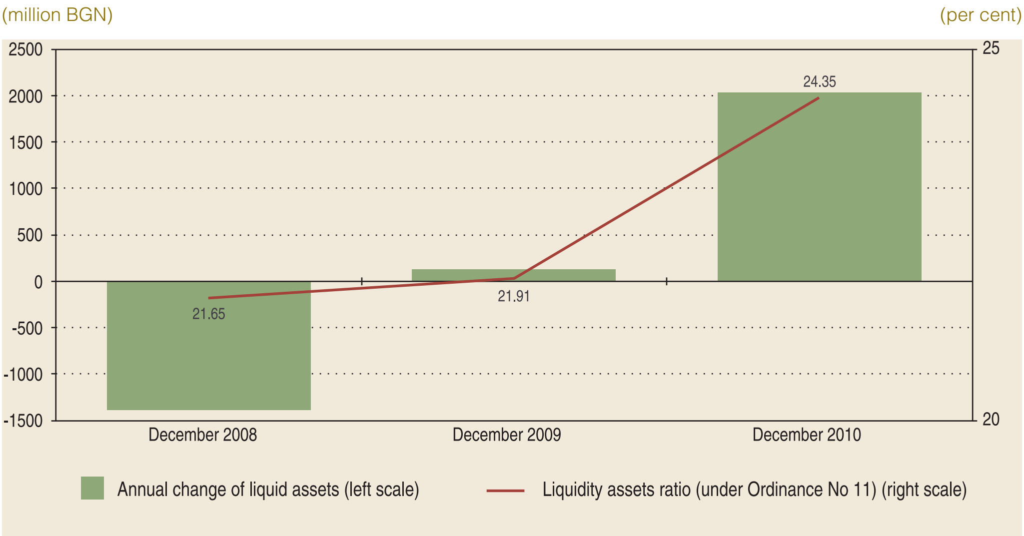
The structure of capital requirements for credit, market and operational risk remained relatively unchanged. Credit risk continued to be the major commitment for total capital requirements by the end of 2010. Increasing its share over the year, the corporate segment, had the largest weight there. Capital requirements for operational risk increased slightly, while those for position, currency, and commodity risk[5] remained insignificant and retained their share in total capital requirements.

Liquidity

Institutions' liquidity continued to underwrite the conduct of financial operations. Over 2010 it moved with the structure and amount of cash flows, its sustained capacity reflecting continuing confidence in banking. Stable rates of attracting resources and high liquidity reflected sustainable deposit growth and limited investment opportunities. By the end of 2010 liquid assets increased by BGN 2 billion (15.2 per cent) on December 2009 to BGN 15.4 billion. Half of the increase was in marketable debt securities issued by central governments or central banks. The increase in cash and subsequent investment into Bulgarian treasury bills and bonds contributed to growth. The liquid asset ratio rose from 21.91 to 24.35 per cent.

Liabilities rose in 2010 by BGN 2.2 billion (3.7 per cent) to BGN 63.2 billion. As a result of the dynamics of total funds attracted in the system, the over-one-year item grew most (BGN 1.3 billion), with one to three months following (BGN 1 billion). Maturities extensions of attracted resources additionally strengthened the stability of funds and supported investment.

Selected Liquidity indicators



Source: BNB.

[4] Specific provisions to cover credit risk were included as an additional capital requirement under Pillar 2 of the Basel II Supervisory Review, its amount automatically decreasing banks' equity.

[5] Commodity risk attends positions in exchange-traded funds or commodity derivatives in investment and trading portfolios.

2. Compliance with Prudent Banking Requirements

No formal contraventions of supervisory regulations were established in 2010. Analyses were more frequent and the monitoring of financial parameters of individual institutions and the system intensified. Supervisory inspections and analyses of regular reports did find deviations from good banking practice and resulted in instructions and recommendations.

Capital Adequacy

Capital cover was adequate to banks' risk profile. Capital adequacy indicators exceeded regulatory minima. Supervisory inspections in several banks found the need for additional capital support.

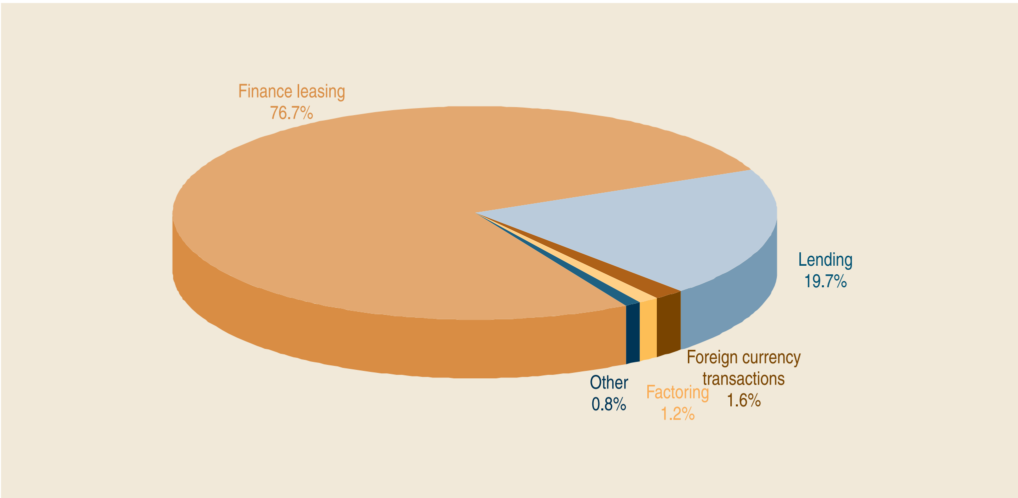
Large Exposures

Supervisory inspections found exposures to individual customers or economically related persons exceeding statutory limits and the banks concerned took measures to remove them.

3. The Performance of Financial Institutions Registered under Article 3, Paragraph 2 of the Law on Credit Institutions

The number of these institutions in 2010 was 222, with 70 per cent of them concentrating on financial leasing and lending. Their total assets reached BGN 6.6 billion by the end of the year, 76.7 per cent of this with lessors, and 19.7 per cent with lenders using own funds. Loans and receivables (including financial leasing) dominated at 77.1 per cent, 67.1 per cent of this receivables denominated in euro.

Shares of Assets of Individual Groups of Financial Institutions by December 2010



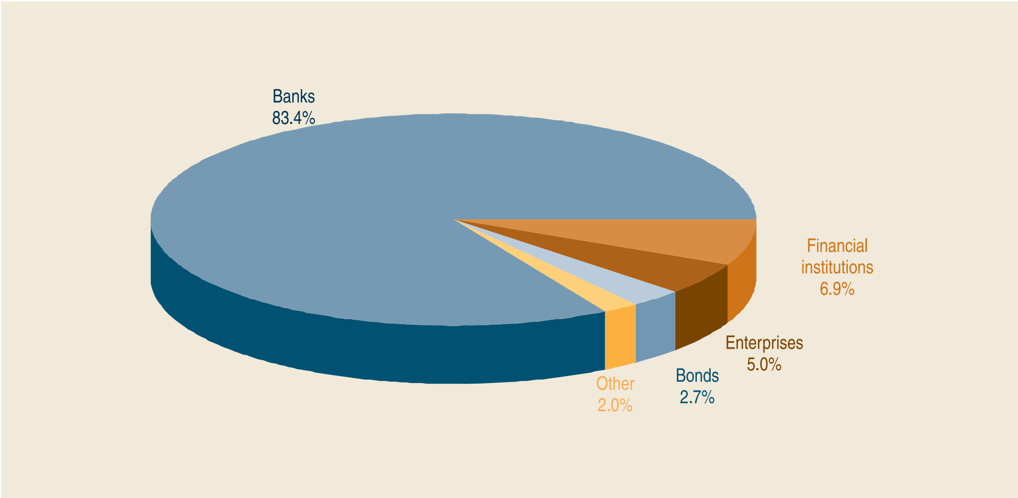
Source: BNB.

The quality of financial companies' assets worsened as it did at banks. The gross amount of impaired loans (including financial leases) was 45.1 per cent of the total credit portfolio (including leases), concentrated at the big ten lessors. Loan impairment[6] (including financial leases) was 13.1 per cent and tended to grow. Despite higher annual impairment costs, the net credit portfolio (including leases) rose 32.4 per cent.

Companies funded their operations mostly by attracting funds from banks and financial institutions. Within the structure of financial liabilities, obligations to banks accounted for 83.4 per cent (of this, 85.2 per cent to foreign banks). Obligations to domestic financial institutions accounted for 6.9 per cent, and to foreign financial institutions 52.9 per cent. Following the structure of assets, attracted euro funds significantly exceeded those in levs.

[6] The degree of loan impairment is the ratio of impairment costs to gross loan value.

Attracted Funds of Financial Institutions by December 2010



Source: BNB.

The financial result amounted to BGN 5.9 million. The lessors suffered significant losses offset by profits at lenders and foreign exchange handlers. The sector's annual profit growth was slower than that of the gross loan portfolio (including leases). ROA and ROE were 0.1 per cent and 0.72 per cent respectively, with a fluctuating trend.

The equity of registered financial institutions amounted to BGN 820 million, 60.3 per cent of this belonging to foreign interests established in the EU. Financial leverage was high. The rate of capital growth over the year slowed as fewer new institutions registered.

4. Banking Supervision Activities

Supervisory efforts to limit the impact of the crisis on the banking system continued in 2010.

Supervisory Policy

Supervisory policy aimed at harmonising national regulations with changed European bank supervision requirements. The major priority of developing anti-cyclic measures for maintaining a flexible and stable bank market continued.

In early 2010 Ordinance No 8 of the BNB on the Capital Adequacy of Credit Institutions was amended to recognise current and prior year profits as part of the capital base without the need for equity holder approval. The requirement for external auditors to confirm these profits to a BNB procedure remained. To synchronise national and EU legislation, the more conservative treatment of two major risk exposure classes was removed. Licensing for using the Standardised Approach for operational risk was eased, motivating banks to improve operational risk management and control.

The package of amendments to the EU Directive on banks' capital adequacy led to national regulation changes, including three major BNB supervisory ordinances: Ordinance No 7 on Large Bank Exposures, Ordinance No 8 on the Capital Adequacy of Credit Institutions, and Ordinance No 11 on Bank Liquidity Management and Supervision. The new provisions harmonised criteria, requirements, and limits for large equity exposures and bank liquidity. Improved opportunities to include hybrid instruments into equity allow banks to diversify capital structures and increase capital sources prudently. Stress-testing of liquidity management was extended. The scope of reliefs through which banks may reduce large exposures narrowed significantly, with the exception of high liquidity and low credit rating security. The amendments also moved exposures to parent and subsidiary banks of the group partially under large exposure rules, limiting excessive exposure concentrations to the companies of the group.

A new supervisory ordinance on banks' remuneration addresses the pay of staff with a significant effect on performance. It introduces a relationship between the variable portion of individual remunerations to long-term results and risk.

The year saw implementation of updated instructions by the Committee of European Banking Supervisors (CEBS) whose functions were discharged by the European Banking Authority (EBA). They promoted awareness of new bank practice requirements. Adapted BNB instructions helped banks establish and maintain the levels, composition and quality of liquidity buffers and survival periods, and recognise hybrid instruments in Tier 1 capital. New risk management guidelines based on CEBS policy addressed the structuring of internal reviews of capital adequacy and the process of supervisory reviews and assessments.

Following publication of the revised Consolidated Financial Reporting Framework, step-by-step drafting of detailed instructions and reporting tables continued. These address assets, liabilities, equity, revenue, and expenditure. Reporting tables for set balance sheet and off-balance sheet items were introduced.

Credit Institutions Supervision

In 2010 the frequency, intensity, and efficiency of supervision over bank operations within existing resources increased amid overall financial uncertainty. Regular reporting and on-site inspections outlined the risk profile of each individual bank in Bulgaria. Analyses of reports on financial ratios and indicators provided regular information on changes in banks' financial state, risk profile, and solvency. Supervisory reviews and assessments by current control offered criteria on whether on-site inspections were due. These inspections addressed risk management quality and identified underestimated risks and threats to solvency.

Given trends in the real economy and banking, supervisory inspections focused on credit and liquidity risk management and capital adequacy. Operational risk level and management were also assessed at some institutions. There were 25 supervisory inspections in 2010. The results of the comprehensive supervisory review suggest that banks maintained higher-than-required solvency, good liquidity, and credit risk adequate to current conditions. The continuous supervisory review found 150 formal contraventions of the regulatory framework and resulted in 170 recommendations to banks' management and controlling bodies of credit institutions. Based on the violations found and recommendations made, orders for administrative enforcement measures were issued and letters were sent to credit institutions' management bodies underlining the need of corrective measures.

The year saw a review of credit institutions' internal capital adequacy analyses. The results were deemed satisfactory.

Work on approving methods for determining capital requirements for credit risk by applying internal rating models intensified. One institution was given leave to apply such an approach to its capital requirements.

Macro-prudential Analyses and Strategies

In supervisory macro-prudential analyses and strategies, the financial parameters of individual credit institutions and the banking system were continuously monitored and analysed. Maintaining banking sector and financial system stability involved the timely identification of problems and monitoring bank risk developments. Relations with risk identification and analysis and forecast units at credit institutions intensified. Various aspects of banks' performance, expected 2010 and 2011 results, and the effects and market sentiments of economic stagnation were studied. Attention focused on possible measures upon reaching set credit and liquidity risk parameters. Regular financial and supervisory reports and up-to-date information advised the public of the state of the banking system. Supervisory indicators, measures, and practices in other EU countries were surveyed to deepen the study of banking processes.

Events on international markets and the new European supervisory architecture increased the intensity of analyses and surveys. The state of the parents of Bulgarian subsidiaries and factors determining European banking trends were carefully monitored. The outcome of 2010 in Bulgarian banking confirmed supervisory expectations. Though unfavourable foreign forecasts failed to materialise, all hypotheses were analysed and preventive measures intensified.

Testing methodologies for major risk types (credit, liquidity, and market) improved further. Stress tests continued to check the ability of the system and individual institutions to withstand various real and hypothetical influences, and the results were used to initiate timely supervisory measures. Experts from the Banking Supervision Department took part in the pan-European banking system stability test in July 2010.

The Single Data Depository/Banking Supervision Reports provided continuity of information on data collection and processing. In 2010 credit institutions were asked to expand reporting. Concurrently, the number of financial institutions under Article 3, paragraph 2 of the Law on Credit Institutions increased significantly. The inclusion of the additional Financial Institutions Module to the Single Data Depository provided timely and reliable information about registered financial institutions.

Special Supervision

Neutralising risks and obviating any possible unfavourable effects of banks' equity structures was a major aspect of special supervision. The ongoing monitoring of banks' equity holders continued. Supervisory efforts ensured a timely and unbiased assessment of the financial standing of equity holders and their capacity to support capital. No deviation from good banking practice on equity holder transparency and clarity and on fund origin was found.

Another priority involved consistent measures against money laundering, terrorist financing, and financial fraud. Banks were required to monitor cash payments yet more closely. It was found that they generally adhered to international standards on counteracting money laundering and implemented effective procedures and policies to minimise the transfer of funds of unclear and/or criminal nature.

Further regular contacts with offices fighting fraud and money laundering under EC and international body assessment report guidelines enhanced effectiveness. Steps to converge supervisory practices for preventing money laundering, terrorism financing, and fraud were initiated with other European supervisors.

Ensuring greater transparency in work with customers and providing clear information was a priority in 2010. Supervisory measures tightened market discipline, strengthened bank customer confidence, improved communication with market participants, and minimised risks to customers. Work on registering entities conducting operations as a financial institution continued.

Corporate management supervision practices converged in line with legal requirements and management trends. Effort focused on transparency through additional financial and other information.

Supervisory Administration, Licensing, and Permits

No new procedures to license credit institutions began in 2010. The 2009 procedure to licence TBIeCard EAD as an electronic money institution was cancelled due to application withdrawal. T.C. Ziraat Bankası of Turkey was granted a license to extend operations of its Bulgarian branch with payment services.

The holders of qualified interest in the Texim Bank AD changed significantly. The Central Cooperative Bank acquired the control package of the Stater Banka AD, Kumanovo, Macedonia. The Bulgarian Development Bank increased its capital by contributing the property rights on the land where its Sofia head office is located. Four banks increased capital for supervisory purposes by attracting debt/equity instruments, and another four repaid early their obligations on such instruments. Changes in banks' management bodies resulted in 29 approvals for their new members. Nineteen notifications by credit institutions intending to conduct direct operations in Bulgaria were received; their number reached 189. Işbank, subsidiary of the private Turkish Işbank licensed in Germany, prepared to open a Bulgarian branch following supervisory approval. Opening is expected in the first half of 2011.

No serious supervisory measures were imposed over the review period. There were ten measures (five by Order under Article 103 of the Law on Credit Institutions) against seven banks. Measures at four of them related to risk management, while the other three related to additional capital support. One bank was asked to report certain items weekly and to provide reports which are usually quarterly every month. Another was asked to provide monthly data on each exposure over a set amount, and another to report two significant items in detail. A bank was put under intensive supervisory monitoring for a reason of non-systemic importance. An objection was raised against a bank's use of instruments reducing credit risk in contravention of supervisory regulations. A large number of customer (mostly borrower) complaints led to a bank being asked to improve customer relations.

In 2010 the number of bank customer complaints sent to the BNB Banking Supervision Department continued rising. Those about loans increased most, from 233 in 2009 to 321 (38 per cent), the sharpest reaction reserved against interest rate increases. Complaints about deposits and payments rose from 55 to 72 (some 30 per cent on 2009), mostly about interest claimed by depositors. Individual banks proposed compromise solutions including the reversal of interest on loans, rescheduling, and payments reductions to preserve customer confidence and goodwill.

Banking Supervision International Relations

Developments on international financial markets intensified communication between the BNB and credit institutions and supervisory bodies abroad. Partner institutions in the EU and beyond, the IMF, the EBRD, foreign bodies and organisations, and rating agencies actively exchanged expert opinions. International institutions and rating agencies based banking system performance assessments on information and macro-prudential analyses and strategies from supervisory bodies. The preparation of expert opinions for EU discussions on participation in the ESCB, CEBS, and supervisory authorities was a priority.

BNB supervision experts actively monitored cross-border bank groups in Bulgaria. Supervisory information was regularly exchanged in line with memoranda of understanding and cooperation.

Experts drafted opinions on issues related to the CEBS and the EC Committee on the Prevention of Money Laundering and Terrorist Financing. They took part in an international forum on statutory reforms in market economies aimed at establishing an external mechanism for corporate control, strengthening capital markets, and improving the investment climate.

VII. The Central Credit Register

The BNB's Central Credit Register provides credit information on the customers of Bulgarian banks and financial institutions.[1] The Register ensures centralisation of the information on the credit indebtedness of customers, access to this information for banks and financial institutions, consolidating the collected information and using it for BNB purposes. It is used by the BNB and lenders, who provide information to it under BNB Ordinance No 22 Article 4.

All loans by banks and financial institutions are reported; exceptions are loans to the government and the BNB, and overdrafts under BGN 1000, provided they are standard exposures in the sense of BNB Ordinance No 9 on the Evaluation and Classification of Risk Exposures of Banks and the Allocation of Specific Provisions for Credit Risk.

By the end of 2010, 102 out of the 222 financial institutions known to the Banking Supervision Department to meet relevant criteria have applied for inclusion into the Register under Ordinance No 22 Article 6. Further institutions are applying for inclusion into the Register and the Banking Supervision Department Public Register.[2]

By the end of 2010 the CCR logged 3,979,775 loans against 3,209,731 a year earlier, with a balance sheet exposure of BGN 57,524 million against BGN 52,451 million a year earlier. By 31 December 2010, 2,039,586 borrowers were in the CCR: 1,931,099 individuals, 8389 self-employed people, 97,299 legal entities, and 2799 foreigners.

Since information for the Banking Supervision Department Credit Portfolio is no longer required, a new CCR information system has increased security and reliability. Revamped Register statements include five-year credit histories on loan and lease servicing, arrears and other items. Information is provided in real time, by classification group.

In 2010 banks and financial institutions conducted 3,588,000 digital certificate searches on 2,610,000 individuals and 978,000 legal entities. This was nearly 518,000 more searches than the 3,070,000 in 2009: an indicator of the Register's importance. There were some 299,000 monthly searches on average.

Ordinance No 22 governs access to Register data. Banks and financial institutions and heirs of deceased persons may apply for statements after paying fees on a scale set by the BNB. By 31 December 2010 there were 4957 applications for statements: 4800 from individuals and 157 by legal entities, against 3277 applications (3092 from individuals and 185 by legal entities) in 2009.

In contact with the World Bank, the European Bank for Reconstruction and Development, and other international organisations, the BNB is exploring joining the Memorandum of Understanding on information exchange between credit registers. It is signed by nine of the fourteen EU members with central credit registers.

[1] The CCR is regulated by BNB Ordinance No 22 on the Central Credit Register of 16 July 2009.

[2] After Ordinance 26 listing into the Public Register, financial institutions under Article 56 of the Law on Credit Institutions criteria have to apply for inclusion into the CCR information system.

VIII. The Fiscal Agent and State Depository Function

Pursuant to the Law on the BNB, the Bulgarian National Bank is the government's fiscal agent and official depository. Under contracts negotiated with the Ministry of Finance to market conditions and prices, the Bank submits to the Ministry statements of budget entities' domestic bank accounts and acts as government debt agent.

The Bank's duties include maintaining and developing the GSAS system for conducting government securities auctions, the ESROT electronic system for registering and servicing government securities trading, the SDTK system for government securities settlement, the Register of Special Pledges, the AS ROAD automated system for registering and servicing external debt, and the IOBFR system for budget and fiscal reserve information servicing.

Revenue from BNB agency functions and related commissions was BGN 1,774,400 over the year (BGN 1,335,500 in 2009): an increase of 32.9 per cent. Active MF issuing brought BGN 964,400 in fees and commissions from government securities transactions: almost double on the prior year.

Information Service

BNB duties under the agreement with the MF involve monitoring all Bulgarian bank accounts of budget entities (down to municipalities) budget, extra budgetary, deposit, foreign currency, and letter-of-credit accounts in levs and foreign currency. Statements of these are submitted to the MF *via* the IOBFR. In addition, the Bank monitors security pledged by budget-servicing banks and tallies it with balances.

On 31 December 2010 the total balance of budget entities' accounts in the BNB and other domestic banks was BGN 6906.2 million,[1] of which BGN 5930.2 million in fiscal reserve accounts.[2] A year earlier the figures were BGN 8473.8 million and BGN 7515.7 million.

The BNB submitted 840 standard summarised budget statements (including 304 fiscal reserve statements) to the MF, up 7 per cent on 2009. The rise was because of increased submission frequency on budget entities' foreign currency accounts at the BNB. Alongside this, the Bank certified 199 summarised quarterly reports by first-level budget-spending entities.

In 2010 the AS ROAD system continued to maintain up-to-date information on the Bulgarian government's foreign financial obligations, on which the BNB is calculating and paying agent. Regular payments effected after coordination with the MF numbered 31 and came to EUR 200.1 million[3]: EUR 61.5 million principal and EUR 138.6 million interest. By the end of the year obligations in the system were EUR 2414.5 million.[4]

Servicing Government Securities Trading

In 2010, 26 government securities auctions were held *via* GSAS, up from 19 (36.8 per cent) in the prior year, reflecting active MF issuing. Two of them, for five- and ten-year (10 years and 6 months) issues, had not been listed on monthly issuing schedules, while a scheduled auction was cancelled by the issuer.

Six fixed-interest tap and two discount issues with diverse maturities and denominations were auctioned. The new 10-years-and-6-month reference issue with most openings (nine) was used to calculate the long-term interest rate for assessing the degree of convergence. The average-weighted residual term to maturity of the placed issues was eight years two months. The Minister of Finance instructed that a ratio different to the 80:20 per

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[1] Balances on foreign currency accounts are recalculated in the respective currency at the BNB exchange rate for 31 December 2010.
[2] Bank accounts in the fiscal reserve by 31 December 2010 are defined by the MF with reference to Council of Ministers' Decrees PMS No 163 of 2010 amending PMS No 324 of 2009 on implementing the 2010 State Budget.
[3] The payments total was recalculated in euro at the BNB rate for 31 December 2010.
[4] The debt total was recalculated in euro at the BNB rate for 31 December 2010.

cent in MF and BNB Ordinance No 5 should be set between competitive and non-competitive bids for each action. In almost half the auctions, this was 70:30 per cent.

The total nominal value of government securities offered by the MF was BGN 948.4 million, around a third denominated in euro. Despite the larger volume offered, demand continued to exceed supply, with a 3.31 average bid-to-cover ratio against 2.01 in the prior year. The total nominal value of issues sold in 2010 was BGN 1508.1 million,[5] up 3.1 times on 2009. Half of these securities were both denominated and payable in euro, as last offered five years ago. The average annual yields of one-year, 2.5-year, 3.5-year, five-year, seven-year, 10.5-year and 15-year issues attained at the auctions were 2.70, 3.22, 3.69, 4.46, 5.62, 6.08 and 6.45 per cent.

The 15-year EUR-denominated issue enjoyed extremely high investor interest. With a record high of 259 bids, its bid-to-cover ratio reached 6.92. The Minister of Finance approved nominal bids of EUR 234.1 million, more than five times the announced amount.

Auctions drew a wide range of investors, including banks (primary and non-primary dealers), institutional investors, pension funds, insurance corporations, the Deposit Insurance Fund, the Employees' Pay Guarantee Fund, and the National Insurance Institute. Banks submitted 73.8 per cent of all bids and 58.7 per cent of approved bids. Their legal duty to secure the balances of budget entities' accounts by blocking domestic and external debt government securities held by themselves in favour of the MF was a reason for this active bidding. Pension funds (mandated to invest half their assets into Bulgarian government bonds or inland deposits) and insurance corporations were other important participants in the auctions, with a clearly pronounced preference for longer-term issues.

Most bids (78.4 per cent) were placed *via* the web-based bid system with universal electronic signatures, and the rest *via* SWIFT. There were no GSAS disruptions during the auctions, with 100 per cent system availability.[6]

ESROT registered primary bond acquisition and payments on maturing government securities of BGN 2233 million[7] (almost double the 2009 sum) under the MF and BNB Ordinance No 5 on the Terms and Procedure for Acquisition, Registration, Redemption and Trade in Government Securities. Principal and interest at maturity totalled BGN 724.9 million, including principal of BGN 591.7 million and interest of BGN 133.2 million, up 5.2 per cent on 2009. This left 28 issues in circulation by 31 December 2010: two short-term (up to a year), six medium-term (one to five years) and 20 long-term (over five years). The total nominal value of government securities registered in ESROT was BGN 3934.2 million,[8] including BGN-denominated issues redeemable in levs at BGN 2707.6 million, EUR-denominated issues redeemable in euro at BGN 949.8 million, and EUR-denominated and USD-denominated issues redeemable in levs at BGN 276.8 million. Circulating euro-denominated issues redeemable in euro posted a significant increase of 136.9 per cent on 2009, their share reaching 24.1 per cent of total outstanding debt against 13.3 per cent at the end of the prior year.

The number and volume of secondary market transactions increased in 2010. The nominal value of government securities transactions in 2010 totalled BGN 76,115.3 million, up 88.9 per cent on 2009. Repos had the largest share (60.5 per cent), followed by blocking and unblocking transactions (33.4 per cent), operations with or between ESROT participants' customers (4.1 per cent), and outright purchases and sales (2.0 per cent).

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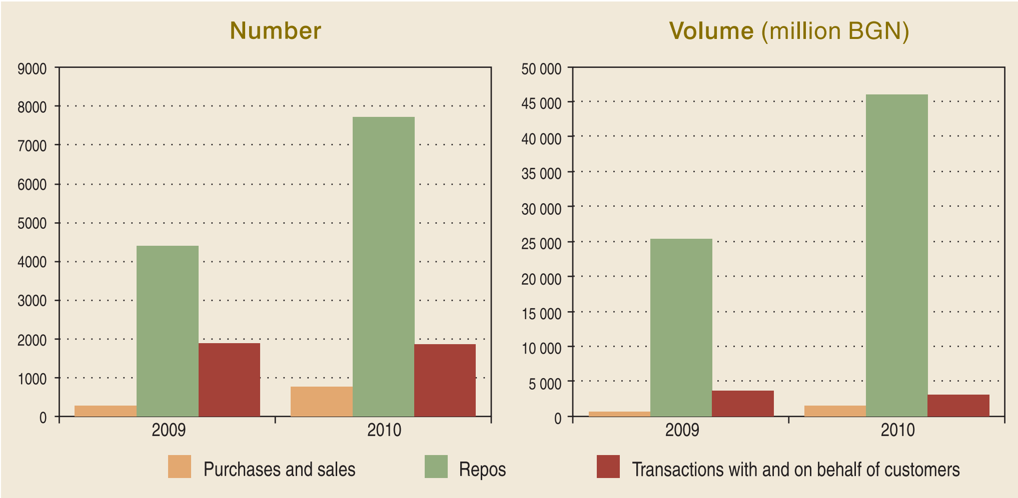
5 Including the lev equivalent of EUR 385.6 million.
6 The ratio of time when the system is fully operational to scheduled operating time.
7 The lev equivalent of payments on foreign currency denominated government securities issues was calculated at the BNB rate on the date of payment.
8 The debt total was recalculated in levs at the BNB rate for 31 December 2010.

Types of Government Securities Transactions

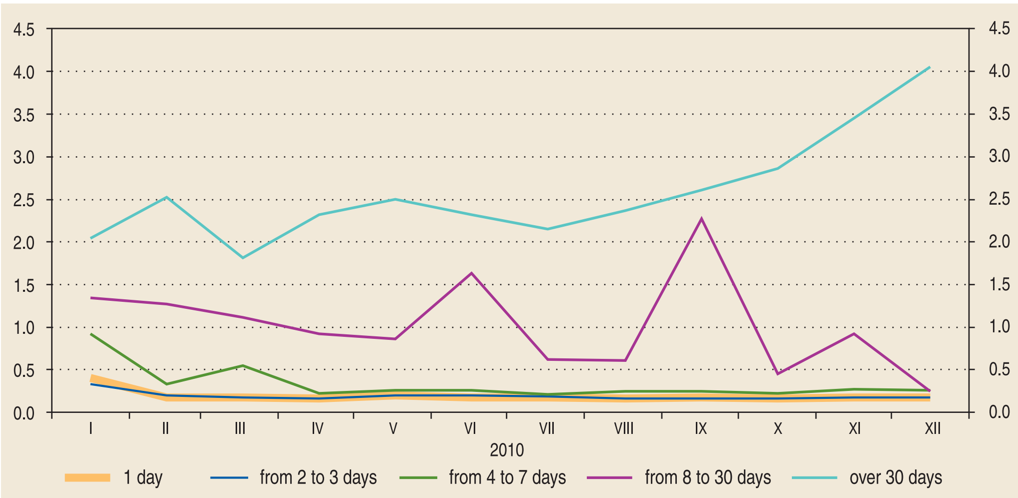


Source: BNB.

Repo agreements with a flow of funds on current accounts had the largest share (82.6 per cent) of the total volume, those concluded for one day being most attractive (over 50 per cent). The average-weighted annual yield was: 0.18 per cent in transactions for one day, 0.19 per cent in transactions for two to three days, 0.27 per cent in transactions for four to seven days, 0.88 per cent in transactions for eight to 30 days, and 2.22 per cent in transactions for over 30 days. Yields of transactions for eight to 30 days fluctuated most (between 0.25 and 2.28 per cent).

Average-weighted Annual Yield on Repo Agreements in Government Securities

(per cent)



Source: BNB.

Low trading with or between ESROT participants' customers showed that banks and institutional investors preferred to keep their government bonds and enjoy longer-term profitability. Hence, they are rarely traded with subsequent registration. Long-term bonds were most marketable on the secondary market, demand indicating the likelihood of re-investment in similar debt instruments. Despite high interest in the primary acquisition of EUR-denominated government bonds redeemable in euro, there was no active secondary market trading. A possible reason was the requirement for euro settlement to be *via* bank correspondence accounts and for these securities to be registered in the depository without a flow on current accounts.

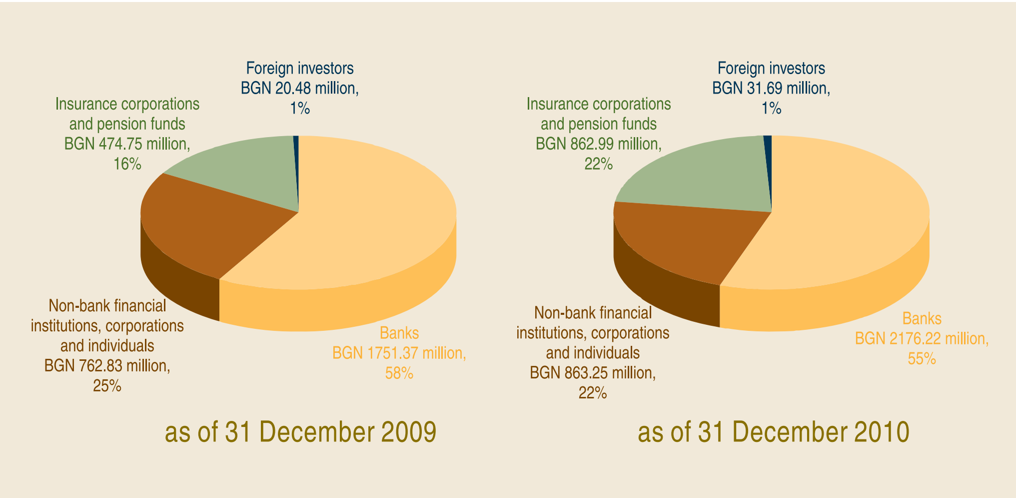
The liquidity ratio[9] on the secondary government securities market was 12.9 in 2010 against 9.9 in 2009, reflecting more active trading.

By an issuer's order, government securities of USD 940,000 issued under ZUNK[10] were cancelled over the year and directed by the MF to cover government obligations under this Law.

In 2010, 17,105 *ISO 15022* notifications and requests for registering transactions in government securities were submitted, up 64.3 per cent on the prior year. Of them, 87.6 per cent were through the ESROT web interface with universal electronic signatures and 12.4 per cent through SWIFT. There were no refusals due to insufficient funds on participants' current accounts.

By holder, the structure of government securities issued on the domestic market by 31 December 2010 was 55 per cent with banks, 22 per cent with insurance corporations and pension funds, 22 per cent with non-bank financial institutions, corporations and individuals, and 1 per cent with foreign investors. Government bonds in insurance corporation and pension fund portfolios reached BGN 863.0 million, up 81.8 per cent in a year. Reflecting the preference for investment offering higher longer-term returns, the share of government bonds with over five-year maturities was 87.9 per cent.

Government Bond Holders



Source: BNB.

ESROT registered significantly more (90.3 per cent in number, 143.6 per cent in volume) blocking and unblocking operations in domestic government securities. Most of this involved banks adjusting security on funds in budget entities' bank accounts under § 22 of the 2010 State Budget Law Transitional and Final Provisions[11] whereby banks regulate the collateral on a real-time basis. The average daily nominals of blocked government securities were BGN 817.7 million, EUR 99.9 million, and USD 32.4 million: a decline on the prior year's BGN 853.0 million, EUR 118.2 million, and USD 48.0 million. In securing budget accounts, servicing banks also blocked foreign government securities. Over the year the latter's average daily nominals were BGN 155.7 million, EUR 110.2 million, and USD 234.7 million: an increase in the share of euro-denominated securities on 2009.

By 31 December 2010 government securities blocked in ESROT under the Law on Special Pledges were worth BGN 82.0 million, down 19.5 per cent in a year (BGN 101.8

[9] The ratio between the volume of government securities transactions and the volume of circulating government securities by the year's end.
[10] The Law on Settlement of Non-performing Credits Negotiated prior to 31 December 1990.
[11] According to § 22, paragraphs 2 and 5, servicing banks secure in favour of the MF funds in all budget entities' lev and foreign currency bank accounts, deposits, and letters of credit by blocking Bulgarian domestic and external debt government securities. Government securities are blocked at the BNB, with the legal effect of a special pledge on them in favour of the MF. Only government securities free of encumbrances are blocked.

million). This resulted from unblocking government securities worth BGN 19.8 million as pledges were deleted from the Register of Special Pledges.[12]

Over the year ESROT offered 99.6 per cent availability,[13] with outages handled under contingency rules for interaction between the systems operated by the BNB. System participants numbered 28: 23 government securities subdepository banks, three investment intermediaries, the Register of Special Pledges, and the MF. Upon successful technical preparedness testing for ESROT communications under MF and BNB Ordinance No 5, Emporiki Bank Bulgaria EAD joined the system on 10 January 2011.

By 31 December 2010, there were 1381 accounts in the government securities settlement system under BNB Ordinance No 31 on Government Securities Settlement. Of them, 28 were for government securities of the issuer (the MF), 552 for participants' own government securities, 449 for government securities market participants' customers, and 352 for encumbered government securities. Government securities on these accounts totalled BGN 3934.2 million in nominal value.

System Development

The first stage of a project to develop and expand IOBFR ended in 2010 with the launch of a new Security module. In mid-year preparations started on a Fiscal Reserve module to collect data from banks automatically, introduce new controls, and generate fiscal reserve account statements for the MF.

To support MF flexible issuing attracting a broad range of investors, GSAS was enabled to provide relevant information on all sectoral breakdowns and facilitate comparisons between the Bulgarian debt market and those elsewhere in the EU.

As domestic euro-denominated government bonds redeemable in euro returned to the market, the MF and ESROT participants asked the Bank to study the legal and technical aspects of the Delivery *versus* Payment principle for primary and secondary market government bond transactions using TARGET2-BNB bank accounts. The proposal, to incorporate the government securities depository into TARGET2-BNB as an ancillary system, also addresses individual processes and mechanisms, options for using euro bank accounts and different modes of TARGET2 participation, internal systems and upgrades to them, and related budgets.

To expand Register of Special Pledges functionality and regulate legal aspects of the recording of circumstances in relation to pledges of book-entry government securities, the Internal Rules for Registering and Servicing Government Securities Trading were amended in mid-2010. This boosted efficiency and reduced delays and access denials.

Under MF and BNB Ordinance No 15 on Control over Transactions in Government Securities and a joint order of the MF and BNB, there were on-sight inspections of 23 ESROT participants performing subdepository functions for their customers, and of ESROT participants' customers other than subdepositories. The inspections showed that government securities subdepositories followed registration rules and safeguarded investors' interests.

[12] The lev equivalent of blocked/unblocked foreign currency denominated government securities is calculated at the BNB rate on the date of transaction.

[13] See Note 6.

IX. International Relations and Participation in the ESCB

In 2010 a series of EU initiatives tackled economic governance, policy cooperation, and competitiveness in areas where the global economic and financial crisis had highlighted shortcomings. BNB representatives on 82 ESCB, European Commission, EU Council committees and working groups, and the Council for European Affairs contributed to the formulation of Bulgaria's positions on the European Semester, the Integrated Guidelines, the reforms in the Stability and Growth Pact, and draft regulations on macroeconomic imbalances. The Bank maintained a position shared by government, that Bulgaria would pursue strategic goals through flexible economic, financial, and stabilisation policies. The new initiatives and regulations, including commitments to the Euro-Plus Pact, the Competitiveness Pact, and the future European Stability Mechanism, should take into account national specifics, and in particular the effect of convergence on the macroeconomic indicators of countries like Bulgaria, so as not to hinder growth and preserve Bulgaria's relative competitive tax advantage.

The Bank was active in formulating the new EU financial supervisory architecture. November 2010 regulations instituted a new European Systemic Risk Board and new financial supervisors for banks, markets, securities, insurance, and pensions. They began work in early 2011.

Growing expert capacity and experience gained in recent years helped expand and deepen international cooperation, the Bank increasingly seen as a major South East Europe technical assistance partner in banking supervision, financial stability, balance of payments statistics, payment systems, and legal convergence with financial *acquis communautaire*.

Participation in the ESCB

The BNB Governor is a member of the ECB General Council and sits on its meetings with EU central bank governors and the ECB President and Vice-President. BNB representatives participated in 12 ESCB committees and 36 working groups, the Human Resources Conference (HRC), and the March 2010 ESCB supervisory macroeconomic research network. Through its representatives on ESCB bodies, committees, and working groups, the Bank helped coordinate monetary policy, draft ECB legal instruments, develop banking payment and settlement infrastructure and statistical reporting, and debate other central banking issues. Under written consultation procedures on draft European Commission legislation, the BNB expressed positions on matters affecting Bulgaria: the Omnibus Directive on supervisory powers, the European Systemic Risk Board proposal, and deposit guarantees.

EU members consult the ECB in writing on relevant legislative bills. The Ministry of Finance consulted the ECB on amendments to the Law on the BNB, the Law on Prevention and Disclosure of Conflicts of Interest, the Administrative Procedure Code, the Currency Law, the Law on Measures Against Money Laundering, and the Law on Cash Payment Restrictions. The BNB consulted the ECB on amendments to the Payment Services entailing amendments to the Law on the BNB and other statutes.

Under the commitment to assist ESCB communications, then the Bank published major ECB publications (Annual Report 2010, Convergence Report 2010, and Monthly Bulletins) in Bulgarian; the latter are on the BNB website.

Participation in Ecofin Council Meetings and in the EU Council and European Commission Committees and Working Groups

The BNB Governor participated in the April and September 2010 informal Ecofin meetings of EU economic and finance ministers. The April 2010 Madrid meeting discussed international financial market tensions relating to public finance crises in some euro area countries. The BNB supported a comprehensive framework to prevent and manage cross-border financial crises and minimise the use of public resources, and better coordination between EU members. The September meeting heard views on the European Commission's economic governance package and Europe 2020 structural reform strategy. Participants highlighted the need for close monitoring of interdependencies between fiscal consolidation, structural reform boosting growth, and financial reforms. Within debates ongoing since early 2010, central bank governors and ministers of finance discussed new levies on banks and financial sector taxes. A need for close coordination between national initiatives was noted to avoid double taxation and unequal treatment of financial institutions. Bulgarian representatives supported financial sector taxes.

The BNB was active in discussing the new EU financial sector supervision, particularly the European Systemic Risk Board (ESRB) and European System of Financial Supervisors (ESFS) with its European Banking Authority (EBA), European Securities and Markets Authority (ESMA), and European Insurance and Occupational Pensions Authority (EIOPA). The BNB Governor is a voting member of the ESRB General Board, while Deputy Governors nominated by the Governor and the Chair of the Financial Supervision Commission are non-voting members. BNB and Financial Supervision Commission representatives also sit on the ESRB Advisory Technical Committee. The Bank coordinated proper representation of Bulgarian positions at sessions with the FSC.

The BNB was active in ECB General Council and ESRB General Board consultations on organisational and conceptual issues, insisting on clear rules and procedures for ESRB warnings and recommendations on systemic risks to financial stability, proper representation for post-2004 EU members in the new supervisory authorities, and on balancing decision publicity and market effect.

The BNB participated in the important debate on boosting deposit guarantees and hence financial stability as a whole. All EU members now have to guarantee deposits of up to EUR 100,000 fully and to finance deposit guarantees through advances and additional contributions if necessary. An EC proposal for proportionate lending between schemes was rejected as jeopardising smaller countries' financial stability. Bank representatives also debated amendments to the Regulation on Credit Rating Agencies. The end of 2010 saw intensive discussions on EC legislation for improved economic governance.

The Bank worked intensively on harmonising national and European legislation at the earliest stage. Over the year, the National Assembly amended the Law on Credit Institutions to increase supervision effectiveness and improve cooperation between Community supervisors, especially those operating in several Member States, and with bank groups and holding companies with head offices in other Member States. The Amendment to the Law on Payment Services and Payment Systems harmonised Bulgarian law with amended European directives. The amended Law on Bank Deposit Guarantee raised bank deposit guarantees to BGN 196,000 in line with Directive 2009/14/EC.

In the Council for European Affairs, the BNB helped formulate national positions and policy on banking and financial services, supervisory practice convergence, payment systems, and strengthening EU economic governance.

Convergence Reports

On 11 May 2010 the ECB and the European Commission adopted convergence reports on the past two years' progress by EU Member States outside the euro area (Member States with a derogation)[1]: Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, and Sweden[2]. Both reports examined compatibility between national legislation and central bank statutes with the Treaty Establishing the European Community and the Protocol and Statute of the ESCB and the ECB, and the degree of sustainable convergence of Member States with derogation.

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[1] Reports were published on 12 May 2010 and are available on www.ecb.int and www.ec.europa.eu.
[2] The United Kingdom and Denmark were not assessed in the convergence reports as they have not requested to launch the euro and have opt-out clauses in their accession treaties.

A comparison between the reports of the two institutions shows that most countries with derogation had not attained full compatibility with the Treaty and Statute. Seven, including Bulgaria, had legal inconsistencies relating to central bank independence, the prohibition on monetary financing, and integration into the Eurosystem. Only Estonia had attained full legislative compliance.

Relations with International Financial Institutions

The BNB Governor attended the bimonthly meetings of Bank for International Settlements (BIS) central bank governors. They are a major forum of international cooperation between member central banks and for discussing world economic development and global economic outlook. At the Annual General Shareholder Meeting in June 2010, the BIS Governors allocated net profit, the BNB receiving a dividend of SDR 5,480,000 (EUR 6.5 million).

The year saw notable progress in IMF reform. The Fund reached agreement on quota increases and future management. The Seoul G20 summit confirmed that IMF reform aimed to retain the Fund as a body relying on Member State quotas, with enough resources to support the longer-term financial needs of its members. In December the BNB Governor voted for the IMF Board of Governors' resolution on the Fourteenth General Review of Quotas and Reform of the Executive Board, increasing IMF quotas by 100 per cent (SDR 238.4 billion to SDR 476.8 billion), making executive members elected; setting a new procedure on composing the Executive Board and electing an Alternate Executive Director for certain duties. The changes increased Bulgaria's IMF quota by SDR 256.1 million from SDR 640.2 million to SDR 896.3 million.

The European Bank for Reconstruction and Development held its 19th Annual Meeting in Zagreb in May. It resolved to raise Bank capital by 50 per cent.

Bilateral Cooperation with Central Banks

Cooperating with other central banks, the main priority of the BNB was to support neighbouring countries preparing for EU membership. BNB expert capacity and technical assistance experience made the Bank a preferred partner in regional projects. Intensive bilateral relations helped these countries make significant progress in membership preparations and strengthening administrative capacity. The technical assistance provided by the Bank played a key role in promoting financial stability in the region and enhancing business and financial cooperation.

Work continued under the twinning project on strengthening the regulatory and supervisory capacity of financial regulators in Montenegro managed by the BNB with the FSC. The project helps the Montenegrin financial sector harmonise with European requirements, with significant Bills drafted on the Financial Stability Council, Financial Collaterals, and Measures against Money Laundering and Terrorist Financing. A mechanism for implementing legislation was established. The Bank conducted staff training to increase administrative capacity.

The BNB was actively involved in the three-year technical assistance programme with the Central Bank of Egypt focused mainly on implementing the new Basel agreement. BNB experts contributed substantially to finalising the draft regulatory framework for banks' own funds, and implementing international accounting standards and forthcoming Basel III changes.

The number of technical assistance projects with BNB participation increased. A two-year technical assistance project for the Central Bank of Serbia was approved in December 2010. Managed by the ECB, it will involve 21 European central banks. BNB experts will share expert knowledge and experience in balance of payments statistics and preparing for EU accession. The Bank will also participate in a twinning project providing expert knowledge and experience in harmonising national and European legislation for the Central Bank of Albania.

X. Statistics

The BNB develops, collects, compiles, and disseminates statistics under Article 42 of the Law on the Bulgarian National Bank and as an ESCB member under Article 5 of the Statute of the ESCB and the ECB. The 2009 amendments to Council Regulation (EC) No 2533/98 of 23 November 1998 concerning the collection of statistical information by the ECB posed additional requirements to BNB statistics.

Methodological and reporting form work was completed for Regulation (EC) No 24/2009 of the ECB of 19 December 2008 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions (ECB/2008/30).

In monetary and interest rate statistics, methodological work and new reporting forms were prepared in line with Regulation (EC) No 25/2009 of the ECB of 19 December 2008 on the balance sheet of the monetary financial institutions sector (Recast) (ECB/2008/32) and Regulation (EC) No 290/2009 of 31 March 2009 amending Regulation (EC) No 63/2002 (ECB/2001/18) concerning statistics on interest rates applied by monetary financial institutions to deposits and loans *vis-à-vis* households and non-financial corporations (ECB/2009/7).

Since early 2010, balance of payments and international position statistics have been published under the amended BNB Ordinance No 27. Regulation (EC) No 924/2009 of the European Parliament and of the Council of 16 September 2009 on cross-border payments in the Community changed the statistical data submission threshold on individual and corporate transfers abroad from BGN 25,000 to BGN 100,000. The thresholds over which resident legal entities and sole proprietors now report to the BNB commercial loans to and from non-residents and transactions other than financial loans were made equal at BGN 50,000. The amendments reduce the burden on reporting units and improve information.

Data on the balance of payments travel, passenger transportation, and compensation of employees – credit and current transfers – credit items were revised in March 2010 after the Bank held a random sample border survey of Bulgarians and foreigners.

Work continued on a new integrated statistics system on the balance of payments, the international investment position, and other statistics. Its major goal is to automate data receipt, control, processing, and dissemination. Preparation began on introducing the sixth edition of the Balance of Payments Manual (IMF, 2008). Because of the substantial volume of preparations and the need to harmonise the new methodology with the European system of accounts, the ECB Statistics Committee and the Eurostat Committee on Monetary, Financial, and Balance of Payments Statistics decided to introduce this edition in 2014. The edition features significant changes in definitions and the presentation of balance of payments items, calling for legislative changes to balance of payments and international investment position statistics.

In cooperation with the ESCB, the BNB continued active support for the Centralised Securities Database project, statistics on securities holdings, and a future database of Bulgarian securities.

The BNB continued compiling data on quarterly financial accounts of the General Government sector under Regulation (EC) No 501/2004 of the European Parliament and of the Council of 10 March 2004 on quarterly financial accounts for general government, as well as data on government finance statistics. The Bank signed a Memorandum of Cooperation with the National Statistical Institute and the Ministry of Finance on developing, compiling, and disseminating government finance statistics and national financial accounts.

In 2010 work on compiling the first part (stock data) of quarterly financial accounts statistics for all sectors under Guidelines ECB/2005/13, ECB/2006/6 and ECB/2007/13 amending Guideline ECB/2002/7 on the statistical reporting requirements of the ECB in quarterly financial accounts was completed.

With the assistance of the NSI, the Bank continued to send to the ECB and the BIS information on macroeconomic indicators. Regular updates and metadata certification under the Special Data Dissemination Standard were made to IMF methodology and schedule.

XI. Research

Economic research, analysis of Bulgarian economic processes, and macroeconomic forecasts support the Bank's management in making decisions and formulating economic policy. In 2010 research reflected the BNB priorities of successful participation in the ESCB. Work focused on studying economic agents' behaviour through microdata, financial sector modelling, and macroeconomic forecasting models.

Specialised research under the 2009 and 2010 Research Plan supported BNB operations by analysing individual economic processes and issues and improving forecasting and modelling. In 2010 work addressed labour market flexibility, price and wage-setting mechanisms, short-term GDP forecasting, evaluating the budget balance cyclical component based on the disaggregated approach applied by the ESCB, empirical sectoral analysis of pricing based on Bulgarian exports, Bulgarian competitiveness, interest rate modelling, and the dynamic stochastic general equilibrium model. Testing and honing the basic model for BNB macroeconometric forecasting continued. Research results were presented in technical reports and at seminars organised by the BNB for experts from relevant bodies, academia, and non-governmental organisations.

In April 2010 an IMF technical mission assisted BNB forecasting and its use of dynamic stochastic general equilibrium models. The experts reviewed progress, advised the Bank on modelling specific issues, and outlined future goals.

In November 2010 the BNB hosted an international conference on small open economies' policy options and adjustment amid a global economic crisis, attracting representatives of Bulgarian and foreign institutions and non-government organisations.

The Guest Researcher Programme supports BNB research and helps establish fruitful cooperation with experts from Bulgaria and abroad on subjects of interest to the Bank. Four researchers worked on behavioural finance and financial stability under the Programme.

Through its Discussion Papers research series, in 2010 the BNB continued to encourage the research potential of Bulgarian economic science and practice in macroeconomics, finance, and economic history. In 2010 the Discussion Papers Editorial Board reviewed five submissions of which three for the Macroeconomics and Finance section.

To mark Asen Hristoforov's 100th anniversary in 2010 the BNB published three volumes of his selected works on economics: monographs, articles, and essays, as well as two autobiographies, various documents, and images related to his life and work.

Publishing the *Monthly Bulletin*, *Economic Review*, *Banks in Bulgaria*, and *Government Securities Market*, the BNB raises public awareness of Bulgarian economic developments and the national banking and financial system.

XII. Information Infrastructure

BNB information infrastructure development involves projects for technological upgrades, for failsafe and reliable information system operation, and for integration with ESCB information and communications systems.

Access to ESCB Systems

In 2010 progress on providing BNB users with access to ESCB systems continued. The Bank successfully transferred services to ESCB-Net between 22 February and 20 March as part of the decentralisation of that platform by June. In the first half-year the Bank worked intensively on the ECB teleconferencing project, with a representative on all extended working group meetings. Document management systems connecting the BNB to the ESCB received constant attention.

BNB Information Systems

The Bank adapted its TurboSwift, SOFI, SAP, and Stematch systems to TARGET2-BNB and changed daily and annual accounting procedures.

The BNB Cash Centre started initial operations in early March. As cash operations began to transfer, the Bank drew up detailed specifications for a new version of its cash reporting, control and management system. This will automate further processes and communicate automatically with banknote processing machines.

Database and applications scope and functionality improved. The second half of 2010 saw progress to a second BNB data centre and key systems back up.

The Central Credit Register changed to include the reporting units and data controls required by BNB Ordinances Nos 22 and 26. A Financial Institution file subsystem with a register of institutions, registration forms, and financial statements augmented the BNB Single Data Depository/Banking Supervision system to Ordinance No 26 requirements. The Government Securities Auction System and the bid registration system received added functionalities.

Ensuring information system integrity and prevention of downtime remained the main data processing task. TurboSwift, human resource, and payroll systems transferred to new servers and work continues on an Oracle update with a new archival mechanism. Continuity procedures changed and improved. A new holiday rota algorithm interfaces with the human resource, access, and working hours systems, avoiding duplicate data entries.

A gradual migration of SAP to new hardware began. Functionality expansion focused on VAT and business trip reporting, improving transfers between asset handlers, developing web-based cash deposits and withdrawals, and BNB statistical reporting.

RINGS

Work on the real-time gross settlement system mainly addressed smooth payments in levs, the TARGET2-BNB euro payments component, and *SWIFT Alliance* matters. The year saw preparations to transfer RINGS operational databases to Oracle 11g to improve reliability, stability, and promptness. Migration procedures are in place to minimise risks. The RINGS central payments repository moved to a new server, updating the database and procedures. There was due testing, software installation, and drawing up of statements on payment orders through the system.

TARGET2-BNB System Component

TARGET2 participation involved creating new technical infrastructure and installing BNB system component software. A new version of the application processing payments generating statements and statistical reports was developed and implemented. In November this TARGET2 component was updated to version 4.0.

SWIFT Alliance

The main and backup SWIFT network connections migrated from *Dual-I* to *Alliance Connect Silver* after testing and software installation. The migration to new *SWIFT Alliance* servers was analysed and procedures were laid down.

BNB IT and Communication Equipment

In October 2010 two independent communications service suppliers won a tender to back up systems in all BNB centres, completing work by the year's close, except at the Burgas cash centre.

Work continued on updating the Bank's communication and information infrastructure, decommissioning of old equipment, and virtualising *Itel*-based server systems. By the end of 2010 the BNB had some 50 virtualised systems, while 30 obsolescent systems were decommissioned. The year saw 140 new workstations created, 100 older workstations closed, and 150 PCs replaced. The *Windows7* OS was duly tested and installed on computers. One hundred printers were installed. Electronic messaging gradually moved to new servers, staff enjoying new e-mail functionalities.

Legal information systems were upgraded, with the *Cilea5* version going live.

Virus protection, workstation, OS, and *MS Office* software was upgraded. Antivirus routines changed.

In 2010 a number of specialised software and hardware products were delivered. Specialists consulted on specifications, requirements, and other items required under the Public Procurement Act.

XIII. Human Resource Management

The priorities of human resource management in 2010 were to maintain the desired professional, qualification, and age structure of staff through selection, qualification improvement, and training, and to ensure health and safety at work.

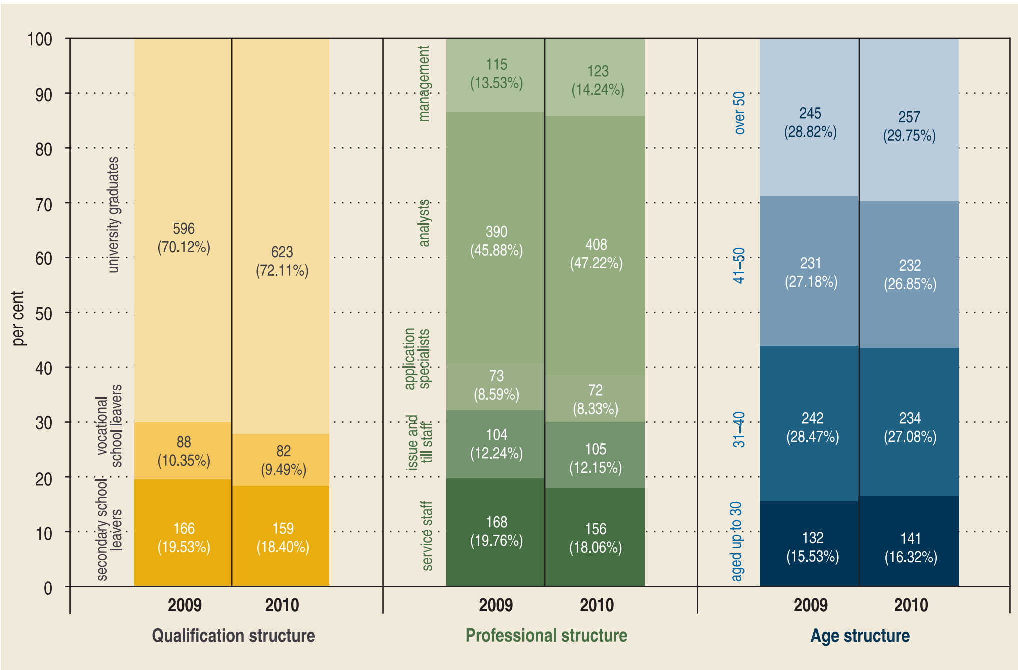
Over the year the Bank continued to pay according to performance, taking into account individual contributions to Bank objectives and tasks under Article 23 of the Law on the BNB.

Recruitment sought to attract employees qualified to meet the requirements set in job descriptions. The BNB participation in the KARIERI 2010 student training and career forum is becoming a tradition. For a third consecutive year, the Bank enjoyed great interest from many young people, with over 500 undergraduates and post-graduates visiting its stand.

Growing BNB duties, including participation in the ESCB, increased the number of staff insignificantly in 2010. Over the year 67 employees joined the Bank, while 49 left, of them 23 to retire. There was no significant year-on-year change: in 2009, 53 employees left the Bank, of whom 16 to retire, while 59 joined.

Staff Structure

(number, share)



Source: BNB.

In 2010 the share of employees aged up to 30 rose again by 0.79 percentage points, their number rising from 132 to 141. Of new entrants, 35 were in the under-35 age group. The share of university graduates also continued rising as expected of a professional structure dominated by analysts. Staff professional structure showed a 1.34 percentage point increase in the share of analysts at the expense of a decreasing share of specialists, cash operations, and service personnel. The share of managerial grades rose insignificantly by 0.71 percentage points.

The Bank promoted internal and external staff mobility. The former helped employees broaden knowledge and experience and improved synergy between structural units. Internal moves in 2010 numbered 36. External mobility, mostly to EU bodies, was also active, with six employees sent on short-term ESCB assignments.

Raising staff qualification through various forms of professional development with different focus, format, and length was another BNB priority. The annual BNB Staff Education and Professional Training Programme sent employees to distance learning programmes, language and professional courses, and seminars in Bulgaria and abroad. These aimed at increasing expertise and skills to better perform major BNB functions and tasks.

The staff induction programme developed further to familiarise new employees with BNB corporate culture, current tasks, internal rules, and administrative procedures.

The number of employees attaining higher academic qualifications increased on the prior year, six employees reading for doctors' degrees, nine for masters' degrees, and nine for bachelors' degrees, all without discontinuing work. Staff was able to gain professional qualifications through internationally recognised distance learning programmes related to Bank functions. In 2010, 28 BNB employees took part in four distance initiatives.

Training organised by leading European central banks and international financial institutions gave employees specialised skills in macroeconomics, international reserve and risk management, banking supervision, statistics, law, and internal audit. In 2010, 200 BNB employees took part in courses, seminars, and conferences abroad. The IMF and the central banks of Germany, France, and the UK were among the Bank's partners.

BNB representatives on ESCB committees and working groups helped formulate and implement common EU strategies and policies. BNB participation in regional projects building and developing the administrative capacity of host countries and institutions evidenced the good professional skills of Bank staff.

Language learning received special attention aimed at ensuring a minimum language proficiency for all employees and a high proficiency for BNB representatives on EU bodies. The relative share of employees with minimum English proficiency (now defined in job descriptions) increased, as did interest in more advanced business English. In 2010, 80 BNB employees attended language courses and 88 per cent of staff covered minimum job description language requirements.

The qualification improvement programme generally followed past guidelines. To cut costs, however, staff courses and seminars will decrease gradually.

The BNB continued to develop its internship programme. In 2010, Bank departments and directorates received 185 trainee applications and approved 85 for training between June and September. Interest focused on international foreign exchange markets, financial markets and payment systems, financial stability, macroeconomic policy, and international economic relations.

In 2010 the BNB again offered fellowships for students reading for Master's and Doctor's degrees in areas relevant to the Bank. Two students won the BNB scholarship competition. A scholarship Ph.D. thesis was published in the BNB *Discussion Papers* series.

In 2010 health and safety at work action focused on improving staff health, providing security, and avoiding injury. To this end, rules were developed in line with new legislation, along with training and instructions for participants in committees and working groups. There was also health and safety risk assessment and management, as well as control and monitoring of operating environment variables.

XIV. Facilities Management

The BNB mainly trades from owned premises and properties. This ensures the level of independence, security, and protection required of a central bank. Property management spending was in line with the BNB annual budget and included new construction, refurbishment and modernisation, deliveries and equipment, repairs, vehicles, supplying assets and cash processing consumables, and optimising power, heating, and water use at BNB premises. Legislative changes on building technical certification ('technical passports' in popular parlance) have imposed the need to certificate all premises before conducting any planned works.

No new properties were bought, sold, or disposed of over the year. The new BNB Cash Centre at 10 Mihail Tenev Street in Sofia was commissioned.

XV. Internal Audit

The Governing Council's 2010 Annual Audit Programme and the Guidelines of the ESCB Internal Auditor Committee entailed twelve audits and one check on audit recommendation implementation. Organisational risk was found to be reasonably well contained.

An audit addressed bank supervision and its contribution to banking stability through examining the attainment of supervision tasks and objectives, organisation and planning, division of responsibilities in on-site inspections, and information reliability.

Two cash operations audits addressed management and control of banknote printing at the BNB Printing Works and of coin and national decoration minting at the State Mint. The audits assessed internal and external risks and their effect on the companies' goals and stakeholder interests. Attention focused on management policy and procedures, fidelity to statutory instruments and principals' instructions, accountability and control, customer relations, organisational structure, staff recruitment and remuneration, stock control, and risk management.

A cash circulation audit addressed reporting, control, and management systems. The audit assessed how the operation contributed to BNB strategic goals. Findings were that control measures ensured accuracy, security, and information reliability to legal and internal rules.

Cash supply and retrieval between BNB territorial units and the Cash Services Company AD were audited to examine the key processes of cash distribution, servicing customers with banknotes and coins, and cash storing. Cash holdings in the Bank's Sofia and provincial cash centres, as well as in the Cash Services Company AD, were examined.

The Trema Finance Kit international reserves information system was audited to examine problem and incident control, change management, system redundancy, and maintenance team functions. The audit aimed at providing reasonable assurance of the system's contribution to the Bank's strategic goals.

The audit of the BNB Cash Centre construction project examined and assessed project management effectiveness and showed reasonable adherence to the Banks' strategic objectives in cash issue and operations. Internal audit monitored the project at all stages to commissioning.

The 30 June 2010 BNB Consolidated Financial Statement audit evaluated the accuracy and scope of BNB financial statements, the reliability and compliance of these statements with the Bank's accounting policy, and control adequacy in preparing them.

The Internal Audit annual programme also planned checks into the implementation of recommendations from previous audits.

BNB Internal Audit operations were assessed to Institute of Internal Auditors' standards and the Audit Manual of the ESCB Internal Auditors Committee. Findings showed that the department was well structured, had adequate understanding of IIA standards, and the Chief Auditor implemented appropriate audit practice and provided management with reasonable assurance of control system effectiveness.

The audits were as follows:

No	BNB Functions	Audits under the BNB Internal Audit Programme
1	Supervisory monitoring on credit institutions	Supervisory monitoring on credit institutions
2	Cash Circulation Maintenance	Banknote Printing Management and Control at the BNB Printing Works
3	Implementation of Monetary Policy and Market Operations	Trema Finance Kit international reserve management system at the BNB
4	Internal Audit	Implementation of Bank Chief Auditor's recommendations
5	Cash Circulation Maintenance	Coin, and medal minting management and control at the State Mint
6	Cash Circulation Maintenance	IT system for BNB cash reporting, control and management
7	Cash Circulation Maintenance	BNB Cash Centre Project
8	Information and Analysis	Audit of the consolidated financial statements as of 30 June 2010
9	Cash Circulation Maintenance	Supplying and retrieving cash between Issue and Cash Directorate units and the territorial units of the Cash Services Company AD
10	Internal Audit	Quality assessment of BNB Internal Audit activities

Source: Audit documents.

There were two 2010 ESCB Internal Auditor Committee annual programme audits. The EURO1 and Trans-European Automated Real-time Gross settlement (TARGET2) local level supervision audit assessed contribution to euro area financial stability and adequacy, and efficient Eurosystem supervision.

ESCB infrastructure and information system operation and maintenance were audited to assess their contribution to information exchange with other EU central banks, providing reasonable assurance of adherence to Bank strategic goals.

Audits under the ESCB Internal Auditors Committee Programme were as follows:

No	BNB Functions	Audits under the ESCB Internal Auditors Committee Programme
1	Bank services provided to the ESCB central banks	Supervision of EURO1 and TARGET2 payment system
2	Bank services provided to the ESCB central banks	Assessment of the maintenance and exploitation of technical infrastructure and information systems of ESCB with a focus on the data exchange interface

Source: Audit documents.

Self-evaluation of 2010 risk was completed on time, the Governing Council receiving a consolidated statement on Bank operational risk in early December 2010. The Operational Risk Methods and Consolidation Division worked to an Operational Risk Management Committee plan. Twenty of the thirty structural units were involved; the inclusion of units is sequenced by priority. The Division provided assistance and coordinated action in risk identification, evaluation, assessment, and analysis and in evaluating control mechanisms and action plans. To improve communication, structural units gained access to shared resources on a network server, access levels differing with seniority.

Auditors improved qualifications and familiarised themselves with latest practice at the ESCB, EU central banks, and the Institute of Internal Auditors in Bulgaria. An internal auditor passed the CISA exam under the Institute of Internal Auditors' programme and qualified with the Information Systems Audit and Control Association (ISACA) on the way to becoming a certified information systems auditor. An Operational Risk Methods and Consolidation Division officer attended a Banque de France operational risk management seminar to learn ECB methodology and exchange experience with colleagues from other central banks.

XVI. BNB Budget Implementation

The BNB Governing Council adopted the BNB budget by Resolution No 124 of 17 November 2009. This report comprises two sections: operational expenditure and the investment programme, pursuant to the BNB Governing Council's Internal Rules on Setting, Implementing, and Reporting the BNB Budget.

I. Operational Expenditure

The BNB spent BGN 80,728,000, or 89.5 per cent of budget on 2010 operations.

Currency circulation cost BGN 18,803,000 or 97.1 per cent of budget and 23 per cent of operational expenditure. Banknote and coin production cost BGN 18,199,000 or 98.9 per cent of budget, including BGN 10,922,000 or 99.7 per cent of budget on banknote printing. Coin minting cost BGN 7,277,000, of which BGN 6,357,000 on circulating and BGN 920,000 on commemorative coins, or 77.9 per cent of budget. Designing new banknotes and coins cost BGN 27,000 or 45 per cent of budget. Circulation servicing machines cost BGN 86,000 or 43 per cent of budget. Cash processing consumables cost BGN 92,000 or 37.6 per cent of budget. Premise rentals at the BNB Printing Works and the State Mint cost BGN 398,000 or 98.3 per cent of projected funds for 2010.

Materials, services, and depreciation spending was BGN 37,716,000 or 87 per cent of budget. Materials cost BGN 969,000 or 73.7 per cent of approved funds under this item and 1.2 per cent of operational expenditure. Transport fleet fuel and spares (BGN 323,000) and office consumables (BGN 267,000) occupied the largest shares. Expenditure on inventories was BGN 248,000, or 89.2 per cent of budget under this item. External services costs came to BGN 16,964,000 or 76.5 per cent of budget and 21 per cent of operational expenditure. Significant items concerned software maintenance subscriptions at BGN 4,112,000, Bloomberg, Reuters, internet, and other service provision at BGN 869,000, and Bankservice AD subscriptions at BGN 487,000 or 32.2 per cent of external service expenditure.

Property and refuse collection levies were BGN 1,410,000. Equipment maintenance was BGN 1,403,000. Mail, telephone, and telex spending came to BGN 866,000, of which SWIFT traffic BGN 173,000. Electric bills were BGN 711,000 and heating and water spending BGN 223,000. Property insurance came to BGN 148,000.

The Bank spent BGN 2,566,000 or 81.9 per cent of annual projections, on its security contract with the Ministry of the Interior.

Major building maintenance cost BGN 2,117,000 or 99.1 per cent of projected funds for 2010.

Consultancy services amounted to BGN 225,000 or 35.4 per cent of budget. They went on preparing information infrastructure and development strategy analyses, a banking confidence survey, and Programme Council for Banking and Finance History publications and research.

Expenses on TARGET2 compulsory modules were BGN 991,000 or 71.2 per cent of budget (BGN 1,392,000).

Depreciation amounted to BGN 19,783,000 or 99.7 per cent of budget under this item.

Payroll, social, and healthcare spending was BGN 20,446,000 or 96.5 per cent of 2010 budget. In accordance with IAS 19, Income of Hired Persons, the Bank reported BGN 187,000 of current retirement obligations and unused paid leave under this item. Social expenditure amounted to BGN 1,841,000 or 89.9 per cent of budget.

Miscellaneous administrative expenditure was BGN 949,000 or 1.1 per cent of all operational expenditure. Inland travel, worth BGN 52,000, involved mainly cash logistics in regional cash centres and checks there.

Foreign travel covered participation in seminars and staff training and cost BGN 237,000 or 39.1 per cent of budget.

In line with the annual BNB Staff Education and Professional Training Programme, BNB employees took part in distance learning programmes and professional courses and seminars held by foreign banks and international financial institutions. Staff training cost BGN 474,000.

Bank representative and protocol expenses came to BGN 178,000 or 0.22 per cent of annual budget for 2010.

The Bank spent BGN 973,000 or 42.7 per cent of annual projections on participation in the ESCB. The cost of BNB representatives' participation in ESCB committees and working groups and other EU bodies was BGN 502,000. Renting telecommunications lines came to BGN 140,000 and staff training cost BGN 53,000. The annual fee for ESCB membership was BGN 220,000. The three Sofia meetings (the ESCB Information Technology Committee, the ESCB Banknote Committee Security Working Group, and the ESCB Monetary Policy Committee Forecasting Working Group) cost BGN 58,000.

II. The Investment Programme

Budgeted investment totalled BGN 15,455,000 in 2010. Implementation of the Investment Programme was BGN 7,387,000 or 47.8 per cent.

Under the new construction, refurbishment, and modernisation item, BGN 3000 went on designing and supervising BNB projects. Funds under the item were not utilised due to the ongoing selection of a technical certification contractor for BNB buildings.

In the period under review, BGN 1,569,000 or 75.6 per cent of approved annual funds went on machines and equipment, vehicles, and other equipment.

Machines and equipment for servicing currency circulation cost BGN 503,000, including BGN 292,000 on BPS sensors for banknote handling machines and BGN 71,000 on additional software adaptation of the BPS 1040 BS machine. Coin container costs were BGN 59,000.

The Bank spent BGN 564,000 on a Xerox DocuColor digital printing machine for the BNB Printing Centre. Over the period, BGN 60,000 went on expanding air-conditioning at BNB buildings and BGN 59,000 on Xerox multifunction photocopiers.

In 2010 funds invested in information systems totalled BGN 5,810,000 or 47 per cent of projections and 79 per cent of total investment for the year.

Investment went mostly into BNB information and communications technology development to maintain a modern technological infrastructure. Hardware costs of BGN 3,180,000 went on communication (BGN 483,000) and computer equipment (BGN 2,697,000). Software expenses of BGN 2,630,000 went on licences (BGN 815,000) and functional expansions of existing systems (BGN 1,815,000).

The year saw an additional subscription of BGN 4700 for European Central Bank equity.

BNB Budget Implementation by 31 December 2010

Indicators	Report 31 Dec. 2010 (BGN'000)	Budget 2010 (BGN'000)	Implementation (%)
Section I. Operational Expenditure	80 728	90 238	89.5
Currency circulation expenditure*	18 803	19 368	97.1
Materials, services and depreciation expenditure*	37 716	43 339	87.0
Staff expenses	20 446	21 195	96.5
Social activity expenditure	1 841	2 048	89.9
Other administrative expenses	949	2 007	47.3
BNB expenditure on membership in ESCB	973	2 281	42.7
Section II. Investment Programme	7 387	15 455	47.8
Expenditure on construction, reconstruction and modernisation	3	810	0.4
Expenditure on acquiring machines, motor vehicles and other equipment*	1 569	2 075	75.6
Expenditure on BNB computerisation*	5 810	12 374	47.0
Investment related to BNB membership in ESCB	5	196	2.6

* Funds under 2010 budget indicators were adjusted pursuant to the Internal Rules on Setting, Implementing, and Reporting the BNB Budget.

Source: BNB.

XVII. Bulgarian National Bank Consolidated Financial Statements for the Year Ended 31 December 2010

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INDEPENDENT AUDITORS' REPORT
TO THE GOVERNING COUNCIL
BULGARIAN NATIONAL BANK

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Bulgarian National Bank and its subsidiaries ("the Bank") which comprise the consolidated statement of financial position as at 31 December 2010, the consolidated 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 Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Bank and its subsidiaries as at 31 December 2010 and of its consolidated financial performance and its consolidated 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 Company 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 consolidated 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 consolidated financial information disclosed in the audited consolidated financial statements of the Bank as of and for the year ended 31 December 2010. Management is responsible for the preparation of the consolidated annual report of the activities of the Bank which was approved by the Governing Council of the Bank on 12 April 2011.

KPMG Bulgaria OOD

KPMG Bulgaria OOD

Sofia, 18 April 2011

Statement of Responsibilities of the Governing Council of the Bulgarian National Bank

The Law on the Bulgarian National Bank requires the Governing Council to prepare financial statements to present the Bank's financial position and performance for the period.

The financial statements of the BNB approved by the Governing Council are prepared in accordance with the International Financial Reporting Standards adopted by the European Commission.

The Governing Council of the Bulgarian National Bank is responsible for maintaining proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Bulgarian National Bank. It has overall responsibility for taking such steps so as to safeguard the assets of the Bulgarian National Bank and to prevent or detect fraud and other irregularities.

Ivan Iskrov

Governor of the BNB

Consolidated Statement of Comprehensive Income for the Year Ended 31 December 2010

(BGN'000)

	Note	31 Dec. 2010	31 Dec. 2009
Interest income	7	413,068	644,397
Interest expense	7	(14,267)	(31,216)
Net interest income		**398,801**	**613,181**
Fee and commission income		7,988	7,783
Fee and commission expense		(3,659)	(3,897)
Net fee and commission income		**4,329**	**3,886**
Net profit/(loss) from financial assets and liabilities at fair value through profit or loss	8	498,495	286,059
Other operating income	9	50,781	35,852
Total income from banking operations		**952,406**	**938,978**
Administrative expenses	10	(105,760)	(105,095)
Profit for the period		**846,646**	**833,883**
Other comprehensive income			
Other comprehensive income		(1,292)	(290)
Other comprehensive income, total		**(1,292)**	**(290)**
Total comprehensive income for the period		**845,354**	**833,593**
Profit attributable to:			
Equity holder of the Bank		846,495	833,728
Minority interest		151	155
Profit for the period		**846,646**	**833,883**
Total comprehensive income attributable to:			
Equity holder of the Bank		845,203	833,438
Minority interest		151	155
Total comprehensive income for the period		**845,354**	**833,593**

The accompanying notes on pages 79 to 102 form an integral part of the Consolidated Financial Statements.

Consolidated Statement of Financial Position as of 31 December 2010

(BGN'000)

	Note	31 Dec. 2010	31 Dec. 2009
ASSETS			
Cash and deposits in foreign currencies	11	5,685,791	4,144,152
Gold, instruments in gold and other precious metals	12	2,708,138	1,937,132
Financial assets at fair value through profit or loss	13	16,947,991	19,142,156
Financial assets available for sale	14	1,508,629	1,416,503
Tangible assets	15	239,723	253,950
Intangible assets	16	11,230	14,302
Other assets	17	54,094	47,742
Total assets		**27,155,596**	**26,955,937**
LIABILITIES			
Banknotes and coins in circulation	18	8,302,428	8,049,100
Due to banks and other financial institutions	19	5,812,535	4,924,976
Liabilities to government institutions and other liabilities	20	5,833,592	7,390,220
Borrowings against Bulgaria's participation in international financial institutions	21	2,761,464	2,594,546
Other liabilities	22	94,983	137,145
Total liabilities		**22,805,002**	**23,095,987**
EQUITY			
Capital	23	20,000	20,000
Reserves	23	4,326,740	3,836,247
Minority interest	24	3,854	3,703
Total equity		**4,350,594**	**3,859,950**
Total liabilities and equity		**27,155,596**	**26,955,937**

The accompanying notes on pages 79 to 102 form an integral part of the Consolidated Financial Statements.

Consolidated Statement of Cash Flows for the Year Ended 31 December 2010

(BGN'000)

	Note	31 Dec. 2010	31 Dec. 2009
Operating activities			
Net profit		846,646	833,883
Adjustments for matching with the net cash flow from operating activities:			
Dividend income		(12,732)	(4,554)
Depreciation	15, 16	26,160	23,392
Loss on disposal of tangible assets		195	415
(Profit) on financial assets and liabilities arising from market movements		(485,111)	(283,434)
(Profit) of associates		(5,387)	(3,350)
Other adjustments		-	(197)
Net cash flow from operating activities before changes in operating assets and liabilities		**369,771**	**566,155**
Change in operating assets			
(Increase) in gold, instruments in gold and other precious metals		(56)	(3,978)
Decrease in financial assets at fair value through profit or loss		1,987,441	1,367,750
Decrease/(increase) in other assets		(2,436)	4,720
Change in operating liabilities			
(Decrease)/increase in currency in circulation		253,328	(1,130,314)
(Decrease)/increase in due to banks and other financial institutions		887,559	(81,510)
(Decrease) in due to government institutions and other liabilities		(1,556,628)	(97,467)
Increase in borrowings from IMF of total allocation of SDR		-	1,302,808
(Decrease)/increase in other liabilities		(42,162)	27,382
Net cash flow from operating activities		**1,896,817**	**1,955,546**
Investing activities			
Purchase of tangible and intangible assets		(9,099)	(69,055)
Dividends received		12,732	4,554
Other investments		(185)	-
Net cash flow from investing activities		**3,448**	**(64,501)**
Financing activities			
Payments to the Government		(354,710)	(400,955)
Net cash flow from financing activities		**(354,710)**	**(400,955)**
Net decrease in cash and cash equivalents		**1,545,555**	**1,490,090**
Cash and cash equivalents at beginning of period		**4,172,475**	**2,682,385**
Cash and cash equivalents at end of period	11, 17	**5,718,030**	**4,172,475**

The accompanying notes on pages 79 to 102 form an integral part of the Consolidated Financial Statements.

Consolidated Statement of Changes in Equity for the Year Ended 31 December 2010

(BGN'000)

Source of changes in equity	Capital	Revaluation of non-monetary assets	Special and other reserves	Total	Minority interest	Total equity
Balance as of 1 January 2009	**20,000**	**138,671**	**3,265,093**	**3,423,764**	**3,548**	**3,427,312**
Profit for the period	-	-	833,728	833,728	155	833,883
Other comprehensive income:						
- other income	-	(290)	-	(290)	-	(290)
Other comprehensive income, total	-	(290)	-	(290)	-	(290)
Total comprehensive income for the period	-	(290)	833,728	833,438	155	833,593
Contributions by and distributions to owners:						
- contribution to the budget of the Republic of Bulgaria	-	-	(400,955)	(400,955)	-	(400,955)
Transactions with owners, total	-	-	(400,955)	(400,955)	-	(400,955)
Balance as of 31 December 2009	**20,000**	**138,381**	**3,697,866**	**3,856,247**	**3,703**	**3,859,950**
Balance as of 1 January 2010	**20,000**	**138,381**	**3,697,866**	**3,856,247**	**3,703**	**3,859,950**
Profit for the period	-	-	846,495	846,495	151	846,646
Other comprehensive income:						
- other income	-	(1,267)	(25)	(1,292)	-	(1,292)
Other comprehensive income, total	-	(1,267)	(25)	(1,292)	-	(1,292)
Total comprehensive income for the period	-	(1,267)	846,470	845,203	151	845,354
Other movements		2,930	(2,930)	-	-	-
Contributions by and distributions to owners:						
- contribution to the budget of the Republic of Bulgaria	-	-	(354,710)	(354,710)	-	(354,710)
Transactions with owners, total	-	-	(354,710)	(354,710)		(354,710)
Balance as of 31 December 2010	**20,000**	**140,044**	**4,186,696**	**4,346,740**	**3,854**	**4,350,594**

The accompanying notes on pages 79 to 102 form an integral part of the Consolidated Financial Statements.

Notes to the Consolidated Financial Statements

1. Statute and Principal Activities

The Bulgarian National Bank (the 'Bank') is 100 per cent owned by the Bulgarian state and is the central bank of the Republic of Bulgaria. The operation of the Bank is governed by the Law on the Bulgarian National Bank (LBNB), which has been effective from 10 June 1997.

Under this Law, the principal activities of the Bank may be summarised as:

- Maintaining price stability through ensuring national currency stability;
- Exclusive right to issue banknotes and coins;
- Regulation and supervision of other banks' activities in the country with a view to banking system stability maintenance;
- Establishment and operation of efficient payment systems and their oversight;
- The Bank may not provide credit to the State or to state-owned institutions, other than credit for purchase of Special Drawing Rights (SDR) from the International Monetary Fund (IMF) in accordance with terms set by law;
- The Bank may not provide credit to banks except in the case of liquidity risk threatening to affect the stability of the banking system;
- The Bank may not deal in Bulgarian government securities;
- The Bank may not issue Bulgarian levs in excess of the Bulgarian lev equivalent of the gross international foreign currency reserves;
- Under terms agreed with the Minister of Finance, the Bank acts as agent for public debts or for debts guaranteed by the State;
- The Bank acts as a central depository of government securities.

The Governing Council of the BNB approved the Consolidated Financial Statements, set out on pages 71 to 102, on 12 April 2011.

2. Applicable Standards

These Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Commission.

3. Basis of Preparation

The Financial Statements are presented in Bulgarian levs rounded to the nearest thousand (BGN'000). They are prepared on a historical cost basis, except for derivative financial instruments, financial assets and liabilities at fair value through profit or loss, available-for-sale assets and properties presented at fair value.

When preparing the financial statements in conformity with IFRSs, the Bank makes judgement, estimates and assumption that affect the reported amounts of assets and liabilities for the following financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under certain circumstances.

4. Basis of Consolidation

Subsidiaries

Subsidiaries are the enterprises controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating polices of an enterprise so as to obtain benefits from its activities. The financial statements of the subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. All receivables and payables, income and expenses, as well as intragroup profits resulting from transactions between Group companies are eliminated unless they are immaterial. The share in the net assets of the Bank's subsidiaries, which corresponds to the minority shareholders' proportionate share, is disclosed separately from Capital and reserves under the Minority interest item.

Associated companies

Associates are those entities in which the Bank has significant influence, but which are neither subsidiary enterprise nor joint venture. Investments in associates are included in the Bank's Consolidated Financial Statements on an equity accounted basis as an amount corresponding to the Bank's share in the associates' own funds as of the end of the reporting period. The Bank's share of associates' net results subsequent to acquisition is disclosed in the Statement of Comprehensive Income as investment income/expenses and is added to/subtracted from the carrying value of the investment.

5. Principal Accounting Policy Elements

(a) Income recognition

Interest income and expense are recognised in the statement of comprehensive income on an effective interest rate basis. The effective interest rate is the rate which precisely discounts the expected future cash payments and income over the term of the financial asset or liability to the book value of the asset or liability. The effective interest rate is determined on the initial recognition of the financial asset or liability and does not change thereafter.

The calculation of the effective interest rate includes all commissions received or paid and any discounts or premiums which are integral parts of the effective interest rate. Transaction costs are intrinsic costs directly attributable to the acquisition, issue or derecognition of a financial asset or liability.

Interest income and expense in the statement of comprehensive income include:

- interest on financial assets and liabilities at amortised cost calculated by the effective interest rate method;
- interest on investment securities available for sale calculated by the effective interest rate method.

Dividends are recognised in the statement of comprehensive income when the Bank establishes the right to their receipt. Exchange rate gains or losses from available-for-sale investments are recognised in the statement of comprehensive income.

Net profit/loss from financial assets and liabilities at fair value through profit or loss includes net gains from operations in securities, net gains from operations in foreign currency, net revaluation gains on securities, net gains from gold revaluation, net gains from revaluation of futures, and net gains from revaluation of assets and liabilities denominated in foreign currencies.

(b) Financial instruments

(i) Classification

For the purposes of measuring financial instruments subsequent to initial recognition, the Bank classifies the financial instruments into four categories:

Financial instruments at fair value through profit or loss are those that the Bank holds primarily for the purpose of short-term profit. These include investments that are not designated for any particular purpose and effective hedging instruments and liabilities from short-term sales of financial instruments. Net receivables under derivatives held for trading (positive fair value), as well as options purchased, if any, are reported as trading assets. All net liabilities under derivatives for trading (negative fair value), as well as options written, if any, are reported as trading liabilities.

Loans and receivables are instruments created by the Bank through providing money to a debtor other than those created with the intention of short-term profit taking.

Held-to-maturity financial assets are assets with fixed or determinable payments and fixed maturity that the Bank has the intent and ability to hold to maturity.

Available-for-sale financial assets are all assets that can not be classified in any other category and are classified as available for sale, as well as any financial asset intended for this purpose at its initial recognition.

(ii) Recognition

The Bank recognises trading financial assets and investments, the Bank's loans and receivables, and financial liabilities at amortised cost on the settlement date. All other financial assets and financial liabilities are recognised on the trade date when the Bank becomes a party to the financial instruments contracts. From that moment on, any gains and losses arising from changes in their fair value are recognised by the Bank.

Financial instruments are initially recognised at fair value, and the financial instruments which are not recognised at fair value through profit or loss include the transaction costs.

(iii) Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured upon the initial recognition, minus principal repayments, plus or minus cumulative amortisation, using an effective interest rate for the difference between the initially recognised amount and the amount at maturity minus any reduction for impairment.

(iv) Fair value measurement and disclosure principles

Fair value is the amount at which an asset can be exchanged or a liability can be settled, between informed consenting parties in a direct deal on the measurement date.

Whenever possible, the Bank measures the fair value of an instrument using quoted prices in an active market of this instrument. A market is considered active if quoted prices are regular and easily accessible and there are actual regular and direct market transactions.

If the market for a financial instrument is not active, the Bank establishes the fair value using valuation techniques. They include using recent arm's length transactions between knowledgeable, willing parties (if available), comparison with the current fair values of other instruments, that are substantially the same discounted cash flow analyses and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Bank, incorporates all factors that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments.

Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. The Bank calibrates valuation techniques and tests them for validity using prices from observable current market transactions in the same instrument or based on other available observable market data.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e., the fair value of the consideration given or received, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When the transaction price provides the best evidence of fair value at initial recognition, the financial instrument is initially measured at the transaction price and any difference between this price and the value initially obtained from a valuation model is subsequently recognised in profit or loss on an appropriate basis over the life of the instrument but not later than when the valuation is supported wholly by observable market data or the transaction is closed out.

Assets and long positions are measured at a bid price; liabilities and short positions are measured at an asking price. Where the Bank has positions with offsetting risks, mid-market prices are used to measure the offsetting risk positions and a bid or asking price adjustment is applied only to the net open position as appropriate. Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Bank entity and the counterparty where appropriate. Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties, to the extent that the Bank believes a third-party market participant would take them into account in pricing a transaction.

(v) Derecognition

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the rights to the receipt of the contractual cash flows from the financial asset in the transaction in which all material risks and profits from the holding of the financial asset are transferred. Any holding in transferred financial assets, which has been originated or kept by the Bank, is recognised as a separate asset or liability.

The Bank derecognises a financial liability when its contractual obligations have been fulfilled or cancelled, or have extinguished.

The Bank conducts transactions for transferring assets recognised in the balance sheet, but it keeps all or almost all material risks and profits from the transferred assets or a portion of them. If some or all material risks and profits have been kept, then the transferred assets are not derecognised from the balance sheet. A transfer of assets with keeping some or all material risks and profits is, for instance, a securities lending agreement or a repurchase transaction.

In transactions where the Bank does not keep, nor does it transfer, all material risks and profits from the holding of a financial asset, it derecognises the asset if it does not keep control of that asset. The rights and obligations kept in the transfer are recognised separately as assets and as liabilities respectively. In transactions where control of the asset is kept, the Bank goes on recognising the asset up to its participation, depending on the extent to which the Bank is exposed to changes in the value of the transferred asset.

In certain transactions, the Bank retains the obligation to service the transferred financial asset for a fee.The transferred asset is derecognised if it meets the derecognition criteria. An asset or liability is recognised for the servicing contract, depending on whether the servicing fee is more than adequate (asset) or is less than adequate (liability) for performing the servicing.

(vi) Offsetting

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 recognized amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under IFRSs, or for gains and losses arising from a group of similar transactions such as in the Bank's trading operations.

(vii) Impairment of assets

Financial assets which are not carried at fair value through profit or loss are reviewed at each reporting date to determine whether there is evidence of impairment. A financial asset is impaired if there is objective evidence of impairment as a result of a loss event that occurred after the initial recognition of the asset and that the loss event had an impact on the estimated future cash flows of the asset and a reliable estimate of the loss can be made.

Objective evidence of impairment loss from financial assets, including equity instruments, is a default or a borrower's inability to repay his obligations, restructuring of loans under unfavourable financial conditions for the Bank, indications that a borrower or the issuer of a financial instrument would go out of business, the disappearance of an active security market, or another public information. Furthermore, in case of a continuous or significant fall in the market value of an investment in equity instruments there is objective evidence of impairment of these equity instruments.

The Bank judges the need of impairment of loans or investments to maturity on an individual or group basis. All individually significant loans and investments to maturity are evaluated for specific impairment. All individually significant loans and investments held to maturity on which no specific impairment losses have been charged are evaluated on a portfolio basis. Loans and advances and held-to-maturity investment securities that are not individually significant are collectively assessed for impairment by grouping together loans and advances and held-to-maturity investment securities with similar risk characteristics. In assessing collective impairment, the Bank uses statistical modelling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgement 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 modelling. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses from assets entered at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of the approximately estimated future cash flows discounted by the initial effective interest rate of the asset. Losses are recognised in profits and losses and go to a corrective account against loans and receivables. Interest on the impaired asset is still recognised through depreciation of the discount. When a subsequent event reduces the impairment loss, the reduction in the impairment loss is reversed in profit and loss.

Impairment losses on available-for-sale investment securities are recognised by transferring the cumulative loss that has been recognised in other comprehensive income to profit or loss as a reclassification adjustment. The cumulative loss that is reclassified from other comprehensive income to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. If in a subsequent period the fair value of an impaired debt security available for sale increases and the increase can be objectively linked to an event that occurred after the impairment loss had been recognised in profit and loss, then the impairment loss is reversed and the reversed amount is recognised in profit and loss. However, any subsequent recovery in the fair value of an impaired equity instrument available for sale is directly recognised in other comprehensive income.

(viii) Financial assets/liabilities held for trading

Financial assets at fair value through profit or loss include instruments for trading which the Bank holds primarily for the purpose to sell or repurchase them in short terms or holds them as part of a portfolio which is managed as a whole with the purpose of short-term profit.

Financial assets and liabilities for trading are initially recognised at fair value in the statement of financial position and the transaction costs go directly to profit and loss. All changes in the fair value are recognised as net income from trading operations in the Comprehensive Income Statement.

Investments are initially recognised at fair value, and the fair value of the investments which are not recognised at fair value through profit or loss includes the transaction costs for the acquisition of the investments. Upon any subsequent measurement, depending on the classification, investments are entered as investments held to maturity or available for sale.

(ix) Investments

(1) Held-to-maturity investments

Held-to-maturity financial assets are non-derivative assets with fixed or determinable payments and fixed maturity that the Bank has the intent and ability to hold to maturity, are not designated at fair value through the profit or loss, and are not available for sale financial assets.

Held-to-maturity investments are carried at amortised cost on the basis of an effective interest rate method. In case of sale or reclassification of more than an insignificant part of the assets held to maturity which are not falling due in the immediate future, there should be a reclassification of the entire portfolio of investments held to maturity in the group of available-for-sale investments. As a result of this reclassification, the Bank may not classify investments as investments held to maturity in the current year, and in the next two years.

(2) Financial assets available for sale

Available-for-sale investments are non-derivative assets that cannot be classified in any other category of financial assets. Equity investments not quoted in the market and whose fair value cannot be reliably measured are carried at cost. All other available-for-sale assets are carried at fair value.

Differences in the fair value are recognised directly in equity until the investment is sold or fully impaired, when the cumulative income and expense recognised in equity are recognised in the Comprehensive Income Statement.

(c) Gold and other precious metals

The BNB as a central bank maintains particular volumes of gold as part of Bulgaria's international reserves. In compliance with the requirements of the Law on the BNB, the Bank may take any necessary action in connection with the acquisition, possession and sale of gross international reserves, including monetary gold. Consequently, monetary gold as part of international reserves may be immediately used by the BNB without further constraints which determines it as a monetary asset and it should be valued at fair value. With regard to the set characteristics of the monetary gold, the management considers that IFRS does not provide a reliable base for the reporting of this asset. Therefore, pursuant to the requirements of *IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors,* the Bank defines the recognition and valuation of the monetary gold as a financial asset reported at fair value through profit or loss as the most reliable and appropriate base for a subsequent valuation of this financial asset.

Gold and other precious metals are measured at market value based on the official London Bullion Market closing price at the balance sheet date.

(d) Equity investments

For the purposes of measuring the equity investments subsequent to initial recognition, they are classified as available-for-sale financial assets and are measured at fair value.

Details of investments held by the Bank are set out in note 14.

(e) Property, plant, equipment and intangible assets

The Bank pursues a policy of recognising land and buildings at revalued amount as per the alternative approach allowed in *IAS 16 Property, Plant and Equipment*. The other groups of property, plant, equipment and intangible assets are measured in the statement of the financial position at their acquisition cost, less accumulated depreciation and impairment losses.

Land and buildings are recognised at fair value which is regularly assessed by professional qualified valuers. The revaluation of property is done asset by asset, and the accrued depreciation at the revaluation date is derecognised on the gross balance sheet account on the assets side, and the net value is recalculated against the revaluation of the asset. When the value of assets increases as a result of revaluation, the increase is reflected directly in the revaluation reserve in equity. When the value of assets decreases as a result of revaluation, the decrease is recognised by decreasing the revaluation reserve in equity, and in case of a shortage, the difference is recognised as an expense in the statement of comprehensive income.

1) Subsequent expenditure

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately is capitalized. All other subsequent expenditures are capitalized only future economic benefits embodied in the item of property, plant and equipment will flow to the Bank. All other expenditures are recognized in the Statement of Comprehensive Income as an expense as incurred.

2) Depreciation

Depreciation is provided on a straight-line basis at prescribed rates designed to write down the cost of revalued amount of property, plant, equipment and intangible assets over their estimated useful lives. Land is not depreciated. The annual depreciation rates used are as follows.

(%)

Buildings	2–4
Plant & equipment	3–15
Computers	30–33.3
Fixtures and fittings	15–20
Motor vehicles	8–25
Intangible fixed assets	20–25

Expenditures incurred for the acquisition of property, plant, equipment and intangible assets are not depreciated until those are brought into use.

3) Calculation of recoverable amount of assets

The recoverable amount of the Bank's property, plant and equipment is the greater of the net selling price or value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using the Bank's incremental borrowing rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

4) Reversals of impairment

In respect of property, plant and equipment, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only up to the amount of the asset's carrying amount before recognizing impairment loss.

(f) Foreign exchange

Income and expenditure arising in foreign currencies are translated to BGN at the official rates of exchange on the transaction date. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated at the official exchange rate of the Bank on that day. Foreign exchange gains and losses resulting from the revaluation of monetary assets and liabilities are recognized in the Statement of Comprehensive Income. Foreign currency denominated non-monetary assets and liabilities are valued at the exchange rate at the date of the transaction or at latest determination date of fair value.

Outstanding forward contracts in foreign exchange are marked to market. The gains and losses on revaluation of outstanding forward contacts are recognized in the Statement of Comprehensive Income.

The exchange rates of the major foreign currencies as of 31 December 2010 and 31 December 2009 are as follows:

Currency	31 December 2010	31 December 2009
US dollars	1 : BGN 1.47276	1 : BGN 1.36409
Euro	1 : BGN 1.95583	1 : BGN 1.95583
Special Drawing Rights	1 : BGN 2.26809	1 : BGN 2.13069
Gold	1 troy ounce: BGN 2081.32	1 troy ounce: BGN 1488.400

(g) Taxation

The Bank is not subject to income tax on income from its core activities. Tax on the profit from subsidiaries for the period comprises current tax and deferred tax. Current tax comprises tax payable calculated on the basis of the expected taxable income for the period, using the effective tax rate or the current one on the balance sheet date. Deferred tax is derived using the balance sheet liability method on all temporary differences between the amounts used for taxation purposes and the carrying amounts of assets and liabilities.

(h) Profit distribution policy of the Bank

The Bank's policy of distribution of profit from banking operations is defined in the Law on the BNB. New BNB Financial Statements and Accounting Policy Internal Rules were adopted by a resolution of the BNB Governing Council in accordance with Article 36, paragraphs 1 and 2 of the Law on the BNB and are effective from 1 January 2007. According to these rules, the Bank allocates to special reserves unrealised net gains and losses arising from revaluation of assets and liabilities denominated in foreign currency or gold. According to the requirements of Article 8, paragraph 2 of the Law on the BNB, the Bank sets aside 25 per cent of the excess of its annual revenue over its annual expenditure into a Reserve Fund. According to Article 8, paragraph 3 of the Law on the BNB, after the allocation to the Reserve Fund, the Bank may allocate reserves to cover market risk losses and other reserves upon a decision of the Governing Council. Subsequent to the allocation of reserves as required by the Law on the BNB, the Bank stipulates the remainder to be paid into the State Budget. The distribution of excess of income over expenditure is set out in note 23.

(i) Cash in hand and deposits in foreign currency

Cash and cash equivalents consist of cash in hand, current accounts and time deposits with maturities of less than three months.

(j) Employee benefits

The Bank has the obligation to pay certain amounts to each employee who retires with the Bank in accordance with the requirements of Article 222, § 3 of the Labour Code in Bulgaria. According to these Labour Code requirements, on termination of the employment contract of an employee who has become entitled to retirement, the emplpoyer is obliged to pay him/her compensation amounting to twice his/her gross monthly salary. If, at the date of retirement, the employee has been employed by the Bank for ten or more years, the amount of the compensation is six gross monthly salaries. As of the statement date, the Management of the Bank estimates the approximate amount of the potential expenditures for every employee based on a calculation performed by an actuary using the projected unit credit method. The estimated amount of the obligation and the main assumptions, on the base of which the estimation of the obligation has been made, is disclosed to the financial statements in note 10.

Termination benefits

Termination benefits are recognised as an expense when the Bank is committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan to either terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognised as an expense if the Bank has made an offer of voluntary redundancy and it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably. If benefits are payable more than 12 months after the reporting period, then they are discounted to their present value.

Short-term employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Bank has a present legal or constructive obligation to pay this amount as a result of past services provided by the employee, and the obligation can be estimated reliably. The Bank recognises as a liability the undiscounted amount of the estimated costs related to annual leave expected to be paid in exchange for the employee's service for the period completed.

(k) New standards and interpretations which have not been adopted so far

Certain new standards, amendments to standards and interpretations which will become effective for financial periods beginning after 1 January 2010, and which have not been taken into account in preparing these Financial Statements. Management does not expect that these future changes will have an impact on the Bank's financial statements.

Papers issued by the IAS Board and the IFRS Interpretations Committee which so far the European Commission has not endorsed for adoption

Management believes that it is appropriate to disclose that the following revised standards, new interpretations and amendments to current standards, which, as of the reporting date, have already been 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 in November 2009) and Amendments to IFRS 9 (issued in October 2010) will become effective on 1 January 2013 and may change the classification and measurement of financial instruments. So far, the size of the potential effect has not been estimated.
- Amendments to IFRS 7 Financial Instruments: Disclosure (issued in October 2010), coming into force as of 1 July 2011 – Management does not expect that these amendments will have an impact on the Bank's financial statements.
- Amendments to IAS 12 Deferred Tax: Recovery of Underlying Assets (issued in December 2010), coming into force as of 1 January 2012 – Management does not expect that these amendments will have an impact on the Bank's financial statements.
- Amendments to IFRS 1 Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (issued in December 2010), coming into force as of 1July 2012 – Management does not expect these amendments to have an impact on the Bank's financial statements.
- Improvements to IFRS 2010 (issued in April 2010), coming into effect on different dates, in principle from 1 January 2011 – Management does not expect these amendments to have an impact on the Bank's financial statements.

6. Financial Risk Management Policy Disclosure

(a) Introduction and overview

The Bank is exposed to the following types of risk in relation to its operations with financial instruments:

- credit risk;
- liquidity risk;
- market risk;
- operational risk.

This note provides information on the Bank's goals, exposures to each of the above types of risk and the policies and processes for risk measurement and management.

General provisions of risk management

The process of the BNB management of the gross international reserves looks to the high security and liquidity of the assets, first, and then to the maximizing returns in the context of the international markets conditions. Its investment strategy depends mainly on the specific function of a central bank operating under a currency board arrangement and in full compliance with the requirements of the Law on the BNB.

The major portion of BNB's international reserves is invested in low-risk discount and coupon securities issued by governments, government agencies or supranational financial institutions, short-term foreign currency and gold deposits placed with first-rate foreign banks. The remaining portion is held in SDRs, and in monetary gold kept in the Bank's vaults.

The risks to the international reserve are managed by an independent risk management unit. It is directly responsible for the strategic asset allocation and the determination of the international reserve benchmark, and prepares and submits for approval the investment management limits. On a quarterly basis, an overall review is made of the changes in the market conditions, the amount and structure of international reserves, and if required, the investment limits and benchmarks are updated. The observance of underlying limits, rules, and procedures is monitored on a daily basis. Reports are regularly prepared both for the needs of international reserves operating management, and for providing updated information to the Bank's management.

All approved financial instruments and asset classes in which the BNB may invest are set out in the Investment Guidelines and Benchmarks for the Management of the Gross International Reserves. The same document defines the main portfolios and the respective benchmarks, as well as all limits for credit, interest, currency and operational risk. The document contains an exhaustive list of approved debt instrument issuers which the BNB may invest in, and a list of foreign financial institutions acting as BNB counterparties.

The international reserves management is governed by rules of behaviour and procedures regulating the performance of the functions and tasks of the main structural units involved in the process. The rules and procedures are included in the Manual of Business Procedures for Foreign Currency Reserve Management.

(b) Credit risk

The BNB is exposed to credit risk through its trading operations and investment activities and in cases where it acts as an intermediary on behalf of the government or other public institutions. The Bank assumes credit risk also in operations of purchases and sales of foreign currency with commercial banks. In general, this credit risk is associated with the probability of insolvency or bankruptcy of a BNB's counterparty or the bankruptcy or insolvency of a issuer, in whose debt instruments the Bank has invested its own funds. Credit risk is limited by setting strict requirements for high credit ratings assigned by internationally recognized credit rating agencies.

From credit risk perspective, the Bank can currently invest in the following types of financial instruments:

- central banks' investment programmes;
- automatic borrowing/lending of securities with the main depository;
- deposits in foreign currency (time deposits and funds on current accounts) with Group One counterparties and/or central banks;
- deposits in gold with Group I counterparties, central banks or supranational financial institutions (time deposits and funds on current accounts);
- commercial securities issued by:
  - governments or government guaranteed institutions;
  - supranational financial institutions;
  - specialised financial agencies;
  - banks;
  - issuers of European covered bonds;
- bonds issued by:
  - governments or government guaranteed agencies;
  - supranational financial institutions;
  - specialised financial agencies;
  - banks and other financial institutions – issuers of secured bonds;
  - financial institutions – government-guaranteed bonds.

All bonds must be with a one-off payment of their face value on the maturity date and without any embedded option, and with a term to maturity not exceeding 30 years.

- Purchases and sales of foreign currency:
  - with a value date of up to 2 business days (spot);
- Futures – interest rate and bond (long and/or short positions are eligible) traded on the international regulated markets.

According to the BNB policy for counterparties in gross international reserve management, foreign financial institutions acting as BNB counterparties are divided into two groups:

- Group One – financial institutions to which the BNB may have a credit exposure. These should have long-term credit rating higher or equal to AA- according to S&P and Fitch Ratings, or Aa3 according to Moody's by at least two of the above indicated agencies.

- Group Two – financial institutions with which the BNB may conclude DVP (Delivery Versus Payment) transactions for the sale or purchase of securities. They should have a short-term credit rating higher or equal to A-1 according to S&P, F-1 according to Fitch Ratings or P-2 according to Moody's by at least two of the above agencies.

The BNB investment constraints set a system of limits of maximum exposures to individual counterparties. The limits are calculated on the basis of an internal credit rating and the capital of the counterparty. The internal credit rating, on its part, is a function of long-term ratings by the above three credit rating agencies. In addition, based on the internal credit rating, limits are set for the maximum term of the deposits in foreign currency or gold with commercial banks, and of the commercial paper issued by them.

Due to the adverse developments with Greece's debt, the spillover of the tension to other countries of the euro area and the sharp decline of market participants' perception of the credit quality of debt issued by European peripheral countries, early in May a ban was introduced on the purchase of debt instruments issued or guaranteed by Portugal, Spain, Ireland, and Italy. Since the middle of this year, new credit restrictions and rules were introduced relating to exposures in government securities of some euro area countries. The eligible issuers of securities were divided into three groups based on their credit risk with respective limits to their exposure at a balance sheet level. To improve security and contain credit risk, new restrictions were introduced: a minimum of 30 per cent of foreign reserves to be invested in German government securities and a maximum of 20 per cent – in government securities of countries from group three.

The ban on investing in Italy's debt was repealed at a later stage in the second half of the year with the maximum allowed exposure falling within the limit set for the group-three countries. At the same time, as a result of the deteriorating macroeconomic parameters and the negative expectations for Portugal's sovereign debt, the country was removed from the list of eligible issuers in whose debt the BNB can invest. In the last quarter of 2010 Ireland too was also removed from the list as a result of its record-high budget deficit, deteriorated international market confidence and as the problems of the almost entirely nationalised banking sector became far too deep for the country to handle.

(c) Liquidity risk

Liquidity risk arises in the funding of the Bank's core activities and in the management of positions. It is primarily manifested in two aspects: the first aspect is the risk for the Bank of being unable to meet its obligations when due, and the second aspect comprises the risk of its being unable to sell an asset on international markets at a fair value within an appropriate time frame in compliance with the respective market conventions.

The Bank's customers are determined by the Law on the BNB. It attracts funds by means of a number of instruments – deposits/investment accounts, a structured indexed account (SIA), settlement accounts and other borrowed funds established by law. The Bank strives to maintain a balance between the maturity of borrowed funds and that of assets through investments in financial instruments with a range of maturities. Limits are set to ensure minimum liquidity by type of currency.

This liquidity is provided on a daily basis, thus ensuring all BNB foreign currency payments. To better manage the liquidity risk from liquidating positions in financial instruments approved for investment, these are grouped into liquidity ranks subject to the degree of difficulty (i.e., discount to fair value) to sell in the market in critical times. There are limits for the various asset classes based on the liquidity ranks.

The Bank continually assesses liquidity risk by identifying and monitoring changes in funding required for meeting its goals and targets set in terms of the overall Bank strategy. As part of its overall liquidity risk management strategy, the Bank has defined some requirements for the management of a portfolio of liquid assets denominated in euro and for maintaining assets denominated in other currencies for the purposes of meeting its cash inflows and outflows.

(BGN'000)

As of 31 December 2010	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Undefined maturity	Total
Financial assets							
Cash and deposits in foreign currencies	5,392,112	293,679	-	-	-	-	5,685,791
Gold, instruments in gold, and other precious metals	-	1,601,618	-	-	-	1,106,520	2,708,138
Financial assets at fair value through profit or loss	800,156	3,346,464	5,869,467	6,655,475	276,429	-	16,947,991
Financial assets available for sale	76,928	-	-	-	-	1,431,701	1,508,629
Total financial assets	**6,269,196**	**5,241,761**	**5,869,467**	**6,655,475**	**276,429**	**2,538,221**	**26,850,549**
Financial liabilities							
Banknotes and coins in circulation	-	-	-	-	-	8,302,428	8,302,428
Due to banks and other financial institutions	5,812,535	-	-	-	-	-	5,812,535
Liabilities to government institutions and other borrowings	4,129,571	863,786	840,235	-	-	-	5,833,592
Borrowings against Bulgaria's participation in international financial institutions	-	-	-	-	-	2,761,464	2,761,464
Total financial liabilities	**9,942,106**	**863,786**	**840,235**	**-**	**-**	**11,063,892**	**22,710,019**
Asset-liability maturity mismatch	**(3,672,910)**	**4,377,975**	**5,029,232**	**6,655,475**	**276,429**	**(8,525,671)**	**4,140,530**

(BGN'000)

As of 31 December 2009	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Undefined maturity	Total
Financial assets							
Cash and deposits in foreign currencies	4,144,152	-	-	-	-	-	4,144,152
Gold, instruments in gold, and other precious metals	331,443	813,935	-	-	-	791,754	1,937,132
Financial assets at fair value through profit or loss	659,899	2,502,051	7,247,056	7,896,911	836,239	-	19,142,156
Financial assets available for sale	71,835	-	-	-	-	1,344,668	1,416,503
Total financial assets	**5,207,329**	**3,315,986**	**7,247,056**	**7,896,911**	**836,239**	**2,136,422**	**26,639,943**
Financial liabilities							
Banknotes and coins in circulation	-	-	-	-	-	8,049,100	8,049,100
Due to banks and other financial institutions	4,924,976	-	-	-	-	-	4,924,976
Liabilities to government institutions and other borrowings	7,368,628	21,592	-	-	-	-	7,390,220
Borrowings against Bulgaria's participation in international financial institutions	-	-	-	-	-	2,594,546	2,594,546
Total financial liabilities	**12,293,604**	**21,592**	**-**	**-**	**-**	**10,643,646**	**22,958,842**
Asset-liability maturity mismatch	**(7,086,275)**	**3,294,394**	**7,247,056**	**7,896,911**	**836,239**	**(8,507,224)**	**3,681,101**

The outstanding contractual maturities of the Bank's financial liabilities are as follows:

(BGN'000)

	Book value	Gross nominal outgoing cash flow	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years
As of 31 December 2010							
Banknotes and coins in circulation	8,302,428	8,302,428	-	-	-	-	8,302,428
Due to banks and other financial institutions	5,812,535	5,812,535	5,812,535	-	-	-	-
Liabilities to government institutions and other borrowings	5,833,592	5,836,123	4,129,729	864,356	842,038	-	-
Borrowings against Bulgaria's participation in international financial institutions	2,761,464	2,761,464	-	-	-	-	2,761,464
	22,710,019	**22,712,550**	**9,942,264**	**864,356**	**842,038**	**-**	**11,063,892**
As of 31 December 2009							
Banknotes and coins in circulation	8,049,100	8,049,100	-	-	-	-	8,049,100
Due to banks and other financial institutions	4,924,976	4,924,976	4,924,976	-	-	-	-
Liabilities to government institutions and other borrowings	7,390,220	7,390,268	7,368,652	21,616	-	-	-
Borrowings against Bulgaria's participation in international financial institutions	2,594,546	2,594,546	-	-	-	-	2,594,546
	22,958,842	**22,958,890**	**12,293,628**	**21,616**	**-**	**-**	**10,643,646**

(d) Market risk

Market risk

All financial instruments are subject to market risk, i.e. the risk of impairment as a result of changes in the market conditions. The instruments are evaluated on a daily basis at fair market value which best reflects current market conditions for the respective type of financial instrument. The Bank manages its portfolios in response to changing market conditions. Exposure to market risk is managed in accordance with the risk limits set in the Investment Limits to the Management of the Gross International Foreign Currency Reserves.

The table below presents one important measure of market risk, i.e. Value at Risk (VaR). VaR is an indicator of the maximum loss over a certain period of time (holding period) and with a certain probability (confidence level or confidence interval). The VaR used in this report is based on a 95 per cent confidence level and a one-day holding period.

The Table below shows VaR of BNB Issue Department assets at 95 per cent confidence interval. VaR calculation is based on the empirical distribution of the yield on assets derived from historical data (30 days time series).

(BGN'000)

	As of 31 Dec. 2010	Average	Maximum	Minimum
2010				
Currency risk	(27,365)	(24,452)	(62,044)	(5,743)
Interest rate risk	(5,117)	(6,167)	(18,016)	(797)
Correlation	(0.07)	(0.06)	0.64	(0.56)
Total	**(26,427)**	**(30,043)**	**(59,974)**	**(4,009)**
2009				
Currency risk	(37,276)	(25,674)	(54,516)	(6,569)
Interest rate risk	(4,539)	(6,787)	(16,109)	(904)
Correlation	0.08	0.10	0.69	(0.37)
Total	**(31,558)**	**(34,876)**	**(64,272)**	**(4,630)**

Interest rate risk

The Bank's operations are subject to the risk of interest rate fluctuations, which impacts the prices of interest-earning assets (including investments) and interest-bearing liabilities. The Bank uses modified duration as a key measurement for interest rate risk. Modified duration measures the effect of the change in the market value of an asset (liability) in percentage points in response to a 1 basis point (1/100th of 1 per cent) change in the interest rate levels. In addition, portfolios' technical parameters such as convexity, duration in a fixed point of the yield curve, etc. are monitored on a daily basis. For each portfolio held by the BNB, the interest rate is limited by a benchmark (model portfolio) and by the investment limits for a maximum deviation of the modified duration of the portfolio from that of the respective benchmark.

Assets and liabilities with floating interest rates involve the risk of changes in the base which serves to determine the interest rates.

(BGN'000)

As of 31 December 2010	Total	Floating rate instruments	Fixed rate instruments		
			Up to 1 month	From 1 to 3 months	Over 3 months
Interest-earning assets					
Cash and deposits in foreign currencies	5,576,186	1,423,858	3,858,954	293,374	-
Gold, instruments in gold and other precious metals	1,601,613	-	-	1,601,613	-
Financial assets at fair value through profit or loss	16,855,601	1,295,612	765,348	3,329,520	11,465,121
Financial assets available for sale	76,928	-	76,928	-	-
Other interest-earning assets	32,239	3,286	6,229	11,138	11,586
Total	**24,142,567**	**2,722,756**	**4,707,459**	**5,235,645**	**11,476,707**
Interest-bearing liabilities					
Due to banks and other financial institutions	5,812,535	-	5,812,535	-	-
Liabilities to government institutions and other borrowings	4,325,526	-	2,622,012	863,514	840,000
Borrowings against Bulgaria's participation in international financial institutions	1,385,521	1,385,521	-	-	-
Total	**11,523,582**	**1,385,521**	**8,434,547**	**863,514**	**840,000**
Interest-bearing assets/liability gap	**12,618,985**	**1,337,235**	**(3,727,088)**	**4,372,131**	**10,636,707**

(BGN'000)

As of 31 December 2009	Total	Floating rate instruments	Fixed rate instruments		
			Up to 1 month	From 1 to 3 months	Over 3 months
Interest-earning assets					
Cash and deposits in foreign currencies	4,002,872	1,308,632	2,694,240	-	-
Gold, instruments in gold and other precious metals	1,007,200	-	193,276	813,924	-
Financial assets at fair value through profit or loss	18,978,406	528,028	649,284	2,477,295	15,323,799
Financial assets available for sale	71,835	-	71,835	-	-
Other interest-earning assets	28,323	9,877	7,433	5,322	5,691
Total	**24,088,636**	**1,846,537**	**3,616,068**	**3,296,541**	**15,329,490**
Interest-bearing liabilities					
Due to banks and other financial institutions	4,924,976	-	4,924,976	-	-
Liabilities to government institutions and other borrowings	4,766,311	-	4,744,797	21,514	-
Borrowings against Bulgaria's participation in international financial institutions	1,301,587	1,301,587	-	-	-
Total	**10,992,874**	**1,301,587**	**9,669,773**	**21,514**	**-**
Interest-bearing assets/liability gap	**13,095,762**	**544,950**	**(6,053,705)**	**3,275,027**	**15,329,490**

For managing interest rate risk and the band of interest rate changes, the sensitivity of financial assets and liabilities to various standard and non-standard interest rate movement scenarios is monitored.

The standard scenarios include the following changes in yield curves: 1) 100 basis points instant and parallel increase; 2) 100 basis points instant and parallel decrease; 3) 50 basis points parallel increase in the yield curves for a period of 12 months, and 4) 50 basis points parallel decrease in the yield curves also for a period of 12 months. The second two scenarios assume that the change in yields takes place at the beginning of the period and over the one-year period the yield curve remains unchanged.

The analysis of the sensitivity of the Bank's assets (to first approximation) to changes in interest rates, assuming a constant balance sheet position and parallel movements of the yield curves of the relevant assets, is as follows:

(BGN'000)

	100 b.p. parallel increase	100 b.p. parallel decrease	50 b.p. parallel increase in 1 year	50 b.p. parallel decrease in 1 year
As of 31 December 2010	(80,298)	80,298	122,359	95,831
As of 31 December 2009	(174,002)	174,002	223,790	171,197

Currency risk

Currency risk exists where there is a mismatch between the currency structure of assets and that of liabilities. From an accounting point of view, the Bank is exposed to currency risk when conducting transactions in financial instruments denominated in foreign currencies other than the Bank's base currency (euro).

With the introduction of the currency board arrangement in Bulgaria and the fixing of the Bulgarian currency to the euro, the Bank's financial statements, prepared in Bulgarian levs, are affected by movements in the exchange rate of the lev against the currencies other than the euro.

To minimize currency risk, there is a limit to the mismatches between the currency structure of assets and that of liabilities. According to Article 31, paragraph 3 of the Law on the BNB, the total market value of assets in a currency other than the euro, SDR and monetary gold, may not deviate by more than +/-2 per cent from the market value of the liabilities denominated in these currencies.

(BGN'000)

	31 Dec. 2010	31 Dec. 2009
Assets		
Bulgarian lev and euro area currencies	21,548,031	22,152,103
US dollar	73,208	204,416
Japanese yen	156	81
Pound sterling	884	76
SDR	2,861,358	2,687,877
Gold	2,669,424	1,908,991
Other	2,535	2,393
	27,155,596	26,955,937
Liabilities, capital and reserves		
Bulgarian lev and euro area currencies	24,318,033	24,154,135
US dollar	73,283	205,507
Japanese yen	-	-
Pound sterling	-	-
SDR	2,761,743	2,594,172
Other	2,537	2,123
	27,155,596	26,955,937
Net position		
Bulgarian lev and euro area currencies	(2,770,002)	(2,002,032)
US dollar	(75)	(1,091)
Japanese yen	156	81
Pound sterling	884	76
SDR	99,615	93,705
Gold	2,669,424	1,908,991
Other	(2)	270

(e) Using accounting judgements and assumptions

The Governing Council discusses the development, choice, and disclosure of essential accounting policies and measurements, as well as their implementation.

These disclosures supplement the notes to the financial risk management.

The Bank is operating in a complicated global economic and financial environment which also affects the Bulgarian market and could have negative implications for the Bank's performance and risk. Management has already taken measures, and its major priorities in the next few years will still be to keep the Bank's stable liquidity position and the continuous improvement in its evaluation methods, international reserves quality control and management.

Major sources of uncertainty for evaluation:

(i) Determination of fair values

The determination of fair values of financial assets and liabilities for which there is no observable market price requires the use of evaluation techniques described in the accounting policy. For financial instruments that trade infrequently and whose price is not transparent, the fair value is less objective and requires various degrees of judgement depending on liquidity, concentration, market factors' uncertainty, pricing assumptions, and other risks affecting the particular instrument.

(ii) Measurement of financial instruments

The Bank measures the fair value of financial instruments using the following hierarchy of methods:

- Level 1: Quoted market price or a price for closing positions for which there is a reliable market;
- Level 2: Valuation techniques based on observable market information. This category of methods is used to evaluate debt securities for which there is no reliable market.

The fair values of financial assets and liabilities traded in international financial markets for which there is accessible market information are based on market quotes or prices formed at the closing of a market. The use of actual market prices and information reduces the need for managerial judgement and assumptions, and the uncertainty surrounding the determination of fair values. The availability of actual market prices and information varies depending on products and markets and changes because of specific events and the general conditions of financial markets. The Bank determines the fair values of all other financial instruments for which there are no current market quotes by using an valuation technique based on a net present value. The net present value is computed by means of market yield curves and credit spreads, where necessary, for the relevant instrument. The purpose of the valuation techniques is to determine a fair value which reflects the price of the financial instrument on the reporting date.

The Bank has established a control environment for measuring fair values. The fair values of financial instruments are set by an independent risk analysis and control unit. Specific controls include: checking the actual price information; regular reviews of current evaluation models and, if necessary, development, approval and introduction of new evaluation models; follow-up verification by means of analysis and comparison of data from various information sources, *etc*.

- Level 3: Valuation techniques, where inputs on financial assets and liabilities are not based on observable market data.

The table below analyses financial instruments reported at fair value using evaluation models. The data does not include equity instruments reported at acquisition cost (note 14).

(BGN'000)

	Level 1: Market quotes in active markets	Level 2: Evaluation techniques using market data	Total
31 December 2010			
Cash and deposits in foreign currency	5,685,791	-	5,685,791
Gold, instruments in gold and other precious metals	2,708,138	-	2,708,138
Financial assets at fair value through profit or loss	16,717,083	230,908	16,947,991
Total	**25,111,012**	**230,908**	**25,341,920**
31 December 2009			
Cash and deposits in foreign currency	4,144,152	-	4,144,152
Gold, instruments in gold and other precious metals	1,937,132	-	1,937,132
Financial assets at fair value through profit or loss	18,943,370	198,786	19,142,156
Total	**25,024,654**	**198,786**	**25,223,440**

7. Interest Income and Expense

(BGN'000)

	31 Dec. 2010	31 Dec. 2009
Interest income		
- on securities	399,226	623,228
- on deposits	13,759	20,562
- on other	83	607
	413,068	644,397
Interest expense		
- on deposits	14,265	23,009
- on other	2	8,207
	14,267	31,216

Interest expenses paid on government deposits in levs as of 31 December 2010 are BGN 5479 thousand and BGN 3099 thousand in foreign currency. Interest expenses paid on deposits in levs of other government organisations as of 31 December 2010 are BGN 266 thousand and BGN 419 thousand in foreign currencies.

8. Net Gains/(Losses) from Financial Assets and Liabilities at Fair Value Through Profit or Loss

(BGN'000)

	31 Dec. 2010	31 Dec. 2009
Net (losses) from operations in securities	(178,949)	(205,274)
Net gains from operations in foreign currency	594	2,902
Net revaluation gains/(losses) on futures	(4,417)	1,238
Net revaluation gains/(losses) on securities	(94,171)	113,432
Net revaluation (losses)/gains on foreign currency assets and liabilities	4,488	(277)
Net revaluation gains on gold	770,950	374,038
	498,495	286,059

9. Other Operating Revenue

(BGN'000)

	31 Dec. 2010	31 Dec. 2009
Revenue of subsidiaries	30,445	26,007
Income from associated companies	5,387	3,350
Income from sale of coins	926	1,370
Dividend income	12,732	4,554
Other income, net	1,291	571
	50,781	35,852

10. Total Administrative Expenses

(BGN'000)

	31 Dec. 2010	31 Dec. 2009
Personnel costs	29,756	30,538
Administrative expenses	47,461	47,103
Depreciation	26,160	23,392
Other expenses	2,383	4,062
	105,760	105,095

Personnel costs include salaries, social and health insurance costs charged under the local legislation provisions as of 31 December 2010, respectively for the BNB: BGN 22,287 thousand, for the Printing Works of the BNB Corp.: BGN 4787 thousand, and for the Bulgarian

Mint EAD: BGN 2682 thousand. The number of employees of the Bank and its subsidiaries is 1233 in 2010 (2009: 1217), including the BNB staff of 864 in 2010 (2009: 850).

Based on actuarial calculations, the Bank has accrued its compensation liabilities to the personnel on retirement and for unused paid annual leave at BGN 187 thousand (31 December 2009: BGN 359 thousand). The retirement and unused paid annual leave compensation for the Bank's subsidiaries as of 31 December 2010 are BGN 95 thousand (31 December 2009: BGN 100 thousand).

Administrative expenses include also the BNB's currency circulation expenses of BGN 18,803 thousand as of 31 December 2010 (31 December 2009: BGN 25,688 thousand).

11. Cash and Deposits In Foreign Currencies

(BGN'000)

	31 Dec. 2010	31 Dec. 2009
Cash in foreign currencies	108,049	140,501
Current accounts in other banks	1,422,158	1,306,928
Deposits in foreign currencies	4,155,584	2,696,723
	5,685,791	4,144,152

Cash and deposits in foreign currencies with correspondents are disclosed as follows:

(BGN'000)

	31 Dec. 2010	31 Dec. 2009
Euro area residents		
In EUR	3,113,775	1,620,893
In other currencies	19	115,982
	3,113,794	1,736,875
Non-euro area residents		
In EUR	1,116,301	1,021,109
In other currencies	1,455,696	1,386,168
	2,571,997	2,407,277
	5,685,791	4,144,152

12. Gold, Instruments in Gold, and Other Precious Metals

	31 Dec. 2010		31 Dec. 2009	
	'000 troy ounces	BGN'000	'000 troy ounces	BGN'000
Gold bullion in standard form	513	1,067,806	513	763,613
Gold deposits in standard form	770	1,601,618	769	1,145,378
Gold in other form	16	33,832	17	24,571
Other precious metals		4,882		3,570
		2,708,138		1,937,132

Gold in standard form includes gold held with correspondents. This gold earns interest at rates between 0.01 per cent and 0.04 per cent *per* annum. Gold in other form includes commemorative gold coins of BGN 28,611 thousand. Other precious metals include silver commemorative coins of BGN 684 thousand and platinum commemorative coins of BGN 4198 thousand. Gold deposits are held with banks whose liabilities are rated with one of the two highest ratings given by two internationally recognized rating agencies.

13. Financial Assets at Fair Value in the Profit or Loss

(BGN'000)

Securities at fair value through profit or loss	31 Dec. 2010	31 Dec. 2009
Foreign treasury bills, notes and bonds	16,947,991	19,142,156
	16,947,991	19,142,156

Securities comprise both coupon and discount securities denominated in euro. The coupon interest of the EUR-denominated securities reached 3.19 per cent in 2010 (31 December 2009: 3.77 per cent).

The value of securities pledged as collateral on futures transactions amounts to BGN 29,306 thousand as of 31 December 2010 (31 December 2009: BGN 29,496 thousand).

The securities issued by foreign governments and other issuers with credit rating graded by at least two of the three credit rating agencies – S&P, Fitch Ratings, or the corresponding Moody's ratings are disclosed as follows:

(BGN'000)

	Issuer's credit rating	31 Dec. 2010	31 Dec. 2009
Investment graded securities			
	AAA	12,172,026	10,740,711
	AA+	818,745	2,186,051
	AA	460,259	30,560
	AA-	2,970,701	4,736,947
	A+	526,260	1,447,887
		16,947,991	19,142,156

14. Financial Assets Available for Sale

(BGN'000)

	31 Dec. 2010	31 Dec. 2009
Republic of Bulgaria's quota in the IMF	1,452,248	1,364,444
Equity investments in international financial institutions	29,572	28,193
Investments in associates	26,809	23,866
	1,508,629	1,416,503

The Republic of Bulgaria's quota in the IMF is SDR 640,200 thousand. BGN 76,928 thousand of the Republic of Bulgaria's quota in the IMF represents the reserve tranche held with the IMF. The IMF pays remuneration (interest) to those members who have a remunerated reserve tranche position, at an average rate of 0.28 per cent.

Equity investments in international financial institutions include the equity investment in the Bank for International Settlements (BIS), Basle, and 25 per cent of the equity investment in BIS Basle is paid up. As of 31 December 2010 the current value of 10,000 thousand shares in SDR amounts to BGN 22,681 thousand while as of 31 December 2009 it was BGN 26,493 thousand (ref. note 28.1).

The capital subscribed, but not paid-in has an option to be paid in within three months upon a decision of the BIS Board of Governors.

Equity investments in international financial institutions do not exceed 10 per cent of the subscribed share capital of the respective institution.

Investments in international financial institutions also include BNB's equity investment in the ECB. The BNB is a member of the ESCB. In accordance with the 2010 amendments to the regulatory frameworks of the national banks of the countries which have not adopted the euro, these pay effectively 3.75 per cent of the subscribed equity investment. The BNB's capital contribution in the ESCB is EUR 3505 thousand or BGN 6855 thousand.

The Bank holds 100 per cent and 95.6 per cent, respectively, of the capital of Bulgarian Mint EAD and Printing Works of the BNB Corp.

The Bank exercises significant influence on the financial and operational policies of the associated companies listed below, and its investments in domestic companies can be analysed as follows:

Name of institution	Share holding per cent	Principal activity
Associated companies		
BORICA–Bankservice AD	36.11	Interbank card payments
International Bank Institute OOD	42.31	Financial training and research
Central Depository AD	20.00	Depository for corporate securities
Cash Services Company AD	20.00	Handling of sealed parcels of Bulgarian coins and banknotes transferred from the BNB and the banks

In 2010, the shareholders of BANKSERVICE AD and BORICA AD signed an agreement to amalgamate their activities through the merger of the two companies into one new company BORICA-Bankservice AD. As a result of the merger agreement, the BNB exchanged its equity participation in BANKSERVICE AD and BORICA AD (35.85 per cent and 36.24 per cent, respectively) for 384 thousand shares or 36.11 per cent of BORICA-Bankservice AD's capital. The exchange of shares was carried out based on a ratio as determined in relation to the fair value of the new company's shares.

15. Tangible Assets

(BGN'000)

	Land and buildings	Plant and equipment	IT equipment	Office equipment	Other equipment (including motor vehicles)	Tangible assets in progress	Total
As of 1 January 2010	182,569	111,298	27,511	8,901	6,270	3,436	339,985
Additions	14	1,546	25	35	61	4,632	6,313
Disposals	-	(719)	(419)	(92)	(11)	(87)	(1,328)
Transfers	2,334	(419)	3,434	260	26	(5,635)	-
As of 31 December 2010	184,917	111,706	30,551	9,104	6,346	2,346	344,970
Depreciation and impairment loss							
As of 1 January 2010	(11,603)	(50,089)	(16,624)	(3,518)	(4,201)	-	(86,035)
Charge for the period	(5,832)	(8,136)	(4,877)	(959)	(498)	-	(20,302)
On disposals	-	570	417	92	11	-	1,090
As of 31 December 2010	(17,435)	(57,655)	(21,084)	(4,385)	(4,688)	-	(105,247)
Net book value as of 31 December 2010	**167,482**	**54,051**	**9,467**	**4,719**	**1,658**	**2,346**	**239,723**
Net book value as of 31 December 2009	**170,966**	**61,209**	**10,887**	**5,383**	**2,069**	**3,436**	**253,950**

When revaluating non-current tangible assets, the Bank writes off the accrued depreciation at the expense of the gross book value of assets, and their net value is recalculated against their revaluation.

16. Intangible Assets

(BGN'000)

	Software	Other intangible assets	Intangible assets in progress	Total
As of 1 January 2010	36,425	41	346	36,812
Additions	33	3	2,750	2,786
Disposals	(2)	(2)	-	(4)
Transfers	2,148	-	(2148)	-
As of 31 December 2010	38,604	42	948	39,594
Depreciation and impairment loss				
As of 1 January 2010	(22,473)	(37)	-	(22,510)
Charge for the period	(5,855)	(3)	-	(5,858)
On disposals	3	1	-	4
As of 31 December 2010	(28,325)	(39)	-	(28,364)
Net book value as of 31 December 2010	**10,279**	**3**	**948**	**11,230**
Net book value as of 31 December 2009	**13,952**	**4**	**346**	**14,302**

Software includes, as of 31 December 2010, licenses purchased by the BNB to the total amount of BGN 815 thousand (31 December 2009: BGN 1848 thousand), and software products to the amount of BGN 1815 thousand (31 December 2009: BGN 1430 thousand).

17. Other Assets

(BGN'000)

	31 Dec. 2010	31 Dec. 2009
Receivables of subsidiaries held with local banks	32,239	28,323
Commemorative coins for sale	423	390
Inventories	15,559	14,038
Accounts receivable	574	2,477
Deferred charges	1,508	2,300
Other receivables	3,791	214
	54,094	47,742

Balances of subsidiaries held with local banks comprise BGN 28,953 thousand of Printing Works of the BNB Corp. and BGN 3286 thousand of Bulgarian Mint EAD.

18. Currency in Circulation

(BGN'000)

	31 Dec. 2010	31 Dec. 2009
Banknotes in circulation	8,133,861	7,892,082
Coins in circulation	168,567	157,018
	8,302,428	8,049,100

19. Due to Banks and Other Financial Institutions

(BGN'000)

	31 Dec. 2010	31 Dec. 2009
Demand deposits from banks and other financial institutions		
- in BGN	3,848,984	2,233,442
- in foreign currency	1,963,551	2,691,534
	5,812,535	4,924,976

The Bank does not pay interest on demand deposits from banks and other financial institutions. Demand deposits include BGN 5793 million representing the required reserves, which all local banks are required to maintain on accounts with the BNB (31 December 2009: BGN 4896 million).

20. Liabilities to Government Institutions and Other Borrowings

(BGN'000)

	31 Dec. 2010	31 Dec. 2009
Current accounts		
- in BGN	961,228	2,006,422
- in foreign currency	246,838	617,487
Time deposit accounts		
- in BGN	2,469,000	3,186,000
- in foreign currency	2,156,526	1,580,311
	5,833,592	7,390,220

Deposits and current accounts of government institutions with the Bank comprise funds held on behalf of state budget and other government organizations. No interest is payable on the current accounts. Government deposit accounts in euro and in levs earn interest between 0 per cent and 0.71 per cent.

21. Borrowings against Bulgaria's Participation in International Financial Institutions

The borrowings against Bulgaria's participation in the IMF as of 31 December 2010 amount to BGN 1,342,143 thousand: SDR 604,659 thousand (as of 31 December 2009: BGN 1,334,801 thousand or SDR 604,863 thousand).

Borrowings from the IMF are denominated in SDRs. Borrowings related to Bulgaria's quota in the IMF are non-interest bearing with no stated maturity. This note includes account No 1 of the IMF for administrative expenses in levs amounting to BGN 3603 thousand (as of 31 December 2009: BGN 3582 thousand).

The Bank's borrowings from the IMF of the general and special allocation of SDRs amount to SDR 474,586, 534 and SDR 136,289,102, respectively. Repayment will take place on IMF's demand. Under Article XX of IMF Statute, the Bank receives interest on the existing SDRs and pays a fee on its borrowings from the general and special allocation at the same interest rate.

22. Other Liabilities

(BGN'000)

	31 Dec. 2010	31 Dec. 2009
European Commission funds	70,135	117,750
Salaries and social security payable	1,431	1,340
Deferred income	1,690	276
Other liabilities	21,727	17,779
	94,983	137,145

As from 1 January 2007 the Republic of Bulgaria, in its capacity as EU Member State, participates in the funding of EU budget. Pursuant to Article 9 of Council Regulation No 1150/2000, the BNB has opened and services accounts in euro and in levs for the funds of the European Commission. The payment instructions for transactions on these accounts are given by authorized persons of the European Commission.

23. Capital and Reserves

The capital of the Bank is determined in the Law on the BNB and amounts to BGN 20,000 thousand.

Non-monetary asset revaluation reserves comprise the net change in fair value of property, equity investments and other non-monetary assets.

Pursuant to Article 36 the Law on the Bulgarian National Bank, unrealised gains/losses arising from the revaluation of assets and liabilities denominated in foreign currencies or gold are transferred to a special reserve account and form special reserves.

Other reserves include the transfers to reserves of 25 per cent of the annual excess of revenue over expenditure after the allocation to special reserves, as well as reserves upon a decision of the BNB Governing Council.

The 2010 profit distribution in accordance with the profit distribution policy disclosed in note 5 (h) is as follows:

(BGN'000)

	31 Dec. 2010	31 Dec. 2009
Profit for the period	**846,646**	**833,883**
Allocation to special reserve under Article 36 of the Law on the BNB:		
Unrealised (gains) from gold revaluation	(770,950)	(374,038)
Unrealised loss from revaluation of financial assets at fair value through profit or loss	202,308	21,730
Unrealised foreign currency valuation (gains)/losses	(4,488)	277
Other unrealised (gains)/losses	4,417	(1,238)
Result after allocation to special reserve, including:	**277,933**	**480,614**
Allocation to Reserve Fund under Article 8 of LBNB	*66,971*	*118,237*
Result from consolidation and minority interest	*10,048*	*7,667*
Allocation to a special-purpose fund under Article 8 of LBNB	-	-
Planned contribution to the state budget	*200,914*	*354,710*

The planned contribution to the state budget of BGN 200,914 thousand as at 31 December 2010 is a resultant value calculated based on the realised excess of revenue over expenditure in the BNB's unconsolidated Financial Statements of BGN 267,885 thousand. Pursuant to Article 8 of the LBNB, 25 per cent of the annual excess of the Bank's revenue over expenditure amounting to BGN 66,971 thousand is allocated to Reserve Fund and to other of the Bank's reserves, and the remainder of BGN 200,914 thousand is allocated as a planned contribution to the state budget.

24. Minority Interest

Printing Works of the BNB Corp is a joint-stock company with two shareholders: the BNB and the Government represented by the Minister of Finance. The BNB holds 95.6 per cent of the company's capital. In 2005 the Government as represented by the Minister of Finance acquired 4.4 per cent of the company's capital – 3093 shares of BGN 1000 par value each.

25. Monetary Liabilities and Gross International Reserves

(BGN'000)

	31 Dec. 2010	31 Dec. 2009
Gross international reserves		
Cash and deposits in foreign currencies	5,685,791	4,144,152
Monetary gold and other instruments in gold	2,669,424	1,908,991
Security investments	16,947,992	19,142,156
Equity investments and quota in the IMF	76,928	71,835
	25,380,135	25,267,134
Monetary liabilities		
Currency in circulation	8,302,428	8,049,100
Due to banks and other financial institutions	5,811,971	4,897,212
Liabilities to government institutions	5,399,763	7,150,724
Other liabilities	504,528	385,010
	20,018,690	20,482,046
Surplus of gross international foreign exchange reserves over monetary liabilities	5,361,445	4,785,088

Interest receivable and interest payable are carried to the relevant financial assets and liabilities.

Monetary gold and other instruments in gold are revalued on a daily basis based on the euro fixing of the London Bullion Market closing price.

26. Related Party Transactions

Bulgarian Government

International Monetary Fund

All the borrowings of the Government of the Republic of Bulgaria from the IMF are undertaken (on-lent) through the BNB. The Government's borrowings from the IMF are matched by a receivable of the Bank from the Government. For the Bank to eliminate any exchange rate fluctuations, the Government receivables are denominated also in SDR.

Interest on these borrowings is paid by the Government. Accordingly, no interest is charged on the receivables from the Government, nor is any interest expense included on the Government's portion of the IMF borrowings.

As of 31 December 2010, the Republic of Bulgaria has not received funds under IMF agreements.

The Republic of Bulgaria's quota in the IMF is secured by promissory notes jointly signed by the Bank and the Government (ref. note 21).

Government bank accounts

Government budget organizations have current accounts and time deposits with the Bank (ref. note 20).

Fiduciary activities

In accordance with the Law on the BNB and under the terms agreed upon with the Minister of Finance, the BNB acts as an agent in government or government-guaranteed debts. With regard to this role, the BNB performs agent and central depository services related to the administration and management of government securities issued by the Ministry of Finance. The Bank receives commission for providing these services. These government securities are not assets or liabilities of the BNB and are not recognized in its consolidated balance sheet. The Bank is not exposed to any credit risk relating to government securities as it does not guarantee them. As of 31 December 2010, the par value of the government securities held in custody was BGN 3934 million (31 December 2009: BGN 3009 million).

27. Subsidiaries

(%)

Ownership interest	31 Dec. 2010	31 Dec. 2009
Bulgarian Mint EAD	100	100
Printing Works of the BNB Corp (ref. note 24)	95.6	95.6

The net income from subsidiaries for the period comprises net profit of BGN 1229 thousand from the Bulgarian Mint EAD (31 December 2009: BGN 784 thousand) and BGN 3431 thousand from the Printing Works of the BNB Corp (31 December 2009: BGN 3533 thousand).

28. Commitments and Contingencies

(i) Participation in the Bank for International Settlements

The Bank holds 8000 shares of the capital of BIS, Basle, each amounting to SDR 5000. Twenty-five per cent of the equity investment in BIS, Basle is paid up. The capital subscribed but not paid in is with an option to be paid in within three months following a decision of the BIS Board of Governors. The contingent amount as of 31 December 2010 is BGN 68,043 thousand (31 December 2009: BGN 66,921 thousand).

(ii) IMF quota and borrowings

The IMF quota is secured by promissory notes jointly signed by the Bank and the Government of the Republic of Bulgaria amounting to BGN 1,342,143 thousand.

(iii) Capital commitments

As of 31 December 2010 the Bank has committed to BGN 496 thousand to purchase non-current assets (31 December 2009: BGN 1349 thousand).

(iv) Other commitments and liabilities

There are no other outstanding guarantees, letters of credit or commitments to purchase or sell either gold, other precious metals or foreign currency.

29. Post-balance-sheet Events

There are no post-balance-sheet events that would require additional disclosure or adjustments to the Bank's Consolidated Financial Statements.

Major Resolutions of the BNB Governing Council

7 January	As of 22 February 2010 the Bulgarian National Bank put into circulation a silver commemorative coin with partial gold-plating '140 years Bulgarian Exarchate' of BGN 10 nominal value.
21 January	Ordinance on Amendment of BNB Ordinance No 21 of 1998 on the Minimum Required Reserves Maintained with the Bulgarian National Bank by Banks was adopted. Ordinance on Amendment of BNB Ordinance No 20 of 2009 on the Issuance of Approvals under Article 11, paragraph 3 of the Law on Credit Institutions was adopted. The accession of the BNB and participating banks in the TARGET2-BNB national system component to TARGET2 as of 1 February 2010 was approved.
4 February	Ordinance No 14 of 2010 on the Content of the Audit Report for Supervisory Purposes was adopted.
25 February	Ordinance on Amendment of BNB Ordinance No 8 of 2006 on Capital Adequacy of Credit Institutions was adopted. As of 22 April 2010 the Bulgarian National Bank put into circulation a silver commemorative coin 'Belogradchik Rocks' of BGN 10 nominal value, issue 2010.
23 March	Report on BNB Budget Implementation as of 31 December 2009 was approved.
7 April	New Internal Rules for Selection and Work with BNB Scholarship Students, effective as of 15 April 2010, were adopted.
21 April	The BNB Annual Report for 2009 was approved. In accordance with Article 8, paragraph 4 of the Law on the BNB, the BNB Governing Council decided to transfer to the MF BGN 354,710,127.92 or 75 per cent of the excess of Bank revenue over expenditure as of 31 December 2009.
3 June	The BNB Governing Council approved the proposals made by the Board of Directors of BORICA AD and Bankservice AD on the merger of these companies, as well as all related documents. The BNB issued a license for conducting activity as a payment institution to the following companies: • Diners Club Bulgaria AD, Intercard Finance AD and TBI Credit EAD to perform payment services within the meaning of Article 4, item 4 (b) and item 5 of the Law on Payment Services and Payment Systems; • Transcard Financial Services EAD to perform payment services within the meaning of Article 4, item 1, item 2, item 3 (b), item 4 (b) and item 5 of the Law on Payment Services and Payment Systems. The BNB issued a license for carrying out activities as a payment system operator to the newly established company BORICA–Bankservice (in a process of establishment) which is formed as a result of the merger of BORICA AD and Bankservice AD.

1 July	The Governing Council of the BNB issued a license for conducting activity as a payment institution to Easypay AD to perform payment services within the meaning of Article 4, item 1, item 2, item 3, item 5 and item 6 of the Law on Payment Services and Payment Systems. As of 1 September 2010 the Bulgarian National Bank put into circulation a partially gold-plated silver commemorative coin '125 years of Bulgaria's Unification' with a nominal value of BGN 10, issue 2010.
15 July	Ordinance on Amendment of Ordinance No 26 on Financial Institutions was adopted.
14 September	The Governing Council of the BNB approved the Report on Execution of the Budget of the Bulgarian National Bank by 30 June 2010. As of 25 October 2010 the Bulgarian National Bank put into circulation a copper commemorative coin '200 Years since the Birth of Zahariy Zograf' with a nominal value of BGN 2, issue 2010.
6 October	Ordinance on Amendment of Ordinance No 8 of 2006 of the BNB on Capital Adequacy of Credit Institutions was approved. Ordinance on Amendment of Ordinance No 7 of 2006 of the BNB on the Large Exposures of Banks was approved. Ordinance on Amendment of Ordinance No 11 of 2006 of the BNB on Bank Liquidity Management and Supervision was approved. As of 15 December 2010 the Bulgarian National Bank put into circulation a gold commemorative coin 'St. Naum' with a nominal value of BGN 100, issue 2010.
4 November	The Report of the Bulgarian National Bank for the January – June 2010 period was approved. The Budget of the Bulgarian National Bank for 2011 was approved.
21 December	Ordinance No 4 of the BNB on Requirements to Remunerations in Banks was approved. Ordinance on Amendment of Ordinance No 8 of 2006 of the BNB on Capital Adequacy of Credit Institutions was approved. Ordinance on Amendment of Ordinance No 12 of 2007 of the BNB on the Supervision on a Consolidated Basis was approved. Ordinance on Amendment of Ordinance No 16 of 2009 of the BNB on Payment Institutions and Payment System Operators Licensing was approved.