



**Bulgarian National Bank**

# **ANNUAL REPORT • 2012**



**BANQUE NATIONALE DE BULGARIE**





**Bulgarian National Bank**

---

**ANNUAL REPORT • 2012**

Published by the Bulgarian National Bank  
1, Knyaz Alexander I Square, 1000 Sofia  
Tel.: (+359 2) 9145 1351, 9145 1209, 9145 1231  
Fax: (+359 2) 980 2425, 980 6493  
Printed in the BNB Printing Centre

Website: [www.bnb.bg](http://www.bnb.bg)

© Bulgarian National Bank, 2013

The BNB Annual Report for 2012 employs data published prior to 1 April 2013.

Materials and information in the BNB 2012 Annual Report  
may be quoted or reproduced without further permission.  
Due acknowledgment is requested.

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

ISSN 1313-1494

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 2012 Annual Report.

A handwritten signature in black ink, appearing to read 'Ivan Iskrov', written over a horizontal line.

Ivan Iskrov  
Governor  
of the Bulgarian National Bank

BNB Governing Council



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

## Governing Council

---

**Ivan Iskrov**

Governor

**Dimitar Kostov**

Deputy Governor

Banking Department

**Rumen Simeonov**

Deputy Governor

Banking Supervision Department

**Kalin Hristov**

Deputy Governor

Issue Department

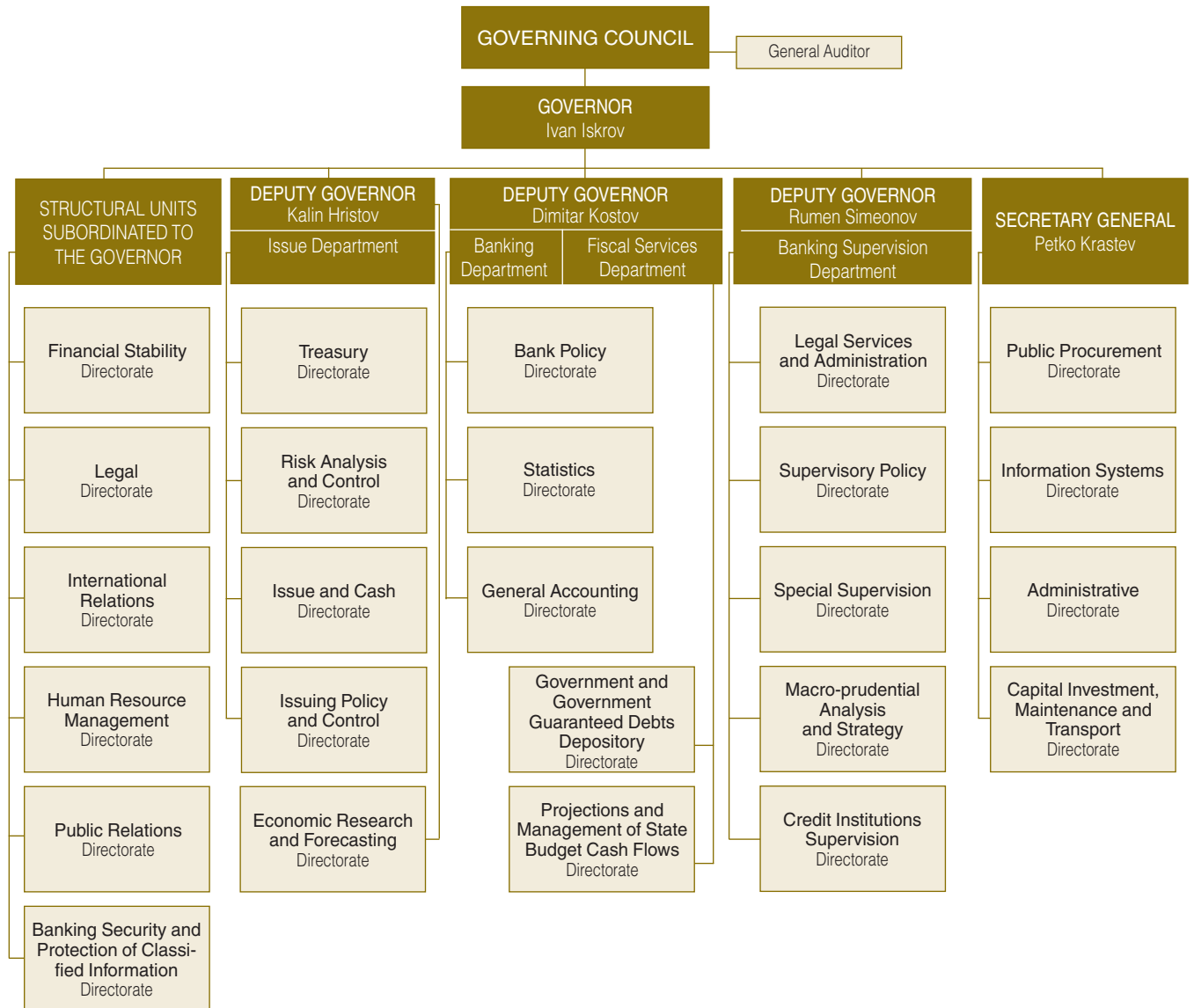
**Penka Kratunova**

**Boryana Pencheva\***

**Statty Stattev**

\* As of 2 December 2012 Boryana Pencheva is a member of the BNB Governing Council. Until 1 December 2012 Oleg Nedyalkov was a member of the BNB Governing Council.

# Organisational Structure of the BNB



## Contents

Summary	9
I. Economic Development in 2012	13
1. The External Environment	13
2. The Bulgarian Economy	16
II. Gross International Reserves	27
1. Gross International Reserve Amount and Structure	27
2. Gross International Reserve Risk and Yield	29
III. Payment Systems	35
1. Payment Systems and Securities Settlement Systems	36
2. Payment System Oversight	38
IV. Bank Reserves at the BNB	40
V. Cash in Circulation	42
VI. Maintaining Banking System Stability and Protecting Depositor Interests	46
1. State of the Banking System	46
2. Assessment of the Performance of Financial Institutions Registered under Article 3, Paragraph 2 of the Law on Credit Institutions	52
3. Banking Supervision	54
VII. The Central Credit Register	58
VIII. The Fiscal Agent and State Depository Function	60
IX. Participation in the ESCB and in EU Institutions' Activities	65
X. International Issues	70
XI. Statistics	72
XII. Research	74
XIII. Information Systems	75
XIV. Human Resource Management	76
XV. Facilities Management	78
XVI. BNB Internal Audit	79
XVII. BNB Budget Implementation	81
1. Operating Expenditure	81
2. Investment Programme	82
XVIII. Bulgarian National Bank Consolidated Financial Statements for the Year Ended 31 December 2012	85
Major Resolutions of the BNB Governing Council in 2012	119
Appendix (CD)	



## Abbreviations

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 Organisation for Payments Initiated by Cards
CM	Council of Ministers
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
EMU	Economic and Monetary Union
ESCB	European System of Central Banks
EU	European Union
FOB	Free on Board
FSC	Financial Supervision Commission
GDP	Gross Domestic Product
HICP	Harmonized Index of Consumer Prices
IMF	International Monetary Fund
MF	Ministry of Finance
NSI	National Statistical Institute
OECD	Organisation for Economic Cooperation and Development
RINGS	Real-time Interbank Gross Settlement System
SDR	Special Drawing Rights
VAT	Value Added Tax
ZUNK	Bulgarian abbreviation of the Law on Settlement of Non-performing Credits Negotiated prior to 31 December 1990 (LSNC)

## Summary

The euro area financial crisis deepened further, impacting European and world growth. Real GDP growth in the euro area dropped 0.6 per cent on 2011. Continuing uncertainty in early 2012 over Greek debt and political developments, Spanish banking vulnerability, Cypriot financial problems, poor credit conditions and deteriorating economic prospects and the uncertainty around the fiscal positions and the sovereign debt of some euro area countries contributed most to the declining economic activity. Nine euro area member states reported real GDP falls, including Italy and Spain, down 2.4 and 1.4 per cent. Real GDP growth in Germany moderated to 0.7 from 3 per cent in 2011 and in France hovered around zero from 1.7 per cent growth in 2011. Estonia and Slovakia led euro area countries in GDP growth at 3.2 and 2 per cent. The US economy continued recovering, real GDP growth rising to 2.2 from 1.8 per cent in 2011. Chinese economic growth moderated further to 7.8 from 9.5 per cent in 2011.

The year saw significant price fluctuations on international financial markets as global interest rates dropped. Demand for low risk assets rose due to uncertainty over euro area debt crises and worsened prospects for the euro area and global economies. The second financial assistance package for Greece, which eased funding conditions and restructured sovereign debt, and financial assistance to recapitalise the Spanish banking sector, were among the main steps to counter widening euro area government bond spreads. Entry into force of the permanent European Stability Mechanism and the ECB's new outright monetary transactions programme were important steps to ease EU financial market tensions. ECB moves to cut rates on main refinancing operations, reduce minimum reserve requirement, and extend non-standard monetary policy measures calmed euro area financial markets. The US Federal Reserve left the federal funds rate unchanged in the 0.00 to 0.25 per cent range and took new non-conventional monetary policy measures to bolster recovery.

Economic growth in Bulgaria began to slow amid the unfavourable international situation and in particular the euro area recession. Real GDP went up 0.8 per cent from 1.8 per cent in 2011. Falling demand from Bulgaria's main trading partner, the euro area, hit goods and service exports. Exporters nevertheless diverted some business to developing countries outside the EU, managing to contain the exports fall to only 0.4 per cent in real terms. Recovering domestic demand, and especially positive fixed asset capital formation and inventory growth, partly offset falling exports. Reflecting the performance of individual GDP components, domestic demand contributed 3.5 percentage points, net exports detracting 2.7 percentage points. The balance of payments trade balance was in deficit by EUR 3622.1 million due to import growth outstripping low nominal export growth. The positive contribution of capital account flows put the cumulative balance of payments, including the current and capital accounts, in surplus by EUR 8.6 million. The current account balance was in deficit by EUR 528.2 million. Compared with 2011, the year saw the significant foreign direct investment inflow of EUR 1478.3 million (3.7 per cent of GDP), boosting investment into Bulgaria and investment goods imports.

Moderating economic activity had a negative effect on the labour market, employment falling 4.3 per cent from 3.4 per cent in 2011. Unemployment increased slightly to 12.3 per cent on average for 2012 from 11.3 per cent in 2011. Labour cost optimisation aligned with falling value added pushed labour productivity up 5.4 per cent, as it had in 2011.

Inflation remained relatively low at 2.4 per cent on average from 3.4 per cent in 2011. The dynamics of international prices continued to be among the major factors behind

consumer price inflation in Bulgaria until the second half of 2012, when the administered price of household electricity overtook them.

The year saw a gradual decrease in monetary aggregate growth rates. Broad money went up 8.5 per cent from 12.2 in 2011, largely due to M1 and quasi-money dynamics. Following rising lending in the first half year, the growth of non-government sector bank claims moderated to 2.8 per cent on an annual basis. Claims from non-financial corporations grew 4.7 per cent, while those from households fell 1 per cent, including overdraft and consumer credit drops of 4.2 and 2.3 per cent. Housing loans continued growing by 0.8 per cent. Ample banking system liquidity continued affecting inter-bank money market trading. As a result, the downward trend in interest continued, especially in long term rates.

Fiscal consolidation continued, the consolidated fiscal programme cash balance in deficit by BGN 357.4 million (0.5 per cent of GDP). Total government revenue and grants rose 9.8 per cent on 2011. Tax revenue increased 4.5 per cent, value added tax and excise duty contributing most with 2.6 and 0.9 percentage points as collectability improved. Consolidated fiscal programme spending, including the EU budget contribution, grew 3.6 per cent on 2011. Capital and social expenditure, which contributed most to spending in the first half year, rose 19.6 and 4.8 per cent respectively. At the year's end, the fiscal reserve rose BGN 1082.2 million to BGN 6081 million. On 22 June, the EU Council's Economic and Financial Affairs Council closed the excessive deficit procedure on Bulgaria following EC recommendation.

Bulgarian National Bank policy takes into account the global and national economies. The Bank pursues its primary goal of maintaining price stability through national currency stability by adhering to the Law on the Bulgarian National Bank and applying its undiluted potential and capabilities energetically. The Bank invests gross international reserves prudently in line with prudent investment principles and practices; regulates and supervises banks to ensure banking stability and protect depositors; assists the establishment and operation of efficient payment systems, regulating operators, payment and electronic money institutions; produces, circulates, and scraps cash; acts as official fiscal agent and depository. It participates in the European System of Central Banks (ESCB) and other EU bodies.

At the end of 2012, the market value of gross international reserves was EUR 15,552 million: EUR 2204 million more than a year earlier. Net income from international reserve management over the year was EUR 243.69 million or 1.92 per cent net yield.

Stark tension and instability on international financial markets, particularly over some euro area countries' government securities prices, cut yield on most assets into which the BNB invested close to zero, and even to negative at the short end of the curve. The Bank introduced new changes to credit risk management, including tightening existing constraints and limits to curb risk further and use available investment opportunities effectively. The ban on purchases of debt instruments issued or guaranteed by countries with worsened fiscal positions and high levels of public debts remained in force. Funds invested into assets with the highest rating averaged 72 per cent over the year.

The worsened international environment and slow economic recovery had a negative effect on bank intermediacy. Uncertainty about economic development prospects resulted in weaker business demand for credit. Households continued saving, boosting deposits in the banking system and preferred to repay loans rather than get new ones. Higher deposit than credit growth helped maintain high banking system liquidity. There were some changes in the asset structure at banking system and individual bank levels. The share of cash and financial instruments (securities) increased, that of high yield assets decreasing. Nevertheless, intensive credit risk management boosted asset yield and by 31 December audited banking system profit came to BGN 525 million: up BGN 51 million (10.8 per cent) on 2011. ROA rose slightly from 0.66 from 0.63 per cent in 2011, ROE rising more to 5.29 from 4.93 per cent in 2011.

The amount and quality of the capital position reflected banks' actions to improve credit portfolio risk management and bolster capital. Average capital indicators remained above EU values. Total capital adequacy accounted for 16.64 per cent by the end of December from 17.55 per cent by the end of 2011. A capital surplus (the excess of capital over regulatory minima) of BGN 2.6 billion at the end of 2012 provided extra resource for covering classified exposures of worsened quality. Tier one capital adequacy ratio fell from 15.73 to 15.13 per cent by the end of 2012. This was because capital requirements rose faster than tier one growth as part of the BNB's national discretionary policy. This obliges banks to make credit risk specific provisions that automatically reduce their capital. Without this policy, system capital adequacy and tier one capital adequacy would have been around 20 and 17 per cent or some 3 and 2 percentage points higher respectively.

While unfavourable economic conditions hit banks' credit portfolio quality, the growing range of credit risk management instruments reduced the rate of asset impairment. By the end of December 2012 the share of exposures past due over 90 days in gross loans (excluding those to credit institutions) reached 16.6 per cent, their net value reaching 10.6 per cent.

National payment systems functioned efficiently and provided payment flow continuity. The BNB's RINGS real time interbank gross settlement system processed most payments (88.2 per cent), greatly cutting payment system risks. RINGS processed 1,041,068 payments for BGN 870,785 million: up 27.7 per cent in value and down 1.5 per cent in number on 2011. Express euro transfers through the TARGET2-BNB national system component continued rising to 136,783 payments for EUR 312,515 million, up 34 and 9.3 per cent on 2011. The BNB supervises payment systems to limit system risk and improve reliability and efficiency.

By the end of 2012, the nominal value of cash in circulation was BGN 9549.9 million, up BGN 821.2 million (9.41 per cent) on 2011. Banknotes accounted for 97.96 per cent of the total value of cash in circulation. By the end of the year over half the banknotes in circulation (54.29 per cent) were BGN 20s and 10s, but over the year the share of BGN 100s and 50s rose 0.25 and 0.63 percentage points. The mean circulating banknote was worth BGN 27.27. The share of circulating coins reached 1.98 per cent of the total value of cash in circulation. By the close of the year there were 1495.3 million circulating coins: up 125.7 million on 2011. The mean circulating coin was worth BGN 0.13. The Bank pursues a comprehensive policy to prevent the spread of non-genuine Bulgarian coins and banknotes. At the end of June, the share of retained non-genuine Bulgarian banknotes was insignificant at 0.0006 per cent of all banknotes in circulation. The relative share of retained non-genuine coins *vis-à-vis* all circulating coins was also very low at 0.00005 per cent.

Under contracts negotiated with the Ministry of Finance to market conditions and prices, the BNB advises the Ministry regularly of budget entities' domestic banks account balances and acts as official debt agent servicing government bond trading. In 2012, 26 government securities auctions offered issues worth BGN 1322.6 million nominal value. Average primary dealers' bids increased to 91 per auction from 82 last year, reflecting greater investor demand. Initial government bond acquisitions and repayment on maturing issues registered in the ESROT system turned over BGN 2016 million, up 7.1 per cent on 2011.

The year saw important decisions on developing the European Union's legislative framework for stability, better coordination of economic policy objectives and instruments, and more favourable growth conditions. There was agreement to expand the European Stability Mechanism toolkit. In February, euro area member states signed the Treaty Establishing the European Stability Mechanism. The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union followed in March. It enhances economic policy coordination and better euro area governance. In the second half year debate centred on the proposed framework for financial institu-



tion recovery and resolution and the establishment of a single supervisory mechanism in the euro area. A lively debate began on deeper integration between member states. Participating in committees and working groups of the European System of Central Banks, the European Commission, the Council of the European Union, the European Systemic Risk Board, the European Banking Authority, and the National Council for European Affairs, the BNB contributed to formulating Bulgarian standpoints on important issues in key economic governance areas and the financial sector. The Bank supports amendments to the regulatory and institutional framework of the euro area in principle; restoring macroeconomic stability there is of primary importance to all EU members. At the same time, these amendments ought not to undermine the functioning of the single market.

# I. Economic Development in 2012

## 1. The External Environment

In 2012 global economic growth slowed down with large regional deviations. It rose in the USA and Japan, abated in China, and dipped into recession in the euro area. Global industrial output rose slightly by 1.8 per cent on 2011, Asian emerging economies contributing most.<sup>1</sup> Euro area output declined significantly. World trade rose a mere 2.3 per cent.

### Major Macroeconomic Indicators (average annual basis)

(per cent)

	Growth			Inflation			Unemployment		
	2010	2011	2012	2010	2011	2012	2010	2011	2012
EU-27	2.1	1.6	-0.3	2.1	3.1	2.6	9.7	9.7	10.5
Euro Area 17	2.0	1.4	-0.6	1.6	2.7	2.5	10.1	10.2	11.4
EU-7	2.3	3.2	0.9	3.2	3.7	3.5	9.4	9.2	9.5
EU-3	2.4	1.4	0.3	3.1	3.9	2.6	7.9	8.0	7.9
United States	2.4	1.8	2.2	1.6	3.1	2.1	9.6	8.9	8.1
Japan	4.7	-0.6	2.0	-0.7	-0.3	0.0	5.1	4.6	4.2
China	10.6	9.5	7.8	3.3	5.5	2.6	4.1	4.0	4.1

**Notes:** The EU7 are countries joining since 2004 less those now in the euro area. The EU3 are the United Kingdom, Sweden, and Denmark. EU-7 and EU-3 indicators are calculated by weighing time series by country weights in group GDP for growth, in group labour force for unemployment, and the weights of the EU-27 in HICP, calculated by Eurostat for inflation.

**Sources:** Eurostat, Bureau of Labor Statistics, Bureau of Economic Analysis, Statistics Bureau of Japan, the National Bureau of Statistics of China, BNB computations.

Real GDP data for 2012 put the euro area in recession. Continued uncertainties in early 2012 over the Greek debt and political crisis, vulnerable Spanish banks and Cypriot finances, poor credit conditions, and some euro area countries' poor fiscal and sovereign debt prospects dampened economic activity. Gross capital formation and to some extent private demand detracted most from overall real GDP in 2012, while net exports added to it. Germany again contributed most to euro area growth at 0.7 per cent from 3 per cent in 2011, while Italy led declines by contracting 2.4 per cent from 0.4 per cent growth in 2011. Spain's real GDP fell 1.4 per cent from 0.4 per cent growth in 2011. French growth hovered at zero from 1.7 per cent in 2011. Estonia (3.2 per cent) and Slovakia (2 per cent) topped growth. Unfavourable euro area economic activity developments pushed up unemployment to 11.4 per cent on 10.2 per cent in 2011.

The US economy continued recovering in 2012, real growth rising to 2.2 per cent, mostly due to private consumption and business investment demand. The first three quarters' upward growth trend switched by the year's close amid concerns about the automatic launch of sizeable budget cuts in early 2013 and the end of recent years' generous tax reliefs. October hurricanes caused enormous damage to the US economy, hitting economic activity recovery, as did debt crises in some euro area countries. While falling, unemployment remained at the relatively high level of 8.1 per cent.

In 2012 world average annual inflation fell across developed and developing economies to 3.6 per cent from 4.5 per cent in 2011.<sup>2</sup> This reflected lower growth in commodity prices and moderating economic growth. Euro area inflation was 2.5 per cent against 2.7 per cent in 2011, core inflation (excluding food, energy, alcohol, and

<sup>1</sup> CPB Netherlands Bureau for Economic Policy Analysis data of 12 April 2013.

<sup>2</sup> International Monetary Fund data of 7 March 2013.

tobacco) rising slightly to 1.5 per cent from 1.4 per cent in 2011.<sup>3</sup> US inflation fell on an average annual basis from 3.1 per cent in 2011 to 2.1 per cent, core inflation (excluding food and energy) rising from 1.7 per cent in 2011 to 2.1 per cent.<sup>4</sup>

Brent crude oil followed an upward trend from USD 111.2 a barrel in January to USD 124.9 at the end of the first quarter. The second quarter saw a dramatic fall to USD 95.6 a barrel in June as markets watched the Greek crisis. In the second half of 2012 prices stabilised close to those of the early year, reaching USD 109.7 a barrel in December. On an average annual basis, Brent crude oil posted an insignificant rise on 2011 in USD, growing 9.2 per cent in EUR. World prices of major goods groups declined on 2011.<sup>5</sup> Food fell 6.7 per cent overall, a first half decline switching in July and August as weather hit cereal yields. This boosted the overall food index during the summer, followed by monthly falls. Metals dropped 8.9 per cent on 2011, nickel, tin, and aluminium leading declines at 23.4, 19, and 15.7 per cent.

In 2012 world financial markets saw significant price fluctuations as global interest rates fell. Demand for low risk assets rose amid euro area debt crises and worsened euro area and world prospects. Measures to address debt crisis such as the second Greek package on easing funding conditions and sovereign debt restructuring, and financial assistance to recapitalise Spanish banks curbed widening euro area sovereign bond spreads. Launch of the standing European Stability Mechanism (ESM), the ECB's outright monetary transactions programme (OMT), and the EUR 120 billion growth and employment package eased EU financial market tensions. ECB moves to cut main refinancing operation (MRO) rates reduced minimum reserve requirement rates and continuing non-standard monetary policy measures aimed to stabilise euro area financial markets.

US government bond yields moved within comparatively broad ranges before ending the year at levels close to those at its start. At the end of the first quarter the entire yield curve rose strongly as optimistic macroeconomic data cut investor appetite for low risk assets. Over the second quarter yields declined as world economic outlook worsened and euro area tensions intensified. This continued into the third quarter at lower rates. In the fourth quarter yields rose uncertainly amid favourable data on the US economy and the December launch of new FOMC non-conventional monetary policy measures.

The general market environment drove leading central banks' monetary policies. On 11 July 2012 the ECB cut main refinancing operation, deposit facility, and marginal lending facility rates by 25 basis points to 0.75, 0, and 1.5 per cent, leaving them unchanged until the end of the year. The ECB's December 2011 and February 2012 three-year operations greatly improved euro area bank liquidity. The 21 December 2011 operation allotted EUR 489.2 billion, while the 29 February 2012 operation allotted EUR 529.5 billion. With these two operations, new refinancing came to approximately EUR 500 billion and euro area banking system excess liquidity reached EUR 800 billion.<sup>6</sup> The ECB additionally boosted liquidity by halving its minimum reserve rate to 1 per cent on 18 January 2012 and expanding the set of instruments accepted as collateral in ECB refinancing operations (including credit claims and debt instruments denominated in US dollars, British pounds and Japanese yens).<sup>7</sup> These measures boosted the ECB balance sheet figure to EUR 3.018 trillion at the year's close, up 10.3 per cent on 2011. In September the ECB announced a new outright monetary transactions (OMT) programme to narrow sovereign bond spreads in euro area states with significant deviations. The programme was for countries receiving European Financial Stability Facility and European Stability Mechanism support, on whose primary bond markets the EFSF and ESM may intervene.

<sup>3</sup> Measured by the Harmonised Index of Consumer Prices (HICP).

<sup>4</sup> Measured by the Consumer Price Index (CPI).

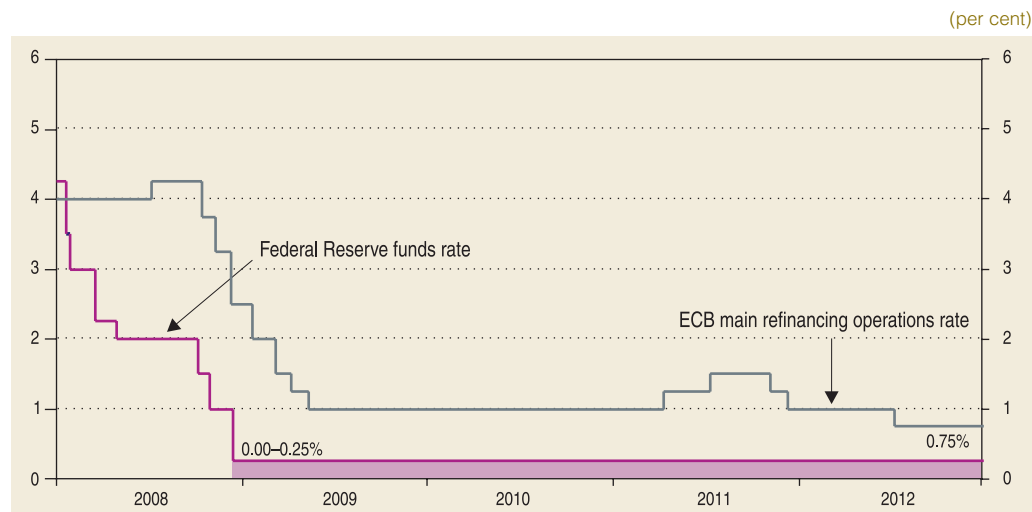
<sup>5</sup> Based on ECB data of 7 March 2013.

<sup>6</sup> Excess liquidity is the difference between the outstanding amount of ECB refinancing operations and the two covered bond purchase programmes, and the amount of required reserves and autonomous factors.

<sup>7</sup> Eurosystem central banks in Austria, Cyprus, France, Italy, Ireland, Portugal and Spain apply this measure.

Increased banking system liquidity greatly curbed euro area interbank money market deposit rates, most pronounced in long-term maturities. The yield curve flattened and EONIA euro area overnight interest fell 50 basis points to 0.13 per cent on the end of 2011. EURIBOR one-month interest fell 92 basis points to 0.11 per cent, that for maturities over three months falling some 135 basis points on average.

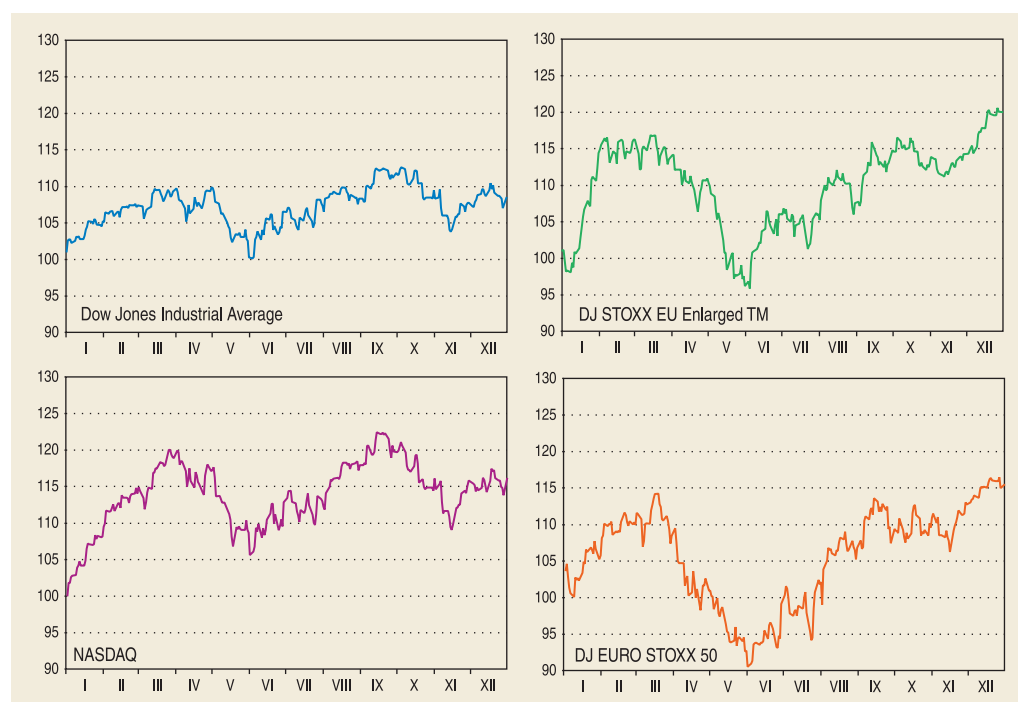
### Federal Reserve System and ECB Interest Rates



Sources: ECB, Federal Reserve System.

In 2012 the US Federal Reserve left reference interest unchanged at 0 to 0.25 per cent. At its June meeting, the FOMC decided to continue extending Federal Reserve assets' average maturities (Operation Twist) to the close of 2012, rather than stopping in June as originally intended. At its September meeting, the FOMC launched a new Federal Reserve asset purchase programme to support economic recovery. At its last meeting for the year on 11 and 12 December, the FOMC launched a new US bond purchasing programme to follow Operation Twist. This will see USD 45 billion of four to 30 year bonds purchased monthly.

### Major Stock Market Indices in 2012



Note: US dollars; December 2011 = 100.



In 2012 European and US stock markets rose on the close of 2011. After initial rises, the Greek crisis hit indices both in Europe and the USA. Market optimism recovered in summer before Fiscal Cliff concerns curbed them in the fourth quarter. In December the US Dow Jones and NASDAQ rose 8.7 and 15.4 per cent on a year earlier, the European EURO STOXX 50 and EURO STOXX EU Enlarged TM rising 15.1 and 17.8 per cent.

## 2. The Bulgarian Economy

Bulgarian economic activity began slowing amid an unfavourable international environment and the euro area entering recession. Real GDP growth fell to 0.8 per cent from 1.8 per cent in 2011. The main reason was reduced external demand for Bulgarian goods and services by major EU trading partners. The export decline was limited, exporters redirecting trade to developing non-EU economies to offset the euro area recession. Exports fell 0.4 per cent in real terms from 12.3 per cent growth in 2011. Domestic demand made the main contribution to real GDP growth as household demand continued recovering and the recent drop in fixed asset investment ended. The economic situation worsening in the second half of 2012 curbed domestic demand slightly in the last quarter. Goods and services imports continued recovering driven by domestic demand and rising inventories. Decreasing exports, with their high import component, curbed import growth to 3.7 per cent in real terms from 8.8 per cent in 2011.

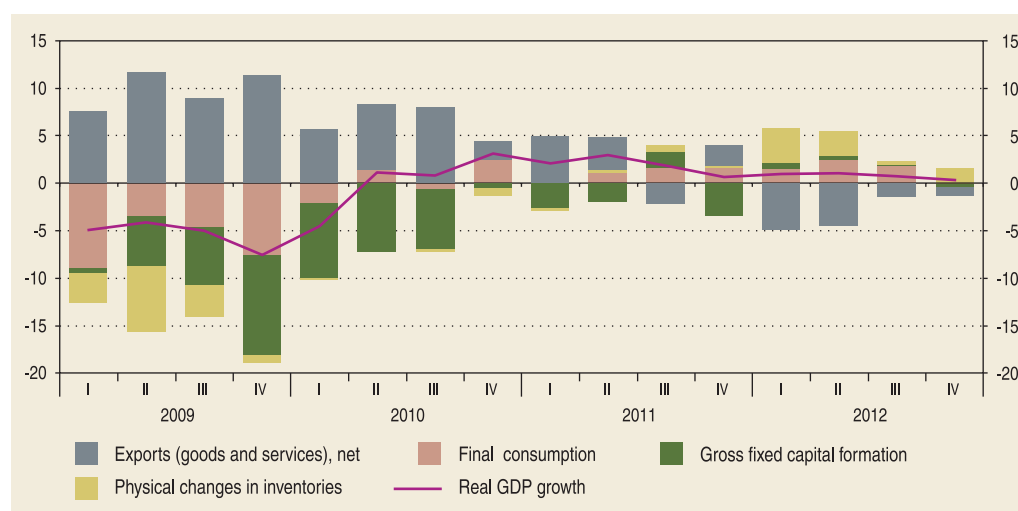
### Real GDP Growth Rate and Contribution by Component of Final Consumption (on the corresponding period of previous year, non-seasonally adjusted data)

	2011		2012	
	Change (per cent)	Contribution, percentage points	Change (per cent)	Contribution, percentage points
GDP	1.8	1.8	0.8	0.8
Final consumption	1.5	1.2	1.8	1.4
Household consumption	1.5	1.0	2.5	1.6
NPISH consumption	-7.4	0.0	14.8	0.1
Final consumption expenditure of the general government sector	3.0	0.2	-2.3	-0.2
Collective consumption	0.3	0.0	-0.4	0.0
Gross fixed capital formation	-6.5	-1.5	0.8	0.2
Physical changes in inventories	-	0.3	-	1.9
Exports (goods and services), net	-	1.8	-	-2.7
Exports (goods and services)	12.3	7.1	-0.4	-0.2
Imports (goods and services)	8.8	-5.2	3.7	-2.5

Sources: NSI, BNB.

## Real GDP Growth Rate and Contribution by Component of Final Consumption

(per cent, percentage points on corresponding quarter of previous year)



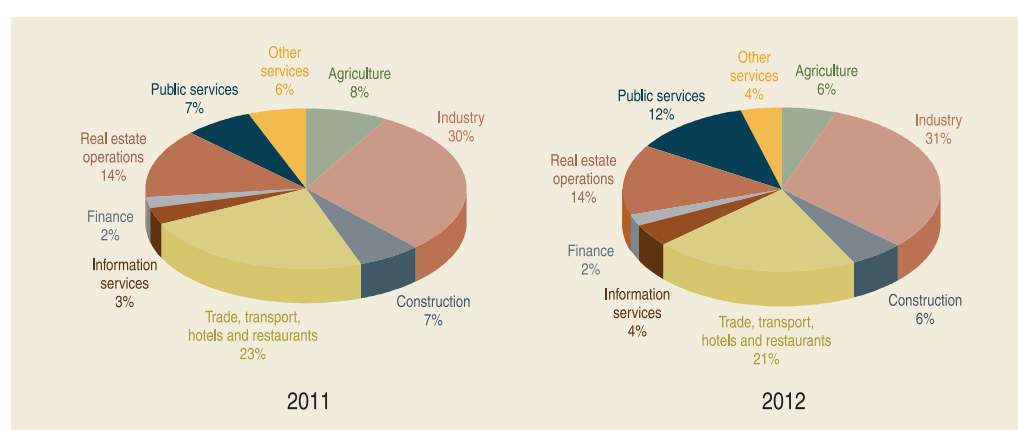
Sources: NSI, BNB.

A household consumption revival starting in 2011 continued over the review year, contributing 1.6 percentage points to real GDP growth. In the second half year rising unemployment and worsened economic situation curbed consumer expenditure growth. Government fiscal consolidation cut government consumption, resulting in an annual final consumption decline.

Recovering inventories made a significant 1.9 percentage point contribution to GDP growth. Fixed asset investment (gross fixed capital formation) showed signs of recovery, rising 0.8 per cent after three consecutive years of declines. Low investment activity reflected business caution about external and internal developments. The increase in government capital expenditure over the year played an essential role in reversing the downward trend in total fixed capital investment.

NSI preliminary data for 2012 show nominal fixed asset spending dropping further in most sectors, services and industry recording 2.4 and 1.2 per cent declines.

## Expenditure on Acquisition of Fixed Assets by Economic Activity



Note: Preliminary data for 2012.

Sources: NSI, BNB.

Gross value added growth slowed to 0.3 from 2.1 per cent in 2011. Industry, trade, transport, hotels and restaurants made positive contributions. Though exports declined, value added in industry increased 1.9 per cent, enhanced domestic demand and improved efficiency contributing thereto. Construction and most services

sub-sectors reported lower activity. Civil engineering output failed to offset a building decrease, value added in construction contracting 3.5 per cent. Sectors relatively less affected by the global crisis (information services, finance and insurance, professional and scientific activities, administrative and support services) also recorded gross value added declines.

### Gross Value Added Change in Real Terms and Contribution by Industry

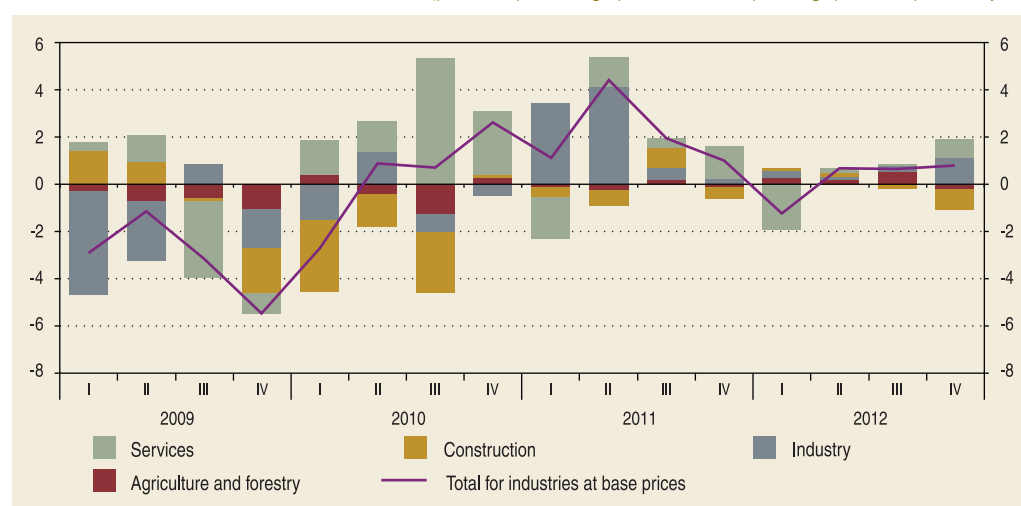
	2011		2012	
	Change (per cent)	Contribution, percentage points	Change (per cent)	Contribution, percentage points
Gross value added	2.1	2.1	0.3	0.3
Agriculture and forestry	-1.1	-0.1	3.5	0.2
Industry*	5.8	1.7	0.8	0.2
Services	0.7	0.4	-0.2	-0.1

\* Industry and construction.

Sources: NSI, BNB.

### Gross Value Added Change in Real Terms and Contribution by Industry

(per cent, percentage points on corresponding quarter of previous year)



Sources: NSI, BNB.

The labour market continued deteriorating in 2012. Employment continued declining at 4.3 per cent from 3.4 per cent in 2011. Services employment had the major contribution, its rate falling 3.2 per cent from 2.7 in 2011. Industry recorded a 5 per cent drop, as in 2011. Agriculture led drops at 6.6 per cent from 3 in 2011.

The NSI Labour Force Survey showed a slight unemployment increase to 12.3 per cent from 11.3 per cent in 2011. Some of the increase reflects this year's inclusion of active job seekers who had been economically inactive in previous years. Measured by the number of Employment Agency registrations, unemployment also increased slightly to 11.1 per cent on average from 10.1 in 2011.

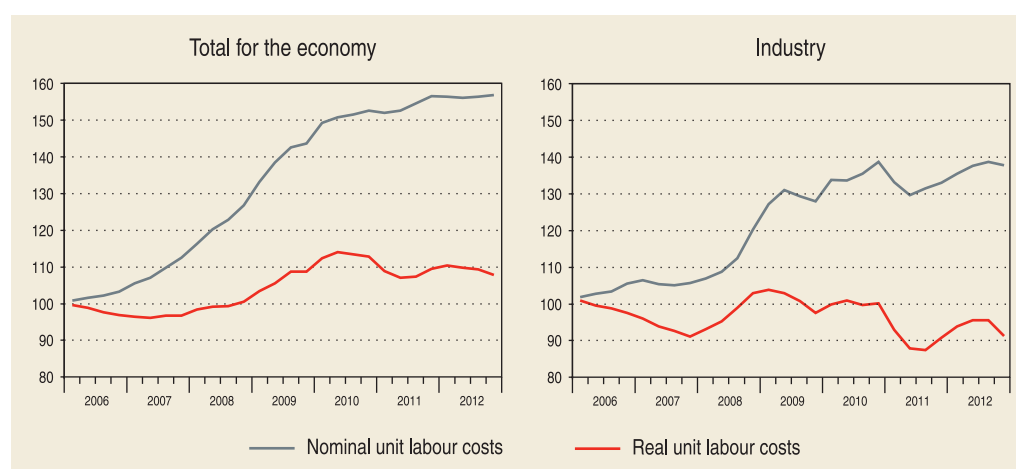
The Labour Force Survey increase in unemployment showed rising long-term (over a year) unemployment, unlike 2011 when it showed mainly rising short-term unemployment (up to a year). The share of long-term unemployment fell slightly to 55 per cent of all unemployed. The Survey shows that the main reasons for higher unemployment were a falling number of temporary and seasonal jobs and redundancies. Despite continuing low demand for labour and limited job creation, the proactive labour market policy directed at maintaining temporary employment is likely to have encouraged working age people to participate in the labour market: the number of discouraged people declined to 227,000. The slight labour supply increase and the overall fall in working age persons boosted the economic activity ratio for 15 to 64s to 67.1 per cent in 2012 from 66.1 in 2011.

National account figures show nominal wage growth reflecting continuing employer cost optimisation. Growth in compensation of employees fell significantly to 1 per cent from 5.1 per cent in 2011, down 1.4 per cent in real terms<sup>8</sup> after a 1.7 per cent rise in 2011. The continuing employment decline and slower employee pay growth slowed nominal labour cost growth to 5.6 from 8.6 per cent in 2011. National accounts show lower paid construction and industrial sub-sector employee pay growth outpacing the average. Major services sectors like trade, transport, hotels and restaurants, and finance and insurance saw nominal employee remuneration fall 1.5 and 2.9 per cent from 12.7 and 3.8 per cent growth in 2011.

Labour cost optimisation consistent with value added changes contributed to the ongoing labour productivity improvement<sup>9</sup> which grew at the same rate as in 2011 (5.4 per cent). Industry, trade, transport, hotels and restaurants (5.6 and 5.1 per cent growth) contributed most.

### Unit Labour Costs

(moving average, 2005 = 100)



Sources: NSI, BNB.

Nominal unit labour costs continued slowing to 0.2 per cent from 3 per cent in 2011 and 5.6 per cent in 2010. This was mainly down to the continued increase in labour productivity and slower growth in compensation *per* employee. Nominal unit labour costs declined in services sub-sectors like trade, transport, hotels and restaurants, financial and insurance activities, and real estate operations. Real unit labour costs falls continued to slow to 2 per cent from 1.8 per cent in 2011.

Inflation remained relatively low, the Harmonised Index of Consumer Prices (HICP) rising 2.8 per cent on 2 per cent in 2011 and average annual inflation at 2.4 per cent from 3.4 in 2011.<sup>10</sup> Major inflation drivers were rising global fuel and food prices translating relatively rapidly to end users, and the significant mid-year rise in administered household electric bills.

The worsened environment and external shocks to business, such as major commodity price increases, drove business pricing and spending. Free production capacity and weak demand made business limit labour and investment costs and match prices to the specifics of individual markets.

In the first half year overall consumer price inflation remained comparatively low at 1.9 per cent. The lack of inflationary international market pressures on domestic food prices curbed inflation, which nevertheless grew in energy products over the first

<sup>8</sup> Based on HICP.

<sup>9</sup> Real GDP measures labour productivity in the overall economy. Sector value added in real terms measures productivity in individual industries.

<sup>10</sup> The analysis employs HICP data.



four months of the year. In the second half of 2012 more expensive fuel and food and increased household electric prices pushed inflation up, while the oil price drop brought cheaper transport fuel, cutting overall consumer price inflation. Food and administratively controlled prices contributed most at 1.1 and 0.8 percentage points to accumulated inflation at the end of 2012.

### Inflation Accumulated since the Year's Start and Contributions by Major Goods and Services Groups to it

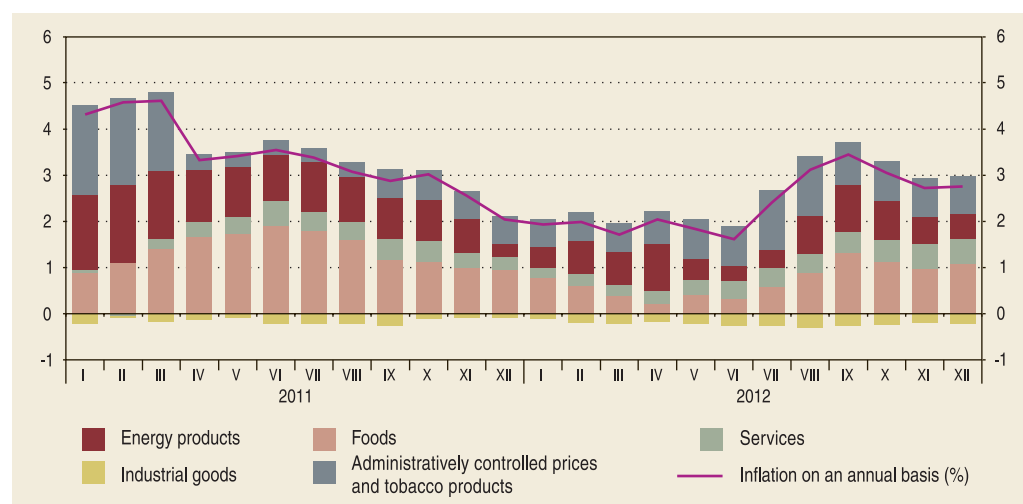
	2011		2012	
Inflation (per cent)	2.0		2.8	
	Rate of inflation by group (per cent)	Contribution, percentage points	Rate of inflation by group (per cent)	Contribution, percentage points
<b>Foods</b>	4.0	0.96	4.2	1.09
Processed foods	5.5	0.85	2.2	0.39
Unprocessed foods	1.2	0.10	8.3	0.69
<b>Services</b>	1.1	0.28	2.1	0.54
Catering	3.8	0.19	3.5	0.18
Transport services	5.0	0.18	3.9	0.17
Telecommunications	-1.8	-0.08	-1.1	-0.06
Other services	-0.1	-0.01	2.3	0.25
<b>Energy products</b>	4.0	0.29	6.3	0.54
Transport fuels	4.0	0.28	6.0	0.49
<b>Industrial goods</b>	-0.4	-0.08	-1.1	-0.21
<b>Administratively controlled prices</b>	4.1	0.63	5.0	0.81
<b>Tobacco products</b>	-0.3	-0.02	0.1	0.00

**Notes:** This structure is to the Eurostat classification, with tobacco products and goods and services with administratively controlled prices shown separately. The administratively controlled price index is calculated through the elementary aggregates level in the consumer basket.

**Sources:** NSI, BNB.

### Annual Inflation Rate and Contributions by Major Goods and Services

(percentage points, per cent)



**Sources:** NSI, BNB.

Core inflation (including services and non-food prices)<sup>11</sup> had an insignificant 0.3 percentage point effect on accumulated inflation with a clear slow rising trend through the year. This was largely due to the rise in services prices, while non-food prices excluding fuels continued to decline marginally, most pronounced in durable goods. Services inflation reflected two major effects: catering and transport prices grew at broadly constant rates because of dearer food and fuel on world markets; inclu-

<sup>11</sup> Core inflation is based on HICP by excluding food, energy products, goods and services with controlled prices and tobacco products.

sive tours and accommodation prices steadied after significant 2010 to early 2012 declines.

The overall current and capital account balance was positive by EUR 8.6 million (0 per cent of GDP) from EUR 536 million (1.4 per cent of GDP) in 2011. The surplus fall was due to the 2012 EUR 528.2 million current account deficit against the 2011 surplus of EUR 39.2 million. Capital transfers of EU funds increased capital account inflow, partly offsetting the current account deficit and contributing to an insignificant surplus on the overall current and capital account (the capital account balance came to EUR 536.8 million on EUR 496.8 million in 2011).

The current account deficit reflected a trade deficit rise to EUR 3622.1 million, up EUR 1466 million on 2011. Several factors contributed to the current account deficit growth. Decreased external demand for Bulgarian goods and services in the EU due to the euro area recession curbed export growth significantly. Recovering domestic demand pushed by foreign direct investment boosted imports. Worsened terms of trade from the fourth quarter of 2011 to September 2012 also increased the trade deficit.

The other current account balances improved on 2011. The net surplus in services amounted to EUR 2397.3 million, up EUR 74.1 million. In 2012 the income balance deficit improved by EUR 470.5 million to EUR 1342 million mainly due to lower income payments (down EUR 298.1 million) on foreign direct investment. Over the year net current transfers rose EUR 354.1 million to EUR 2038.6 million, mainly reflecting EUR 426.1 million greater transfers to the general government sector.

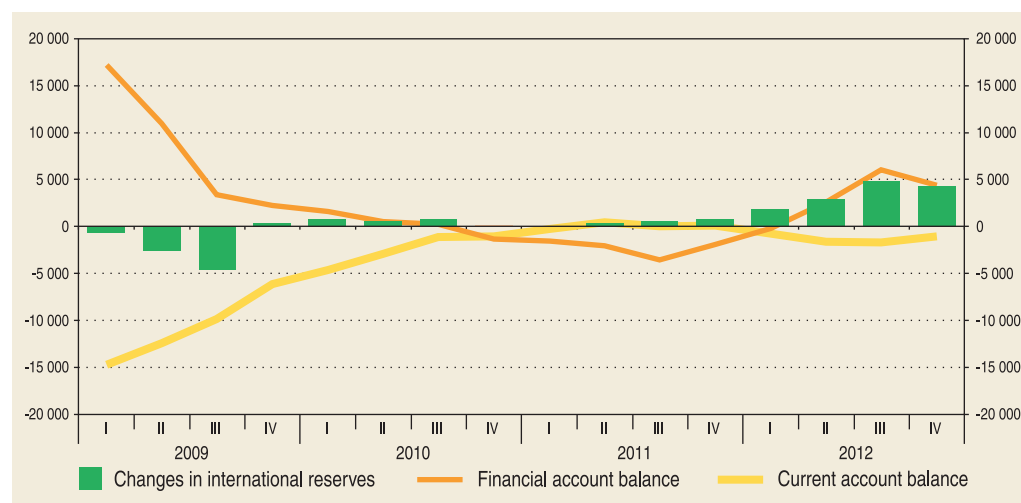
Nominal export growth slowed to 2.6 per cent from 30.2 per cent in 2011. The 8.9 per cent growth of imports outstripped that of exports, accelerating in the first half year driven by a moderate domestic demand recovery and decelerating in the second half driven by domestic demand moderation resulting from the euro area recession and worsening home economic situation. Individual commodity groups' exports differed. Minerals and fuels contributed most to moderate growth at 5.2 percentage points. Base metals and their products (-1.9 percentage points), and textiles, leather, clothing, footwear and other consumer goods (-1.4 percentage points) slowed export growth. Individual groups by end use all grew, energy resources (4.5 percentage points) and investment goods (3.7 percentage points) leading.

Preliminary balance of payments data show EUR 1478.3 million (3.7 per cent of GDP) FDI into Bulgaria from EUR 1314.6 million (3.4 per cent of GDP) in 2011. Highest net receipts were in electricity (EUR 536.4 million), trade (EUR 424.5 million), construction (EUR 306.3 million), transport, and storage and communications (EUR 247.5 million). Financial intermediation (EUR 150.7 million) had the largest net payments.

The balance of payments financial account ended the year with a EUR 2231.3 million surplus from a EUR 968.2 million deficit in 2011. This was mainly due to foreign direct investment inflows and a July EUR 950 million Bulgarian Eurobonds issue on international capital markets. Bank transactions also contributed, banks increasing both assets (by EUR 481.8 million, total portfolio and other investment) and liabilities (by EUR 832.4 million, total portfolio and other investment) mainly from one-off effect transactions in November. The same month saw high inflows on other bank liabilities and corresponding outflows on debt instrument portfolio assets. Excluding these transactions, banks' foreign assets and liabilities decreased over the year. Their gross external debt rose EUR 806 million, largely reflecting the above transactions. Hence, the share of banks in total gross external debt increased to 17.2 per cent in December on 15.6 per cent in 2011.

### Current Account, Financial Account, and International Reserve Movements (on an annual basis)

(BGN million)



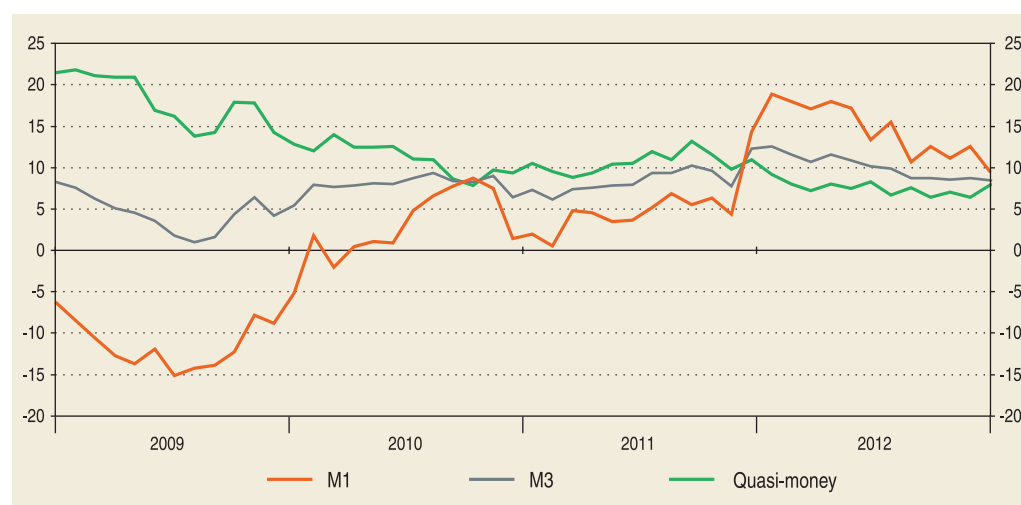
Source: BNB.

Gross external debt rose EUR 1364 million to EUR 37.6 billion (94.8 per cent of GDP) in December. This reflected increased bank and general government debt resulting from the Eurobond issue. Public and publicly guaranteed debt rose EUR 398.1 million. Non-bank sector's intercompany loans also rose to EUR 15,623.2 million (up EUR 157.3 million on end-2011). Other sectors' debt fell EUR 185.2 million. The year saw EUR 7856 million loan and deposit receipts<sup>12</sup> and EUR 6254.4 million of principal obligations serviced.

All external current, capital, and financial transactions between January and December 2012 increased BNB international reserves by EUR 2161 million, valuation adjustments and price revaluations excluded. If changes in international foreign reserves on the BNB Issue Department balance sheet were taken into account, including valuation adjustments and price revaluations, growth is estimated at EUR 2203.8 million.

### Monetary Aggregates (annual change)

(per cent)

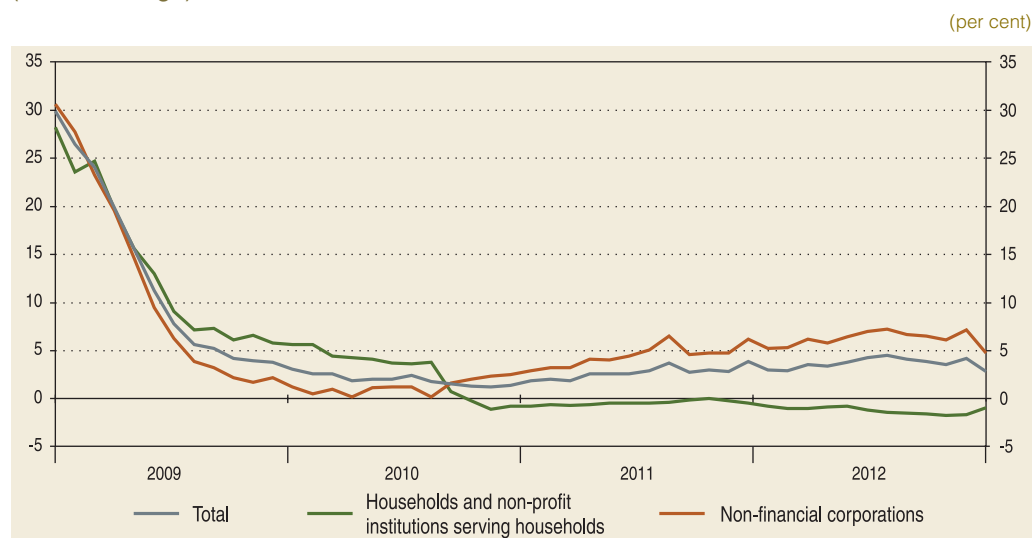


Source: BNB.

<sup>12</sup> Revolving and trade loans excluded.

Monetary aggregate growth rates slowed from 2011.<sup>13</sup> In December the annual growth rate of broad money was 8.5 per cent from 12.2 per cent in 2011. The M1 monetary aggregate and quasi-money (up 7.9 per cent growth) contributed greatly to the lower growth of broad money. The narrow monetary aggregate M1 rose 9.5 per cent from 14.4 per cent in 2011. Money outside banks grew 9.1 per cent on 5.9 per cent in 2011.

### Claims on the Non-Government Sector (annual change)



Source: BNB.

After a lending rise in the first half year, the annual growth rate of banks' claims on the non-government sector slowed to 2.8 per cent by December. Slower claims growth compared to nominal GDP growth cut the claims on the non-government sector to GDP ratio to 71.9 per cent by the end of June (down 0.2 percentage points on the end of 2011). Low corporate investment and an unfavourable labour market situation which curbed household spending drove credit dynamics. Claims on non-financial corporations grew 4.7 per cent from 6.1 per cent at the end of the prior year. Household lending remained weak, with a 1 per cent rate of decline by the end of the year. Overdrafts and consumer loans fell 4.2 and 2.3 per cent, unlike housing loans which retained a positive growth rate of 0.8 per cent.

The BNB quarterly lending survey showed bank corporate lending standards tightening somewhat, mostly as regards maximum terms and amounts, collateral requirements, and credit risk premia; interest continued falling. Banks pointed to the macroeconomic environment, the business climate in sectors occupying large shares of credit portfolios, and collateral and credit risks as reasons for tighter lending. In consumer and housing lending, however, banks eased standards. They continued to fund lending from residents' deposits; households' and non-financial corporations' deposits rose BGN 3.6 billion and BGN 0.6 billion or EUR 3.8 billion overall.<sup>14</sup> In addition to lending, in the first half of 2012 banks continued using the significant inflow of attracted funds to repay foreign liabilities and increase foreign assets. The downward trend in foreign liabilities endured in the second half year, foreign assets also declining.<sup>15</sup> Banking liquidity remained high, the liquid asset ratio reaching 26 per cent in December.

Banks managed lev liquidity mainly by trading through foreign currency (euro) with the BNB. This performed the main function of the currency board: buying and sell-

<sup>13</sup> This analysis is based on BNB monetary statistics.

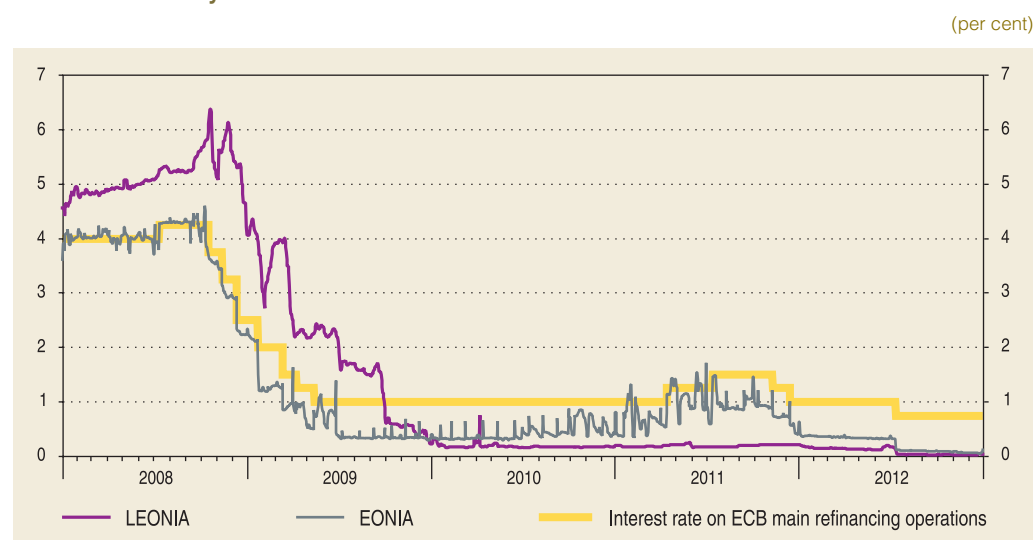
<sup>14</sup> BNB monetary statistics data.

<sup>15</sup> Such a trend could be identified if the one-off effect of November 2012 transactions were eliminated. These transactions involved concurrent increases in banks' foreign assets and liabilities, boosting their levels at the end of 2012.



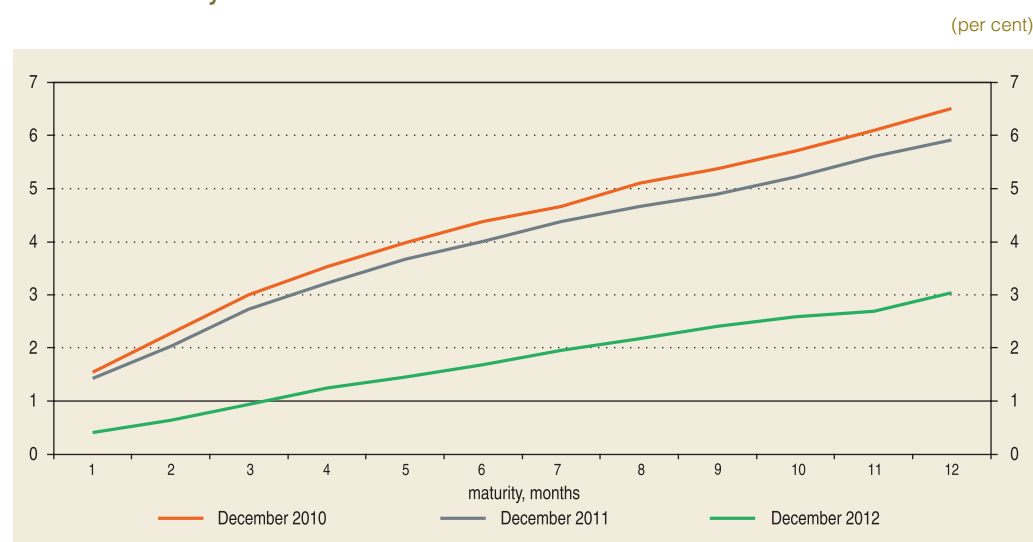
ing national currency on demand against euro at the fixed exchange rate<sup>16</sup> under the Law on the Bulgarian National Bank. Total foreign currency market turnover was EUR 646 billion<sup>17</sup>, up 49 per cent on the prior year. The three main segments of that market (turnover between banks, banks' transactions with the BNB, and trading between banks and final customers) all grew. Net turnover between banks (excluding the BNB) rose EUR 709.7 million. This segment saw a change in the structure of traded currency, interbank transactions in euro (excluding the BNB) further increasing their share to 96.1 per cent. The increase was entirely at the expense of USD transactions whose share declined to 3.4 per cent.

### Interbank Money Market Interest Rates



Sources: BNB, ECB.

### Interbank Money Market Yield Curve



Note: Average SOFIBOR/SOFIBID Index.

Source: BNB.

In 2012 ample banking system liquidity continued affecting interbank money market trade. The downward trend in interest levels continued, especially in long-term maturities. The average interbank deposit and repo interest rate fell to 0.12 per cent from

<sup>16</sup> See Chapter II.

<sup>17</sup> This comprises transactions by banks and the BNB in foreign currency against leva 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.

0.24 in the prior year. The LEONIA/EONIA spread was negative throughout the year at 13 basis points from 67 basis points in 2011, contracting to 5 basis points on average in the fourth quarter. The narrowing of the negative spread reflected EONIA declines due to unlimited long-term liquidity provision to euro area banks in late 2011 and early 2012 and the decrease in the deposit facility rate to nil from July 2012.

Interbank money market transactions totalled BGN 46.9 billion, down 46 per cent on 2011. Deposits comprised 77.1 per cent of turnover and repo operations in government securities 22.9 per cent. Overnight transactions dominated the structure of deposit operations at 83.3 per cent.

Fiscal consolidation continued in 2012, most pronounced in higher budget revenue and the effective reduction of current non-interest expenditure. The cash balance on the consolidated fiscal programme improved by BGN 1131 million (1.6 per cent of GDP) to BGN -357.4 million (a 0.5 per cent deficit of GDP), BGN 734.9 million lower than the BGN 1092.3 million target.

Total government revenue and grants increased 8.2 per cent to BGN 27,470 million. In contrast to 2011 (when the increase in consolidated fiscal programme revenue was entirely due to higher tax income), indirect taxes including receipts from grants contributed most at 4.6 percentage points to annual total budget revenue growth. This was broadly due to the higher absorption rate of EU Cohesion and Structural Funds which boosted grants revenue by 62 per cent. Value added tax revenue (2.6 percentage points) and excise (0.9 percentage points), helped by early 2012 moves to increase tax collection, contributed most to tax revenue growth (4.5 per cent).

In 2012 total government expenditure reached BGN 27,828 million, the 3.6 per cent increase on the prior year reflecting mainly higher capital<sup>18</sup> (19.6 per cent) and social (4.8 per cent) expenses. Wage and operational expenditure<sup>19</sup> were close to the prior year's levels (up 1.7 and 0.7 per cent), lower subsidies (-22.7 per cent) helping most to limit total expenditure growth.

On 22 June 2012 the Economic and Financial Affairs Council (ECOFIN) decided to close the excessive deficit procedure against Bulgaria following EC recommendation.

At the end of 2012 fiscal reserves amounted to BGN 6081 million, up BGN 1082.2 million on the end of December 2011.

Demand for Bulgarian government securities in the primary market remained high, pushing the bid-to-cover ratio to 2.75 from 2.33 in 2011. Reflecting higher demand, the average annual yield attained in the primary market fell on the prior year in all maturity segments.

The decline in primary market yields helped secondary market bond prices, Bulgarian long-term interest<sup>20</sup> dropping 179 basis points in December on the end of the prior year to 3.44 per cent.<sup>21</sup>

As part of the government's debt management strategy, a positive net government securities issue of BGN 525.5 million sold in the domestic market financed part of the budget deficit and the amortisation payments on government debt. To finance maturing global bonds in January 2013, on 2 July 2012 Bulgaria issued five-year Eurobonds with a nominal value of EUR 950 million and an annual interest coupon of 4.25 per cent on international capital markets. Investor bids exceeded the quantity offered by the Ministry of Finance six fold and the attained yield upon the initial offering was 4.44 per cent. Eurobond demand remained high, pushing up prices in the secondary market. At the end of 2012 Bulgarian Eurobonds maturing in 2017 were traded at a premium, their price reaching 109.1 (corresponding to an annual yield of

<sup>18</sup> Capital expenditure includes also changes in government reserve stocks.

<sup>19</sup> Including social insurance contributions.

<sup>20</sup> The long-term interest rate for assessing the degree of convergence is based on the yield to maturity in the secondary market according to a long-term security (benchmark) issued by the Ministry of Finance (central government) and denominated in national currency.

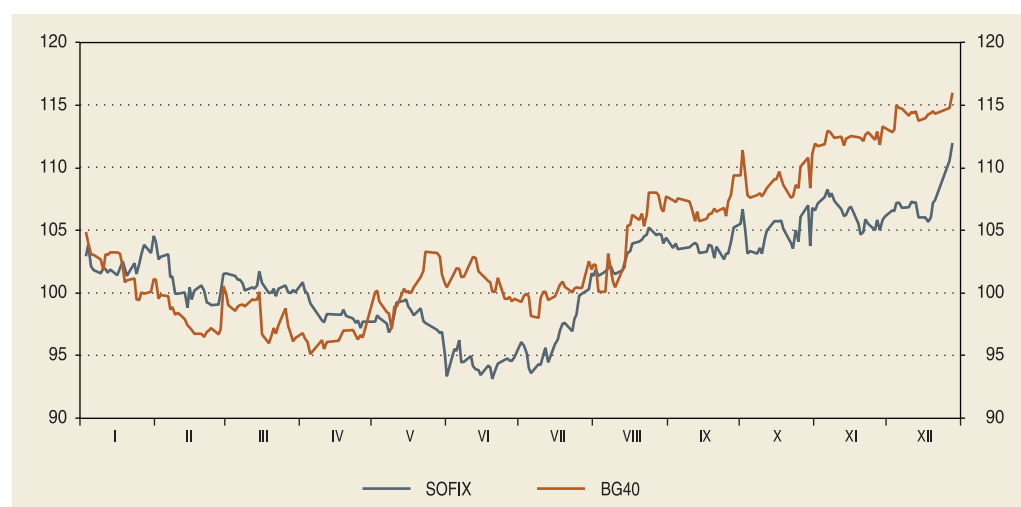
<sup>21</sup> For more information on government bond primary and secondary markets, see Chapter VIII.

2.11 per cent) from an issue price of 99.2. USD-denominated global bonds maturing in 2015 quoted at 113.9 per cent (1.3 per cent yield)<sup>22</sup> in December 2012 and USD-denominated ZUNK bond prices hovered around nominal, as in 2011.

Over the first half of 2012 the leading Bulgarian Stock Exchange<sup>23</sup> SOFIX and BG40 indices showed low volatility, staying close to late 2011 levels. The second half year saw rises. By the year's end SOFIX and BG40 rose to 7.2 and 10 per cent on 2011, following leading international markets. The volume of secondary market shares rose 11.7 per cent to BGN 536.6 million, bond turnover falling 22 per cent to BGN 95.5 million. Over the counter equity transactions turned over BGN 570.4 million<sup>24</sup>, bonds turning over BGN 44 million. By the year's end Bulgarian Stock Exchange market capitalisation was BGN 9.8 billion or 12.7 per cent of GDP from 16.5 per cent of GDP in 2011.

### Bulgarian Stock Exchange Indices in 2012

(December 2011 = 100)



Sources: BNB, Bulgarian Stock Exchange.

<sup>22</sup> Reuters data.

<sup>23</sup> On 1 March the Bulgarian Stock Exchange restructured instrument trading into a Main and Alternative markets segmented by instruments. The Main Market Premium Equities Segment is roughly the former Official Equities Market Segments A and B. The Standard Equities Segment is the former Unofficial Equities Market Segment A. The Alternative Market is for issues outside Main Market issuer, trading duration, turnover, and transaction numbers criteria. Its Equities Segment is roughly the former Unofficial Equities Market Segment B. The former Official and Unofficial Bond Markets are now a Main Market Bonds Segment.

<sup>24</sup> Major exchange traded and over-the-counter transactions involved, *inter alia*, Bulgartabac Holding AD, the Agro Finance REIT, Sopharma AD, the Advance Terrafund REIT, Eurohold Bulgaria AD, Petrol AD, Kaolin AD, Sofia-BT AD and the ELARG Agricultural Land Opportunity Fund REIT (in liquidation).

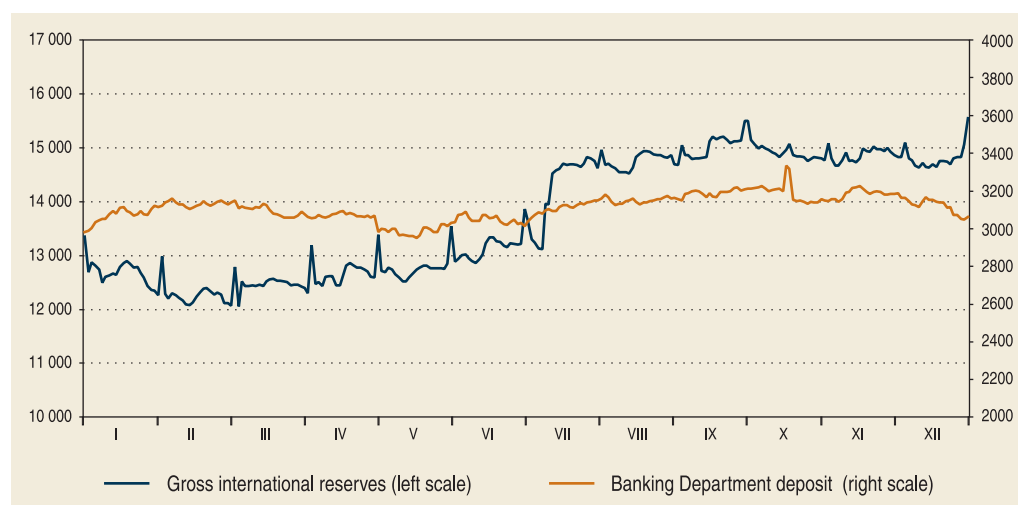
## II. Gross International Reserves

Gross international reserves are managed to the Law on the Bulgarian National Bank provisions,<sup>25</sup> investment constraints, business procedures and methodologies, and opportunities offered by international financial markets. They comprise the Issue Department balance sheet assets and have to provide complete coverage for monetary liabilities at the lev euro fixed exchange rate set by the Law on the Bulgarian National Bank.<sup>26</sup> The excess of gross international reserves over monetary liabilities forms the Banking Department deposit item or the net value of the Issue Department balance sheet.<sup>27</sup>

### Gross International Reserves and Banking Department Deposit in 2012

(EUR million)

(EUR million)



Note: The chart shows daily Issue Department balance sheet movements and the Banking Department deposit in the Issue Department balance sheet

Source: BNB.

### 1. Gross International Reserve Amount and Structure

By the end of June 2012 the market value of gross international reserves was EUR 15,552 million: an increase of EUR 2204 million on the end of 2011.<sup>28</sup> The 16.5 per cent annual increase was mainly from foreign currency inflows into BNB clients' accounts and rising government funds in the Issue Department balance sheet, the rising number of circulating banknotes, and commercial banks' BNB reserves.

<sup>25</sup> There were no Law on the BNB amendments concerning gross international reserve management in 2012.

<sup>26</sup> The Law on the BNB Article 28, paragraph 2 defines the Bank's monetary obligations as all circulating banknotes and coins issued by itself, and all BNB account balances held by others except the IMF. The Law on the BNB Article 28, paragraph 3 lists assets which may comprise gross international reserves: monetary gold; Special Drawing Rights; banknotes and coins in freely convertible foreign currency; freely convertible foreign currency held by the BNB in accounts with foreign central banks or other financial institutions or international financial organisations with one of the two highest ratings by two internationally recognised credit rating agencies; securities issued by foreign countries, central banks, other foreign financial institutions, or international financial organisations assigned one of the two highest ratings by two internationally recognised credit rating agencies; the balance of accounts receivable and payable on BNB forward or repo agreements with (or guaranteed by) foreign central banks, public international financial institutions with one of the two highest ratings from two internationally recognised credit agencies; and BNB futures and options binding non-residents and payable in freely convertible foreign currency. The Law on the BNB calls for asset market values.

<sup>27</sup> The Law on the BNB Article 28, paragraph 1 provides that "the aggregate amount of the monetary liabilities of the BNB shall not exceed the lev equivalent of gross international reserves" at the fixed exchange rate.

<sup>28</sup> Further in this Chapter, balances in commercial banks' accounts in the TARGET2-BNB national system component worth EUR 508 million at the end of December and the two tranches totalling EUR 611 million received in August and September 2009 upon general SDR allocation by the IMF are not included in the analysis of changes in BNB gross international reserves. See the BNB Annual Report 2009, p. 25.

## External Cash Flows in Foreign Currency

(million EUR)

	2011	2012
<b>I. Euro purchases and sales</b>		
at tills	-11	-10
in banks	-532	-307
bank purchases	33,698	46,550
bank sales	-34,230	-46,856
<b>Subtotal I</b>	<b>-543</b>	<b>-317</b>
<b>II. Currency outflows to banks, the MF, and others.</b>		
Minimum Required Reserves	-128	40
Government and other depositors (Total)	647	1,804
<b>Subtotal II</b>	<b>520</b>	<b>1,844</b>
<b>Total I + II</b>	<b>-24</b>	<b>1,527</b>

Notes: Annual averages. Figures may not add up due to rounding.

Source: BNB.

EUR 1804 million of deposits into government and other accounts, EUR 942 million of which from the July 2012 domestic market Bulgarian Eurobonds issue and deposits into the European Commission's BNB account, contributed most to the market value of international reserves. Net reserve currency sales to banks resulting in a EUR 307 million outflow were also significant. There was EUR 40 million of minimum reserves in commercial banks' BNB accounts.

Monetary gold continued its upward trend to 13.04 per cent of the market value of assets. This reflected its rising world price. The average share of euro-denominated assets was 86.44 per cent.

## Currency Structure of Gross International Reserves

(per cent)

Currency	Issue Department Balance Sheet	
	2011	2012
EUR	86.76	86.44
USD	0.10	0.19
XAU	12.79	13.04
XDR	0.33	0.31
CHF	0.01	0.01

Notes: Annual averages. Figures may not add up due to rounding.

Source: BNB.

The structure of assets by financial instrument changed somewhat, securities decreasing some 4 per cent to 67.55 per cent of the market value of assets in favour of short-term deposits and cash with first rate foreign banks. The change reflected negative yields on the least risky securities for much of the year, making short-term deposits more attractive.

## Gross International Reserves by Financial Instrument

(per cent)

Financial instrument	2011	2012
Vault cash*	5.95	6.79
Deposits**	22.49	25.65
Securities**	71.57	67.55

Notes: Annual averages. Figures may not add up due to rounding.

\* Account balances, payments, and monetary gold.

\*\*Including foreign currency and gold instruments.

Source: BNB.

Most international reserve assets continued to be in the under a year sector by residual maturity (64.85 per cent on average: current accounts, short-term deposits in foreign currency and gold, and short-term securities). Sectors over three years declined in favour of the one to three-year sector rising to 31.95 per cent.

### Gross International Reserves by Residual Term to Maturity

(per cent)

Maturity Sector	2011	2012
Up to a year	70.92	64.85
One to three years	22.05	31.95
Three to five years	5.33	1.92
Five to ten years	1.49	1.15
Over ten years	0.22	0.13

Notes: Annual averages. Figures may not add up due to rounding.

Source: BNB.

## 2. Gross International Reserve Risk and Yield

### The Market Environment

In 2012 euro area financial markets remained unstable amid deteriorating macroeconomic indicators and public debt crises.<sup>29</sup> ECB injections of over EUR 1 trillion of long-term liquidity in two three-year refinancing operations calmed financial markets in late 2011 and early 2012. The late February EUR 130 billion second Greek bailout package also helped, as did the March cut of EUR 107 billion of Greek debt held by private creditors.

Early in the second quarter market expectations worsened with the Greek political and Spanish banking crises. Spanish and Italian sovereign bond yields rose steeply, passing 6 per cent in the over a year maturity sectors. This brought concerns about market financing for these countries. German and Dutch bond yields dropped to negative in the short-term maturity sectors.

Market tensions eased as the ECB stated it would offer unlimited liquidity and launched outright monetary transactions (OMTs) on 6 September to buy sovereign bonds on the secondary market. The ECB will buy sovereign bonds with maturities of up to three years if issuers follow strict fiscal consolidation and allow the European Stability Mechanism to buy their sovereign bonds on primary markets.

In the last quarter market tensions rose following concerns that Greece would not implement the financial consolidation needed for its next bailout loan tranche; in November the Greek parliament voted budget cuts, buying back EUR 31.9 billion of Greek sovereign debt at 33.8 per cent of nominal price in December. The same month Spain received EUR 39.5 billion of help for its banks at 12.5 years average loan maturity.

The US Federal Reserve kept federal funds interest at 0 to 0.25 per cent and took new unconventional measures for growth. It continued extending the average maturity of Federal Reserve portfolio assets, in September launching an additional programme to support the housing market by buying mortgage bonds. In December the US Federal Open Market Committee launched a programme to buy USD 45 billion of four- to 30-year US sovereign bonds a month. Public finance legislation deadlines at the year's close made markets jittery.

### Euro Area and US Sovereign Bond Yields

German bond yield fell 16 basis points to -0.02 per cent in the two-year maturity sectors, varying between -0.09 and 0.34 per cent over the year. Ten-year yield fell 51 basis points to 1.32 per cent, varying between 1.17 and 2.06 per cent. ECB main

<sup>29</sup> See Chapter I.



refinancing operation interest rate cuts further depressed interest in the up to two years sector over the third quarter. Demand for quality assets rose at the year's end as the euro area faced recession and the EC, ECB and IMF curbed European economic activity expectations for 2012 and 2013.

Crisis measures in the euro area brought Italian, Spanish, Irish, and Portuguese sovereign bond spreads closer to the German benchmark. Some widening followed in the second quarter and first half of the third quarter. Portuguese bond spreads narrowed most (-1220 basis points in the two-year and -584 basis points in the ten-year maturity sectors), followed by Irish ones (-566 basis points in the two-year and -339 basis points in the ten-year maturity sector). The EU and IMF felt both countries were progressing with economic programmes tied to financial assistance.

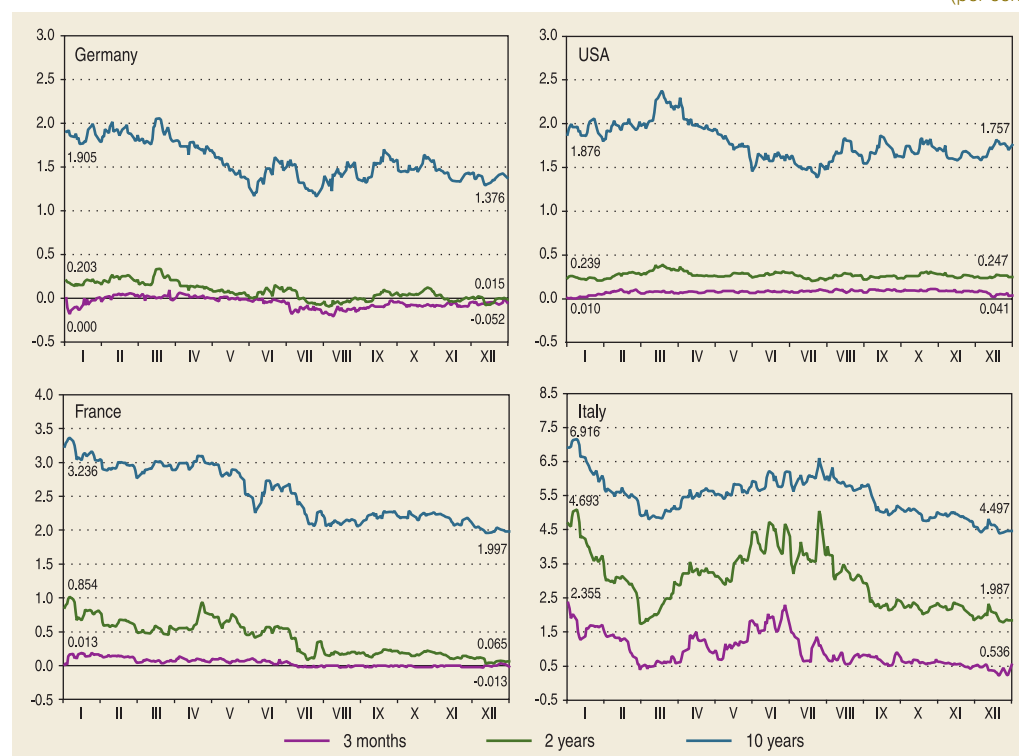
Spanish sovereign bond spreads narrowed slightly by 16 basis points in the two-year maturity sector but widened 69 basis points in the ten-year maturity sector, reflecting banking problems, poor economic prospects, budget consolidation, and the downgrading of Spanish sovereign debt by three major rating agencies. Despite market speculation, Spain did not request financial support and completed its 2012 issuing programme early.

Italian sovereign bond spreads narrowed by 297 basis points in the two-year and 210 basis points in the ten-year sectors. Dutch bond spreads remained almost unchanged, widening 6 basis points in the two-year and narrowing 18 basis points in the ten-year sectors, despite the worsening outlook and political uncertainty with early parliamentary elections in September.

French spreads narrowed 59 basis points in the two-year and 64 basis points in the ten-year sectors. Two of the three rating agencies downgraded French credit ratings. Moody's emphasised worsened economic prospects and fiscal position uncertainty. Spreads also narrowed in Austria and Belgium by 109 and 204 basis points in the two-year and 64 and 152 basis points in the ten-year sectors. At the end of 2012 Austrian, French, and Dutch two-year bond yields were about equal.

### Government Bond Yield to Maturity in 2012

(per cent)



US bond yield moved within relatively broad ranges, mainly in the over five-year maturity sector, reverting to early 2012 levels at the year's end. Two-year yield fluctuated between 0.20 and 0.39 per cent, ten-year yield moving within the wider 1.39 to 2.38 per cent range. At the end of the first quarter the entire yield curve rose strongly as optimistic macroeconomic data cut demand for low risk assets. Worsened global prospects and euro area tensions hit yield in the second quarter, continuing to depress it somewhat in the third quarter. Continuation of Operation Twist (the Federal Reserve portfolio maturity extension programme) until the year's end depressed the long end in the third quarter. In the fourth quarter yield, though fickle, rose driven by good macroeconomic data and unconventional FOMC measures. Tense negotiations on the legislative prevention of a Fiscal Cliff (sharp adverse effects following the end of significant individual and business tax relief in late 2012 and budget cuts in early 2013) curbed yield.

### Gold and Exchange Rates

In 2012 the US dollar depreciated 2.1 per cent against the euro, especially in the second half. The rate moved within the wide range of 0.74 to 0.84 with strong fluctuations. The dollar reached a euro high in mid-year amid market uncertainty on the Greek elections. Worsening euro area macroeconomics additionally hit investor confidence and expectations. The trend switched in the second half as the euro offset earlier losses to appreciate at the year's close. The rate reflected Federal Reserve and ECB monetary policies.

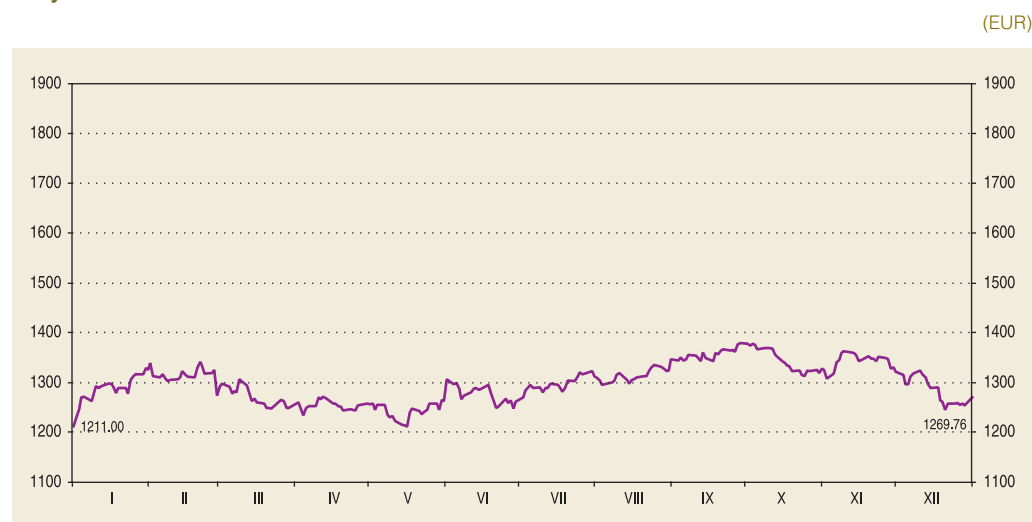
### The USD/EUR Exchange Rate in 2012



### Troy Ounce Gold Price in US Dollars in 2012



## Troy Ounce Gold Price in Euro in 2012



In 2012 the US dollar gold price rose, with gold sought as an investment haven and leading central banks seeking to induce growth. Gold moved within the wide band of USD 1540 to 1790 per troy ounce, rising 6.3 per cent in dollars and 5 per cent in euro overall.

### Major Types of Risk

Net value risk in the Issue Department balance sheet measured by value-at-risk (VaR)<sup>30</sup> was -5.99 per cent in 2012. International reserve **interest rate risk** measured by reserves' average modified duration was 0.82. The duration was slightly higher than the 0.77 average in 2011.

The Law on the Bulgarian National Bank provision that the sum of the absolute values of open foreign currency positions<sup>31</sup> in currencies other than the euro, SDR, and monetary gold should not exceed 2 per cent of the market value of monetary liabilities in these currencies constrained international reserve **currency risk**. There were minimal open positions in currencies other than the euro over the year, the open position in monetary gold in the Issue Department balance sheet posing the main currency risk to the BNB.

**Credit risk** remained a major factor causing uncertainty on EU bond markets. Strong demand for low risk assets continued through the year and euro area periphery sovereign bond spreads remained wide. Yield on most assets into which the BNB invested was thus exceptionally low and even negative at the short-term end.

In this unfavourable and dynamic market, the BNB continued the conservative approach to credit risk of recent years, keeping major investment constraints unchanged. Permissible sovereign bonds fell into the three inherent sovereign risk groups introduced in the second half of 2010. Most other measures to curb overall risk to the Bank remained in force. The ban on debt instruments issued or guaranteed by countries with worsened fiscal positions and high public debt stayed. In early 2012 the proportion of reserves having to be invested into the least risky Group I rose from 30 to 40 per cent, falling to 35 per cent in the third quarter to balance security and liquidity with earnings. The year also saw a ban on sovereign bonds with negative yields.

As financial market tensions eased and markets improved somewhat in the last quarter, the maximum maturity for new investment into sovereign bonds rose from

<sup>30</sup> 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.

<sup>31</sup> An open foreign currency position is the difference between the value of assets and liabilities in any currency other than the euro.

three to ten years for Group I, from three to five years for Group II, and from six months to a year for Group III. Maturity limits of foreign currency and gold deposits at BNB counterparties changed a number of times as markets changed.

Dynamic financial markets called for an evolving credit risk management methodology, mainly fine tuning of existing rules, constraints, and limits to curb risk to the BNB and use investment opportunities under the Law on the BNB more effectively.

By the year's close, some 73 per cent of the international reserves were invested into assets with the highest AAA long-term credit rating, their value averaging 72 per cent over the year.

Strict monitoring and control of investment restrictions and business procedures for international reserve management constrained **operational risk**.

## Return and Efficiency

Net income from assets in euro is the sum of income from 1) investing gross international reserves in original currency; 2) currency imbalance yield;<sup>32</sup> and 3) spending on liabilities. Over the year the Bank earned EUR 164.35 million from gross international reserve investment, or 1.32 per cent return. The EUR 79.55 million currency imbalance yield was almost entirely due to the change in the euro price of monetary gold. Interest paid on Issue Department balance sheet liabilities was EUR 0.22 million.<sup>33</sup> These three components brought net earnings of EUR 243.69 million or 1.92 per cent net return.

### International Reserves Income and Rate of Return in 2012

Quarter	Net income (1)+(2)+(3)	Investment income (1)	Currency imbalance yield (2)	Expenditure (interest) on liabilities (3)
First quarter	120.19	66.35	53.95	-0.12
Second quarter	38.94	23.25	15.71	-0.02
Third quarter	198.22	48.14	150.12	-0.04
Fourth quarter	-113.67	26.61	-140.24	-0.04
Total income, EUR million	243.69	164.35	79.55	-0.22
Total rate of return, per cent	1.92	1.32	0.60	0.00

Source: BNB.

Gross international reserves are split operationally into portfolios depending on currency and investment goal, each with a benchmark, investment goals, and investment limits set by the BNB. Major BNB portfolios and results from their management are in the table below.

To diversify management styles and reduce operational risk, most euro-denominated assets continued to be split into two investment portfolios with identical limits and benchmarks, managed by different BNB teams. A third portfolio formed on 1 October 2012; earnings in the table were attained between 1 October and 31 December. By the close of 2012, external managers at international financial institutions managed about 5.5 per cent of international reserves, each with a benchmark, with investment goals and limits set by the BNB. Beside additional diversification, using them helped exchange expertise in international market investment management. Liquid portfolios mainly assist immediate BNB currency payment needs.

<sup>32</sup> Currency imbalance yield is the result of the effects of exchange rate movements on assets' and liabilities' open foreign currency positions.

<sup>33</sup> Data on the Issue Department are not entered directly into the information system for international reserve management; they are provided to it via the accounting system interface.

## Portfolio Profitability and Risk in 2012

Portfolio	Profitability		Volatility (risk) <sup>1</sup>		Information ratio <sup>4</sup>
	Absolute (per cent)	Relative <sup>2</sup> (basis points)	Absolute (basis points)	Relative <sup>3</sup> (basis points)	
Investment 1, EUR	1.00	-19	37	20	-0.94
Investment 2, EUR	1.51	28	36	20	1.43
Investment 3, EUR	2.29	0	171	0	-
External manager A, EUR	1.35	43	48	11	3.79
External manager B, EUR	1.18	26	55	22	1.22
Liquidity, EUR	1.85	-5	73	44	-
Liquidity, USD	0.52	49	36	36	-

<sup>1</sup> Risk means the standard deviation of yield.

<sup>2</sup> The positive/negative relative yield of a given portfolio is the attained profit/opportunity cost against the respective benchmark yield. Relative yield is rounded to 1 basis point; within the -0,5 and 0 band it is -0, and within the 0 and 0.5 band +0.

<sup>3</sup> The relative risk against the benchmark indicates the deviation degree of the risk characteristics of the portfolio from those of the benchmark through active portfolio management. The risk is on an annual basis.

<sup>4</sup> The information coefficient indicator is the ratio between the relative yield of the portfolio to its relative risk (on an annual basis). The item is calculated only for actively managed portfolios.

Source: BNB.

## III. Payment Systems

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

Bulgaria's lev settlement systems are:

- RINGS, a real time gross settlement system, operated by the BNB;
- Ancillary systems settling transactions in RINGS:
  - BISERA, for settling customer transfers at a designated time, operated by BORICA–Bankservice AD;
  - BORICA, for servicing bank card payments in Bulgaria, operated by BORICA–Bankservice AD;
  - SEP, for mobile telephone payments, operated by SEP Bulgaria AD.

Bulgaria's euro settlement systems are:

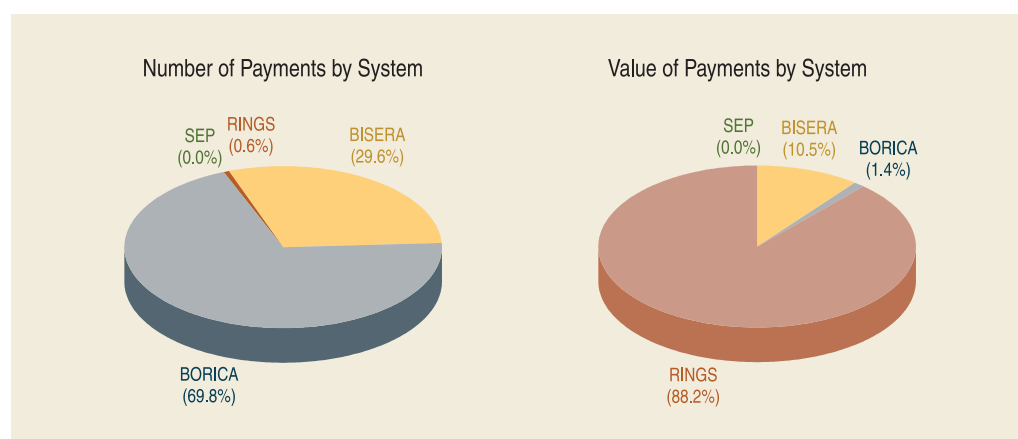
- The TARGET2 national system component, TARGET2-BNB, run by the BNB;
- The TARGET2-BNB ancillary system:
  - BISERA7-EUR for servicing customer transfers at a designated time, operated by BORICA–Bankservice AD.

Bulgaria's securities settlement systems are:

- The book entry government securities settlement system, run by the BNB;
- The book entry securities registration and servicing system, run by the Central Depository.

In 2012 RINGS processed 88.2 per cent of payments by value in Bulgaria. Values around 80 per cent are optimal for the operation of real time gross settlement systems. In addition, RINGS processed 0.6 per cent of lev payments.

### Distribution of Lev Payments in Bulgaria by Payment System in 2012



Source: BNB.

Payments processed by BORICA rose 8.1 per cent in value and 6.3 per cent in number on 2011. The value and number of ATM cash withdrawals rose 6 and 1.3 per cent respectively. The number of POS terminal transactions fell 11.2 per cent in value and 3.1 per cent in number. BISERA payments grew 9.1 per cent in value and 4.2 per cent



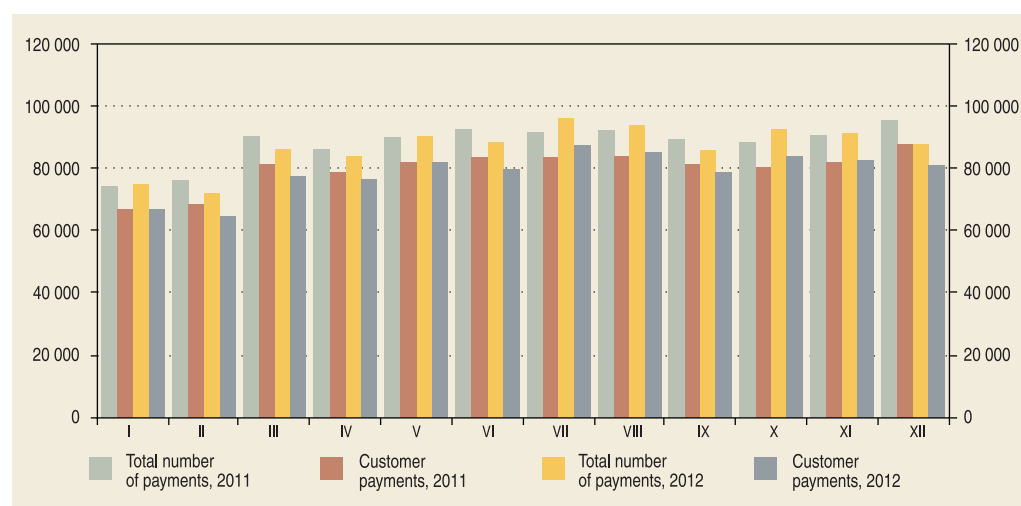
**RINGS Real Time Gross Settlement System**

in number on 2011. Central Depository transaction value rose 35.4 per cent on 2011, the number dropping 35.6 per cent. By the close of June 2012 only seven domestic banks participated in SEP. Transactions through the system declined 15.5 per cent in value and 28.2 per cent in number on 2011.

## 1. Payment Systems and Securities Settlement Systems

Processing most payments in Bulgaria through the Real Time Gross Settlement System (RINGS) cut payment risk: one of the major goals of a central bank. In 2012 RINGS processed 1,041,068 payments for BGN 870,785 million: up 27.7 per cent in value and down 1.5 per cent in number on 2011. Customer payments numbered 945,177, or 90.8 per cent of total payments, for BGN 170,073 million (19.5 per cent of the value of all payments). The daily average value of payments was BGN 3442 and daily average number was 4115. In 2012, 71.2 per cent of payments went through by noon and 88.1 per cent by 2:30 pm. As regards system traffic, 82.7 per cent of RINGS payments were by 2:30 pm. On 31 December 2012, 32 banks participated in RINGS.

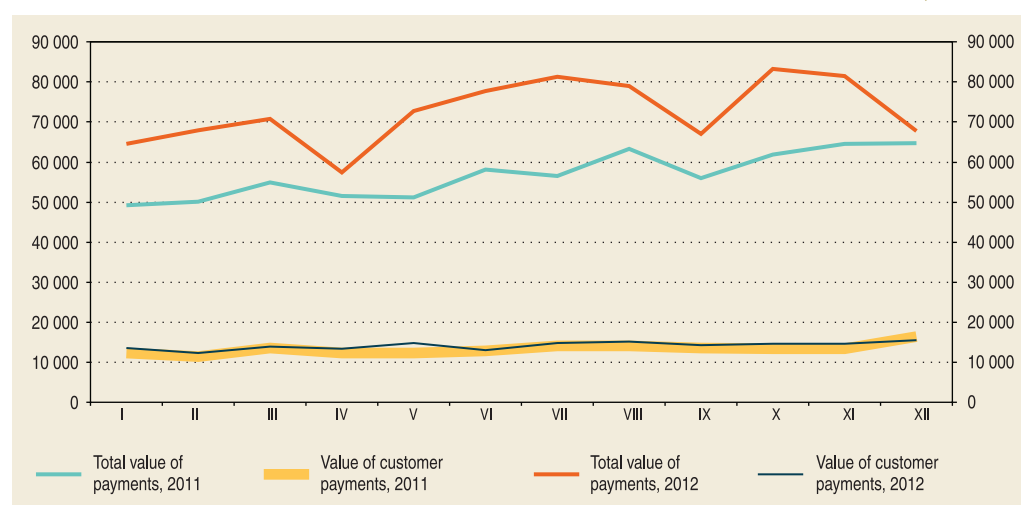
### Number of RINGS Payments in 2011 and 2012



Source: BNB.

### Value of RINGS Payments in 2011 and 2012

(BGN million)



Source: BNB.

In 2012 no payments failed by the close of the RINGS' system day due to insufficient funds in participants' accounts, indicating good liquidity management by banks. There was no recourse to the Reserve Collateral Pool: an interbank mechanism guaranteeing settlement of payment and securities' system orders. RINGS offered 99.7 per cent availability.<sup>34</sup>

### TARGET2-BNB National System Component

TARGET2 settles gross euro payments in real time using central bank money. It is a Single Shared Platform (SSP) system, with participating and connected central banks operating system components. The BNB runs the TARGET2-BNB national system component and is responsible for the business relations of its participants and coordination with the European Central Bank and participating central banks. On 31 December 2012 the ECB and 23 EU central banks connected with TARGET2.

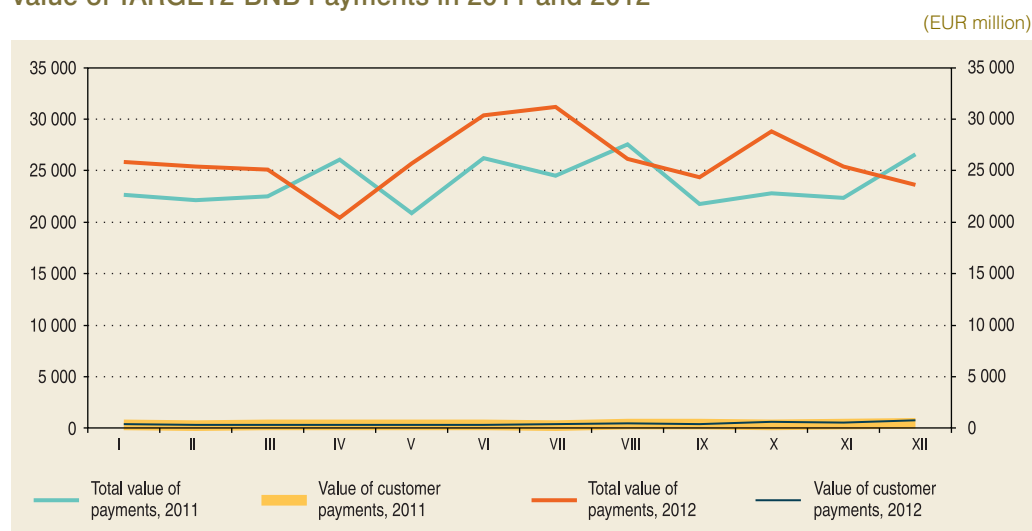
The TARGET2-BNB national system component includes the BNB, 20 direct participant banks, three addressable BIC holders, and the BISERA7-EUR ancillary system for settling customer transfers in euro at a designated time.<sup>35</sup>

### Number of TARGET2-BNB Payments in 2011 and 2012



Source: BNB.

### Value of TARGET2-BNB Payments in 2011 and 2012



Source: BNB.

<sup>34</sup> The ratio of time when the system worked to scheduled operating time.

<sup>35</sup> For an up-to-date list of TARGET2 participants through TARGET2-BNB national system component, see the BNB website. By 31 December 2012 the BISERA7-EUR ancillary system included 15 of 20 direct participant banks in TARGET2-BNB.

### **Bulgarian Payment and Settlement System Development**

In 2012 TARGET2-BNB processed 136,783 payments for EUR 312,515 million, including 107,480 customer payments for EUR 5049 million: up 9.3 per cent in value and 34 per cent in number on 2011.

Payments by other system components to banks were 92.2 per cent of the value and 88.9 per cent of the number of all TARGET2-BNB payments. There were 534 average daily payments, worth an average of EUR 1221 million. The daily value peak was EUR 2332 million, with a daily numbers peak of 872.

The BISERA7-EUR ancillary system processes customer transfers in euro at a designated time. Over the review period the BISERA7-EUR ancillary system processed 20,694 payments, worth EUR 238 million, up 182.3 per cent in value and 103.1 per cent in number on 2011.

In July 2012 the Governing Council amplified Ordinance No 3 on Terms and Procedure for Payment Transactions and Employing Payment Instruments with electronic money provisions facilitating pre-paid card acceptance by payment service providers (PSPs) and merchants. Amendments regulate POS terminal operations, processing, and settlement with pre-paid cards. There are also new provisions on payment order execution.

March 2012 saw Regulation (EU) No 260/2012 of the European Parliament and of the Council of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euro and amending Regulation (EC) No 924/2009 mandating non-euro area EU members to migrate to SEPA direct debit and credit transfer by 31 October 2016. It sets out rules for EU credit transfer and direct debit in euro and directs PSPs to adopt IBAN and ISO 20022 XML standards.

The Single Euro Payments Area (SEPA) was a most significant harmonisation of EU small payments. It transformed divergent small payments infrastructures into a single euro payments area, boosting security and efficiency. SEPA credit transfers and card payments launched in early 2008, payment service end users enjoying SEPA direct debits since November 2009. By the end of the 2012 all Bulgarian banks could handle SEPA credit transfers. The share of such payments by Bulgarian banks was some 47 per cent of customer euro payments within the scope of Regulation (EU) No 260/2012 of the European Parliament and of the Council of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euro. BISERA7-EUR operated by BORICA-Bankservice AD handles only SEPA payments. To ensure bank availability for SEPA payments to and from foreign banks, BISERA7-EUR connected with SEPA Clearer and Equens. This allows SEPA crediting between banks in Bulgaria and other EU countries, mainly Germany, Greece, Italy, the Netherlands, Poland, as well as Switzerland.

By the end of 2012, 77.6 per cent of Bulgarian cards, including 75.7 per cent of debit and 97.2 per cent of credit cards were to the EMV standard.<sup>36</sup> EMV implementation into the card payments infrastructure was practically complete, with 100 per cent of ATMs and 99.2 per cent of POS terminals migrated.

## **2. Payment System Oversight**

Limiting system risk and improving Bulgarian payment systems' reliability and efficiency were the major goals of payment systems overseers. They monitored observance of standards and recommendations by the Bank for International Settlements, the International Organization of Securities Commissions, the European Central Bank, and the European System of Central Banks. Amendments to the Law on the Public Offering of Securities from 28 December 2012 complemented the Law on Payment Services and Payment Systems with provisions on PSP supervision, breaches,

<sup>36</sup> EMV is a credit and debit smart or chip card standard developed by Europay, MasterCard, and Visa.

the Conciliation Commission on Payment Disputes, and sanctions for breaches of Regulation (EC) No 1781/2006, Regulation (EC) No 924/2009, and Regulation (EU) No 260/2012.

Governing Council Resolution No 2 of 26 January 2012 under the Law on Payment Services and Payment Systems Article 97, paragraph 1 in connection with Article 137, paragraph 1 licensed BORICA–Bankservice AD as a settlement finality payment system operator for designated time customer transfers in euro.

Finding that the same Law Article 10, paragraph 4 payment institution licensing conditions obtained, Governing Council Resolution No 11 of 23 February 2012 under Article 12, paragraph 1 in connection with Article 137, paragraph 1 licensed Euromoney Transfer OOD as an Article 4, item 6 money remittance business.

Finding that the conditions of the same Law Article 10, paragraph 4, items 5, 6, 8, and 10 were not met, on 18 December 2012 the Governing Council refused to grant an Article 14, items 1 and 2 payment institution license to Factor I.N. AD to provide Article 4, items 1, 2, 3c, and 6 payment services.

The Bank conducted three Article 137, paragraph 2 in connection with Article 114, item 4 and Article 122 spot on-site checks at credit institutions and five planned supervisory inspections at payment institutions.

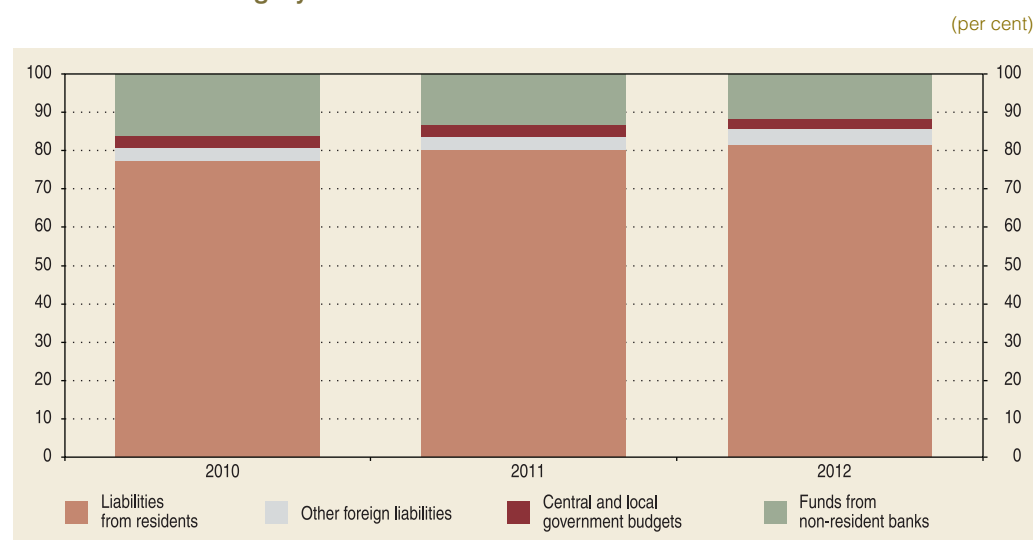
The year saw these changes to relevant BNB registers:

- 303 agents listed and 249 delisted onto/from the public register of licensed payment institutions, branches, agents under Article 17 of the Law;
- 41 agents and two branches listed onto the public register of licensed electronic money institutions and their branches and agents under Article 17 of the Law;
- 37 payment institutions from other EU states operating in Bulgaria and 209 agents listed onto the BNB Ordinance No 16 of 16 July 2009 Article 7 public register;
- 12 electronic money institutions licensed elsewhere in the EU and issuing, distributing, and redeeming electronic money, and one agent listed onto the same Ordinance Article 39 public register.

## IV. Bank Reserves at the BNB

In 2012 reserves reflected mainly growing funds attracted from residents as Bulgarians and their businesses continued saving.<sup>37</sup> The average daily value of attracted bank funds for reserve calculation purposes (excluding central and local government) rose 9.2 per cent on 2011, or 18.7 and 2.1 per cent in lev and foreign currency liabilities. Funds from residents (excluding central and local government) rose 11 per cent, those from non-residents 0.7 per cent. Central and local government budget liabilities grew 3.8 per cent.

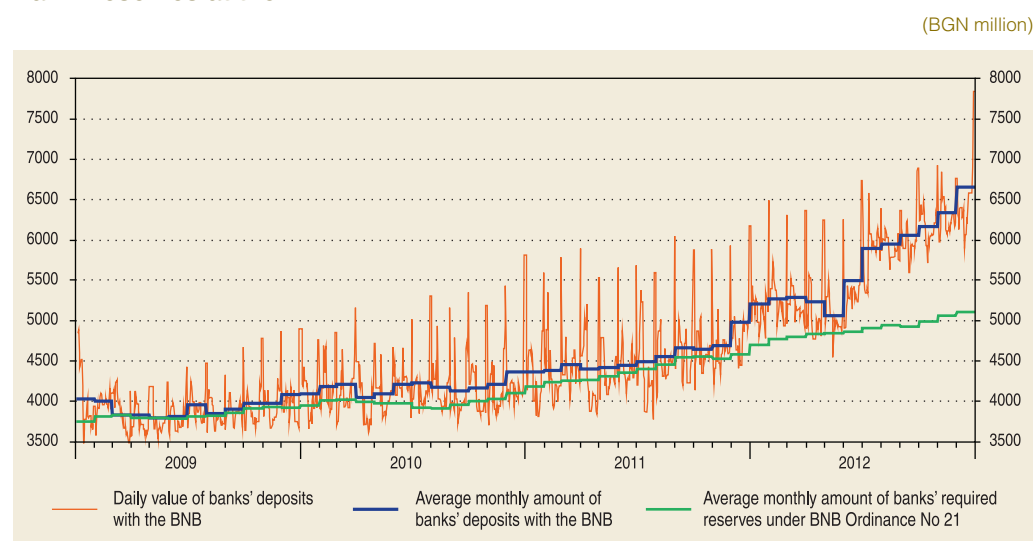
### Structure of Banking System Attracted Funds\*



\* Average daily value for reserve calculation purposes.

Source: BNB.

### Bank Reserves at the BNB



Source: BNB.

<sup>37</sup> In 2012 there were no amendments to Ordinance No 21 on the Minimum Required Reserves Maintained with the Bulgarian National Bank by Banks.

Change in the structure of attracted funds through the year did not affect the implicit ratio of minimum required reserves which stayed at 8.9 per cent.<sup>38</sup> Reserve assets covering this ratio include funds on banks' BNB accounts (7.8 percentage points) and half of cash balances recognised as reserve assets (1.1 percentage points). The currency structure of banks' reserve assets changed: lev reserves fell 4.0 per cent on 2011 and foreign currency reserves rose 62.2 per cent, their share in banks' total reserves rising to 33.8 per cent on average for the year.

In 2012 banks' excess reserves rose significantly, reserves in banks' BNB Ordinance No 21 accounts exceeding minima by 8.7 per cent against a 3 per cent 2011 excess. Banks also significantly increased balances in their TARGET2-BNB accounts in the second half of 2012 to an average of 14.9 per cent of their funds on the accounts with the BNB. Reasons for rising excess reserves and TARGET2-BNB funds were the state of euro area money markets, ECB monetary policy, high savings, relatively low credit demand, and prudent lending.

---

<sup>38</sup> Ordinance No 21 reserves are 10 per cent of banks' deposit bases, 5 per cent of funds attracted from abroad and nil on government and local budget funds.

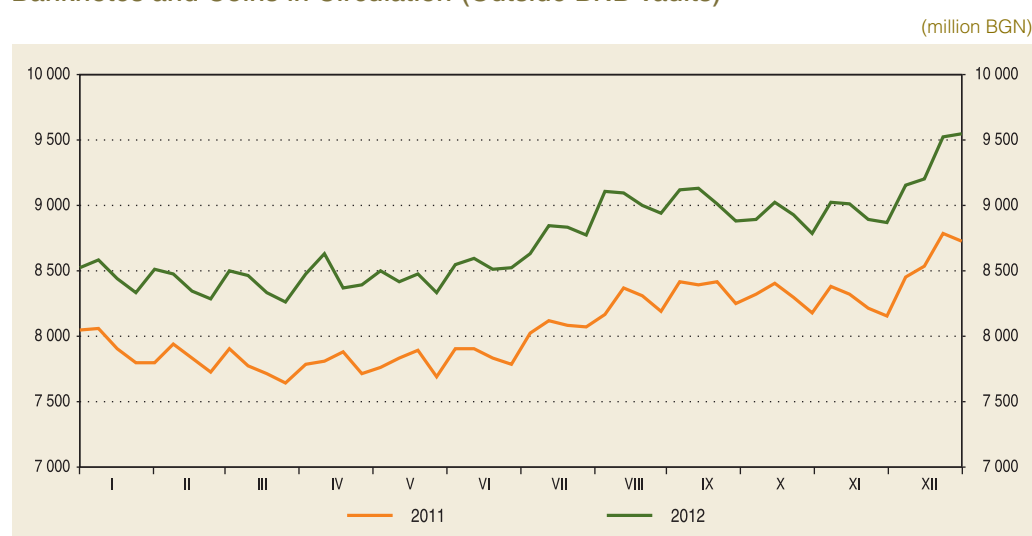


## V. Cash in Circulation

The Bulgarian National Bank has a monopoly on Bulgarian cash issue.<sup>39</sup> The Bank's cash is legal tender mandatorily acceptable as payment at full face value without restriction. The BNB prints banknotes, mints coins, and preserves and scraps uncirculated or withdrawn cash.

Circulating cash at the end of 2012 was worth BGN 9549.9 million in nominal terms, up BGN 821.2 million (9.41 per cent) on the end of 2011. By the end of 2012 banknotes accounted for 97.96 per cent of the value of circulating cash, 0.02 percentage points down in favour of coins.

### Banknotes and Coins in Circulation (Outside BNB Vaults)



Source: BNB.

Over the year the number of circulating banknotes grew faster than in 2011 to 343 million worth BGN 9354.7 million: up 23.8 million (7.45 per cent). Their nominal value grew BGN 806 million (9.43 per cent). In 2011 banknotes grew 1.89 per cent in number and 5.10 per cent in value.

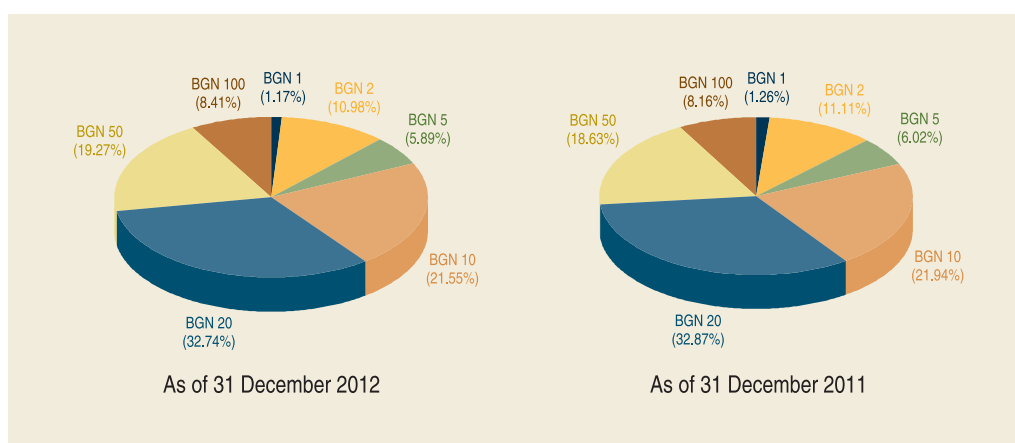
By the end of 2012 the BGN 20 banknote was most common in circulation at 32.74 per cent of banknotes or 112.3 million pieces, down 0.14 percentage points in a year. The shares of BGN 100 and 50 banknotes grew 0.25 and 0.63 percentage points.

By the end of 2012 the BGN 50 banknote held the largest share in the structure of circulating banknotes at 35.52 per cent, followed by BGN 100 and 20 banknotes at 30.84 and 24.01 per cent.

The average value of a circulating banknote was BGN 27.27, up BGN 0.49 mainly due to growth in high-value banknotes, giving BGN 100 and 50 a lead.

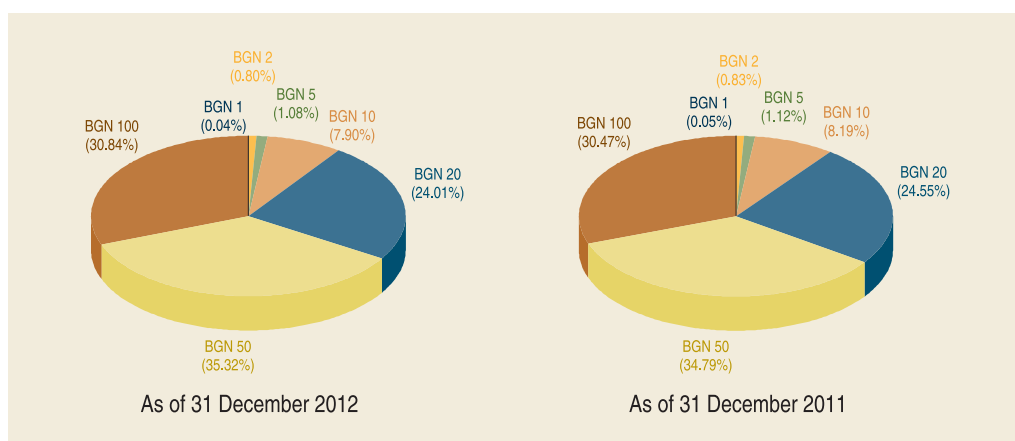
<sup>39</sup> Law on the Bulgarian National Bank Article 2, paragraph 5 and Article 25.

### Share of Individual Denominations in the Total Number of Circulating Banknotes



Source: BNB.

### Share of Individual Denominations in the Total Value of Circulating Banknotes



Source: BNB.

The share of circulating coins reached 1.98 per cent of the value of circulating cash. At the end of 2012, the number of circulating coins<sup>40</sup> was 1495.3 million, worth BGN 189.1 million.

The long-term trend to progressive annual growth in the number and value of circulating coins continued, matching that of 2011. Another continuing trend was in the numerical rise of low-value coins. In late 2012 BGN 0.50 rose more than 9 per cent on an annual basis.

In a year the number of circulating coins grew by 125.7 million (9.18 per cent) and their value by BGN 14.8 million (8.48 per cent). Growth was pronounced in BGN 0.01 and 0.02 coins which rose by 41.2 and 37.7 million (10.06 and 11.34 per cent). The number of high-value coins (BGN 0.10 and BGN 0.50) rose 6.39 to 9.48 per cent.

The share of low-value coins (BGN 0.01, 0.02, and 0.05) has risen at the expense of others in recent years to 66.64 per cent of the number of circulating coins.

In a year, the shares of BGN 0.01 and 0.02 coins rose 0.24 and 0.48 percentage points, while that of BGN 0.50 rose 0.01 percentage point. The shares of BGN 0.05, 0.10, 0.20, and 1.00 fell 0.22, 0.34, 0.16 and 0.02 percentage points.

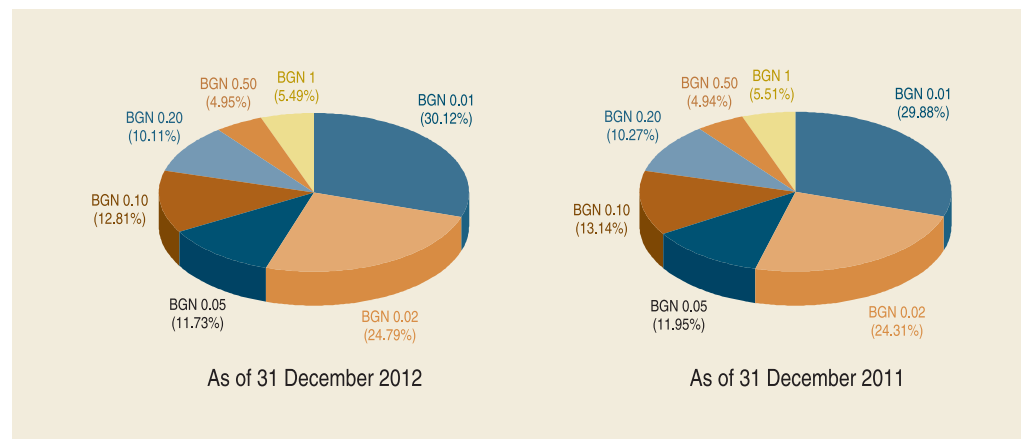
At the end of 2012 BGN 1 coins had 43.37 per cent of the total value of circulating coins, followed by 0.50 and 0.20 at 19.58 and 15.99 per cent.

<sup>40</sup> Excluding commemorative coins.

At the close of 2012 the average coin in circulation was worth BGN 0.13, as in late 2011.

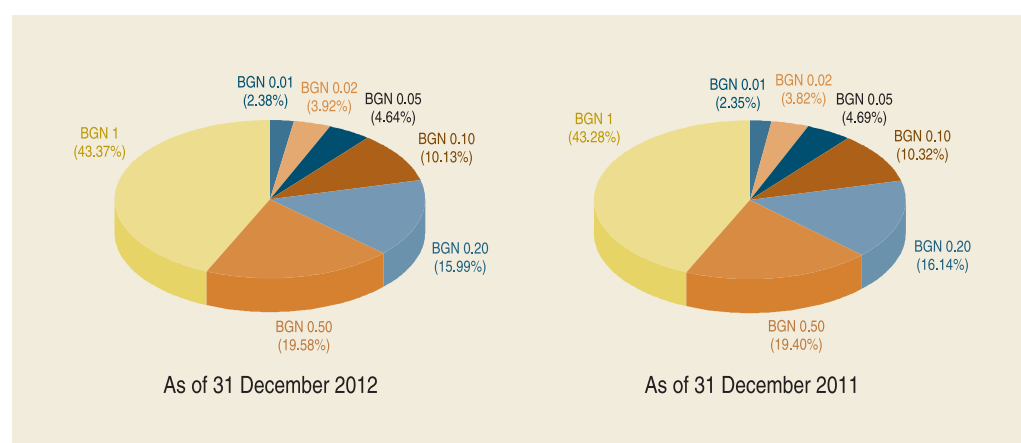
Commemorative coins retained their 0.06 per cent share in the value of circulating cash.

### Share of Individual Nominal Values in the Total Number of Circulating Coins



Source: BNB.

### Share of Individual Nominal Values in the Total Value of Circulating Coins



Source: BNB.

### Non-genuine Banknotes and Coins

In 2012 the BNB National Analysis Centre retained 1876 non-genuine circulating Bulgarian banknotes: 984 fewer on 2011. The share of retained non-genuine circulating banknotes was very low at 0.0006 per cent, on 0.0009 per cent in 2011. This indicates continuing high cash circulation security.

The BGN 20 banknote had the largest share of all retained non-genuine banknotes at 46.54 per cent, followed by 50 (25.05 per cent) and 10 (23.56 per cent). Non-genuine BGN 2, 5, 10, and 100 banknotes numbered 91 (4.85 per cent of all retained non-genuine banknotes).

The year saw authenticity evaluations of 634 non-genuine coins, including 78 BGN 1, 549 0.50 and seven 0.20 coins. The 2012 share of retained non-genuine Bulgarian coins in the total number of circulating coins was 0.00005 per cent.

As regards non-genuine foreign banknotes and coins in Bulgaria, in 2012 the National Analysis Centre retained 1802 euro banknotes, 1155 US dollar banknotes, and 156 assorted foreign banknotes.

Jointly with European and international bodies the BNB continued comprehensively counteracting and preventing coin and banknote counterfeiting and the spread of non-genuine money. Continuous staff training at banks, financial institutions, exchange bureaux, and other professional cash handlers offers appropriate prevention and safeguards cash circulation integrity.

#### **BNB Issue and Cash Activities**

BNB issue and cash operations include: banknote printing; accepting, delivering, repaying, processing, authenticity and fitness checking of banknotes, coins, and foreign currency; exchanging damaged cash; and destroying unfit Bulgarian banknotes and coins.

In 2012 the Bank supplied 60.9 million new banknotes and 105 million new coins worth BGN 921.9 million under contracts with producers. The BNB launched the five commemorative coins planned in its 2012 minting programme under the Law on the BNB Article 25, paragraph 1.<sup>41</sup>

Banknote and coin deposits and withdrawals from the BNB totalled BGN 27,423.6 million in 2012. Banks deposited BGN 13,301.4 million of cash: up 2050.3 million (18.22 per cent) on 2011. BGN 14,122.2 million of cash was withdrawn: up 2445.1 million (20.94 per cent) in a year.

In 2012 banknotes returned to BNB tills an average of 2.35 times a year. High-value banknotes had lower return frequencies, BGN 100 and 50 denominations returning 0.52 and 1.14 times. BGN 10 and 20 banknotes, most commonly dispensed by ATM terminals, returned 3.80 and 3.15 times.

In 2012 BNB and Cash Services Company<sup>42</sup> banknote processing machines tested 755.6 million banknotes and 172 million coins. Banknote authenticity and fitness checks were to ensure compliance with banknote quality and integrity standards. Compared with 2011, processed banknote numbers rose 17.59 per cent, coins rising 20.49 per cent. BGN 10 and 20 banknotes and BGN 0.10, 0.20, and 1.00 coins were most frequently processed by value.

Banknotes failing fitness standards numbered 84.4 million, up 7.7 million (10.03 per cent) on 2011. Their share of processed banknotes was 11.17 per cent.

Processing and fitness checks revealed 0.8 million unfit coins, up 44.03 per cent in a year. The share of unfit coins in the total circulating coins processed in 2012 was 0.49 per cent.

In 2012 BNB reserve currency purchases came to EUR 0.43 million, including EUR 0.27 million from budget organisations and EUR 0.16 million from individuals. Over the same period BNB reserve currency sales were EUR 9.6 million, including EUR 5.8 million to budget organisations and EUR 3.8 million to individuals.

Implementing regulations on cash quality and recycling and setting standards for sorting and customer-operated machines were BNB priorities in 2012. The Bank performed seven full and 34 spot on-site checks at credit institutions and professional cash handlers.

<sup>41</sup> For information on new banknotes and circulating and commemorative coin issues, see the BNB website.

<sup>42</sup> The Cash Services Company AD is a public equity company owned by the BNB and four banks. It handles cash and provides BNB Ordinance No 18 services.

## VI. Maintaining Banking System Stability and Protecting Depositor Interests

### 1. State of the Banking System

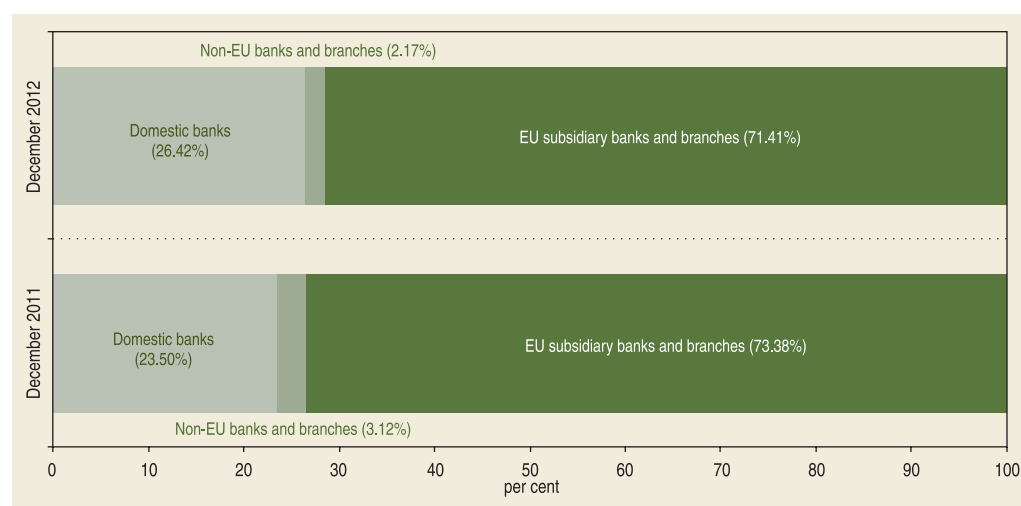
A slack economy and meagre investment continued affecting Bulgarian banks in 2012. Strong savings and low credit demand continued. Growing household deposits boosted banking liquidity, rendering subsidiary banks less dependent on parents. Higher growth rate of attracted funds compared with credit growth was a factor for maintaining high banking system liquidity. Balance sheets of individual institutions and the entire system experienced changes reflecting the reduction in high liquid assets and an increase in the share of cash and financial instruments (securities). Loan portfolio obsolescence posed challenges. Active credit risk management helped improve profitability. Profits exceeded last year's. The capital position reflected banks' actions to improve credit portfolio risk management and raise extra capital. Capital indicators exceeded EU averages.

#### Structural Changes in the Banking System Balance Sheet

By the end of 2012 banking assets totalled BGN 82.4 billion. They grew faster than in 2011 at 7.4 per cent, reflecting a 7.6 per cent rise in attracted funds.<sup>43</sup>

Ample liquidity and weak credit demand changed balance sheets. By the year's close, credit portfolio growth slowed due to loan sales and write-offs. Corporate and household deposit growth, which had offset reduced financing from parent companies, also slowed. Free resource went mostly into high liquid instruments providing higher yield (mostly securities). By the end of the year, the share of loans and advances in assets fell to 73.0 per cent from 78.6 per cent a year earlier. Cash rose BGN 1.8 billion (24.2 per cent), its share in assets rising to 11.5 per cent. The securities portfolio grew similarly, reflecting mostly rising offering.

#### Market Shares of Domestic and Foreign Banks



Source: BNB.

Reported growth of resources from non-resident sources was not a result of a change to strategies of parent companies but of one-off effects.<sup>44</sup> It did not greatly affect the

<sup>43</sup> A late 2012 rise in non-resident resource reflecting one-off transactions greatly changed this indicator.

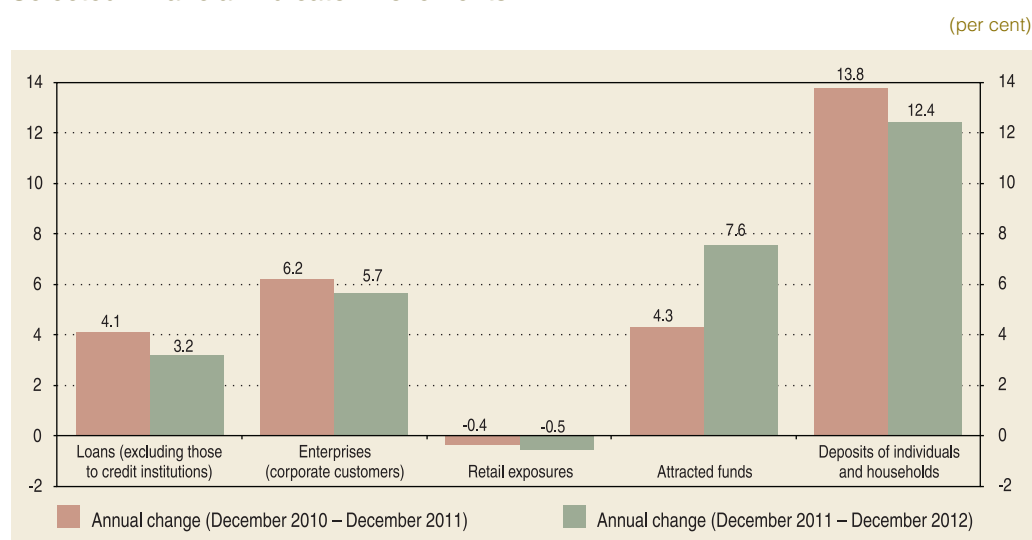
<sup>44</sup> A late 2012 credit institution transaction with its parent greatly increased banking system assets. Without this transaction, banking system attracted funds would have risen by BGN 3.2 billion (4.8 per cent).

financing structure, residents providing 80.5 per cent of funds at the year's close. Household deposit growth was again the main driver.

Domestic banks increased their market share to 26.4 per cent, contributing significantly to rising system assets. EU subsidiary banks' market share fell to 65.3 per cent, EU bank branches increasing to 6.1 per cent. The market shares of non-EU banks and branches also fell. The five largest banks held 49.5 per cent of the system's balance sheet assets at the year's close.

**Lending** Low demand curbed credit growth to 3.2 from 4.1 per cent in 2011. Domestic banks accounted for over 80 per cent of credit portfolio growth. Corporate loans rose BGN 2.1 billion (5.7 per cent), contributing most to the increase in gross lending. Exposures to non-credit institutions also grew BGN 169 million (20.2 per cent). Households continued avoiding new loans, lending to them contracting 1.9 per cent as in 2011, only mortgage loans rising 0.8 per cent.<sup>45</sup> Household lending declined BGN 98 million (0.5 per cent).<sup>46</sup> Central governments repaid loans, exposures to it falling BGN 325 million (55 per cent). Claims on credit institutions fell BGN 1.4 billion (17.1 per cent) mostly through a decline in placements with non-resident banks. The share of gross loans denominated in euro remained static (61.3 per cent), those denominated in levs rising to 34.6 per cent, and in other currencies falling to 4.1 per cent.

### Selected Financial Indicator Movements



Source: BNB.

**Attracted Funds** In 2012 attracted funds rose by BGN 5 billion to BGN 70.7 billion in December. The higher growth of 7.6 on 4.3 per cent in 2011 reflects mostly the increase in repos with credit institutions.<sup>47</sup> Individual and household deposits rose BGN 4 billion (12.4 per cent). Despite slower individual and household deposit growth, their share in total attracted funds rose to 50.7 per cent. Funds attracted from institutions other than credit rose 2.3 on 12.1 per cent in 2011, cutting their share to 31.2 per cent.

Funds attracted from credit institutions increased BGN 704 million (7 per cent), mostly from non-residents. This pushed the share of nonresident funds in attracted funds to 19.5 per cent. Household deposit growth changed the currency structure of attracted funds again, the share of lev denominated resource rising to 48.1 per cent at the expense of euro's 45 per cent. The shares of other currencies remained almost static at 6.9 per cent. Changes in funding sources did not change the share of fixed interest

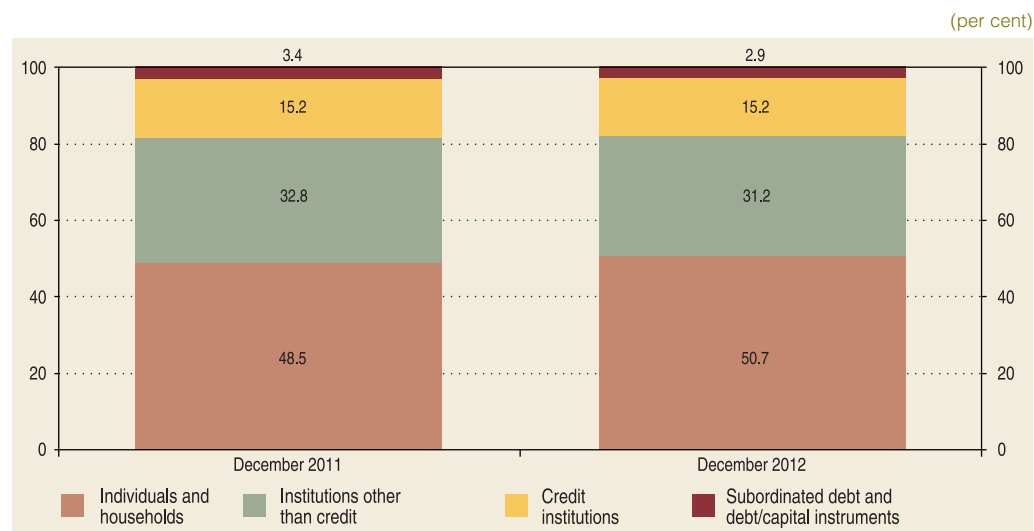
<sup>45,46</sup> The insignificant difference in credit growth rates shown here, in the Summary, and Section I reflects methodological differences in determining credit portfolio scopes for statistical and supervisory purposes.

<sup>47</sup> See footnote 44.



rate resource, which by the close of the year accounted for 81 per cent of attracted funds.

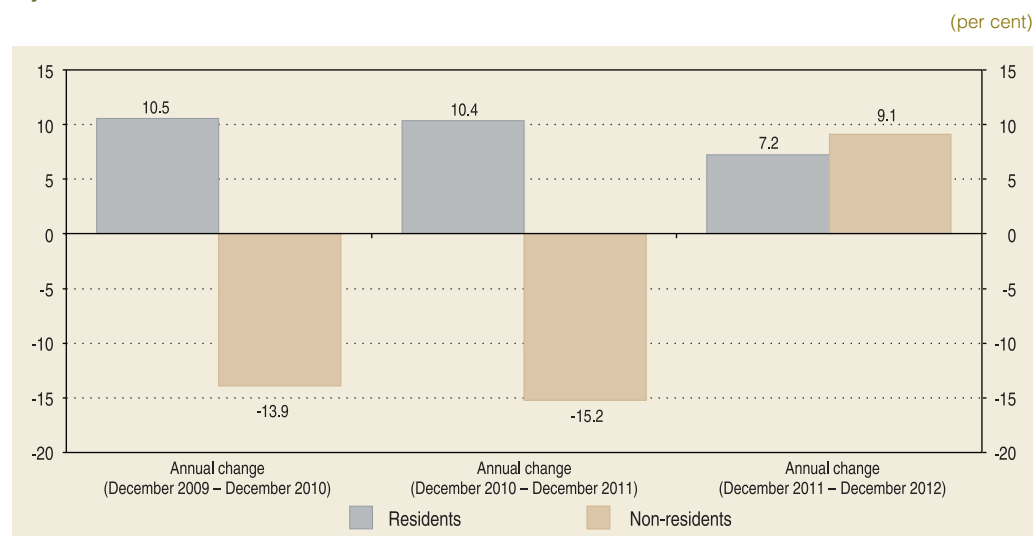
### Structure of Attracted Funds



Note: The sum does not add up to 100 due to rounding.

Source: BNB.

### Dynamics of Funds Attracted from Residents and Non-Residents



Source: BNB.

### Balance Sheet Equity and Financial Results

Banking sector balance sheet equity rose BGN 474 million (4.6 per cent) on the end of 2011 to BGN 10.8 million. All major capital components contributed. Reserves, including retained earnings (BGN 217 million) and revaluation reserves, contributed most to the annual balance sheet equity growth (BGN 107 million). Measures to strengthen the capital position boosted issued capital by BGN 99.7 million.

The banking sector's financial result was BGN 525 million, proving that Bulgarian banks managed to ride out environmental negatives. Audited banking system profit exceeded that of 2011 by BGN 51 million, reversing a downward trend since 2009.

### System Risk Profile

The negative trend in credit risk, the major risk for Bulgarian banks, remained. Cash flow improvement through exposure renegotiation and restructuring slowed down. To bolster portfolios, banks intensified the shedding of non-performing off-balance sheet assets by selling loans to deteriorated exposure companies or derecognised them

to restructure balance sheets. Despite slower classified loan growth, non-performing loans (past due over 90 days) continued pressuring operating income. Sparse investment alternatives, weak credit demand, and insufficient administrative spend optimisation also hit profitability. Individual banks and the entire system strengthened their liquid capacity. In 2012 the ongoing substitution of non-resident with resident attracted funds improved liability maturity structure. Capital indicators show adequate capital position management.

### Asset Quality

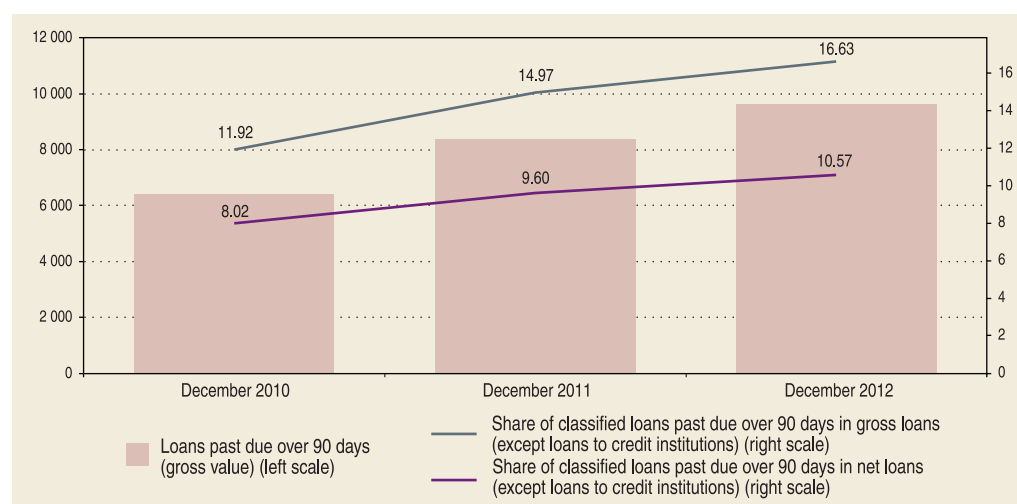
As the slack economy hit credit portfolio quality, a growing choice of credit risk management tools curbed asset impairment. Annual classified loan growth fell to 5.7 from 13.7 per cent at the end of 2011. The classified portions of corporate and household loans rose 5.3 and 6.6 per cent respectively. In household exposures, the classified portion of housing loans rose 13.4 per cent, falling 3.0 per cent in consumer loans.

The annual growth of loans past due over 90 days slowed to 14.6 from 30.2 per cent in 2011. This reflected loan derecognitions, portfolio sales, and security acquisitions affecting asset quality indicators, capital ratios, and profitability. At the year's close the share of exposures past due over 90 days in gross loans (excluding the ones to credit institutions) was 16.6 per cent with a net value of 10.6 per cent.<sup>48</sup>

### Classified Loans Past Due over 90 Days

(BGN million)

(per cent)



Source: BNB.

Sparse opportunities to invest incoming resource into high liquid assets (loans) and continuing low interest on domestic and international markets led banks to invest in debt and boost cash. This boosted overall asset quality, loans excluded. Investment into Bulgarian government securities rose BGN 1.4 billion (34.5 per cent), their share in the securities portfolio coming to 56.8 per cent by the end of 2012.

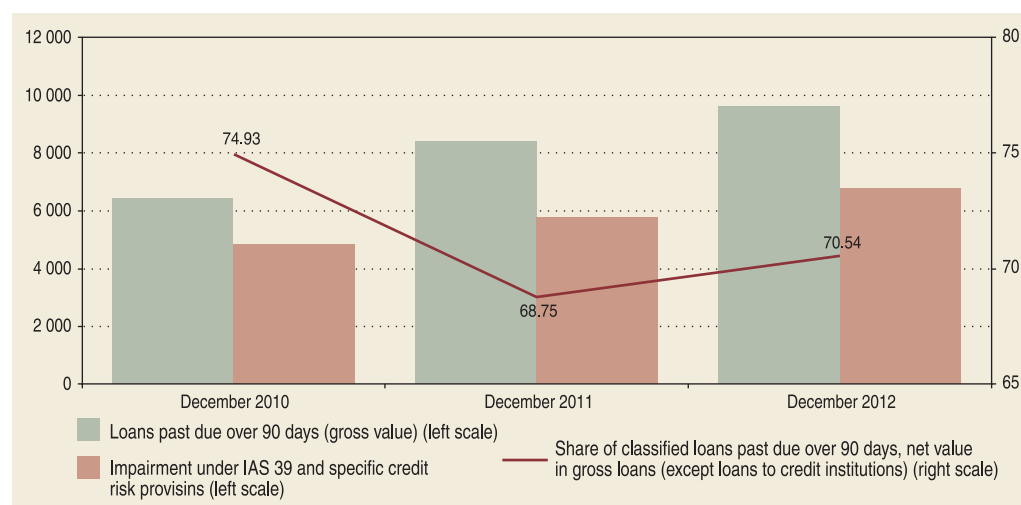
Rising impairment costs and specific credit risk provisions boosted system provisioning buffers. Classified exposure provisioning rose 6 percentage points to 46.1 per cent. Coverage for exposures past due over 90 days (including also those classified as loss) improved from mid-year, with 70.5 per cent of them covered by accumulated impairment and specific provisions by the end of 2012.

<sup>48</sup> The net value of non-performing loans is gross loan value less impairment costs.

### Coverage of Non-performing Exposures Past Due over 90 Days

(BGN million)

(per cent)



Source: BNB.

### Profitability

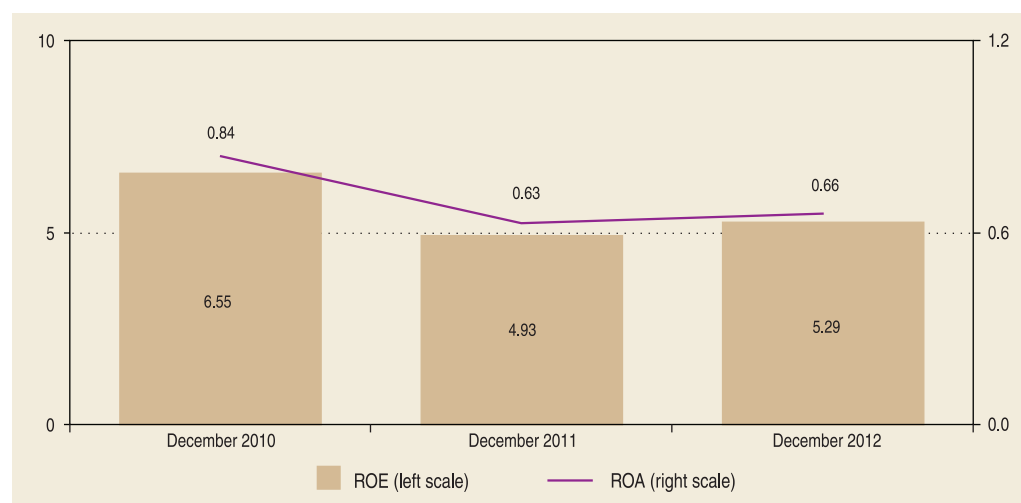
Banking system profit by 31 December 2012 was BGN 525 million, up 51 million (10.8 per cent) on last year. Higher profit pushed annual ROA slightly from 0.63 to 0.66 per cent. ROE grew stronger from 4.93 to 5.29 per cent.

Falling interest income and rising interest expenditure continued depressing net interest, posing the greatest challenge to banks' profits. Lower net income from fees and commissions and high administrative spending also hit banks' profitability. Lower impairment cost growth and higher net income from financial instruments and operating income helped improve the banking sector financial result from the prior year.<sup>49</sup> In December, most institutions sold worsened credit portfolios, earning cash and reintegrating impairment allocations.

### Return on Assets and Return on Equity

(per cent)

(per cent)



Source: BNB.

The net interest margin fell to 3.61 per cent from 4.16 in 2011. While problematic loan servicing continued hitting interest income from the credit portfolio, interest-bearing assets rose BGN 3.8 billion (5.5 per cent), helping revenue somewhat through investment into liquid and low yield assets. Progressively increasing interest bearing liabilities (mostly time deposits) also eroded the interest rate margin. Unused credit capac-

<sup>49</sup> Banking system impairment costs in 2012 decreased by BGN 148 million.

ity, combined with low interest rate levels on domestic and international markets, forced banks to invest into debt and hold more cash; this brought interest earnings that fell from 7.29 to 6.62 per cent at the end of 2012.

The share of net income from financial instruments changed most (to 7.4 per cent of total revenue) in banks' income structure through rises in securities and foreign exchange trading and loan sales.

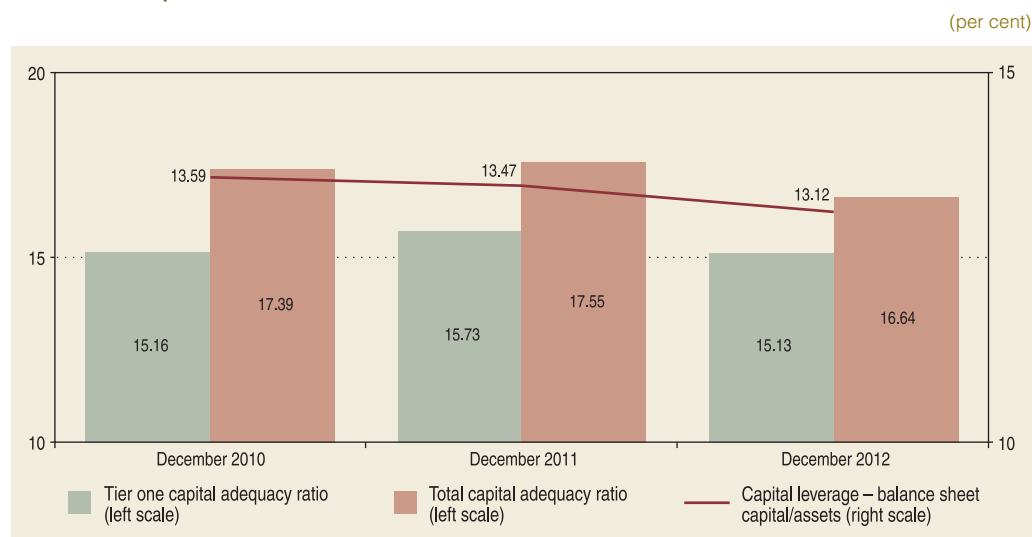
Despite challenges to the profitability of banks administrative spending was not sufficiently reduced, increasing by BGN 21 million (1.2 per cent) on the end of 2011.

## Equity

Banks preserved their capacity to absorb existing and new risks in an adverse economic environment. By the end of 2012, basic capital ratios suggested that accumulated buffers endured and the capital position remained stable. Total system capital adequacy of 16.64 per cent (from 17.55 per cent a year earlier) remained near the EU top by the end of 2012. Capital surplus (the excess of capital over regulatory minima) was BGN 2.6 billion at the end of 2012, providing extra resource to cover classified exposures of worsened quality. The year's audited financial results may provide additional capital support where necessary.

Banking system capital reflected several factors. Rises in issued capital and reserves boosted own funds, while increased specific credit risk provisions and lower subordinated term debt depressed equity.<sup>50</sup> The tier one capital adequacy ratio fell to 15.13 from 15.73 per cent in a year through capital requirements growing faster than tier one capital. Capital indicator analysis and assessment should be in the context of the BNB's national discretionary policy. Ordinance No 9 on the Evaluation and Classification of Risk Exposures of Banks and Allocation of Specific Provisions for Credit Risk mandates banks to make specific credit risk provisions based on the standard approach which directly reduces their capital. Had this not been so, banking system capital adequacy and tier one capital adequacy by the close of the year would have been some 3 (*i.e.* about 20 per cent) and 2 (*i.e.* about 17 percent) percentage points higher.

## Selected Capital Indicators



Source: BNB.

Increases in paid-in and registered capital and reserves boosted the role of tier one capital to 90.9 per cent of own funds by the end of 2012. This shows sufficient potential to accumulate capital resource if needed.

<sup>50</sup> Specific provisions to cover credit risk were included as an additional Basel II Supervisory Review Pillar 2 capital requirement enacted Ordinance No 9 of the BNB.

Balance sheet equity grew slower than assets, pushing leverage (balance sheet equity over net assets) down to 13.12 from 13.47 per cent last year.

The structure of capital requirements for different risks (credit, market, and operational) remained relatively static. Credit risk continued to be the major risk, engaging the major part (58.1 per cent) of total capital requirements. The corporate segment led, retail exposures and those secured by property falling significantly on 2011. Operational risk capital requirements fell slightly to 7.8 per cent, while position, foreign exchange, and commodity risks remained under 1 per cent.

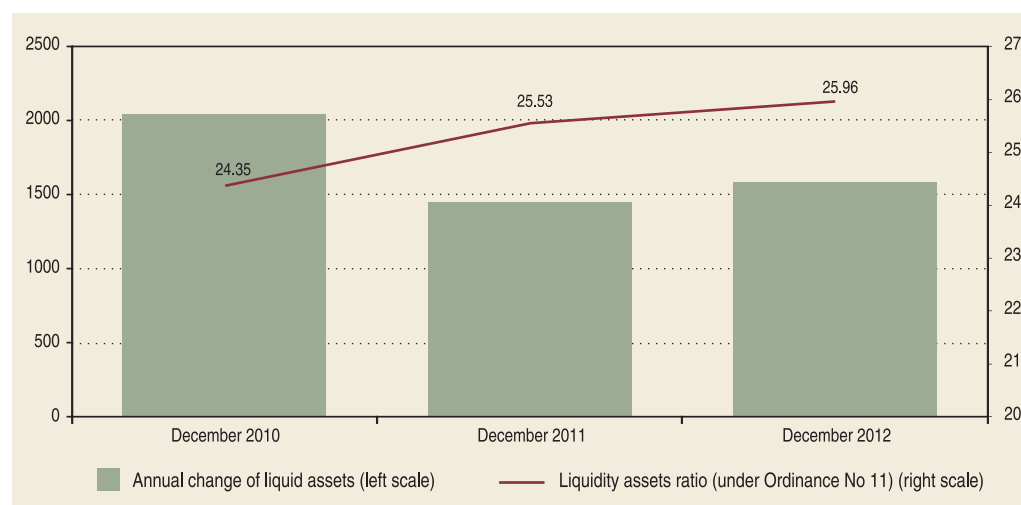
## Liquidity

Liquidity continued to ensure adequate coverage of attracted funds and normal financial intermediation during 2012. Financing sources remained stable, household savings continuing to provide most funds. Continuing confidence in banks meant steady fund inflows and high liquidity. The liquid asset ratio hovered at 25–26 per cent, reaching a five year high of 25.96 per cent at the year's close. Liquid asset growth of BGN 1.6 billion (9.4 per cent) was similar to that in 2011, these assets reaching BGN 18.4 billion. Rising by BGN 1.8 billion, cash offset the fall in balances on current accounts with banks and interbank deposits of up to seven days. Continuing weak credit demand boosted investment into marketable debt, Bulgarian sovereign bonds especially. The share of cash in liquid assets rose to 51.3 per cent. Cash balances on current accounts with banks and interbank deposits fell to 29.1 per cent. Liabilities (outflow) rose BGN 5 billion (7.5 per cent) to BGN 71 billion. Attracted resource maturity lengthened, adding to strengthened liquidity.

### Selected Liquidity Indicators

(BGN million)

(per cent)



Source: BNB.

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

These financial institutions numbered 302, most lending own funds (112) and offering financial leasing (72).<sup>51</sup> The market share of lessors continued falling, that of lenders, consultants and acquisition specialists continuing to rise. By the end of the year, the sector's assets totalled BGN 6.9 billion, an insignificant increase of 0.6 per cent on 2011. The top 20 institutions' assets were BGN 4.9 billion or 70.8 per cent of all sector assets. The sector held 8.4 per cent of banking system assets. Lessors retained their

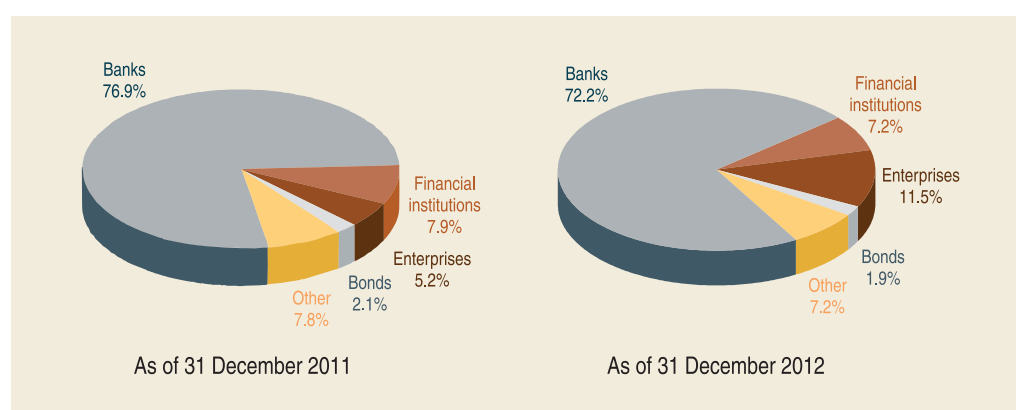
<sup>51</sup> Companies struck from the register of financial institutions numbered 27 due to termination of financial operations under the Law on Credit Institutions Article 3, paragraph 1, companies winding up, or statutory breaches.

dominance (59.5 per cent) despite losing market share on last year. Lenders boosted their market share to 20.5 per cent. Acquisition specialists, consultants and guarantors doubled assets to BGN 933 million by the end of 2012. Foreign exchange traders' assets fell 29 per cent on 2011, as did their profits and own funds.

The share of loans and receivables (including financial leasing) item remained dominant at 72.2 per cent (BGN 5 billion) in assets. Claims on financial lessors continued falling (to 57.2 per cent) on the prior two years in favour of a 21.6 per cent rise in business loans. Consumer loans were steady to 13.6 per cent. The foreign currency item shows a leading share (59.3 per cent) of receivables denominated in euro and other currencies. The sector's gross credit portfolio fell to BGN 5.5 billion, of which 46.8 per cent impaired loans (including receivables on financial leases). Worsened asset quality was mostly due to rising gross impaired receivables on financial leases (67.5 per cent) and ever rising receivables past due over 90 days.

Institutions continued funding operations with short-term funds attracted from banks (BGN 3.9 billion) despite a significant BGN 4.3 billion decrease on last year. This resource comprised 72.2 per cent of the sector's total attracted funds (BGN 5.5 billion). Most funds from banks were denominated in euro (88.4 per cent).

### Sources of Attracted Funds of Financial Institutions under Article 3, Paragraph 2 of the Law on Credit Institutions



Source: BNB.

Within the structure of financial liabilities, the distribution of funds by counterparty changed in favour of corporate financing (11.5 per cent), its share rising 5.2 per cent on 2011.

The 2012 financial result amounted to BGN 119 million, down BGN 28 million on 2011's BGN 147 million.<sup>52</sup> Consultants and bank and other financial institution interest acquisition specialists reported higher profits than lessors and factorers. Poor financial results and contracting operations resulted in lower sector profitability and financial indicators, with ROA at 1.7 per cent and ROE at 9.9 per cent.<sup>53</sup> Financial indebtedness exceeded equity several fold and current liquidity fell from 16.9 to 14.3 per cent.<sup>54</sup>

Equity increased 12.6 per cent to BGN 1.2 billion from 1.1 billion in 2011. This reflected effective capital growth at companies with negative equity values, which ended the year having to support capital positions.<sup>55</sup> Foreign interest in the sector fell from 59.7 per cent to 57.6 per cent in the year as companies with foreign capital left the register.

<sup>52</sup> Significant profit drops at foreign exchange and precious metal traders reflect 2011 transactions attracting 2012 dividend payments.

<sup>53</sup> ROA and ROE were 2.13 and 13.7 per cent.

<sup>54</sup> Current liquidity is the ratio between liquid assets and liquid liabilities.

<sup>55</sup> Amendments to BNB Ordinance No 26 (Darjaven Vestnik, issue 60 of 7 August 2012) and changes to the provision on equity mandated financial institutions with negative equity values to bring them into compliance by the year's close.

### 3. Banking Supervision

EU financial market stability and recovery developments in 2012 called for vigilance about Bulgarian banks' capital and liquidity positions. To this end, the banking supervision efforts over the review period were aimed at keeping capital and liquidity buffers sufficiently high to maintain banking system stability. Priorities involved improving the regulatory framework, continuous monitoring of credit institution operations, and protecting depositor interests.

#### Supervisory Policy

In 2012 BNB supervisors laid the grounds for the statutory framework to incorporate EU regulatory reform. The new EU supervisory architecture harmonises regulatory regimes and practice to the utmost through direct enactment by Member States. Supervisors ensured the Bulgarian regulatory framework retained its discretion, allowing the Bank to continue pursuing specific anti-cyclic policies with regard to banks and financial intermediaries. This particularly referred to capital requirements stemming from the new Regulation on supervisory requirements to banks and investment intermediaries based on Basel III. The national supervisory framework changed to reflect European Banking Authority (EBA) standards aimed at converging EU national practices. Drafting and debating rules on equity, credit risk adjustments, key risk factors and the reporting of liquidity ratios and bank large exposure ratios occupied much attention.

The Bank enacted Market Operations Risk Management Guidelines based on relevant EBA guidelines. These define and explain operational risks attending trading. Specific principles and measures for identifying, controlling, and monitoring these risks are in preparation, split into three groups: management, internal control, and reporting systems.

The Bank drafted Internal Bank Management Guidelines to expand and improve the internal management framework. The draft develops applicable principles and requirements for reliable and effective bank structures, staff, management, and supporting committee skills, and independent risk management and internal control aligned to institution market strategies and risk profiles.

The BNB's duty to collect information on banking remuneration practice and trends involved new Ordinance No 4 of the BNB on Requirements for Remuneration in Banks reporting forms and instructions, especially on staff grade differentials.

#### Macro-prudential Analyses and Strategies

Protecting banking system stability entails macro- as well as micro-prudential monitoring. Supervisory macro-analyses and strategies continuously monitored and analysed banking system finances, as well as those of banks whose behaviour or risk exposure could threaten system stability. Efforts centred on timely problem and risk identification. Communication with credit institution risk identification and analysis and forecast units involved surveying expected performance and credit risk management. Information from banks supplemented current financial reporting for supervisory purposes, covering major business plan parameters like assets, attracted funds, and capital. Information on parameters like lending and financing and on risk areas like loan quality and capital support provided more detail on expected results and measures to contain various types of risk in banks' balance sheets.

Methods for testing the impact of major risks (credit, liquidity and market) improved further. Stress tests continued to check the ability of the system and individual credit institutions to withstand diverse real and hypothetical impacts, their results guiding supervisory measures.

The BNB's strategy of active public communication kept the public abreast of the state of the banking system through regular paper and electronic publications supplemented by monthly press releases.



### Credit Institutions Supervision

Supervisory monitoring on credit institutions complies with the dynamics of banking processes and the need of timely precise and objective analysis on the performance and development of each bank. It involved monthly analyses of regular reports on financial ratios, indicators, and variables. It highlighted changes in banks' financial performance, risk profile, and solvency. The results of off-site supervisory reviews and assessments guided on-site inspections of risk management, underestimated risks, and rising solvency risk.

On-site inspections followed the full supervisory inspection model, including evaluating minimum capital requirements on credit, operational, and market risk (Basel II Pillar I), alongside concentration risk, bank portfolio interest risk, and other risks typical of banks (under Pillar II, Supervisory Review). They focused on credit, liquidity, operational, market risk management, concentration risk, and institutions' profit potential and led to final assessments on capital adequacy ratios and potential threats to equity integrity. On-site inspections also assessed internal capital adequacy analyses at some of the largest banks.

There were 20 supervisory inspections. The comprehensive supervisory review suggests that banks maintained solvency above regulatory minima, alongside high liquidity, and credit risk management adequate to current conditions. There were no conditions for equity erosion at any bank.

### Special Supervision

Work aimed to establish effective systems for barring criminal funds from banks and applying sound corporate governance. The finances of banks' shareholders were regularly analysed to assess their ability to back institutions financially if needed. Banks' fulfilment of Deposit Insurance Fund (BDIF) obligations was also examined. Monitoring banks' offering of products and services and of the recommendations they made improved transparency. Analysing financial institutions' operations also changed the requirements for institution registering and functioning.

Significant effort went on creating a supervisory model consistent with evolving international standards for preventing money laundering and terrorist financing. Inspections applied the risk-based approach. Written instructions and meetings aired best international practice for effective barriers against banks transferring criminal funds. Control mechanism inspections found sufficient resource and adequate protection against attempts to use banks for money laundering and terrorist financing.

The BNB website helped financial service consumers make informed decisions by carrying appropriate information. This highlighted the importance of basic awareness and the decisions consumers needed to make before entering into contracts.

The Bank cooperated with the BDIF to harmonise bank practice in calculating deposit bases.

Proposals on implementing the National Strategy on Counteracting Money Laundering emerged in the context of interinstitutional cooperation.

Joint BNB inspections with the Financial Supervision Commission and the State National Security Agency resulted in measures against entities offering unregistered and unlicensed financial services.

Cooperation with competent authorities intensified on cases requiring specialist knowledge and experience in detecting financial crime, including information exchanges through international legal assistance.

The number of registered legal entities operating as financial institutions continued rising by 13 per cent on last year. Transactions mostly involved financial leasing and lending funds not raised by public deposit taking or other refundable sources. Analyses of registered institutions' finances prompted the introduction of equity thresholds to safeguard against financial deterioration, with associated deadlines. The Bank anticipates that some institutions would fail to effect changes and would incur penalties. Criteria for defining core operations tightened and the regimen for companies

**Supervisory  
Administration,  
Licensing,  
and Permits,  
Micro- and  
Macro-  
prudential  
Supervisory  
Actions**

handling EU target project and programme funds changed. Due to a lack of financial operations or breaches of Ordinance No 26, 18 companies were struck from the financial institution register.

No new procedures for licensing credit institutions opened in 2012. Following a notification procedure TBI Bank will open a branch in Romania. The Latvian Regional Investment Bank branch opened in 2008 prepared to close. TBI Bank EAD and the Bulgarian American Credit Bank AD broadened the scopes of their licenses to provide the full range of payment services.

There were significant changes in some banks' shareholder structures. The BNB approved Bulgarian American Credit Bank AD qualified shareholder CSIF AD to become majority shareholder. The French Crédit Agricole restructured its indirect participation in Emporiki Bank Bulgaria EAD and renamed its Bulgarian subsidiary Crédit Agricole Bulgaria EAD. Sheikh Dr Adil Saeed Ahmed Al Shanfari of the Shanfari Group based in Oman participated in the Investbank AD equity increase, acquiring an over 20 per cent stake. The Bulgarian Acquisition Company II S.a.r.L. controlled by the General Reserve Fund of the Sultanate of Oman increased its Corporate Commercial Bank AD stake to over 33 per cent. The Municipal Bank AD increased its equity without significant shareholder changes.

The First Investment Bank AD sold two bond issues of EUR 20 million each meeting tier one capital conditions and included attracted funds into its equity. Three banks took the opportunity of increasing tier two capital through capital instruments (subordinated term debt) and three others repaid subordinated term debt early. There were no substantive changes in banks' management bodies. Eight institutions got approvals to elect new board members.

The supervisory bodies of sixteen EU Member State credit institutions notified the BNB of intent to provide cross-border services in Bulgaria, bringing their number to 212.

Micro- and macro-prudential supervision brought administrative and corrective measures to remove breaches, improve risk management, and strengthen capital buffers at individual banks. None of the measures reflected departures from standard bank practice; they aimed to bolster protection against putative future risks and halt external contagion:

***Macro-prudential measures***

Due to heightened liquidity risk related to aspects of the Greek crisis, Bulgarian subsidiaries of parent banks registered in Greece and Alpha Bank operating in Bulgaria through a branch received specific prescriptions on liquidity management and operational risk arising from parent bank information systems. This protected balance sheets from external risks and halted speculation of a direct transfer of instability to the Bulgarian banking system.

Despite higher capital and risk provisioning requirements in the national regulatory framework, banks received recommendations to refrain from set exposure classes and liquidate investment into set instruments. All credit institutions were recommended to maintain additional liquidity buffers and frameworks to assist organic capital growth. Additional instruments to intensify the frequency and scope of banks' financial reporting to the BNB were introduced.

***Corrective supervisory measures (micro-prudential measures)***

Remedial measures involved supervisory instructions to remove breaches (including capital regulation violations), impose appropriate constraints and prescribe capital increases. Supervisory constraints imposed in 2007 against one bank ended. Two credit institutions received individual instructions to improve risk management and remove specific weaknesses. A domestic bank was instructed to improve security

valuation, with another instructed to remove weaknesses in credit, operational, and market risk management alongside liquidity and internal controls. Supervisory inspections found more than 180 formal regulatory framework violations (most not directly threatening institution stability) and issued 150 recommendations to managements.

Bank supervisory powers under the Law on the BNB aim to maintain banking system stability and protect depositor interests, and do not cover protecting financial service consumers. Nevertheless, the BNB continued receiving complaints from bank customers and other financial service consumers. Some 85 per cent were from individuals. Banks again considered some 6 per cent of these complaints partly or wholly justified and settled them wholly or partially.

## VII. The Central Credit Register

The Central Credit Register (CCR) is an information system on debt to Bulgarian banks, financial institutions, payment institutions, and electronic money institutions. It is organised and maintained by the Bulgarian National Bank.<sup>56</sup>

The CCR lists all loans by these institutions, irrespective of amount. Loans to government and the Bulgarian National Bank are exempt, as are agreed overdrafts under BGN 1000 classified as standard under Ordinance No 9 on the Evaluation and Classification of Risk Exposures of Banks and Allocation of Specific Provisions for Credit Risk.

Early 2012 amendments to Ordinance No 22<sup>57</sup> extended CCR scope to payment institutions and electronic money institutions lending under the Law on Payment Services and Payment Systems Article 19. Institutions lending under the Law on Credit Institutions Article 56 (after Ordinance No 26 listing into the public register) are now in the CCR, as are payment and electronic money institutions lending under the Law on Payment Services and Payment Systems Article 19 (after Law on Payment Services and Payment Systems Article 17 listing into the public register).

The CCR provides uniform debt information under Ordinance No 22 Article 4, participant access to debt records, and information to the BNB. Extended coverage improved credit risk analyses. By the end of 2012 there were 197 participants: 31 banks, 165 financial institutions, and one payment institution. The 19 new participants included 17 financial institutions, a bank, and a payment institution. Six financial institutions were deleted under Ordinance No 22 Article 8, item 1 in relation to Ordinance No 26 Article 9.

By the end of 2012, the Register logged 2,114,000 borrowers: 2,007,000 individuals, 97,000 legal entities, 3000 foreigners, and 7000 self-employed people.

Provided in real time, customer debt information includes loan status, arrears, and repaid loans for five years back, and borrowing histories. Credit history is crucial in assessing creditworthiness and curbing the risk of bad loans. Data help CCR participants identify reliable borrowers. By the end of 2012 the CCR listed 4,025,000 loans with a balance sheet exposure of BGN 62,766 million. Residual debts up to BGN 5000 predominated with individuals (66.4 per cent), while debts of BGN 5000 to 50,000 predominated with legal entities (37.9 per cent).

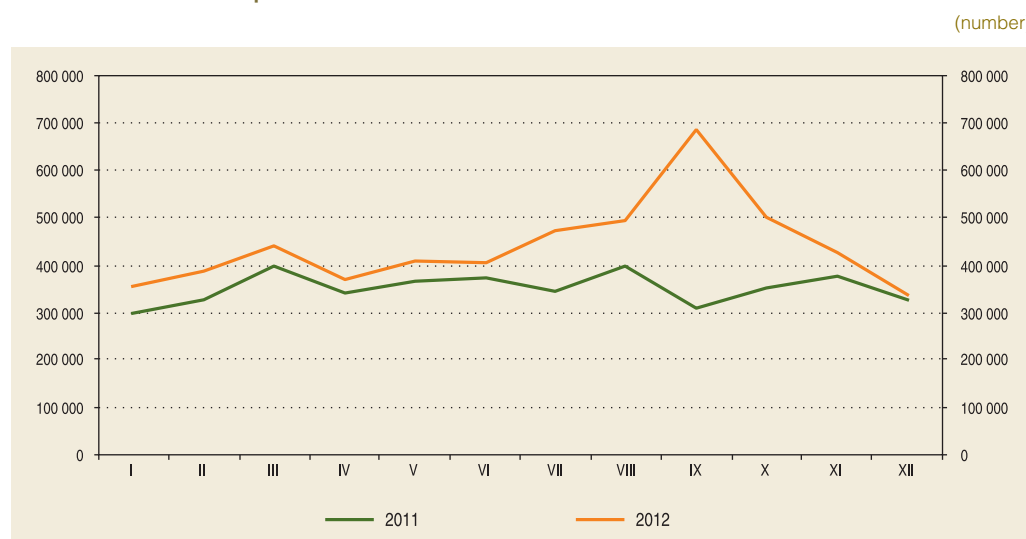
In 2012 banks and financial institutions conducted 5,277,000 digital certificate searches on 4,078,000 individuals and 1,199,000 legal entities. This was 954,000 more than in 2011 (4,323,000): an important indicator of the reliability and quality of Register information. The average monthly searches were 438,000 on 360,000 in 2011.

Ordinance No 22 governs CCR information disclosure to reporting agents, individuals, and legal entities. Individuals enjoy one free access to CCR data a year. In 2012 there were 7105 applications for statements: 6898 from individuals and 207 from legal entities on 5709 in the prior year (5493 from individuals and 216 from legal entities).

<sup>56</sup> Ordinance No 22 of the BNB of 16 July 2009 governs the CCR and its information flows.

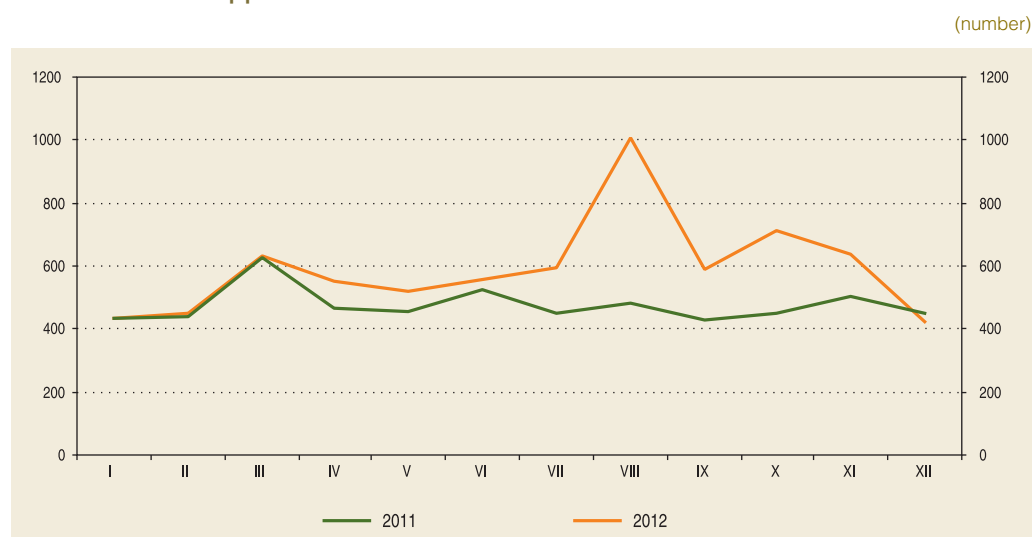
<sup>57</sup> Amendments to the Law on Credit Institutions Article 56 in late 2011 (Darjaven Vestnik, issue 105 of 29 December 2011) triggered changes to Ordinance No 22.

### Number of CCR Inspections in 2011 and 2012



Source: BNB.

### CCR Statement Applications in 2011 and 2012



Source: BNB.

To improve CCR service, application submission and data receipt went automatic in November 2012.

CCR data collection and maintenance follow EU Member State central bank national credit register good practice. Register data form a reliable basis for future information exchanges between national credit registers. Intra-Community information exchange will broaden information on borrowers listed in national credit registers.

## VIII. The Fiscal Agent and State Depository Function

The Law on the BNB makes the Bulgarian National Bank the state's fiscal agent and official depository. The Bank collects and submits information on budget entities' domestic bank accounts and acts as government debt agent under contracts negotiated to market conditions and prices with the Ministry of Finance (MF).

The GSAS system for conducting government securities auctions, the ESROT electronic system for registering and servicing government securities trading, the GSSS government securities settlement system, 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 all service the BNB functions.

Agency fee and commission revenue was BGN 1,646,600, up 1.19 per cent on 2011. This was mainly due to higher fees and commissions from processing paperwork on auctions, primary market government bond registration and settlement, and issue maturities (BGN 836,600 on BGN 817,200 in 2011), and higher monthly fees for new GSAS, ESROT and GSSS participants.

### Information Service

In meeting BNB obligations related to state budget information servicing under the agreement signed with the MF, daily and periodical data on operations and balances on budget, extra budgetary, deposit, foreign currency, and letter-of-credit accounts of budget entities and municipalities in levs and foreign currency with the BNB and other banks in Bulgaria were regularly collected, processed, stored and submitted to the MF *via* the IOBFR system for budget and fiscal reserve information servicing. The Bank monitored for the MF security pledged by banks under the State Budget Law, tallying it with account balances on a daily basis. The year saw 887 statistical reporting forms sent, including 307 on the fiscal reserve, up 3 per cent on 2011. The increase was because of an MF call for daily advice on municipal account balances over set periods each month. There were 203 summarised quarterly statements on first level budget entities.

By the close of 2012 the number of budget servicing banks (including the BNB) in IOBFR, working to joint Minister of Finance and BNB Governor instructions, was 23 against 21 a year earlier.<sup>58</sup> Based on summarised information, on 31 December 2012 the total balances on budget entities' accounts came to BGN 7645.2 million<sup>59</sup>, up 27 per cent on 31 December 2011. Over three quarters (BGN 5811.2 million) was in BNB accounts and the rest with domestic banks. Account balances rose 8.9 per cent on 2011, mainly through late December municipal balance rises. At the end of 2012, as a year earlier, almost 60 per cent of balances outside the BNB were at five banks, four of which the same in both years.

Approximately 80 per cent of budget funds were in fiscal reserve bank accounts.<sup>60</sup> On 31 December 2012 this came to BGN 6081 million, of which BGN 3422.2 million with the State Fund for Guaranteeing the Stability of the State Pension System (the Silver Fund), the MF National Fund, the State Agriculture Fund<sup>61</sup>, and the Teachers' Pension Fund. These funds are disbursed for statutory purposes.

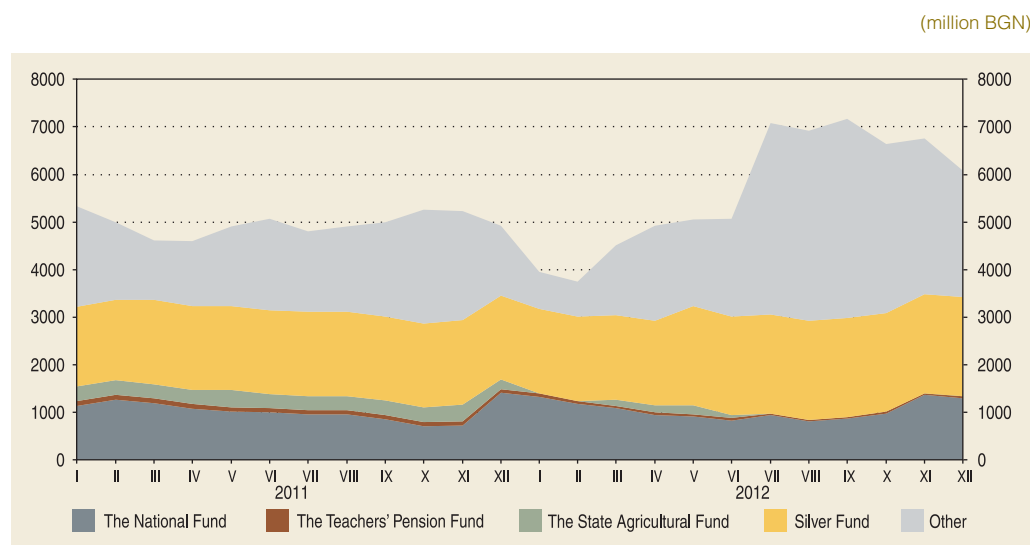
<sup>58</sup> To facilitate bank operations in 2012, new instructions of the Minister of Finance and the BNB Governor were introduced at the initiative of the BNB to consolidate all effective provisions on budget information servicing with effect from 1 July 2012.

<sup>59</sup> Foreign currency account balances are in levs at relevant BNB exchange rates on 31 December 2012.

<sup>60</sup> The MF sets the scope of bank accounts whose 31 December 2012 balances are in the fiscal reserve by reference to Council of Ministers' Decree No 367 of 2011 on implementing the 2012 State Budget.

<sup>61</sup> On 31 December 2012 the balance of State Agriculture Fund accounts was BGN 0.1 million from BGN 193.4 million on 31 December 2011.

## Fiscal Reserve Structure



Sources: MF, BNB.

The AS ROAD system provided information on Bulgaria's foreign financial obligations, for which the BNB is calculating and paying agent.<sup>62</sup> The second and third tranches of the credit agreement between the Bulgarian government and the European Investment Bank to the amount of EUR 82.4 million and EUR 50 million, as well as the EUR 950 million Eurobonds issue on international capital markets were registered in 2012 upon MF advice. There were 35 regular payments of EUR 204.3 million in coordination with the MF: EUR 58 million principal and EUR 146.3 million interest.<sup>63</sup> By 31 December 2012 AS ROAD showed EUR 3434.5 million<sup>64</sup> of obligations from EUR 2438.4 million a year earlier.<sup>65</sup> Structurally, euro-denominated debt continued occupying the largest share, followed by USD and JPY at 75.4, 24 and 0.6 per cent.

### Servicing Government Securities Trading

There were 26 MF scheduled auctions held *via* GSAS. They offered seven tap medium and long-term fixed interest issues with average maturities of six years.<sup>66</sup> The early 2012 ten-year-and-six-month reference issue in BGN had most openings (six) and was used to calculate long-term interest for assessing the degree of convergence.

The MF offered BGN 1322.6 million of bonds, up BGN 97.1 million on 2011.<sup>67</sup> Of this, 41.4 per cent (BGN 547.6 million) was denominated in euro. Bids by primary dealers exceeded supply, with an average bid-to-cover ratio of 2.75 on 2.33 in 2011. The average number of primary dealer bids *per* auction also increased to 91 from 82 in 2011. The BGN 1387.7 million nominal value of bids by non-bank institutions (including the lev equivalent of EUR 249.3 million) was almost 1.7 times greater than 2011's BGN 817.6 million. Pension funds were among the most active with 18.4 per cent of bids, followed by insurance corporations (5.6 per cent), the National Insurance Institute (4.6 per cent), and the Bulgarian Deposit Insurance Fund (4.6 per cent). Bank bids also rose, their share falling to 61.8 from 71.4 per cent in 2011.

Despite greater demand, the MF did not approve all bids at two auctions and rejected all bids at another two. It approved a larger than projected volume at another auction. The Ministry sold BGN 1161.1 million of bonds (including the lev equivalent of EUR 194.5 million) or 87.8 per cent of the scheduled volume. Over half went to primary and non-primary dealer banks.

<sup>62</sup> Under the government debt agency agreement between the BNB and MF.

<sup>63</sup> The payments total was recalculated in euro at the BNB's 31 December 2012 rate.

<sup>64</sup> The debt total was recalculated in euro at the BNB's 31 December 2012 rate.

<sup>65</sup> The debt total was recalculated in euro at the BNB's 31 December 2011 rate.

<sup>66</sup> In 2012 the MF made a series of issuing schedule changes, with two new auctions in the first quarter and two euro-denominated auctions cancelled in the second quarter.

<sup>67</sup> See the *Government Securities Market* quarterly for detail on primary and secondary market developments.

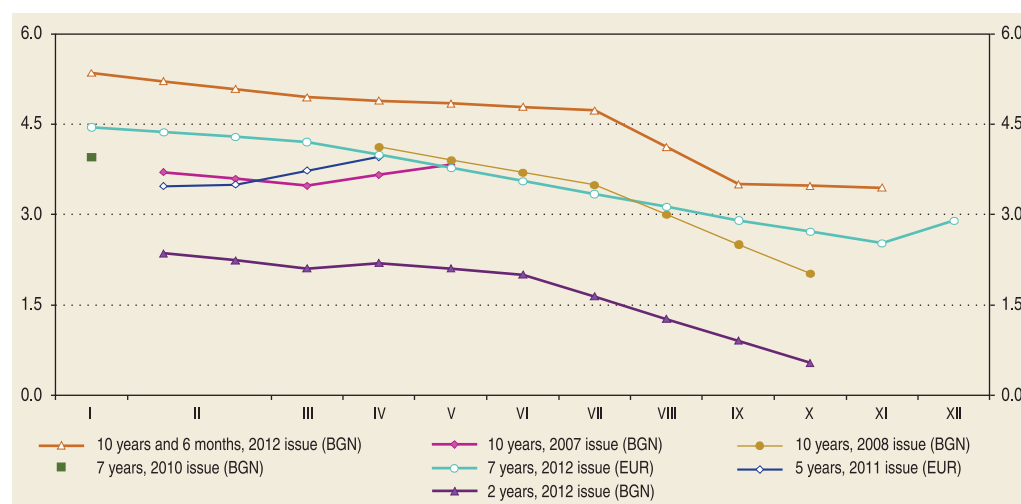


Average annual auction yields of lev-denominated two, seven, ten-year and 10.5-year issues were 1.82, 3.96, 3.45, and 4.32 per cent, with 3.48 and 3.56 per cent for euro-denominated five and seven-year issues.

The Budget received BGN 1160 million from bond sales, spending BGN 634.6 million on repayments. Thus, positive net government bond financing was BGN 525.4 million.

### Average Annual Yield Attained at Domestic Government Securities Auctions in 2012

(per cent)



**Note:** The MF rejected all bids at the five, seven-year EUR bond auctions on 9 April, and 10 December; the chart shows the average annual yield of submitted bids.

**Source:** BNB.

ESROT showed BGN 2016 million worth of initial government bond acquisitions and maturing issue repayments, up 7.1 per cent on 2011.<sup>68</sup> The increase was mainly due to the greater volume of principal and interest payments. The system showed 891 regular MF coordinated payments of BGN 854.9 million, including BGN 205 million interest. After primary registration and payments, 25 issues were in circulation by the end of 2012: four medium-term (one to five years) and 21 long-term (over five years) worth BGN 4981 million<sup>69</sup> or 11.4 per cent up on the BGN 4473 million a year earlier. Currency structure changed little, with BGN-denominated issues redeemable in leva at BGN 3451.4 million (69.3 per cent), EUR-denominated issues redeemable in euro at BGN 1315.5 million (26.4 per cent) and EUR and USD-denominated issues redeemable in leva at BGN 214.1 million (4.3 per cent).

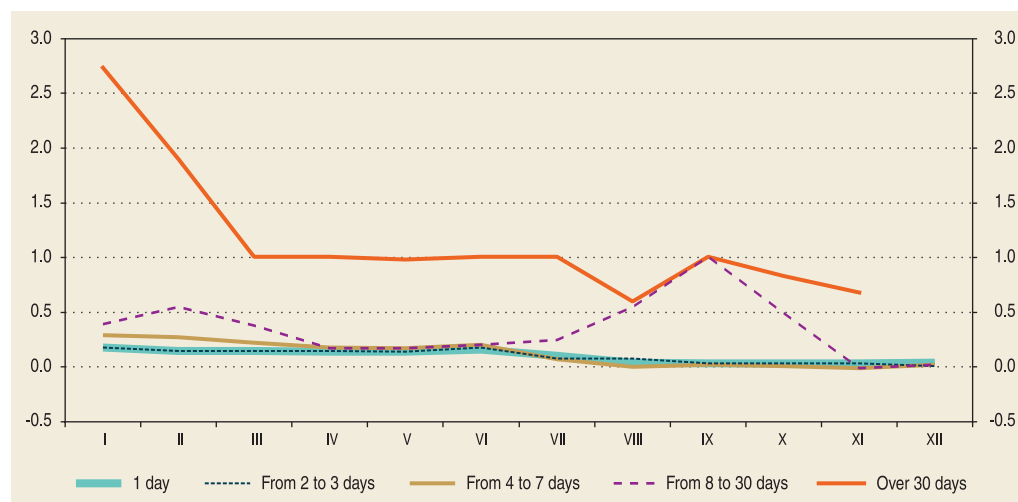
The total nominal volume of secondary market government bond transactions in ESROT was BGN 38,089.4 million from BGN 77,557.9 million in 2011. Repo agreements had the largest share at 61.2 per cent, followed by blocking and unblocking transactions, operations with or between ESROT participants' customers, and outright purchases and sales at 25.8, 8.3 and 4.7 per cent. Falling yields and rising prices, especially in the second half year, cut traded volumes in all segments.

Repos with a flow of funds on current accounts had the largest volume share (86.8 per cent), those concluded for a day being most attractive (65 per cent). Average-weighted annual yields by maturity were 0.1 per cent in transactions concluded for a day, 0.11 for two to three days, 0.15 for four to seven days, 0.32 for eight to 30 days, and 1.01 for over 30 days. As last year, the greatest fluctuations were at the long end of the yield curve. The share of free of payment repos (13.2 per cent) fell further on 2011 (17.9 per cent), most of them for government bonds denominated and redeemable in euro.

<sup>68</sup> The lev equivalent of payments on foreign currency denominated bond issues was calculated at the BNB rate on the day of payment.

<sup>69</sup> The total amount of government securities was recalculated in leva at the BNB's 31 December 2012 rate.

### Average-weighted Annual Yield of Repo Agreements in Domestic Government Securities in 2012



Source: BNB.

ESROT showed BGN 3169.6 million worth of operations with or between system participants' customers. Outright purchases and sales hit a secondary market low at BGN 1786.2 million. Bonds traded across the whole yield curve, long-term issues prevailing, at greatly varying prices. Average annual yield of the ten-year-and-six-month reference issue steadily fell over the year from 5.3 to 3.44 per cent. Weaker trading cut the secondary market liquidity ratio to 5.67 from 13.59 in 2011.<sup>70</sup>

The issuer cancelled USD 898,200 of ZUNK<sup>71</sup> bonds over the year, approving them for repayment of obligations to government.

The year saw 10,050 ISO 15022 government bond transaction notifications and registration requests, with no refusals due to insufficient bonds or funds in participants' current accounts.

Compared with the close of 2011, government bonds in bank portfolios rose greatly by BGN 368 million. Those in insurer and pension fund portfolios rose by BGN 211.9 million, 90 per cent of them long-term ones. At the end of 2012, 55 per cent of government bonds were with banks, 27 per cent with insurance corporations and pension funds, 17 per cent with non-bank financial institutions, corporations and individuals, and 1 per cent with foreign investors, against 54, 25, 20 and 1 per cent a year earlier.

Most blocking and unblocking operations in domestic bonds met the statutory requirement for securing available funds in budget entities' bank accounts by helping banks regulate security in real time.<sup>72</sup> The lack of dramatic fluctuations in budget balances with banks cut their volume by 42 per cent on 2011. Average daily nominals of domestic bonds blocked in ESROT came to BGN 1009.1 million, EUR 182 million and USD 21.8 million from BGN 985.8 million, EUR 145 million and USD 30.6 million a year earlier. Servicing banks also blocked sovereign bonds issued on international markets (external debt government securities) by transferring them into dedicated

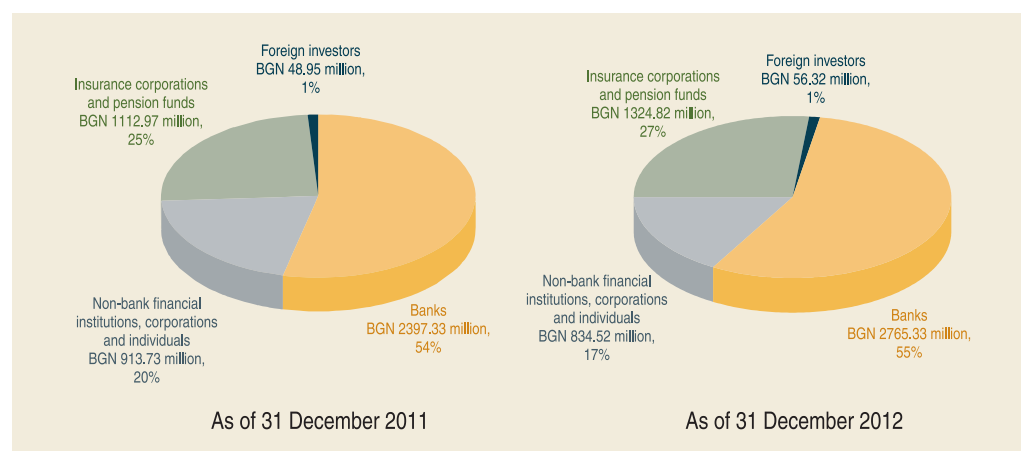
<sup>70</sup> The ratio between the 2012 secondary market transactions volume and the volume of government bonds circulating at the year's close.

<sup>71</sup> The Law on Settlement of Non-performing Credits Negotiated prior to 31 December 1990.

<sup>72</sup> According to § 24, paragraph 2 of the Transitional and Final Provisions of the Republic of Bulgaria 2012 State Budget Law, funds in all bank accounts, deposits and letters of credit of budget entities (municipalities included) in levs and foreign currencies, except for the funds under Article 19 of the Law on the Bulgarian Development Bank, are secured by servicing banks in favour of the MF through blocking Bulgarian domestic and external debt government securities. Government bonds 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 or security may be blocked.

BNB accounts. Their average daily nominals were BGN 33.5 million, EUR 90.2 million, and USD 165.5 million, the euro-denominated share rising on 2011.<sup>73</sup>

### Holders of Government Securities Issued in the Domestic Market



Source: BNB.

On 31 December 2012 government bonds blocked in ESROT under the Law on Registered Pledges amounted to BGN 83.2 million, up 20.2 per cent on December 2011 (BGN 69.2 million).<sup>74</sup>

Over the year ESROT offered 99.6 per cent availability, outages handled under redundancy rules for BNB systems.<sup>75</sup> The inclusion of a new bank into the government securities depository increased system participants to 31: 26 government securities subdepository banks, three investment intermediaries other than banks, the Reserve Collateral Pool, and the MF.

On 31 December 2012 there were 1329 accounts in the government securities settlement system under Ordinance No 31 on Government Securities Settlement. Of them, 25 were for the issuer's bonds (the MF), 537 for participants' bonds, 416 for participants' customers, and 351 for encumbered bonds. Account nominals tallied with the total amount of outstanding issues at BGN 4981 million.

### System Development

ESROT, GSSS and other relevant systems received technical and functional updates in line with the MF proposal to settle euro-denominated bonds in banks' TARGET2 accounts by delivery *versus* payment and the Governing Council's launching a project to include the BNB government securities depository into TARGET2-BNB as an ancillary system. There was also internal integration testing, including with the ECB. Since this project requires both financial resources and legislative adjustments, the MF and the BNB are coordinating draft amendments to MF and BNB Ordinance No 5 and the government debt agency agreement under Article 43, paragraph 2, item 3 of the Law on the BNB.

<sup>73</sup> These are EIB debt securities accepted as collateral by the MF along with Bulgarian government bonds issued on the domestic and external markets.

<sup>74</sup> The lev equivalent of foreign currency denominated blocked/unblocked bonds was calculated at the BNB rate on the day of the transaction.

<sup>75</sup> See footnote 34.

## IX. Participation in the ESCB and in EU Institutions' Activities

The year saw important moves to develop the EU's legislative framework for stability, coordinate economic policy better, and improve growth conditions. In February euro area states signed the Treaty Establishing the European Stability Mechanism, expanding the existing mechanism.<sup>76</sup> The next month saw the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. Debate in the second half year focused on the proposed financial institution recovery and resolution framework and the establishment of a supervisory mechanism for the euro area. The European Council, the European Commission, the Eurogroup, and the ECB launched a debate on the future of EMU.

The BNB sat on ESCB, European Commission, EU Council, European Systemic Risk Board (ESRB), and on the national Council for European Affairs committees and working groups.

### European System of Central Banks

The BNB Governor is a member of the ECB General Council alongside other EU central bank governors and the ECB President and Vice-President. BNB representatives sit on 12 ESCB committees and 31 working groups, the Human Resources Conference (HRC), and in two ESCB supervisory macroeconomic research and competition networks.<sup>77</sup> The Bank helps elaborate ECB legal instruments on monetary and banking infrastructure, payment and settlement systems, statistics, and other central banking issues.

The BNB was active in ESCB consultations elaborating ECB positions on national and Community central banking legislation. More important BNB opinions concerned the European Commission's proposed directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, and the proposed regulation on prudential requirements for credit institutions and investment firms. The Bank also commented on the proposal for a Council regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions and a proposal for a regulation of the European Parliament and of the Council amending the regulation establishing a European Banking Authority, the proposed European Parliament and Council directive proposal for a directive of the European Parliament and the Council on the establishing a framework for the recovery and resolution of credit institutions, and the Hungarian financial transaction tax. In consultations on the 2012 ECB Convergence Report, the BNB commented on the methodology for calculating convergence criteria and interpreting convergence sustainability.

EU members have to consult the ECB on legislative bills within its purview. The Ministry of Finance consulted the ECB on amendments to the Law on the State Fund for Guaranteeing the Stability of the State Pension System and on the draft Law on Public Finance.

The Bank continued translating and producing ECB periodicals under the agreed ESCB communications policy, including the ECB Annual Report 2011, the Conver-

<sup>76</sup> The new Treaty amended the July 2011 one to ensure a more flexible and efficient EMU and came into force on 8 October after ratification by all 17 member states.

<sup>77</sup> BNB representatives sit on the Accounting and Monetary Income Committee (AMICO), the Financial Stability Committee (FSC), the Banknotes Committee (BANCO), the Eurosystem/ESCB Communications Committee (ECCO), the Information Technology Committee (ITC), the Internal Auditors Committee (IAC), the International Relations Committee (IRC), the Legal Committee (LEGCO), the Market Operations Committee (MOC), the Monetary Policy Committee (MPC), the Payment and Settlement Systems Committee (PSSC), the Statistics Committee (STC), and the Human Resources Conference of Eurosystem Banks/ESCB (HRC).

**European  
Systemic  
Risk Board,  
European  
Banking  
Authority,  
Colleges of  
Supervisors**

gence Report 2012, and Monthly Bulletin chapter summaries, the latter on the BNB website.

On 31 May and 1 June the Bank hosted a session of the Executive Board of the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB).

The BNB was actively involved in ESRB activities and participated in the meetings of the ESRB General Council and other ESRB substructures. Alongside monitoring systemic risks to EU finances, the ESRB General Board focused on Community and national macro-prudential policy, the macro-prudential aspects of the proposed single euro area supervisory mechanism, interbank reference interest rate reform, and changes in money market funds regulations.<sup>78</sup>

The Board made two recommendations on bank financing and money market funds. The one on bank financing included measures to mitigate liquidity risk and risks encountered by banks in funding themselves to supply normal credit. The BNB shared the view that monitoring and assessment would mitigate system risks arising from high levels of secured funding and innovative funding sources in some member states. It noted that the recommendation did not require action in Bulgaria, where bank liquidity and funding risk had long been monitored. Secured funding was not typical of Bulgarian banks and no action was required by the regulator.

The second ESRB recommendation, on systemic risks arising from money market funds, supported the European Commission's proposal to amend rules on these funds.

The ESRB continued monitoring the European Commission's capital requirements directive and regulation proposals and implementation of the Solvency II Directive in insurance with reference to macro-prudential policy scope and objectives. The Board's categorical views on the credit institution capital requirements directive and regulation largely reflected the BNB view that national authorities' freedom to adapt supervisory policy to national specifics was key to financial stability.

Further to 2011 ESRB recommendations on lending in foreign currency and credit institution funding in US dollars, the Bank helped compile information on Bulgarian banks' assets and liabilities currency and maturity structures for the EBA and the ESRB. With the FSC and the Ministry of Finance, the BNB reported to the ESRB on both recommendations, meeting the call for 2012 reports on action. The recommendation on lending in foreign currency was to national authorities and supervisors, while the one on US dollar funding was to national supervisors. In the first report the BNB reiterated its consistent view that lending in euro did not threaten financial stability due to the euro-based currency board. As regards risks related to lending in currencies other than euro, Bank macroprudential policy consistently curbed them.

BNB experts joined public consultations on the new capital requirements framework (Basel III) and worked on EBA and European body committees and working groups drafting and implementing new international capital standards for banks. The EBA standing committees and working groups surveyed and assessed information flows between home and host authorities, single passport regime notifications, supervisory inspections, bank stress test monitoring, and joint supervisory college decisions. The surveys shared experience and developed EBA technical standards. The approach to banking product and service supervision and analysis changed. Terms and conditions for some common bank products were studied and banks were instructed to make them easier to understand by the general public.

The BNB worked with the 13 colleges supervising cross-border bank groups operating in Bulgaria. There was regular supervisory information exchange under memoranda of understanding and cooperation. Consolidating supervisory bodies made

<sup>78</sup> The BNB sits on the ESRB General Board, Advisory Technical Committee, and three working groups.

joint assessments of risks to banks with Bulgarian subsidiaries and issued group decisions on capital adequacy.

**European  
Council,  
Ecofin, and  
Economic  
and  
Financial  
Committee**

EU financial stability and growth remained top priorities for these European bodies.

The 25 participating member states signed the Treaty on Stability, Coordination and Governance in the European Monetary Union on 2 March 2012 at the European Council.<sup>79</sup> Alongside Bulgaria, signatories outside the euro area were Denmark, Hungary, Latvia, Lithuania, Poland, Romania, and Sweden.<sup>80</sup> The Treaty strengthens EMU by budgetary discipline through a fiscal compact, tighter economic policy coordination, and improved euro area governance. Welcoming it in principle, the BNB consistently backed the government position that member states had to be free to wage duly coordinated national tax policies. As agreed in negotiations, Bulgaria shall enforce only certain provisions until accession to the euro area. The whole Treaty will become binding at Bulgarian accession to the euro area, abrogation of the derogation under Article 5 of the Act concerning the accession of the Republic of Bulgaria and Romania and the adjustments to the Treaties on which the European Union is founded.

As scheduled under the second European semester, on 12 April Bulgaria presented its updated 2012 National Reform Programme and 2012 to 2015 Convergence Programme. The Bank helped draft the Programmes which outline 2012 Annual Growth Report priorities. Further to the Programmes, on 10 July 2012 Ecofin made recommendations on public finance, pension reform, the labour market and poverty, education and innovation, administrative capacity, electronic government and the judicial system, and the energy market and business environment. Bulgaria inserted additional measures in the National Reform Programme Action Plan.

Publication of the EC Annual Growth Review in November 2012 launched the third European Semester. The European Commission also reported on the alert mechanism for early identification of potential risks to member state economies using a scoreboard of economic indicators reporting on the existence of internal and external imbalances. Monitoring indicators highlighting internal and external imbalances, it now has a new financial sector indicator to identify system imbalances and risks. The BNB has repeatedly opposed this as it feels no indicator can reflect the complex relationships between the financial and real sectors; calculations in the statistical annex of the alert mechanism report which claim to show imbalances in the finances of member states with stable banking systems that have not used public funds confirm this.

The European Council mandated its President to present views on deeper integration and a detailed roadmap to genuine EMU. His reports, prepared with the President of the European Commission, the President of the Eurogroup, and the ECB president, were presented at the June, October, and December European Councils. They propose a genuine EMU based on an integrated financial framework resting on a single supervisory mechanism, an integrated budget framework with closer coordination of member states' fiscal policies and a solidarity mechanism, closer coordination of structural reforms between member states and the EU, and more accountability with greater European and national parliament involvement. The reports are potentially significant for all member states. The BNB position is that member states should pursue national fiscal, structural, and supervisory reforms, instead of creating new centralised mechanisms.

Talks continued on the second legislative package on enhanced economic governance comprising two regulations proposed by the European Commission for the euro area at the end of 2011. One aims to improve coordination and monitoring of euro

<sup>79</sup> Given no consensus on amending EU treaties to enable new measures under the Treaty on Stability, Coordination and Governance in the European Monetary Union, euro area governments adopted the Treaty as a binding international agreement.

<sup>80</sup> On 27 January 2012 the 41st National Assembly acceded to the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.



area members' draft budgets, and the other strengthens the legal basis of monitoring euro area members tackling financial stability issues, receiving financial assistance, or likely to need it. Bulgaria supported the two regulations in principle as ensuring euro area macroeconomic stability and averting future EU crises. The BNB also supported government's position against the excessive powers and independence the proposals grant the European Commission. The Bank also shared government's concern about financial market reactions to putative EC requests for changes to draft national budgets and about possible suspensions of EU funds upon macroeconomic imbalance procedures. Member states and the European Parliament failed to reach agreement and debate continues.

The BNB Governor participated in two informal Ecofin meetings of EU members' ministers of finance and central bank governors. The March meeting in Denmark tackled EU financial stability prospects and risks, the proposed financial transactions tax (FTT), and the financial institutions recovery and resolution framework. Alongside other member states, Government and the BNB consistently opposed EU level harmonisation of financial sector taxation. The 11 members in favour decided to introduce FTT through the TFEU enhanced cooperation mechanism.<sup>81</sup>

The mid-September 2012 Ecofin Cyprus meeting focused on the economy, risks to financial stability, proposals to distinguish between investment and traditional banking, and the single supervisory mechanism. The latter, mandatory for euro area countries, would involve transferring great powers to the ECB. Non-euro area countries may join, but without a voice in ultimate decisions or access to financial institution support mechanisms. The BNB position is that Bulgaria should not join before entering the euro area.

On 15 May 2012 Ecofin adopted a general approach on two proposals to amend credit institution and investment firm supervision (CRD IV package<sup>82</sup>). This opened the way to talks with the European Parliament on adopting the package that will continue in 2013. In negotiations Bulgaria insisted on national supervisors being able to set additional capital buffers for systemic risk, and on preferential treatment for Bulgarian banks on capital requirements for foreign currency positions in euro given the currency board. Bulgaria's major objections related to maximum harmonisation of capital requirements, the concept of a liquidity subgroup, and the EC proposal that unrated institutions be ranked by the ratings of bonds issued by their governments. The Bulgarian position attracted the support of the BNB and other member states and a portion of the Bulgarian arguments found its way into the general approach.

The BNB continued to be active on the Economic and Financial Committee. Debate there focused on economic governance and restoring confidence in the financial sector. In the context of the European semester, the Committee assessed EU financial stability, national fiscal and macroeconomic policy surveillance, the single supervisory mechanism, the European position on the growth framework, international monetary system reform, and financial regulation discussed by the G20, IMF, and Financial Stability Board. On measures to reinforce banking, the BNB consistently argued that Bulgarian banks' high capital and liquidity levels and accumulated capital buffers guaranteed system stability.

To strengthen national systems for credit institution restructuring, in June 2012 the European Commission proposed a directive establishing a credit institution and investment firm recovery and resolution framework. This would regulate prevention, recovery and restructuring, national resolution authorities, cross-border banks, and supervisors' powers. Bulgaria supports minimum harmonisation requirements in this area in principle. It also calls for balance between home and host countries, for

<sup>81</sup> The enhanced cooperation mechanism meets the requirements of the Treaty on European Union Article 20 and the Treaty on the Functioning of the European Union Articles 326 to 334. The procedure requires nine or more members to show interest in enhanced cooperation, specifying its scope and aims.

<sup>82</sup> The CRD IV package proposes a Directive and a Regulation on supervision requirements for credit institutions and investment firms, to replace Directives 2006/48/EC and 2006/49/EC.



important national supervisory powers to remain, and for national authorities to have greater freedom, including in deciding which bodies would tackle resolution. The BNB does not support the concept of group support, since transferring assets within groups affects not only financial institution finances but also those of member states. The Bank opposes mandatory lending between resolution funds.

Intensive debate on the European Commission's proposed directives on residential property credit and deposit guarantee schemes continued. Bulgaria tabled its views at tripartite meetings of the European Commission, European Parliament, and Council. Government supported the first directive as protecting consumers and adding financial stability requirements. Other views concerned advice to customers, encouraging financial awareness, determining loan interest, and lending in foreign currency. European Parliament proposals on the right to withdraw from agreements during the reflection period, requirements for property valuers and valuations, and arrears, and credit register supervision were not supported. On the deposit guarantee scheme directive, the BNB supported government's preference for the current 20 business day settlement period and for settling in national currency or euro. The Bank and government opposed deposit guarantee fund targets beyond which contributions would cease as they consider fund growth important for financial stability.

The Council of Europe's Committee of Experts on the Evaluation of Measures against Money Laundering and Terrorist Financing (MONEYVAL) conducted the fourth evaluation round of bank supervisors and banks' adoption of Financial Action Task Force (FATF) in the second half of 2012. The BNB provided information on the legal framework and supervisory and bank action under the recommendations and Directive 2005/60/EC establishing EU-wide prevention. There were consultations with United Nations' Security Council Committee 1737 officers on specific measures related to high risk country financial flows.

In May the BNB held a seminar for senior Bulgarian bankers to advise them in depth of new EU financial measures. The event also enhanced coordination between institutions and helped transpose new EU legislative requirements more effectively in the national legal framework.

## X. International Issues

### International Financial Institutions

The Law on the Bulgarian National Bank encourages the Bank to participate in international initiatives to further monetary and credit policy cooperation.

The Bulgarian National Bank holds equity in the Bank for International Settlements (BIS). The BNB governor sat at the regular bimonthly meetings of the BIS central bank governors: a major forum for cooperation between member central banks and discussion on world economic development and global economic and international financial market prospects. The BNB governor represented the Bank at the Annual General Shareholder Meeting in late June 2012, where the BIS Governors allocated net profit, the BNB receiving a dividend of EUR 2.9 million.

Where the state participates in international financial institutions such as the International Monetary Fund, the European Investment Bank, the European Bank for Reconstruction and Development, and the World Bank Group, the BNB is its official fiscal agent and depository.

The BNB Governor is a member of the IMF Board of Governors where he represents the state. On 25 July 2012 the National Assembly ratified the IMF Statute Executive Board reform in the Board of IMF Governors Resolution 66-2 of 15 December 2010. Bulgaria thus fulfilled its commitment to support ongoing IMF reforms to enhance Fund management, transparency, and legitimacy. The IMF and World Bank Group Annual Meeting of 9 to 14 October 2012 announced that as part of governance reforms Belgium and Luxembourg would join the Dutch Constituency, which includes Bulgaria, creating a new Constituency. The Netherlands and Belgium would in future alternate in nominating Executive Directors for this new Constituency for two year terms, an advisor to the Constituency Executive Director continuing to represent Bulgaria.

October and December government resolutions approved Bulgaria's participation in the IMF move to distribute windfall gold sale profits to the Fund's Poverty Reduction and Growth Trust in favour of less developed countries. Bulgaria's contribution was SDR 5.93 million.

A BNB Deputy Governor serves as EBRD Alternate Governor for Bulgaria. At the June Annual Meeting, the Governor for Bulgaria was elected Chair of the Board of Governors. For the first time in EBRD history a representative of a country in which the Bank has projects has been elected Chair.

Bulgaria supported the decision of the Board of Governors of the European Investment Bank to increase capital by EUR 10 billion.

In January the BNB paid its annual contribution of USD 8500 to the International Accounting Standards Committee Foundation.

### Central Bank Cooperation and Technical Assistance

A Member of the Bank of Japan Policy Board visited the BNB in March. The visit featured a seminar on Opportunities and Challenges facing Japan and the Bank of Japan. In recent years, the Bank has strengthened relations with the People's Bank of China. A Chinese Development Bank delegation visited the BNB. Discussions with BNB Deputy Governors focused on banking sector development, central bank policies, promoting further cooperation between the BNB and the Chinese Development Bank, and Chinese investment into Bulgaria. Central Bank of Azerbaijan experts visited the Bank, exchanging experience in licensing, supervision, and payment systems law.

The BNB continued pursuing extensive cooperation with Balkan central banks to promote financial stability and European prospects in the region. Apart from regular consultations and visits, the Bank participates in technical cooperation projects financed by the European Union to provide specialised technical assistance, taking into account national specifics and individual central bank tasks.

Successful participation by BNB experts in technical assistance projects enhanced the Bank's experience and capacity. The three year banking supervision technical cooperation programme for the Central Bank of Egypt managed by the ECB and other central banks ended successfully in March 2012. In cooperation with the central banks of Italy and Greece, the BNB was responsible for the strategic areas of a standardised approach to credit risk, own funds, and reporting. BNB experts developed a new regulatory capital framework compliant with Basel II which also takes into account some Basel III related changes.

Work continued on the Strengthening the Institutional Capacity of the Central Bank of Serbia<sup>83</sup> project where the BNB is responsible for statistics and EU pre-accession assistance. BNB experts helped the Central Bank of Serbia draft a pre-accession action plan. The Bank shared experience and advised the Central Bank of Serbia on implementing a direct reporting system for balance of payments statistical purposes and on aligning external debt statistics with the IMF External Debt Statistics Guide. In October the ECB launched a technical assistance project with the Central Bank of Macedonia and the BNB was the only non-euro area central bank invited to participate. BNB cooperation with the Central Bank of the Republic of Kosovo focused on banking supervision and relations with international financial institutions. Discussions covered organisational and financial issues linked with IMF relations as government agents, as well as individual accounting practices.

The Bank participates in the Central Asia, Black Sea Region and Balkan Countries' Central Bank Governors' Club, and the Group of Banking Supervisors from South Eastern Europe.

---

<sup>83</sup> Scheduled to end on 31 January 2013, the project was extended to 31 December 2013 at Serbian request. The BNB was invited to take part in the extension due to its successful implementation of earlier commitments.

## XI. Statistics

The BNB gathers, processes, and supplies statistics under the Law on the Bulgarian National Bank Article 42 and as an ESCB member under the Statute of the ESCB and the ECB Article 5. Alongside the additional requirements of the 2009 amendments to Council Regulation (EC) No 2533/98 of 23 November 1998 concerning the collection of statistical information by the ECB, the Bank also supplies statistics to the European Systemic Risk Board through the ECB.

Monetary and interest rate statistics are adopting 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) methodological guidelines. These give users more comprehensive analyses of financial institution and counterparty financial operations.

Preparations to implement new methodological guidelines on monetary and financial statistics progressed alongside work on the new European System of Accounts (ESA 2010), expected in 2014, and new user requirements. They involved setting up working groups with the National Statistical Institute. The project should shed more light on economic sectors and financial instruments.

Expected harmonisation of the ESCB statistical reporting framework on insurance and re-insurance will reflect the sector's importance to financial stability and systemic risk. The Bank shall examine proposals on the framework's scope and its applicability to Bulgaria.

The ECB project to extend and augment the RIAD financial institution register involved analysing suggested additional requirements on its structure and contents, sources of information, and possible action.

The Bank continued reporting balance of payments and international investment position statistics using information collected directly from residents. The BNB collects this through quarterly surveys of receipts and payments between residents and non-residents on services, remuneration, insurance, and other balance of payments current account items. The methodology for compiling data on exports and imports of services and some other operations on the current account was changed to comply with the requirements of Regulation No 924/2009 of the European Parliament and of the Council of 16 September 2009 on cross-border payments in the Community.

Work on introducing the sixth edition of the Balance of Payments Manual (IMF, 2008) by 2014 progressed. Preparations are complex due to the need to harmonise the new methodology with European System of Accounts (ESA'2010) and the fourth edition of the OECD Benchmark Definition of Foreign Direct Investment (2008). The sixth edition of the Balance of Payments Manual significantly changes definitions and presentations of balance sheet and international investment position items. Amendments to Ordinance No 27 of the BNB on the Balance of Payments Statistics and the International Investment Position are under way.

Work continued on managing data quality for the ESCB Centralised Securities Database project and compiling a Bulgarian securities database. The BNB was part of the Securities Holdings Statistics project, of significance to other statistics and financial stability analyses.

The Bank continued compiling Regulation (EC) No 501/2004 of the European Parliament and of the Council of 10 March 2004 and reporting data on government finances to ECB requirements General Government sector quarterly financial account data.

The BNB now gathers Guideline ECB/2002/7 (recast) on the statistical reporting requirements of the ECB in the field of quarterly financial accounts flows statistics alongside quarterly financial accounts data on all economic sectors (stock data). The update was ready by the close of 2012, when the Bank signed a Memorandum of Understanding for the development, production and dissemination of data in the field of government financial statistics and on national financial accounts with the National Statistical Institute and the Ministry of Finance.

With NSI help, the Bank continued sending macroeconomic information to the ECB and the Bank for International Settlements. There were regular updates and metadata certification under the Special Data Dissemination Standard to an IMF methodology and dissemination schedule using NSI and Ministry of Finance statistics.

Work progressed on an Integrated Statistical Information System to automate data collection, control, processing, and dissemination. A new ECB data exchange interface went live. The new SDMX-ML statistical representation standard moved into implementation.

The BNB publishes monthlies and quarterlies, including a Monthly Bulletin, with comprehensive data and clarifications on balance of payments monetary and interest rates statistics, gross external debt, and the international investment position.

## XII. Research

Economic research, analyses of the Bulgarian economy, and macroeconomic forecasts support the Bank's management in making decisions and formulating economic policy. In 2012 research focused on financial sector modelling, studying the macroeconomic effect of fiscal policy, and developing macroeconomic forecasting models.

Specialised research under the 2011 and 2012 Research Plan supported BNB operations by analysing set economic processes and issues and helped elaborate forecasting and modelling tools. Under the Plan research focused on Bulgarian export competitiveness on international markets, the financial sector dynamic stochastic general equilibrium model, macro-financial models linking financial stability with the state of the economy, credit modelling, fiscal multiplier research, and the relationship between monetary aggregates and inflation. Testing and honing the BNB's basic macroeconometric forecasting model continued. Research results featured in technical reports and seminars organised by the Bank for relevant bodies, academia, and non-governmental organisations.

In July 2012 the Bank held an international conference on Monetary and Macro Supervision Policies: Conflicting or Complementary. It heard academic contributions to the interplay of these policies and practical supervisory issues.

The Guest Researcher Programme supports BNB research and helps cooperation with experts from Bulgaria and abroad on subjects of interest to the Bank. Five guest researchers participated in 2012.

Through its *Discussion Papers* series, the BNB continued encouraging the research potential of Bulgarian economic science in macroeconomics and finance. The Editorial Board reviewed three submissions, publishing two.

The BNB's *Economic Review* quarterly analyses balance of payments dynamics, monetary aggregates, and external environment developments' bearing on the real economy and price stability. The *Review* presented short-term quantitative assessments of developments in major macroeconomic indicators: inflation, economic growth, exports and imports, the balance of trade, and the balance of payments current account. It carried the results of BNB analyses of set economic issues.

## XIII. Information Systems

In 2012 BNB information systems staff implemented ECB/ESCB projects, developed and updated the Bank's communication and information infrastructure, designed a policy and procedures for the security of information systems within the working group to the BNB IT Security Policy and a BNB IT Security Committee, implemented hardware and software solutions for providing business processes' continuation and data protection, designed a module for reconciling nostro accounts and securities in the core banking system environment, administered and monitored RINGS, TARGET2-BNB, SWIFT Alliance and implemented a project on the transfer of user accounts from EUMIDES (ESCB User Management, Identity and Directory Services). Ensuring system integrity and preventing downtime, developing the communications and information infrastructure, and working on process continuity and data protection were their main tasks. Besides the current work on administering and monitoring the systems important tasks associated with updating of hardware and software were successfully accomplished.

Work to backup major BNB systems by duplication continued. Backup of the new ESROT and GSSS versions went live using encrypted ethernet communications between the main and duplicating centres. New switchgear updated BNB data arrays. Information security policy and procedure formulation continued to the BNB IT Security Committee schedule.

Design of the new Cash System (the BNB cash reporting, control and management system) ended. New business processes were tested and prepared for launch.

The core banking system functionality, particularly system and individual element security, expanded after end-user consultations. Paperwork and a schedule for the core banking system hardware and software migration were prepared. A new module reconciles nostro accounts and securities in SAP. This successful project cut information systems maintenance costs and boosted infrastructure performance.

Payment system maintenance involved mainly ensuring the smooth function of RINGS for lev payments in Bulgaria, the TARGET2-BNB Bulgarian component of TARGET2 for euro payments, and related Swift Alliance systems.



## XIV. Human Resource Management

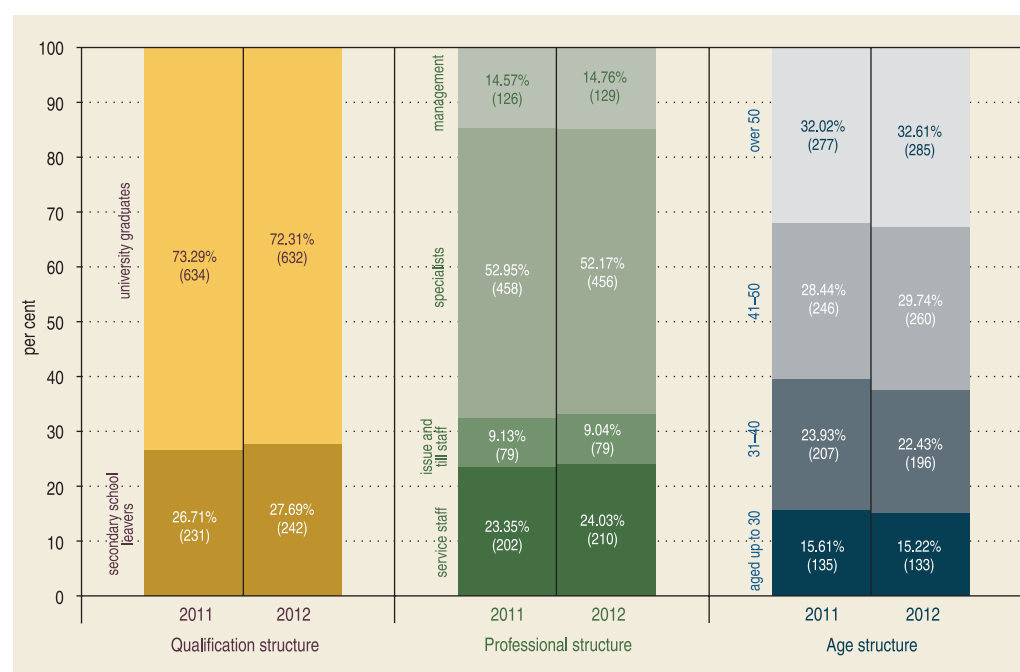
BNB human resource management in 2012 optimised staff training, qualifications, professional and age structure to match administrative and analytical capacity to the Bank's high standards. The performance-related pay policy continued, alongside through training and professional development, maintaining a sociable environment, and promoting health and safety at work.

By the end of 2012 staff numbered 874 on 865 a year earlier. Forty six were appointed in 2012 (47 in 2011), more than half (25) under 29. Recruitment was aimed at attracting highly qualified and competent experts.

Turnover remained low: 33 left in 2012 (47 in 2011) of whom seven retired (18 in 2011). This reflected the established organisational culture, motivating working environment, effective teamwork, training and professional advancement opportunities, the sociable environment, and the state of the labour market.

### Staff Structure

(per cent, number)



Source: BNB.

The BNB continued attracting candidates with relevant degrees as required by the policy of recruiting highly qualified staff. Graduates made up 72 per cent of staff, over three quarters of them with master's degrees. Over the year 20 employees read for doctor's degrees (six more than in 2011). There were no major changes to staff age and professional structure on 2011 under the BNB internal job classification. Women made up 64 per cent of staff and men 36 per cent.

The practice of offering diverse modes of labour mobility continued, broadening staff professional expertise and exchanging experience across business areas in the Bank or with other ESCB central banks and the ECB. In 2012 eleven employees moved jobs within the Bank: twice the number of 2011. Four employees went on short-term ECB appointments.

Pay continued reflecting individual results and contribution to Bank performance.

Employees enjoyed plenty of opportunities to train with national and international organisations, foreign banks, and international financial institutions. They went on specialised courses and seminars at ESCB central banks and international financial institutions, specialised training with ESCB committees and other bank and financial supervision bodies, personal, team and leadership skills seminars, and certification programmes. More than 230 staff went on courses, seminars, and conferences abroad.

Induction training continued to familiarise new employees with Bank culture, tasks and objectives, internal rules, and procedures. In 2012, 37 new staff attended three induction sessions.

Twenty seven staff boosted their educational attainments at different universities without discontinuing work. Strong interest continued in distance learning programmes: 17 staff went on six programmes and on reserve management and internal audit certification programmes. The first staff member embarked on a certification programme for internal auditors in risk management assurance.

Staff attended specialised courses on labour and social security legislation, health and safety at work, and public procurement.

More than 80 staff attended language courses providing proficiency levels consistent with job descriptions; English was most widely sought.

Information technology training imparted and updated software and systems skills. It addressed key competences and external service cost optimisation. The BNB provided conditions for professional training required for performing duties related to operating, servicing, and maintaining machines and other equipment.

EU and Bulgarian law place health and safety at work firmly within the human resource ambit. Preventive measures included drafting safety instructions for new machines and introducing protective equipment. The working conditions committee and working groups met a number of times. An approved programme prevented and limited occupational risks and workplace hazards. Working environment monitoring and management kept conditions in line with modern requirements and standards.

As a national institution, the BNB continued providing career opportunities to young people and encouraging students to conduct research. The BNB programme offering scholarships for master's and doctor's degrees enjoyed strong interest. One master's degree scholarship was awarded in 2012 after a competition.

The year saw the strongest yet interest in the BNB internship programme: applicants exceeded 280 (double their number in 2011), with 65 of them selected.

The Bank was at the March student training and career forum and the April professional training and development forum hosted by the Sofia University of the National and World Economy. It participated in the Varna Free University's Chernorizets Hrabar initiative to acquaint students with national institutions and business organisations, and in the Svishtov D A Tsenov Academy of Economics survey into the educational and professional fitness levels of its alumni working at the BNB. In November the BNB participated in a finance and insurance career event. At these fora the Bank promoted its internships, scholarships, guest researcher programmes, and career openings.

## XV. Facilities Management

The BNB mainly trades from owned premises and properties. This provides the independence, security and protection befitting a national institution. Property spending included construction, refurbishment and modernisation, deliveries and equipment, maintenance of transformers, power supply, distribution boards, diesel generators, emergency power supply, plant rooms, boilers, lifts, and HVAC, vehicles, asset and cash processing consumables, and optimising BNB power, heating, and water use was in line with the BNB budget.

There being no function for some properties, to optimise costs in 2012 the BNB granted to the Metropolitan Municipality one property in the Krasna Polyana area of Sofia, and to the government through the Varna Regional Administration two properties in Varna.

## XVI. BNB Internal Audit

Audits followed a Governing Council schedule. Seven followed the BNB Internal Audit Programme after a major functions risk evaluation. Five followed the ESCB Internal Auditor Committee Programme.

A banknote and coin audit assessed control system performance, risks, and efficiency in cash acceptance, transfer, and storage at BNB units.

An audit on monetary policy and market operations addressed how minimum required reserves maintained by banks with the BNB were calculated. It assessed effective achievement of related tasks and the reliability and integrity of significant information.

An audit addressed the RINGS Real-Time Interbank Gross Settlement System. It obtained reasonable assurance of corporate governance adequacy and efficiency, risk management, and control over RINGS administration and operation.

BNB consolidated financial statements by 30 June 2012 were audited to assess information accuracy and integrity to obtain reasonable assurance of reliability, compliance with Bank accounting policy, and control system adequacy.

An audit addressed BNB budget planning, monitoring and reporting. It assessed control system performance, risks, and efficiency.

BNB Internal Audit quality in 2011 and 2012 was also assessed for compliance with Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing and its Code of Ethics.

In 2012 an audit looked at how effectively and rapidly BNB units implemented recommendations from prior audits. It was also aimed at assessing adequacy, effectiveness, and timeliness of the measures undertaken by the managers of respective units.

### Audit under the Internal Audit Programme

Functions	Audits
Banknotes and Coins	Organisation and control of cash acceptance, delivery, and storage at BNB units
Monetary Policy and Market Operations	Regulation of minimum required reserves maintained by banks with the BNB
Payment and Securities Settlement Systems	RINGS
Financial Accounting and Financial Statements	BNB Consolidated Financial Statements for the Year to 30 June 2012
Planning, Control, and Organisation	Planning, monitoring, and reporting the BNB budget
Internal Audit	Internal Audit quality in 2011 and 2012
BNB Internal Audit	Implementation of recommendations from prior BNB Internal Audit Programme audits

Source: BNB.

There were five audits under the ESCB Internal Auditor Committee programme for 2012 and the BNB Internal Audit Programme approved by the Governing Council.

The Centralised Securities Database (CSDB) was audited to review major processes, risks and controls, and areas of key significance. The audit aimed at reasonable assurance of adequate and efficient risk management.

An audit addressed the ESCB information technology network and telecommunications infrastructure. It aimed at reasonable assurance of adequate and efficient risk and corporate management of network services and security.

An audit obtained reasonable assurance of adequate corporate and risk management of TARGET2.

ESCB Risk Management was audited to provide reasonable assurance of effective risk management in achieving business objectives and assess process and function risk management frameworks.

An audit looked at the implementation of recommendations from prior ESCB Internal Auditor Committee programme audits at BNB structural units, addressing management adequacy, effectiveness, and timeliness.

### The ESCB Internal Auditors Committee Programme

Functions	Audits
Statistics	The Centralised Securities Database
Information and communication technologies	ESCB IT network and telecommunications infrastructure
Payment and securities settlement systems	TARGET2 in use
Planning, Control, and Organisation	ESCB risk management
Internal Audit	Implementation of recommendations from prior ESCB Internal Auditors Committee Programme audits

Source: BNB.

The Chief Auditor coordinated Internal Audit Unit work with external auditors KPMG Bulgaria. A Republic of Bulgaria Audit Office inspecting team received help in determining the annual excess of Bank revenue over expenditure owed to the exchequer and in reporting BNB budget performance.

Internal auditors continued to give opinions on draft internal regulations and to sit on working groups and committees regulating major BNB and subsidiary functions.

The BNB Operational Risk Management Committee 2012 plan methodology changed to improve horizontal risk management. In December the Governing Council adopted the consolidated operational risk report. Process automation software for BNB operational risk management began going live in May. Technical contingencies postponed completion to 2013.

Internal Audit staff trained at the ESCB and the Institute of Internal Auditors in Bulgaria on the latest guidelines and professional practice. BNB representatives took part in conferences and seminars at ESCB central banks and the Operational Risk International Working Group.

## XVII. BNB Budget Implementation

The BNB Governing Council adopted the BNB Budget for 2012 with Resolution No 103 of 29 November 2011. Pursuant to the Internal Rules on Drafting, Implementing, and Reporting the BNB Budget, this report comprises two sections: Operating Expenditure and Investment Programme.

### 1. Operating Expenditure

In 2012, the BNB spent BGN 73,278,000 or 87.1 per cent of budget.

Currency circulation cost BGN 11,866,000 or 91.6 per cent of budget and 16.2 per cent of operating expenditure. Banknote and coin production cost BGN 11,431,000, of which BGN 6,646,000 for banknotes and BGN 4,785,000 for coins, including BGN 3,958,000 for circulating coins. The BNB Governing Council's commemorative coin programme cost BGN 827,000. Designing new banknotes and coins cost BGN 31,000, including four design competitions for 2013 commemorative coins. Spending on machines for servicing circulating cash was BGN 99,000. Consumables for banknote and coin processing cost BGN 131,000. Premise rentals at the Cash Services Company and the State Mint cost BGN 163,000.

Materials, services, and depreciation cost BGN 35,239,000 or 82.9 per cent of budget and 48.1 per cent of operating expenditure. Materials cost BGN 943,000 or 1.3 per cent of operating expenditure. Vehicle fleet fuel and spares (BGN 390,000) and office consumables (BGN 298,000) had the largest share in this group. The Bank spent BGN 105,000 on inventories. External services cost BGN 16,254,000 or 22.2 per cent of operating expenditure. Significant items were software maintenance subscriptions at BGN 3,421,000, mandatory TARGET2 modules at BGN 1,099,000, Bloomberg, Reuters, internet and other systems at BGN 1,131,000, and Bankservice subscriptions at BGN 533,000 or 38 per cent of external service spending. Property and refuse collection levies were BGN 1,314,000. Equipment maintenance cost BGN 1,505,000. Mail, telephone and telex cost BGN 719,000 including voice service optimisation costs. Electric bills were BGN 747,000 and heating and water spending was BGN 271,000. Property insurance premia were BGN 148,000. The Bank spent BGN 2,206,000 on security and fire protection. Major buildings maintenance cost BGN 2,254,000.

Consultancy services cost BGN 158,000 and included, inter alia, obtaining technical passports for BNB premises, analysing internal wireless communications, property valuations and cadastral changes, legal services, tax advice, and running the Banking and Financial History Research and Publications Programme Council. Since the authorities extended the term for structural surveying and premise technical passports, the Bank spent no monies under this item. Since the Bank used in-house services to effect SWIFT migration and repair cash issuing equipment, there was no spending on consultancy services under these items.

In 2012 depreciation cost BGN 18,042 or 24.6 per cent of operating expenditure.

Payroll, social, and healthcare spending was BGN 21,129,000 or 99.1 of budget and 28.8 per cent of operating expenditure. The Bank reported BGN 492,000 of current retirement obligations and unused paid leave under IAS 19, Income of Hired Persons.

Social expenditure was BGN 2,153,000 or 95.5 per cent of budget and 2.9 per cent of operating expenditure.

Miscellaneous administrative spending was BGN 1,234,000 or 58.3 per cent of budget and 1.7 per cent of operating expenditure. Inland travel worth BGN 72,000

involved mainly regional cash centre logistics and checks. Foreign travel unrelated to the ESCB and other EU bodies cost BGN 265,000.

The annual BNB Staff Education and Professional Training Programme sent staff on distance learning and conventional courses and seminars at the ESCB, European Commission and EU bodies, banks, and international financial institutions. Staff training cost BGN 698,000.

Bank representative and protocol expenses were BGN 198,000 or 0.3 per cent of operating expenditure.

BNB participation in the ESCB and other EU bodies cost BGN 1,657,000 or 55.8 per cent of budget and 2.3 per cent of operating expenditure. The cost of BNB representatives on ESCB committees and working groups and other EU bodies was BGN 700,000. Telecommunication line rental cost BGN 265,000, including staff training costs of BGN 42,000. The annual fee for European Banking Authority membership was BGN 647,000. Over the year the BNB hosted a meeting of the ECB Committee on Monetary, Financial, and Balance of Payments Statistics. It spent BGN 5000 under this item.

## 2. Investment Programme

The investment budget for 2012 was BGN 13,999,000, of which BGN 8,686,000 or 62 per cent was spent.

Under the construction, refurbishment and modernisation item, BGN 7000 or 1.2 per cent of budget went on an architect's project for the restoration of the Plovdiv BNB Cash Centre façade. Further spending under this item awaits a survey and a technical passport, either of which might entail works the Bank has to cover as owner.

Machine and equipment, vehicle, and sundry equipment investment was BGN 802,000 or 36 per cent of budget.

Currency circulation machines and equipment investment was BGN 289,000, including BGN 249,000 into banknote stores, BGN 19,000 into banknote handlers, BGN 12,000 into installing label printers for banknote handlers and BGN 9000 into other equipment for cash operations.

The Bank invested BGN 193,000 into air conditioning, BGN 55,000 into furniture, BGN 48,000 into a regional cash centre loading platform, BGN 21,000 into de-icing and lightning protection systems at regional cash centres, and BGN 14,000 into staff recreation homes equipment. Special currency circulation vehicles worth BGN 864,000 were not purchased as the public procurement procedure attracted a single candidate.

Information systems investment was BGN 7,873,000 or 71.7 per cent of budget and 90.6 per cent of the investment programme. Funds went mostly into the information and communication infrastructure. An investment funds optimisation changed priorities and reordered projects.

Of the BGN 5,055,000 invested into hardware, BGN 3,655,000 went into computers and BGN 1,400,000 into communications equipment.

Of the BGN 2,818,000 invested into software, BGN 995,000 went into licences and BGN 1,823,000 into functionality expansions for existing systems.

There was no investment into BNB membership in the ESCB.

The Bank invested BGN 4000 into purchasing the National Bank of the Republic of Macedonia's share in the International Banking Institute Sofia.



## BNB Budget Implementation by 31 December 2012

Indicator	Report 31 December 2012 (BGN'000)	Budget 2012 (BGN'000)	Implementation (per cent)
<b>Section I. Operating expenditure</b>	<b>73,278</b>	<b>84,117</b>	<b>87.1</b>
Currency circulation expenditure	11,866	12,954	91.6
Materials, services, and depreciation	35,239	42,511	82.9
Staff expenditure	21,129	21,315	99.1
Social activity expenditure	2,153	2,254	95.5
Other administrative expenditure	1,234	2,115	58.3
BNB expenditure on ESCB membership	1,657	2,968	55.8
<b>Section II. Investment programme</b>	<b>8,686</b>	<b>13,999</b>	<b>62.0</b>
Expenditure on construction, refurbishment, modernisation	7	596	1.2
Expenditure on machines, vehicles, and other equipment	802	2,229	36.0
Expenditure on BNB computerisation*	7,873	10,974	71.7
Investment related to ESCB membership	0	196	0
Other investment*	4	4	100

\* Funds under 2012 budget indicators were adjusted in line with the Internal Rules on Drafting, Implementing, and Reporting the BNB Budget.

Source: BNB.



# **XVIII. Bulgarian National Bank Consolidated Financial Statements for the Year Ended 31 December 2012**

Independent Auditors' Report to the Governing Council of the Bulgarian National Bank .....	86
Statement of Responsibilities of the Governing Council of the Bulgarian National Bank .....	88
Consolidated Statement of Comprehensive Income for the Year Ended 31 December 2012 .....	89
Consolidated Statement of Financial Position as of 31 December 2012 .....	90
Consolidated Statement of Cash Flows for the Year Ended 31 December 2012 .....	91
Consolidated Statement of Changes in Equity for the Year Ended 31 December 2012 .....	92
Notes to the Consolidated Financial Statements .....	93



**KPMG Bulgaria OOD**  
45/A, Bulgaria Boulevard  
Sofia 1404  
Bulgaria

Telephone +359 (2) 9697 300  
Telefax +359 (2) 9805 340  
E-mail [bg-office@kpmg.com](mailto:bg-office@kpmg.com)  
Internet [www.kpmg.bg](http://www.kpmg.bg)

**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 2012, 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.



KPMG Bulgaria OOD, a Bulgarian limited liability company and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Registered with the Commercial Register at the Bulgarian Registry Agency  
Identity Code 040595851

IBAN BG06 RZBB 9155 1060 2664 18  
BIC RZBBBGSF  
RaiffeisenBank (Bulgaria) EAD



### *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 2012 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 2012. 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 25 April 2013.

*KPMG Bulgaria OOD*

KPMG Bulgaria OOD

Sofia, 25 April 2013

## 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.*

A handwritten signature in black ink, appearing to read 'I. Iskrov', with a long horizontal flourish extending to the right.

Ivan Iskrov  
Governor of the BNB



## Consolidated Statement of Comprehensive Income for the Year Ended 31 December 2012

(BGN'000)

	Note	2012	2011
Interest income	7	420,601	435,230
Interest expense	7	(1,931)	(26,422)
<b>Net interest income</b>		<b>418,670</b>	<b>408,808</b>
Fee and commission income		8,291	8,220
Fee and commission expense		(6,343)	(3,654)
<b>Net fee and commission income</b>		<b>1,948</b>	<b>4,566</b>
Net income from financial assets and liabilities at fair value through profit or loss	8	10,212	269,585
Other operating income	9	47,408	54,016
<b>Total income from banking operations</b>		<b>478,238</b>	<b>736,975</b>
Administrative expenses	10	(106,328)	(107,328)
<b>Profit for the period</b>		<b>371,910</b>	<b>629,647</b>
<b>Other comprehensive loss</b>			
Other comprehensive loss		(276)	(524)
<b>Other comprehensive loss, total</b>		<b>(276)</b>	<b>(524)</b>
<b>Total comprehensive income for the period</b>		<b>371,634</b>	<b>629,123</b>
<b>Profit attributable to:</b>			
Equity holder of the Bank		371,804	629,410
Non-controlling interest		106	237
<b>Profit for the period</b>		<b>371,910</b>	<b>629,647</b>
<b>Total comprehensive income attributable to:</b>			
Equity holder of the Bank		371,528	628,886
Non-controlling interest		106	237
<b>Total comprehensive income for the period</b>		<b>371,634</b>	<b>629,123</b>

The accompanying notes on pages 93 to 117 form an integral part of the Consolidated Financial Statements.



## Consolidated Statement of Financial Position as of 31 December 2012

(BGN'000)

	Note	31 December 2012	31 December 2011
<b>ASSETS</b>			
Cash and deposits in foreign currencies	11	9,376,167	6,722,318
Gold, instruments in gold and other precious metals	12	3,207,354	3,096,194
Financial assets at fair value through profit or loss	13	17,801,193	16,252,939
Financial assets available for sale	14	1,515,709	1,541,720
Tangible assets	15	223,558	225,219
Intangible assets	16	6,368	7,687
Other assets	17	62,004	63,398
<b>Total assets</b>		<b>32,192,353</b>	<b>27,909,475</b>
<b>LIABILITIES</b>			
Banknotes and coins in circulation	18	9,549,921	8,728,750
Due to banks and other financial institutions	19	7,845,160	6,179,598
Liabilities to government institutions and other liabilities	20	6,952,197	5,234,032
Borrowings against Bulgaria's participation in international financial institutions	21	2,775,165	2,824,412
Other liabilities	22	100,748	164,627
<b>Total liabilities</b>		<b>27,223,191</b>	<b>23,131,419</b>
<b>EQUITY</b>			
Capital	23	20,000	20,000
Reserves	23	4,944,965	4,753,965
Non-controlling interest	24	4,197	4,091
<b>Total equity</b>		<b>4,969,162</b>	<b>4,778,056</b>
<b>Total liabilities and equity</b>		<b>32,192,353</b>	<b>27,909,475</b>

The accompanying notes on pages 93 to 117 form an integral part of the Consolidated Financial Statements.

## Consolidated Statement of Cash Flows for the Year Ended 31 December 2012

(BGN'000)

	Note	2012	2011
<b>OPERATING ACTIVITIES</b>			
Net profit		371,910	629,647
Adjustments:			
Dividend income		(8,621)	(7,961)
Depreciation and amortisation	15, 16	24,667	25,969
Loss/(profit) on disposal of tangible assets		825	(689)
(Profit) on financial assets and liabilities arising from market movements		(251,774)	(350,658)
(Profit) of associates		(325)	(61)
Other adjustments		(45)	(66)
<b>Net cash flow from operating activities before changes in operating assets and liabilities</b>		<b>136,637</b>	<b>296,181</b>
<b>Change in operating assets</b>			
(Increase) in gold, instruments in gold and other precious metals		(2,740)	(485)
Increase/(decrease) in financial assets at fair value through profit or loss		(1,428,212)	687,636
Decrease in other assets		209	606
<b>Change in operating liabilities</b>			
Increase in currency in circulation		821,171	426,322
Increase in due to banks and other financial institutions		1,665,562	367,063
Increase/(decrease) in due to government institutions and other liabilities		1,718,165	(599,560)
(Decrease)/increase in other liabilities		(63,879)	69,644
<b>Net cash inflow from operating activities</b>		<b>2,846,913</b>	<b>1,247,407</b>
<b>INVESTING ACTIVITIES</b>			
Acquisition of tangible and intangible assets		(22,338)	(8,217)
Dividends received		8,621	7,961
Other investments		(4)	200
<b>Net cash flow used in investing activities</b>		<b>(13,721)</b>	<b>(56)</b>
<b>Financing activities</b>			
Payments to the Government		(180,528)	(200,914)
<b>Net cash flow used in financing activities</b>		<b>(180,528)</b>	<b>(200,914)</b>
<b>Net increase in cash and cash equivalents</b>		<b>2,652,664</b>	<b>1,046,437</b>
<b>Cash and cash equivalents at beginning of period</b>		<b>6,764,467</b>	<b>5,718,030</b>
<b>Cash and cash equivalents at end of period</b>	11, 17	<b>9,417,131</b>	<b>6,764,467</b>

The accompanying notes on pages 93 to 117 form an integral part of the Consolidated Financial Statements.

## Consolidated Statement of Changes in Equity for the Year Ended 31 December 2012

(BGN'000)

Source of changes in equity	Capital	Revaluation of non- monetary assets	Special and other reserves	Total capital and reserves	Non- controlling interest	Total equity
<b>Balance as of 1 January 2011</b>	<b>20,000</b>	<b>140,044</b>	<b>4,186,696</b>	<b>4,346,740</b>	<b>3,854</b>	<b>4,350,594</b>
Profit for the period	-	-	629,410	629,410	237	<b>629,647</b>
Other comprehensive income:						
other income	-	(524)	-	(524)	-	<b>(524)</b>
Other comprehensive income, total	-	(524)	-	(524)	-	<b>(524)</b>
Total comprehensive income/(loss) for the period	-	(524)	629,410	628,886	237	<b>629,123</b>
Other movements	-	(747)	-	(747)	-	<b>(747)</b>
Contributions by and distributions to owners:						
contribution to the budget of the Republic of Bulgaria	-	-	(200,914)	(200,914)	-	<b>(200,914)</b>
Transactions with owners, total	-	-	(200,914)	(200,914)	-	<b>(200,914)</b>
<b>Balance as of 31 December 2011</b>	<b>20,000</b>	<b>138,773</b>	<b>4,615,192</b>	<b>4,773,965</b>	<b>4,091</b>	<b>4,778,056</b>
<b>Balance as of 1 January 2012</b>	<b>20,000</b>	<b>138,773</b>	<b>4,615,192</b>	<b>4,773,965</b>	<b>4,091</b>	<b>4,778,056</b>
Profit for the period	-	-	371,804	371,804	106	<b>371,910</b>
Other comprehensive income:						
other income	-	(235)	(41)	(276)	-	<b>(276)</b>
Other comprehensive income, total	-	(235)	(41)	(276)	-	<b>(276)</b>
Total comprehensive income for the period	-	(235)	371,763	371,528	106	<b>371,634</b>
Other movements	-	-	-	-	-	<b>-</b>
Contributions by and distributions to owners:						
contribution to the budget of the Republic of Bulgaria	-	-	(180,528)	(180,528)	-	<b>(180,528)</b>
Transactions with owners, total	-	-	(180,528)	(180,528)	-	<b>(180,528)</b>
<b>Balance as of 31 December 2012</b>	<b>20,000</b>	<b>138,538</b>	<b>4,806,427</b>	<b>4,964,965</b>	<b>4,197</b>	<b>4,969,162</b>

The accompanying notes on pages 93 to 117 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, which has been effective since 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;
- Regulation and supervision of the activity of payment system operators, payment institutions and electronic money institutions in the country;
- The Bank shall not extend credit and guarantees in any form whatsoever, including through purchase of debt instruments, to the Council of Ministers, municipalities, as well as to other government and municipal institutions, organisations and enterprises;
- 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 reserves;
- The Bank shall act as the fiscal agent and depository for the State.

The Governing Council of the BNB approved the Consolidated Financial Statements, set out on pages 85 to 117, on 25 April 2013.

### 2. Applicable Standards

These Financial Statements have been prepared in accordance with the 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), which are the functional currency of the Bank. 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 entities controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an entity 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 *Non-controlling 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 accounted for in the Bank's Consolidated Financial Statements using the equity method 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 *profit or loss* as investment income/expenses and is added to/subtracted from the carrying value of the investment.

## 5. Significant Accounting Policies

### (a) Income recognition

Interest income and expense are recognised in the *profit or loss* using the effective interest rate method. The effective interest rate is the rate which precisely discounts the estimated future cash payments and income over the term of the financial asset or liability to the carrying amount 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 transaction costs and fees and points that are integral part of the effective interest rate. Transaction costs include incremental costs directly attributable to the acquisition, issue or derecognition of a financial asset or liability.

Interest income and expense in the *profit or loss* include:

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

Dividend income is recognised in the *profit or loss* when the Bank establishes the right to receive income. Foreign currency differences arising from available-for-sale investments are recognised in the *profit or loss*.

Net income 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. Derivatives held for trading (positive fair value), as well as options purchased, if any, are reported as trading assets. Derivatives for trading (negative fair value), as well as options written, if any, are reported as trading liabilities.

*Loans and advances* are instruments issued 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 those financial assets designated as available for sale at initial recognition.

#### (ii) Recognition

The Bank recognises trading financial assets and investments, the Bank's loans and advances, and financial liabilities at amortised cost on the date at which they are originated. All other financial assets and financial liabilities are initially recognised on the trade date at which the Bank becomes a party to the contractual provisions of the instrument. From that moment on, any changes in their fair value are recognised by the Bank as income or expense.

Financial instruments are initially measured at fair value, plus for an item not recognised at fair value through profit or loss transaction costs directly attributable to its acquisition or issue.

**(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 initial amount recognised and the maturity amount, minus any reduction for impairment.

**(iv) Fair value measurement and disclosure principles**

Fair value is the amount for which an asset could be exchanged or a liability be settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

When available, the Bank measures the fair value of an instrument using quoted prices in an active market of that instrument. A market is regarded as active if quoted prices are regularly published and easily accessible and represent actual and regularly occurring market transactions on an arm's length basis.

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 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 them 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 substantially all risks and rewards of ownership 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 are discharged or cancelled or expired.

The Bank enters into transactions whereby it transfers assets recognised in its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. If all or substantially all of the risks and rewards are retained, then the transferred assets are not derecognised from the statement

of financial position. Transfers of assets with retention of all or substantially all risks and rewards is, for example, securities lending and repurchase transactions.

In transactions where the Bank neither retains nor transfers substantially all risks and rewards of ownership of a financial asset, it derecognises the asset if it does not retain the control of that asset. The rights and obligations retained in the transfer are recognised separately as assets and as liabilities respectively. In transactions where control of the asset is retained, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by 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 offset the recognised 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. Financial assets are 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 other 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 considers the need of impairment of loans or investments held to maturity at both specific assets and collective level. All individually significant loans and investments held to maturity are assessed 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 carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of the estimated future cash flows discounted by the original effective interest rate of the asset. Impairment losses are recognised in profit or loss and reflected in an allowance account against loans and advances. Interest on the impaired asset continues to be recognised through unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through 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 which the Bank acquires or incurs principally for the purpose of selling or repurchasing in the near term, or holds as part of a portfolio that is managed together for short-term profit or position taking.

Initially, the financial assets and liabilities for trading are recognised at fair value in the statement of financial position with transaction costs recognised in profit or loss. All changes in the fair value are recognised as part of net income from trading operations in the profit and loss.

***(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 using the effective interest rate method. A reclassification of more than an insignificant part of the assets held to maturity that are not falling due in the immediate future, result in a reclassification of the entire portfolio of investments held to maturity as available for sale investments. As a result of this reclassification, the Bank may not classify investments as held to maturity in the current year and the following 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 other comprehensive income until the investment is sold or fully impaired when the cumulative gains and losses previously recognised in other comprehensive income are reclassified to profit or loss as a reclassification adjustment.

**(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. Pursuant to the requirements of the 'General provisions for defining the valuation basis in the financial statements' to the IFRS, the Bank defines the recognition and valuation of the monetary gold as an 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 reporting 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 presents land and buildings in the statements of financial position at revalued amount as per the alternative approach allowed in IAS 16 Property, Plant and Equipment. The other items of property, plant, equipment and intangible assets are measured at cost, less accumulated depreciation, and impairment losses.

Land and buildings are measured at fair value which is regularly assessed by professionally qualified valuers. The revaluation of property is done asset by asset, and any accumulated depreciation at the revaluation date is derecognised against the gross carrying amount of the asset, and the net amount restated to the revalued amount of the asset. When the value of assets increases as a result of revaluation, the increase is reflected directly in the other comprehensive income. 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 profit or loss.

**1) Subsequent expenditure**

The separately accounted for expenditure incurred to replace a component of an item of property, plant and equipment are capitalised. All other subsequent expenditures are capitalised only when future economic benefits embodied in the item of property, plant and equipment will flow to the Bank. All other expenditures are recognised in the *profit or loss* 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 the 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.

	(per cent)
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 they 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 recognising impairment loss.

**(f) Foreign exchange**

Gains and losses 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 currency gains and losses resulting from the revaluation of monetary assets and liabilities are recognised in the profit or loss. Non-monetary assets and liabilities denominated in foreign currency are retranslated to the functional currency at the exchange rate at the date that the fair value was determined.

Outstanding forward contracts in foreign currency are marked to market. The gains and losses on revaluation of outstanding forward contracts are recognised in the profit or loss.

The exchange rates of the major foreign currencies as of 31 December 2012 and 31 December 2011 are as follows:

Currency	31 December 2012	31 December 2011
US dollars	1 : BGN 1.48360	1 : BGN 1.51158
Euro	1 : BGN 1.95583	1 : BGN 1.95583
Special Drawing Rights	1 : BGN 2.28017	1 : BGN 2.32068
Gold	1 troy ounce : BGN 2463.73	1 troy ounce : BGN 2380.35

#### (g) Taxation

The Bank is not subject to income tax from its core activities. Income tax 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 at the reporting 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.

The deferred tax is calculated using tax rates which are expected to be applied for the period of asset realisation or liability settlement. The effect on the deferred tax from changes in the tax rates is recorded in the statement of comprehensive income up to the amount already charged or reported directly as other comprehensive income.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the unused tax losses or tax credit can be utilised. The deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

#### (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. Internal rules for preparation of financial statements and accounting policies were adopted upon a decision of the Governing Council effective from 1 January 2007, which are in compliance with Article 36, paragraphs 1 and 2 of the Law on the BNB. 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 revenue 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 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 employer 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. 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 ter-

minate 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, 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 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 IFRS and interpretations (IFRIC) not yet adopted as at the reporting date**

A number of new standards, amendments to standards and interpretations which will become effective for financial periods beginning after 1 January 2012 has not been adopted when preparing these consolidated financial statements. Management does not expect that these future changes will have an impact on the Bank's Financial Statements.

#### ***Standards, interpretations and amendments to standards that have not been early adopted – endorsed by the EC:***

- Amendments to IFRS 7 – Financial Instruments: Disclosure – Transfers of Financial Assets shall be applied, at latest, as from the beginning of the first financial year starting on or after 1 January 2013. The Bank is evaluating the new requirements but it is not expected the Amendments to have any impact on the financial statements.
- IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IFRS 12 Disclosure of Interests in Other Entities and IAS 27 Separate Financial Statements (2011) superseding IAS 27 Consolidated and Separate Financial Statements (2008), and IAS 28 Investments in Associates and Joint Ventures (2011) superseding IAS 28 Investments in Associates (2008) shall be applied, at latest, as from the beginning of the first financial year starting on or after 1 January 2014. The Bank does not expect IAS 27 (2011) to have a material impact on the financial statements, since it does not result in a change in the Bank's accounting policy.
- IFRS 13 Fair Value Measurement provides a single source of guidance on how fair value is measured, and replaces the fair value measurement guidance that is currently dispersed throughout IFRS. Subject to limited exceptions, IFRS 13 is applied when fair value measurements or disclosures are required or permitted by other IFRSs. The Bank does not expect IFRS 13 to have material impact on the financial statements since management considers the methods and assumptions currently used to measure the fair value of assets to be consistent with IFRS 13.
- Amendments to IAS 1 Presentation of Items of Other Comprehensive Income shall be applied, at latest, as from the beginning of the first financial year starting on or after 1 July 2012. The effect of initial adoption of the amendments will depend on the specific items of other comprehensive income as at the date of initial application.
- Amendments to IAS 12 Deferred Tax: Recovery of Underlying Assets shall be applied, at latest, as from the beginning of the first financial year starting on or after 1 January 2013. The Bank does not expect the amendments to have any impact on the financial statements, since they do not result in a change in the Bank's accounting policy.
- Amendments to IAS 19 Employee Benefits shall be applied, at latest, as from the beginning of the first financial year starting on or after 1 January 2013. The Bank does not expect the amendments to have a material impact on the financial statements, since they do not result in a change in the Bank's accounting policy.
- Amendments to IAS 32 Offsetting Financial Assets and Financial Liabilities shall be applied, at latest, as from the beginning of the first financial year starting on or after 1 January 2014. The Bank is in the process of analysing the changes; however, it does not expect that these will have a material impact on its financial statements.
- IFRIC Interpretation 20: Stripping Costs in the Production Phase of a Surface Mine coming into effect as of 1 January 2013. The Bank does not expect that the amend-

ments will have any material impact on the financial statements since none of its activities fall within the scope of the standard.

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

***Standards, interpretations and amendments to standards, 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 had already been issued by the International Accounting Standards Board (IASB), were not yet endorsed for adoption by the European Commission and therefore were 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 as of 1 January 2015 and may change the classification and measurement of financial instruments.
- Amendments to IFRS 1 Government Loans will become effective as of 1 January 2013.
- In December 2011 the IAS Board issued amendments to IAS 32 Offsetting Financial Assets and Financial Liabilities which will become effective as of 1 January 2014.

## **6. Financial Risk Management Policy Disclosure**

### **(a) Introduction and overview**

The Bank is exposed to the following types of risk in relation to the 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***

In the process of management of the gross international reserves, the Bank aims to achieve high security and liquidity of the assets, first, and then to maximising returns in the situation of the current global financial markets. 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 relatively low credit risk assets such as discount and coupon securities issued by governments, government agencies or supranational financial institutions, and 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 reserves 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 model portfolios (benchmarks) are updated. The monitoring of underlying limits, rules, and procedures is undertaken 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 can invest are set out in internal documents. The documents define the main portfolios and the respective model portfolios (benchmarks), as well as limits for credit, interest rate, currency and operational risk, and list the approved debt instrument issuers which the BNB can invest in and the 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.

#### (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 banks. In general, this credit risk is associated with the probability of insolvency of a BNB's counterparty or the insolvency of an issuer, in whose debt instruments the Bank has invested its own funds. The credit risk in managing BNB's gross international reserves is assessed in line with the requirements in Article 28, paragraph 3 of the Law on the BNB. According to these requirements, the BNB may invest in debt instruments issued by foreign governments, central banks, other foreign financial institutions or international financial organisations whose debts are rated with one of the top two grades by two internationally recognised credit rating agencies and are payable in freely convertible currency in line with internally developed methodology as per the requirements of Article 28 of the Law on the BNB.

According to these requirements, the approved types of financial instruments for investment of funds in managing the international reserves are as follows:

- Investment programmes with central banks;
- Automatic borrowings/lending of securities with the main depository;
- Deposits in foreign currency (time deposits and funds on current accounts) with counterparties or central banks;
- Deposits in gold (time deposits and funds on current accounts) with counterparties, central banks or supranational financial institutions;
- Commercial securities (of up to 1 year term to maturity), issued by governments or government guaranteed institutions, supranational financial institutions, specialised financial agencies, banks, and other financial institutions – issuers of European covered bonds;
- Bonds issued by governments or government guaranteed institutions, supranational financial institutions, specialised financial agencies, banks and other institutions – issuers of covered bonds. All bonds must be with a one-off payment of their face value on the maturity date and without any embedded option;
- Purchases and sales of foreign currency with a value date of up to two business days.

Two basic types of limits are set. They are calculated on the basis of the market value of foreign currency reserves – 1) maximum or minimum limit on the weight of each asset class and 2) individual maximum acceptable exposure of the BNB to an issuer/counterparty (concentration limit).

#### (c) Liquidity risk

Liquidity risk arises in the funding of the Bank's core activities and in the management of positions. It has two aspects: the risk for the Bank of being unable to meet its obligations when due and the risk of being unable to sell an asset on international markets at a fair value within an appropriate timeframe in compliance with the respective market conventions.

The BNB seeks to maintain a balance between the maturity of liabilities and that of assets through investments in financial instruments with a range of maturities. The financial liability instruments provided by customers are primarily deposit/investment accounts and settlement accounts. The Bank maintains minimum level of liquidity by type of currency on a daily basis to ensure all BNB payments in foreign currency. To better manage the risk arising from liquidation of positions in financial instruments, the latter are grouped by liquidity rank subject to the level of difficulty (*i.e.* discount from the fair value), at which they could be sold on the market in time of crisis. Limits are set for the different types of financial instruments based on the liquidity ranks.

As part of its overall liquidity risk management strategy, the Bank has defined 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.



The Bank's financial assets and liabilities, analysed by residual term to maturity from the date of the statement of financial position to the date of any subsequent agreement or contractual maturity, are as follows:

(BGN'000)

	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	Undefined maturity	Total
<b>As of 31 December 2012</b>							
<b>Financial assets</b>							
Cash and deposits in foreign currencies	9,376,167	-	-	-	-	-	9,376,167
Gold, instruments in gold, and other precious metals	1,898,930	-	-	-	-	1,308,424	3,207,354
Financial assets at fair value through profit or loss	595,538	892,795	5,702,448	10,328,839	281,573	-	17,801,193
Financial assets available for sale	77,757	-	-	-	-	1,437,952	1,515,709
Other assets	8,906	11,000	21,058	-	-	-	40,964
<b>Total financial assets</b>	<b>11,957,298</b>	<b>903,795</b>	<b>5,723,506</b>	<b>10,328,839</b>	<b>281,573</b>	<b>2,746,376</b>	<b>31,941,387</b>
<b>Financial liabilities</b>							
Banknotes and coins in circulation	-	-	-	-	-	9,549,921	9,549,921
Due to banks and other financial institutions	7,845,160	-	-	-	-	-	7,845,160
Liabilities to government institutions and other borrowings	6,770,169	21,514	160,514	-	-	-	6,952,197
Borrowings against Bulgaria's participation in international financial institutions	-	-	-	-	-	2,775,165	2,775,165
<b>Total financial liabilities</b>	<b>14,615,329</b>	<b>21,514</b>	<b>160,514</b>	<b>-</b>	<b>-</b>	<b>12,325,086</b>	<b>27,122,443</b>
<b>Asset-liability maturity mismatch</b>	<b>(2,658,031)</b>	<b>882,281</b>	<b>5,562,992</b>	<b>10,328,839</b>	<b>281,573</b>	<b>(9,578,710)</b>	<b>4,818,944</b>
<b>As of 31 December 2011</b>							
<b>Financial assets</b>							
Cash and deposits in foreign currencies	6,526,069	-	196,249	-	-	-	6,722,318
Gold, instruments in gold, and other precious metals	1,365,445	466,816	-	-	-	1,263,933	3,096,194
Financial assets at fair value through profit or loss	1,353,216	1,844,674	7,926,658	4,787,545	340,846	-	16,252,939
Financial assets available for sale	79,138	-	-	-	-	1,462,582	1,541,720
Other assets	12,534	6,706	22,909	-	-	-	42,149
<b>Total financial assets</b>	<b>9,336,402</b>	<b>2,318,196</b>	<b>8,145,816</b>	<b>4,787,545</b>	<b>340,846</b>	<b>2,726,515</b>	<b>27,655,320</b>
<b>Financial liabilities</b>							
Banknotes and coins in circulation	-	-	-	-	-	8,728,750	8,728,750
Due to banks and other financial institutions	6,179,598	-	-	-	-	-	6,179,598
Liabilities to government institutions and other borrowings	3,241,167	1,992,865	-	-	-	-	5,234,032
Borrowings against Bulgaria's participation in international financial institutions	-	-	-	-	-	2,824,412	2,824,412
<b>Total financial liabilities</b>	<b>9,420,765</b>	<b>1,992,865</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>11,553,162</b>	<b>22,966,792</b>
<b>Asset-liability maturity mismatch</b>	<b>(84,363)</b>	<b>325,331</b>	<b>8,145,816</b>	<b>4,787,545</b>	<b>340,846</b>	<b>(8,826,647)</b>	<b>4,688,528</b>



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
<b>As of 31 December 2012</b>							
Banknotes and coins in circulation	9,549,921	9,549,921	-	-	-	-	9,549,921
Due to banks and other financial institutions	7,845,160	7,845,160	7,845,160	-	-	-	-
Liabilities to government institutions and other borrowings	6,952,197	6,952,306	6,770,171	21,514	160,621	-	-
Borrowings against Bulgaria's participation in international financial institutions	2,775,165	2,775,165	-	-	-	-	2,775,165
	<b>27,122,443</b>	<b>27,122,552</b>	<b>14,615,331</b>	<b>21,514</b>	<b>160,621</b>	<b>-</b>	<b>12,325,086</b>
<b>As of 31 December 2011</b>							
Banknotes and coins in circulation	8,728,750	8,728,750	-	-	-	-	8,728,750
Due to banks and other financial institutions	6,179,598	6,179,598	6,179,598	-	-	-	-
Liabilities to government institutions and other borrowings	5,234,032	5,234,261	3,241,167	1,993,094	-	-	-
Borrowings against Bulgaria's participation in international financial institutions	2,824,412	2,824,412	-	-	-	-	2,824,412
	<b>22,966,792</b>	<b>22,967,021</b>	<b>9,420,765</b>	<b>1,993,094</b>	<b>-</b>	<b>-</b>	<b>11,553,162</b>

#### (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 and to changes in the liability structure of Issue Department balance sheet. Exposure to market risk is managed in accordance with the risk limits set in the Investment Limits for the Management of the Gross International 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 (called 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.

For the calculation of the total risk, the currency risk and the interest rate risk, the empiric distributions, derived from time series of 30 daily observations of total income, currency income and interest income of assets, respectively, have been used. The correlation between the currency and interest rate risk is also presented. For each of the parameters, the value as of the last date for the period, the average value for the whole period, as well as minimum and maximum values have been calculated.

(BGN'000; per cent)

	As of 31 December 2012	Average	Maximum	Minimum
Currency risk	(45,500)	(30,633)	(58,452)	(13,641)
Interest rate risk	(2,569)	(4,109)	(7,756)	(558)
Correlation (per cent)	0.18	0.17	0.62	(0.26)
Overall risk	(43,651)	(30,609)	(55,072)	(14,952)
	As of 31 December 2011	Average	Maximum	Minimum
Currency risk	(47,488)	(48,590)	(117,776)	(19,207)
Interest rate risk	(1,867)	(7,117)	(12,912)	(1,680)
Correlation (per cent)	(0.07)	0.17	0.70	(0.45)
Overall risk	(49,352)	(48,625)	(116,265)	(18,352)

### 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 1 basis point (1/100th of 1 per cent) change in the interest rate levels. In addition, portfolios' technical parameters such as protuberance (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)

	Total	Floating rate instruments	Fixed rate instruments		
			Up to 1 month	From 1 month to 3 months	Over 3 months
As of 31 December 2012					
<b>Interest-earning assets</b>					
Cash and deposits in foreign currencies	9,312,713	3,757,976	5,554,737	-	-
Gold, instruments in gold and other precious metals	1,898,799	-	1,898,799	-	-
Financial assets at fair value through profit or loss	17,755,040	1,008,804	587,958	893,303	15,264,975
Financial assets available for sale	77,757	-	77,757	-	-
Other interest-earning assets	40,964	5,939	2,967	11,000	21,058
<b>Total</b>	<b>29,085,273</b>	<b>4,772,719</b>	<b>8,122,218</b>	<b>904,303</b>	<b>15,286,033</b>
<b>Interest-bearing liabilities</b>					
Due to banks and other financial institutions	7,845,160	-	7,845,160	-	-
Liabilities to government institutions and other borrowings	3,137,548	-	2,955,656	21,514	160,378
Borrowings against Bulgaria's participation in international financial institutions	1,392,900	1,392,900	-	-	-
<b>Total</b>	<b>12,375,608</b>	<b>1,392,900</b>	<b>10,800,816</b>	<b>21,514</b>	<b>160,378</b>
<b>Interest-bearing assets/liability gap</b>	<b>16,709,665</b>	<b>3,379,819</b>	<b>(2,678,598)</b>	<b>882,789</b>	<b>15,125,655</b>
As of 31 December 2011					
<b>Interest-earning assets</b>					
Cash and deposits in foreign currencies	6,635,495	2,242,276	4,197,636	-	195,583
Gold, instruments in gold and other precious metals	1,498,736	-	1,031,942	466,794	-
Financial assets at fair value through profit or loss	16,165,186	1,342,240	1,338,616	1,833,778	11,650,552
Financial assets available for sale	79,138	-	79,138	-	-
Other interest-earning assets	42,149	3,788	8,746	6,706	22,909
<b>Total</b>	<b>24,420,704</b>	<b>3,588,304</b>	<b>6,656,078</b>	<b>2,307,278</b>	<b>11,869,044</b>
<b>Interest-bearing liabilities</b>					
Due to banks and other financial institutions	6,179,598	-	6,179,598	-	-
Liabilities to government institutions and other borrowings	3,465,346	-	1,474,249	1,991,097	-
Borrowings against Bulgaria's participation in international financial institutions	1,417,647	1,417,647	-	-	-
<b>Total</b>	<b>11,062,591</b>	<b>1,417,647</b>	<b>7,653,847</b>	<b>1,991,097</b>	<b>-</b>
<b>Interest-bearing assets/liability gap</b>	<b>13,358,113</b>	<b>2,170,657</b>	<b>(997,769)</b>	<b>316,181</b>	<b>11,869,044</b>

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 spread of assets and liabilities and expectations for parallel movements of the yield curves of the relevant assets, is as follows:

(BGN'000)

	100 basis points parallel increase	100 basis points parallel decrease	50 basis points parallel increase in 1 year	50 basis points parallel decrease in 1 year
As of 31 December 2012	(230,899)	230,899	30,313	27,870
As of 31 December 2011	(138,134)	138,134	177,533	113,485

### Currency risk

For the Bank, a 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 entering into transactions with financial instruments denominated in foreign currencies other than the 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 leva, are affected by movements in the exchange rate of the lev against the currencies other than the euro.

To minimise 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 foreign 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 December 2012	31 December 2011
<b>Assets</b>		
Bulgarian lev, euro and currencies of euro area countries*	26,120,887	21,906,659
US dollar	29,355	19,195
Japanese yen	131	220
Pound sterling	232	212
SDR	2,876,171	2,927,098
Gold	3,162,928	3,053,483
Other	2,649	2,608
	<b>32,192,353</b>	<b>27,909,475</b>
<b>Liabilities, capital and reserves</b>		
Bulgarian lev, euro and currencies of euro area countries	29,384,535	25,062,368
US dollar	29,235	19,154
Japanese yen	-	-
Pound sterling	3	-
SDR	2,775,978	2,825,351
Other	2,602	2,602
	<b>32,192,353</b>	<b>27,909,475</b>
<b>Net position</b>		
Bulgarian lev, euro and currencies of euro area countries	(3,263,648)	(3,155,709)
US dollar	120	41
Japanese yen	131	220
Pound sterling	229	212
SDR	100,193	101,747
Gold	3,162,928	3,053,483
Other	47	6

\* Currencies of Member States prior to their accession to the euro area, which are bought by the central banks.

**(e) Using accounting judgements and assumptions**

The Governing Council discusses the development, selection and disclosure of critical accounting policies and assumptions, as well as their application.

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 valuation 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 an expert's judgement depending on liquidity, concentration, market factors uncertainty, pricing assumptions, and other risks affecting the particular instrument.

***(ii) Valuation of financial instruments***

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

- **Level 1:** Quoted market price or closing price for positions for which there is a reliable market;
- **Level 2:** Valuation techniques based on observable market information about yield curve. This category of methods is used to measure debt securities for which there is no reliable market.
- **Level 3:** Valuation techniques, where inputs on financial assets and liabilities are not based on observable market data.

The fair values of financial assets and liabilities traded in international financial markets for which there is available market information are based on market quotations or closing market prices. The use of observable market prices and information reduces the need for management judgement and estimation and also reduces the uncertainty associated with determination of fair values. Availability of observable market prices and inputs varies depending on products and markets and is prone to changes based on 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 a 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 framework with respect to the measurement of fair values. The fair values of financial instruments controls are set by an independent risk analysis and control unit. Specific controls include: verification of observable prices and inputs; regular reviews of current valuation models and, if necessary, development, approval and introduction of new valuation models; follow-up verification by means of analysis and comparison of data from various information sources, *etc.*

The table below analyses financial instruments reported at fair value using valuation 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 Valuation techniques using market data	Total
<b>31 December 2012</b>			
Cash and deposits in foreign currency	9,376,167	-	9,376,167
Gold, instruments in gold and other precious metals	3,207,354	-	3,207,354
Financial assets at fair value through profit or loss	17,703,397	97,796	17,801,193
<b>Total</b>	<b>30,286,918</b>	<b>97,796</b>	<b>30,384,714</b>
<b>31 December 2011</b>			
Cash and deposits in foreign currency	6,722,318	-	6,722,318
Gold, instruments in gold and other precious metals	3,096,194	-	3,096,194
Financial assets at fair value through profit or loss	15,830,248	422,691	16,252,939
<b>Total</b>	<b>25,648,760</b>	<b>422,691</b>	<b>26,071,451</b>

## 7. Interest Income and Expense

(BGN'000)

	2012	2011
<b>Interest income</b>		
– from securities	407,822	399,463
– from deposits	12,777	35,558
– from other	2	209
	<b>420,601</b>	<b>435,230</b>
<b>Interest expense</b>		
– on deposits	1,931	26,380
– on other	-	42
	<b>1,931</b>	<b>26,422</b>

Interest paid on foreign currency government deposits as of 31 December 2012 was BGN 23 thousand.

Interest paid on foreign currency deposits of other organisations as of 31 December 2012 was BGN 263 thousand.

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

(BGN'000)

	2012	2011
Net (losses) from operations in securities	(232,416)	(137,592)
Net gains from operations in foreign currency	465	566
Net revaluation (losses) on futures	266	(1,857)
Net revaluation gains /(losses) on securities	134,869	19,297
Net revaluation gains on foreign currency assets and liabilities	(1,392)	1,600
Net revaluation gains on gold	108,420	387,571
	<b>10,212</b>	<b>269,585</b>

## 9. Other Operating Income

(BGN'000)

	2012	2011
Income from subsidiaries	36,603	43,252
Income from associated companies	325	61
Income from sale of coins	735	1,027
Dividend income	8,621	7,961
Other income, net	1,124	1,715
	<u>47,408</u>	<u>54,016</u>

Dividend income includes dividends from BNB's participation in BIS, Basle, amounting to BGN 5790 thousand and from BNB's participation in BORICA-Bankservice of BGN 2831 thousand.

## 10. Total Administrative Expenses

(BGN'000)

	2012	2011
Personnel costs	31,298	30,769
Administrative expenses	46,538	46,966
Depreciation	24,667	25,969
Other expenses	3,825	3,624
	<u>106,328</u>	<u>107,328</u>

Personnel costs include salaries, social and health insurance costs charged under the local legislation provisions as of 31 December 2012, and social activities costs, respectively for the BNB: BGN 23,282 thousand, for the Printing Works of the BNB Corp.: BGN 5,088 thousand, and for the Bulgarian Mint EAD: BGN 2,928 thousand. The number of employees of the Bank and its subsidiaries was 1237 in 2012 (2011: 1230), including the BNB staff of 874 in 2012 (2011: 865).

Based on actuarial calculations, the Bank has accrued compensation liabilities for personnel on retirement and for unused paid annual leave at BGN 492 thousand (31 December 2011: BGN 297 thousand). The retirement and unused paid annual leave compensation for the Bank's subsidiaries as of 31 December 2012 was BGN 134 thousand (31 December 2011: BGN 207 thousand).

Administrative expenses include the BNB's currency circulation expenses of BGN 11,866 thousand for the year ended 31 December 2012 (31 December 2011: BGN 9551 thousand).

## 11. Cash and Deposits in Foreign Currencies

(BGN'000)

	31 December 2012	31 December 2011
Cash in foreign currencies	61,274	84,383
Current accounts in other banks	3,708,545	2,240,100
Deposits in foreign currencies	5,606,348	4,397,835
	<u>9,376,167</u>	<u>6,722,318</u>

Cash and deposits in foreign currencies with correspondents are disclosed as follows:  
(BGN'000)

	31 December 2012	31 December 2011
Euro area residents		
In EUR	4,988,011	4,333,864
In other currencies	2	2
	4,988,013	4,333,866
Non-euro area residents		
In EUR	2,969,733	955,697
In other currencies	1,418,421	1,432,755
	4,388,154	2,388,452
	9,376,167	6,722,318

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

	31 December 2012		31 December 2011	
	'000 troy ounces	BGN'000	'000 troy ounces	BGN'000
Gold bullion in standard form	513	1,263,999	513	1,221,222
Gold deposits in standard form	771	1,898,930	770	1,832,261
Gold in other form	16	39,882	16	38,693
Other precious metals		4,543		4,018
		3,207,354		3,096,194

Gold in standard form includes gold held with correspondents. This gold earns interest at rates between 0.01 per cent and 0.35 per cent *per annum*. Gold in other form includes commemorative gold coins of BGN 33,701 thousand. Other precious metals include silver commemorative coins of BGN 674 thousand and platinum commemorative coins of BGN 3644 thousand. Gold deposits are held with banks whose liabilities are rated with one of the two highest ratings given by two internationally recognised rating agencies.

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

(BGN'000)

	31 December 2012	31 December 2011
Securities at fair value through profit or loss		
Foreign treasury bills, notes and bonds	17,801,193	16,252,939
	17,801,193	16,252,939

Securities comprise both coupon and discount securities denominated in euro. The maximum coupon interest of the EUR-denominated securities was 2.43 per cent in 2012 (31 December 2011: 2.98 per cent).

As of 31 December 2012 there were no securities pledged as collateral on futures transactions. (31 December 2011: BGN 30,284 thousand).

The securities issued by foreign governments and other issuers or relevant issuers with credit rating graded by at least two of the six internationally recognised credit rating agencies – Standard&Poor's, Fitch Ratings, Moody's, DBRS, R&I and JCR – are disclosed as follows:



(BGN'000)

	Issuer's credit rating	31 December 2012	31 December 2011
Investment graded securities by the emission/issuer's credit rating	AAA	15,329,029	12,001,433
	AA+	554,126	1,831,948
	AA	322,808	540,800
	AA-	1,492,674	1,826,299
	A+	81,710	52,459
	A	20,846	-
		<u>17,801,193</u>	<u>16,252,939</u>

#### 14. Financial Assets Available for Sale

(BGN'000)

	31 December 2012	31 December 2011
Republic of Bulgaria's quota in the IMF	1,459,765	1,485,699
Equity investments in international financial institutions	29,693	30,098
Investments in associates	26,251	25,923
	<u>1,515,709</u>	<u>1,541,720</u>

The Republic of Bulgaria's quota in the IMF is SDR 640,200 thousand. The sum of BGN 77,757 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 0.13 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 2012 the current value of 10,000 thousand shares in SDR amounted to BGN 22,802 thousand, while as of 31 December 2011 it was BGN 23,207 thousand (ref. note 28). 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 central 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 ECB is EUR 3505 thousand or BGN 6855 thousand.

The Bank holds 100 per cent and 95.6 per cent, respectively, of the capital of the 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:

<b>Associated companies</b>	Share holding per cent	Principal activity
BORICA-Bankservice AD	36.11	Interbank card payments
International Bank Institute OOD	44.23	Financial training and research
Cash Services Company AD	20.00	Handling of sealed parcels of Bulgarian coins and banknotes transferred from the BNB and the banks

In 2012 the BNB acquired the share of the Macedonian central bank in the International Banking Institute OOD worth BGN 4 thousand.

## 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
<b>As of 1 January 2012</b>	184,803	111,192	34,348	9,142	6,653	2,343	348,481
Additions	58	2,209	133	96	51	16,831	19,378
Disposals	(1,319)	(419)	(1,817)	(32)	(16)	(376)	(3,979)
Transfers	14	653	4,733	332	7	5,739	-
Revaluation	700	-	-	-	-	-	700
As of 31 December 2012	184,256	113,635	37,397	9,538	6,695	13,059	364,580
<b>Depreciation and impairment loss</b>							
As of 1 January 2012	(23,256)	(64,066)	(25,710)	(5,142)	(5,088)	-	(123,262)
Charge for the period	(5,816)	(8,269)	(4,959)	(902)	(442)	-	(20,388)
On disposals	87	418	1,768	30	17	-	2,320
Revaluation	308	-	-	-	-	-	308
As of 31 December 2012	(28,677)	(71,917)	(28,901)	(6,014)	(5,513)	-	(141,022)
<b>Net book value as of 31 December 2012</b>	<b>155,579</b>	<b>41,718</b>	<b>8,496</b>	<b>3,524</b>	<b>1,182</b>	<b>13,059</b>	<b>223,558</b>
<b>Net book value as of 31 December 2011</b>	<b>161,547</b>	<b>47,126</b>	<b>8,638</b>	<b>4,000</b>	<b>1,565</b>	<b>2,343</b>	<b>225,219</b>
<b>As of 1 January 2011</b>	184,917	111,706	30,551	9,104	6,346	2,346	344,970
Additions	43	10,648	14	38	105	5,735	16,583
Disposals	(157)	(12,073)	(602)	(174)	(52)	(14)	(13,072)
Transfers	-	911	4,385	174	254	(5,724)	-
As of 31 December 2011	184,803	111,192	34,348	9,142	6,653	2,343	348,481
<b>Depreciation and impairment loss</b>							
As of 1 January 2011	(17,435)	(57,655)	(21,084)	(4,385)	(4,688)	-	(105,247)
Charge for the period	(5,822)	(8,077)	(5,226)	(926)	(452)	-	(20,503)
On disposals	1	1,666	600	169	52	-	2,488
As of 31 December 2011	(23,256)	(64,066)	(25,710)	(5,142)	(5,088)	-	(123,262)
<b>Net book value as of 31 December 2011</b>	<b>161,547</b>	<b>47,126</b>	<b>8,638</b>	<b>4,000</b>	<b>1,565</b>	<b>2,343</b>	<b>225,219</b>
<b>Net book value as of 31 December 2010</b>	<b>167,482</b>	<b>54,051</b>	<b>9,467</b>	<b>4,719</b>	<b>1,658</b>	<b>2,346</b>	<b>239,723</b>

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	Development costs	Total
As of 1 January 2012	41,326	152	-	41,478
Additions	117	-	2,843	2,960
Disposals	(21)	-	-	(21)
Transfers	2,843	-	(2,843)	-
As of 31 December 2012	44,265	152	-	44,417
<b>Depreciation and Impairment loss</b>				
As of 1 January 2012	(33,717)	(74)	-	(33,791)
Charge for the period	(4,252)	(27)	-	(4,279)
On disposals	21	-	-	21
As of 31 December 2012	(37,948)	(101)	-	(38,049)
<b>Net book value as of 31 December 2012</b>	<b>6,317</b>	<b>51</b>	<b>-</b>	<b>6,368</b>
<b>Net book value as of 31 December 2011</b>	<b>7,609</b>	<b>78</b>	<b>-</b>	<b>7,687</b>

Software includes, as of 31 December 2012, licenses purchased by the BNB to the total amount of BGN 995 thousand (31 December 2011: BGN 372 thousand), and software products to the amount of BGN 1823 thousand (31 December 2011: BGN 1354 thousand).

(BGN'000)

	Software	Other intangible assets	Development costs	Total
As of 1 January 2011	38,604	42	948	39,594
Additions	-	127	1,922	2,049
Disposals	(148)	(17)	-	(165)
Transfers	2,870	-	(2,870)	-
As of 31 December 2011	41,326	152	-	41,478
<b>Depreciation and Impairment loss</b>				
As of 1 January 2011	(28,325)	(39)	-	(28,364)
Charge for the period	(5,414)	(52)	-	(5,466)
On disposals	22	17	-	39
As of 31 December 2011	(33,717)	(74)	-	(33,791)
<b>Net book value as of 31 December 2011</b>	<b>7,609</b>	<b>78</b>	<b>-</b>	<b>7,687</b>
<b>Net book value as of 31 December 2010</b>	<b>10,279</b>	<b>3</b>	<b>948</b>	<b>11,230</b>

Software includes, as of 31 December 2011, licenses acquired by the BNB to the total amount of BGN 372 thousand (31 December 2010: BGN 815 thousand), and software products to the amount of BGN 1354 thousand (31 December 2010: BGN 1815 thousand).

## 17. Other Assets

(BGN'000)

	31 December 2012	31 December 2011
Cash held by subsidiaries with local banks	40,964	42,149
Commemorative coins for sale	353	357
Inventories	15,581	15,023
Accounts receivable	2,762	3,271
Deferred charges	1,712	1,623
Other receivables	632	975
	<b>62,004</b>	<b>63,398</b>

Cash held by subsidiaries with local banks comprised BGN 35,025 thousand of Printing Works of the BNB Corp. and BGN 5939 thousand of Bulgarian Mint EAD.

**18. Banknotes and Coins in Circulation**

(BGN'000)

	31 December 2012	31 December 2011
Banknotes in circulation	9,354,746	8,548,706
Coins in circulation	195,175	180,044
	<u>9,549,921</u>	<u>8,728,750</u>

**19. Due to Banks and Other Financial Institutions**

(BGN'000)

	31 December 2012	31 December 2011
Demand deposits from banks and other financial institutions		
– in BGN	5,082,592	4,417,459
– in foreign currency	2,762,568	1,762,139
	<u>7,845,160</u>	<u>6,179,598</u>

The Bank does not pay interest on demand deposits from banks and other financial institutions. Demand deposits include BGN 5008 million representing the required reserves, which all local banks are required to maintain on accounts with the BNB (31 December 2011: BGN 4636 million).

**20. Liabilities to Government Institutions and Other Liabilities**

(BGN'000)

	31 December 2012	31 December 2011
Current accounts		
– in BGN	1,742,186	1,379,232
– in foreign currency	2,072,463	389,454
Time deposit accounts		
– in BGN	2,684,000	2,434,000
– in foreign currency	453,548	1,031,346
	<u>6,952,197</u>	<u>5,234,032</u>

The government's deposits and current accounts with the Bank comprise funds held on behalf of state budget and other government organisations. No interest is payable on the current accounts.

Foreign currency and BGN government deposits earn interest referent to the yield of the interest-bearing FIXBIS of the Bank for International Settlements which was 0.00 per cent in 2012 (in 2011: between 0.00 per cent and 1.09 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 2012 amounted to BGN 1,385,694 thousand: SDR 604,475 thousand (as of 31 December 2011: BGN 1,289,622 thousand: SDR 604,475 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 3721 thousand (as of 31 December 2011: BGN 3463 thousand).

The Bank's borrowings from the IMF of the general and special allocation of SDRs amounted to SDR 474,586,534 and SDR 136,289,102, respectively. Repayment will take place on IMF's demand. Under Article XX of the 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 December 2012	31 December 2011
Funds of EU institutions and bodies	80,678	130,486
Salaries and social security payable	2,430	1,916
Deferred income	1,052	1,680
Other liabilities	16,588	30,545
	<b>100,748</b>	<b>164,627</b>

'Funds of EU institutions and bodies' include European Commission's funds and European Investment Bank's funds. Pursuant to Article 9 of Council Regulation No 1150 of 2000 and Bulgaria's participation in the funding of the EU budget, the Bank opened accounts of the European Commission. As of 31 December 2012 the funds on these accounts were BGN 43,767 thousand. In 2011 the Bank opened accounts with the European Investment Bank (EIB) for the purposes of a financial arrangement between the Government of the Republic of Bulgaria and the EIB with the funds on these accounts amounting to BGN 36,911 thousand as of 31 December 2012 (as of 31 December 2011: BGN 61,519 thousand).

## 23. Capital and Reserves

The capital of the Bank is determined by 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 of 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, upon a decision of the BNB Governing Council.

The 2012 and 2011 profit distribution in accordance with the profit distribution policy disclosed in note 5 (h) is as follows:

(BGN'000)

	2012	2011
<b>Profit for the period</b>	<b>371,910</b>	<b>629,647</b>
Allocation to special reserve under Article 36 of the Law on the BNB		
Unrealised (gains) from gold revaluation	(108,420)	(387,571)
Unrealised (gains)/loss from revaluation of financial assets at fair value through profit or loss	(120,042)	5,559
Unrealised foreign currency valuation (loss)/gains	1,392	(1,600)
Other unrealised (gains)/loss	(266)	1,857
<b>Result after allocation to special reserve, including.</b>	<b>144,574</b>	<b>247,892</b>
Allocation to Reserve Fund under Article 8 of the Law on the BNB	35,278	60,176
Result from consolidation and non-controlling interest	3,462	7,188
Allocation to a special-purpose fund under Article 8 of the Law on the BNB	-	-
Planned contribution to the state budget	105,834	180,528

The planned contribution to the state budget of BGN 105,834 thousand as of 31 December 2012 is a resultant value calculated based on the realised excess of revenue over expenditure in the BNB's unconsolidated Financial Statements of BGN 141,112 thousand. Pursuant to Article 8 of the Law on the BNB, 25 per cent of the annual excess of the Bank's revenue over expenditure amounting to BGN 35,278 thousand is allocated to the Reserve Fund and to other reserves, and the remainder of BGN 105,834 thousand is allocated as a planned contribution to the state budget.

## 24. Non-controlling Interest

Printing Works of the BNB Corp is a joint-stock company with two shareholders: the BNB and the Government represented by the Ministry of Finance. The BNB holds 95.6 per cent of the company's capital and the State holds the remaining 4.4 per cent of the company's capital.

## 25. Monetary Liabilities and Gross International Reserves

(BGN'000)

	31 December 2012	31 December 2011
<b>Gross international reserves</b>		
Cash and deposits in foreign currencies	9,376,167	6,722,318
Monetary gold and other instruments in gold	3,162,928	3,053,483
Security investments	17,801,193	16,252,939
Equity investments and quota in the IMF	77,757	79,138
	<b>30,418,045</b>	<b>26,107,878</b>
<b>Monetary liabilities</b>		
Currency in circulation	9,549,921	8,728,750
Due to banks and other financial institutions	7,843,045	6,177,657
Liabilities to government institutions	5,811,193	4,359,186
Other liabilities	1,223,797	1,007,273
	<b>24,427,956</b>	<b>20,272,866</b>
Surplus of gross international reserves over monetary liabilities	<b>5,990,089</b>	<b>5,835,012</b>

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

As of 31 December 2012 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 organisations 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, 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 recognised in its consolidated statement of financial position. The Bank is not exposed to any credit risk relating to government securities as it does not guarantee them. As of 31 December 2012, the par value of the government securities held in custody was BGN 4981 million (31 December 2011: BGN 4473 million).

## 27. Subsidiaries

(per cent)

	31 December 2012	31 December 2011
<b>Ownership interest</b>		
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 736 thousand from the Bulgarian Mint EAD (31 December 2011: BGN 1747 thousand) and BGN 2401 thousand from the Printing Works of the BNB Corp (31 December 2011: BGN 5380 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 2012 was BGN 68,405 thousand (31 December 2011: BGN 69,620 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 1,385,694 thousand.

### *(iii) Capital commitments*

As of 31 December 2012 the Bank has committed to BGN 184 thousand to purchase non-current assets (31 December 2011: BGN 43 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. Events after the Reporting Date

There are no events after the reporting date that require additional disclosure or adjustments to the Bank's financial statements.





## Major Resolutions of the BNB Governing Council in 2012

- 26 January** The BNB Governing Council issued a license for carrying out activities as an operator of a payment system with settlement finality in euro to BORICA–Bankservice AD.
- 23 February** The BNB Governing Council issued a license for a payment institution providing payment services to Euromoney Transfer OOD (in formation) executing cash transfers.
- As of 19 March 2012 the Bulgarian National Bank put in circulation copper commemorative coin '125th Anniversary of Dimcho Debelyanov's Birth' of the 'Bulgarian Artists' series with a nominal value of BGN 2, issue 2012.
- 15 March** The BNB Governing Council approved the Report on the BNB Budget Implementation as of 31 December 2011.
- As of 23 April 2012 the Bulgarian National Bank put in circulation a silver commemorative coin 'Chudnite Mostove' with a nominal value of BGN 10, issue 2012.
- 5 April** The BNB Governing Council adopted Ordinance on Amendment of BNB Ordinance No 22 on the Central Credit Register.
- 24 April** The BNB Governing Council approved the BNB Annual Report for 2011.
- 15 May** The BNB Governing Council approved the Report on Budget Implementation of Administrative Expenditure of the Bulgarian Deposit Insurance Fund for 2011.
- As of 11 June 2012 the Bulgarian National Bank put into circulation a partially gold-plated silver commemorative coin '250 Years of Slavo-Bulgarian History' with a nominal value of BGN 10, issue 2012.
- 12 July** The BNB Governing Council adopted Ordinance on Amendment of BNB Ordinance No 3 of the BNB of 2009 on the Terms and Procedure for the Execution of Payment Transactions and Use of Payment Instruments.
- The BNB Governing Council approved the amendments to the Tariff of Fees Collected by the BNB for Servicing Customers with Banknotes and Coins, effective as of 1 August 2012.
- As of 11 September 2012 the Bulgarian National Bank put into circulation a silver coloured commemorative coin 'The Lad and the Wind' of the 'Bulgarian Folk Tales' series with a nominal value of BGN 5, issue 2012.
- As of 8 October 2012 the Bulgarian National Bank put into circulation a gold commemorative coin 'St. Petka of Bulgaria' of the 'Bulgarian Iconography' series with a nominal value of BGN 100, issue 2012.

- 24 July** The BNB Governing Council adopted Ordinance on Amendment of BNB Ordinance No 26 on Financial Institutions.
- 18 September** The BNB Governing Council approved the Report on the BNB Budget Implementation as of 30 June 2012.
- 22 November** The BNB Governing Council approved the Report of the Bulgarian National Bank for the January – June 2012 period.
- The BNB Budget for 2013 was approved.
- 4 December** The BNB Governing Council approved the Report on Budget Implementation of Administrative Expenditure of the Bulgarian Deposit Insurance Fund for 2013.
- 18 December** The BNB Governing Council adopted Ordinance Repealing Ordinance No 28 on Information Collected by Banks about Cross-border Transfers and Payments.
- Ordinance No 28 on Information and Documents Provided to Payment Service Providers in Executing Cross-border Transfers and Payments to Third Parties was adopted.
- The BNB Governing Council refused to grant a license to Factor I. N. AD to provide payment services.