

Bulgarian National Bank

ANNUAL REPORT • 2013



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YEARS



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ANNUAL REPORT • 2013



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

Under the provisions of Article 1, paragraph 2 and Article 51 of the Law on the Bulgarian National Bank, I have the honour of presenting the Bank's 2013 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: Tsvetan Gunev, Kalin Hristov, Statty Stattev, Dimitar Kostov.

Governing Council

Ivan Iskrov

Governor

Dimitar Kostov

Deputy Governor

Banking Department

Kalin Hristov

Deputy Governor

Issue Department

Tsvetan Gunev*

Deputy Governor

Banking Supervision Department

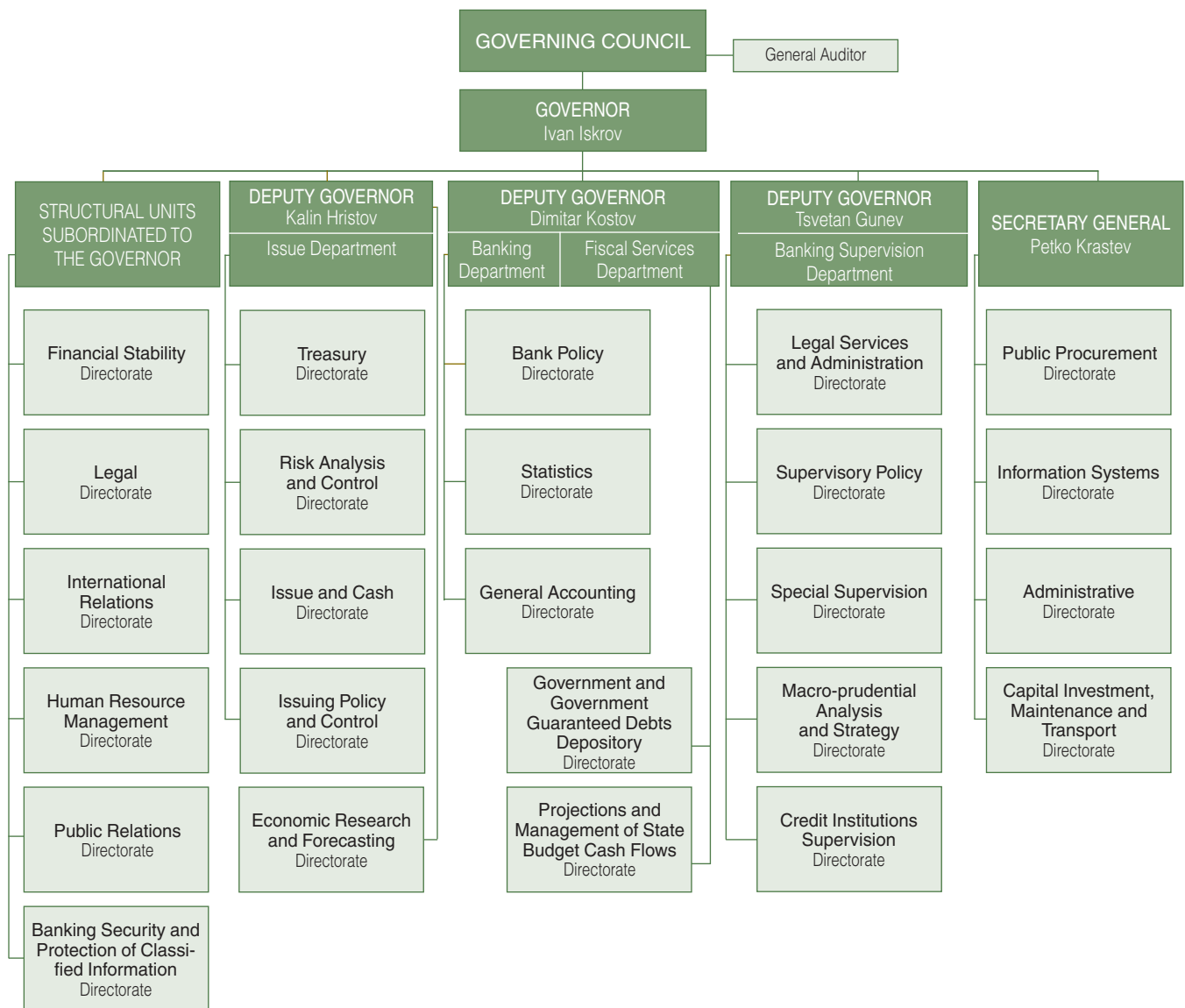
Penka Kratunova

Boryana Pencheva

Statty Stattev

* Tsvetan Gunev is a Deputy Governor of the BNB in charge of the Banking Supervision Department since 16 June 2013. Until 15 June 2013 Rumen Simeonov was a Deputy Governor in charge of this department.

Organisational Structure of the BNB



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Abbreviations

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

Summary

In 2013 the global economy grew 3 per cent from 3.2 per cent in 2012, with divergent trends across regions. US real growth slowed to 1.9 per cent from 2.8 per cent in 2012. Japanese and Chinese growth remained close to 2012 levels at 1.5 per cent and 7.7 per cent. The euro area remained in gradually lessening recession with economic activity indicators improving. The decline in euro area GDP reached 0.4 per cent from 0.7 per cent in 2012. This was mostly down to Italy, Greece, and Spain which nevertheless declined less than in 2012, while France grew 0.2 per cent in real terms from 0 per cent in 2012. German growth slowed to 0.4 per cent from 0.7 per cent in 2012.

Global inflation fell to 3.3 per cent from 3.8 per cent in 2012. This reflected lower energy and major commodity and raw materials prices in international markets. Brent oil fell 2.8 per cent in US dollars and 5.8 per cent in euro. Food and cereals fell 7.5 and 8.1 per cent and metals some 5.5 per cent from 2012. World raw materials and energy prices depressed inflation in the advanced economies to 1.2 from 1.7 per cent in 2012. Euro area annual inflation was 0.9 per cent from 2.2 per cent in 2012. US inflation moderated to 1.5 per cent by end-2013 from 1.7 per cent in 2012. In emerging and developing economies inflation slowed to 5.4 per cent from 6 per cent at end-2012.

Tensions continued easing on international financial markets, as they have since mid 2012 with short interruptions in 2013. The first half year saw sizeable price movements and changes in sentiment accompanied by favourable and unfavourable news. In February and March expectations worsened due to worse than expected macroeconomic data for the euro area, especially compared with steady US improvement. The Cyprus financial crisis, though short-lived, brought distress in markets. The long interval between Italian elections in February and the formation of a cabinet in April also depressed market expectations. In late March and early April measures to resolve the Cyprus crisis were in place, Italy formed a cabinet, and the European Financial Stability Mechanism (EFSM) and European Financial Stability Facility (EFSF) loans to Italy and Portugal were extended from 12.5 to 19.5 years, all helping ease market tensions. The cut in ECB main refinancing rates and the marginal lending facility rate in early May further stabilised the markets.

Price fluctuations again increased in May and June as the US Federal Reserve announced a possible reduction of asset purchases (quantitative easing) until year-end. By raising expectations of a new global interest rate cycle, this dramatically changed market sentiment and pushed long-term interest rates up. Steps to gradual US Federal Reserve asset purchase cuts came only at the year's close.

In the second half-year international financial market tensions calmed as euro area indicators began improving and Irish and Spanish financial support programmes ended. In early July the ECB stated it expected key interest rates to remain unchanged for an extended period and any change would rather be downwards. The ECB reiterated this in subsequent months to calm money market interest rates.

Early repayment of ECB December 2011 and February 2012 long-term financing operations by euro area banks also shored up market sentiment. Better financing conditions and a decreasing need to maintain liquidity buffers allowed euro area banks to repay 89 per cent in net and 44 per cent in gross terms.

Actions to prepare the integrated financial framework based on the single supervisory mechanism (SSM) for euro area banks also had a positive effect. The regulation

conferring prudential credit institution supervision duties on the ECB came into force in November 2013. The end of the year saw agreement on the general principles of a single supervisory mechanism as an element of the euro area banking union.

Gradual improvement in the external environment, particularly in the second half of 2013, helped increase the economic activity in Bulgaria. Real GDP grew 0.9 per cent on 0.6 in 2012 with the positive contribution of net exports. Exports rose 8.9 per cent in real terms, while weak demand restricted import growth to 5.7 per cent. Amid continuing uncertainty and unfavourable labour market conditions household consumption dropped 2.3 per cent, while savings rose compared with the previous year. Fixed capital investment shrunk 0.3 per cent in real terms. As a result of stronger growth of exports of goods and services (both in real and nominal terms) and slower import growth the trade deficit contracted to EUR 2353.3 million in 2013 (against a deficit of EUR 3460.3 million in 2012). In 2013 the overall balance of payments current and capital account balance was in surplus by EUR 1217.7 million (3.0 per cent of GDP) from EUR 207.1 million in 2012 (0.5 per cent of GDP).

Despite the flat economy and cost cuts by businesses, the number of employed persons remained more or less steady, dropping 0.4 per cent following the 2.5 per cent drop in 2012. Unemployment rose slightly from 12.3 on average in 2012 to 12.9 per cent. Labour productivity grew 1.3 per cent from 3.2 in 2012. Compensation of employees for the total economy grew 5.3 from 5.8 per cent in 2012, or 5 per cent in real terms from 3.3 per cent in 2012.

Annual inflation was negative because of lower international food and fuel prices and late 2013 cuts in the regulated household electricity prices (-0.9 per cent from a 2.8 per cent rise in 2012). The GDP deflator declined 0.8 per cent. By component of final use, goods and services imports and exports deflators, final consumer demand expenditure and fixed capital investment fell, while the government demand deflator rose.

Annual broad money grew 8.9 per cent on 8.4 in 2012, with deposits redeemable at notice of up to three month and overnight deposits contributing most at 6.9 and 5.6 percentage points; the contribution of deposits with agreed maturity was negative (-4.4 percentage points). Weak demand for loans in the context of still weak economic activity and intensive household saving governed lending. Claims on the non-government sector grew just 0.3 per cent from 2.8 per cent in 2012. Bank's claims on non-financial corporations also grew more slowly in 2013 at 0.3 per cent, while the decline in banks' claims on households tended to moderate to 0.2 per cent at the end of December from -1 per cent by end-2012.

Continuing attracted fund rises and low credit demand gave banks ample liquidity. They invested much of it into external assets and used it to cut foreign liabilities. By August, their net external asset balance was positive, reaching BGN 1.55 billion in December. A portion of liquidity went into Bulgarian government securities.

The consolidated fiscal programme was in a BGN 1450.3 million (1.9 per cent of GDP) deficit, up BGN 1091.5 million on 2012. The budget position reflected weak domestic demand and limited tax revenue growth coupled with rising social support spending and public sector employee compensation. Total consolidated state budget revenue and grants rose 5.5 per cent, tax revenue contributing most at 3.1 percentage points. Annual direct and indirect tax revenue grew 3.3 per cent and 2.2 per cent respectively. Non-tax and grant revenue rose 10.6 and 12.2 per cent respectively. Overall government expenditure rose 9.3 per cent with expenditure on social insurance and support and compensation of employees in the public sector pushing it up most at 3.2 and 2.2 percentage points respectively. Government capital expenditure rose 11.6 per cent.

The Bulgarian National Bank took note of domestic and global developments and the Law on the Bulgarian National Bank requirements in pursuing its primary goal of

price stability through national currency stability. The Bank followed the principles and practice of prudent investment. It regulates and supervises banks in Bulgaria to maintain banking system stability and protect depositors. It assists the implementation, operation, and oversight of efficient payment systems by regulating and supervising payment system operators, payment institutions, and electronic money institutions. In its capacity as issuing bank, the BNB mints and prints cash and handles uncirculated and withdrawn cash. The Bank is Bulgaria's fiscal agent and government depository and is active in the European System of Central Banks (ESCB) and EU institutions.

Gross international reserves had a market value of EUR 14,425.9 million, a EUR 1126.6 million fall on 2012. The drop reflected a EUR 493.7 million fall in the value of monetary gold after a 31 per cent fall in the euro price of gold on world markets by end-2013, and EUR 429 million of foreign currency outflows mainly from banks selling reserve currency and reducing their reserves at the BNB. The net earnings from managing the gross international reserve comprised: EUR 28.5 million investment income; EUR 509.85 million of exchange rate losses and price revaluations on Issue Department balance sheet open foreign currency positions mostly due to the drop in the monetary gold price; and EUR 0.05 million interest paid on the Issue Department balance sheet liabilities. This gave negative net earnings of EUR 481.86 million (-3.63 per cent net yield for the year).

The BNB continued pursuing a conservative risk management policy for international reserve investment amid uncertain and fluctuating world securities prices. Pursuing its main objectives while ensuring high international reserve security and liquidity, the Bank continued investing most assets into German and French government securities with up to three-year maturities, German government guaranteed debt, and short-term deposits.

In supervision, the BNB aimed to improve the national regulatory framework in compliance with changes at EU level to strengthen banks' capital positions, improve liquidity management, and overcome the crisis. Monitoring and assessment of banking stability involved structural and dynamic analyses. Methods included obtaining periodical and specific information covering systemic risk and identifying problem areas in good time. Supervisory reviews and assessments of credit institutions through off-site monitoring and on-site inspections found breaches and malpractice resulting in measures to improve risk management and maintain credit institutions' stability and reliability.

The Bank's conservative policy and timely action by bank managements ensured banking stability and maintained the system's positive indicators. Total banking capital adequacy rose from 16.6 per cent in 2012 to 17.0 per cent in 2013. The capital surplus rose to BGN 2.8 billion, providing additional resource to cover worsened quality classified exposures. The net value of non-performing banking system credit portfolio loans dipped to 10.1 per cent from 10.6 per cent in 2012. The liquid assets ratio moved between 25.0 per cent and 27.0 per cent, reaching 27.0 per cent by the year's close. Audited banking profit totalled BGN 504 million, dropping BGN 21 million from 31 December 2012. Return on assets was 0.60 per cent from 0.66 per cent in 2012, with return on equity at 4.90 per cent from 5.29 in December 2012.

The Bank oversees payment systems and payment continuity. The BNB's RINGS real time gross settlement system processed 86.5 per cent of payments by value in Bulgaria or 1,027,556 payments for BGN 797 billion. The number of payments through the BNB's Trans-European Automated Real-time Gross settlement Express Transfer system for the euro national system component, TARGET2-BNB, rose 32.2 per cent. In addition to operating Bulgaria's two major payment systems, the Bank supervised other national payment systems to limit system risk and improve reliability and efficiency.

BNB issue and cash operations include: banknote printing and coin minting; accepting, delivering, repaying, processing, authenticity and fitness checking of Bulgarian

banknotes and coins, and foreign currency; exchanging damaged cash; and destroying unfit Bulgarian banknotes and coins. There were 359.2 million coins in circulation, worth BGN 10,041.4 million. The average circulating banknote was worth BGN 27.95. There were 1626.7 million circulating coins worth BGN 205.9 million. The average circulating coin was worth BGN 0.13. The share of retained non-genuine Bulgarian banknotes was 0.000623 per cent of total banknotes in circulation, with that of retained non-genuine Bulgarian coins was 0.000038 per cent. To control cash integrity and security, in 2013 the BNB made eight full and 28 spot on-site checks at credit institutions and service providers.

Under contracts negotiated to market conditions and prices with the Ministry of Finance, the Bank collects, processes, keeps and submits information on budget entities' domestic bank accounts to the Ministry of Finance and acts as government debt agent. The IOBFR system for budget and fiscal reserve information servicing drew up 913 statistical reporting forms, including 308 fiscal reserve forms, up 3 per cent on 2012. There were 30 government securities auctions *via* the GSAS system. The ESROT Electronic System for Registering and Servicing Government Securities Trading registered BGN 38,237.9 million worth of government securities transactions, up 35.3 per cent on 2012. Since November 2013 government securities market participants can settle primary and secondary market transactions denominated and payable in euro through bank accounts in TARGET2. A direct link between the BNB Government Securities Depository and the Clearstream Banking S. A. international central securities depository in Luxembourg went live in December.

There were numerous EU and euro area financial legislation changes. In June the Capital Requirements Regulation (CRR) and Directive (CRD) were finally adopted the general principles of the Directive on credit institution and investment firm recovery and resolution were agreed. The regulation conferring specific tasks to the European Central Bank for single supervision over euro area credit institutions came into force in November 2013. In December general principles on the EU Commission proposal for creating a single supervisory mechanism were agreed upon.

In ESCB, European Commission, EU Council, European Systemic Risk Board, European Banking Authority, and Council for European Affairs committees and working groups, the BNB helped formulate Bulgarian positions on economic governance and finance. The Bank backed the changes in the EU and euro area legislative and institutional framework in principle, since macroeconomic stability has key significance for all member states. It insisted on the need for reform not to undermine the functioning of the single market.

The BNB continued to step up cooperation with Western Balkan central banks and back their preparations for EU accession. Through technical assistance projects financed by the EU and managed by the ECB, the Bank boosted its capacity to provide technical assistance to regional central banks.

I. Economic Development in 2013

1. The External Environment

The global economy grew 3.0 per cent from 3.2 in 2012.¹ Developments diverged by region, US growth slowing, while China grew at the rates set in 2012. Euro area growth moderated in real terms on last year.

Global industrial output rose slightly by 2.0 per cent² from 1.7 per cent in 2012, the US economy and Asian emerging economies growing most. World trade accelerated to 3 per cent on 2.8 in 2012.³

Major Macroeconomic Indicators

(per cent)

	Average Annual Real GDP Growth			Inflation (end of year)			Unemployment Rate (average annual)		
	2011	2012	2013	2011	2012	2013	2011	2012	2013
EU	1.7	-0.4	0.1	3.0	2.3	1.0	9.6	10.4	10.8
Euro area-17	1.6	-0.7	-0.4	2.7	2.2	0.9	10.1	11.3	12.0
New EU Member States	3.3	0.9	1.3	3.8	3.0	0.7	9.4	9.5	9.8
EU-3	1.4	0.3	1.5	3.7	2.5	1.7	7.9	7.9	7.5
United States	1.8	2.8	1.9	3.0	1.7	1.5	8.9	8.1	7.4
Japan	-0.5	1.4	1.5	-0.2	-0.1	1.6	4.6	4.3	4.0
China	9.3	7.7	7.7	4.1	2.5	2.5	4.1	4.1	4.1

Notes: The EU includes Croatia, joining on 1 July 2013. The new EU members joined since 2004, less those now in the euro area. The EU-3 are the United Kingdom, Sweden, and Denmark. New EU member 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 in HICP, calculated by Eurostat for inflation. Preliminary GDP figures for Greece.

Sources: Eurostat, ECB, Bureau of Labor Statistics, IMF, World Economic Outlook, Statistics Bureau of Japan, BNB computations.

The euro area continued in gradually weakening recession. Annual real GDP fell 0.4 per cent, private consumption and gross capital formation detracting less and net exports adding less. GDP declines were largely down to Italy (-1.9 per cent from -2.4 per cent in 2012), Greece⁴ (-3.9 per cent from -7.0 per cent in 2012) and Spain (-1.2 per cent from -1.6 per cent in 2012). Their declines were lower than in 2012, while economic activity in France accelerated slightly to 0.2 per cent on 0 in 2012. Germany had a limiting effect on average euro area real economic growth, its real GDP growth moderating to 0.4 per cent in 2013 from 0.7 per cent in 2012. Still weak economic activity in the euro area pushed up unemployment to 12.0 per cent, Spanish and Italian deterioration contributing most.

Real US economic growth fell to 1.9 per cent from 2012. Dropping government demand after automatic budget expenditure restrictions and uncertainty about further fiscal consolidation measures were key factors driving the slowdown. Tax increases additionally hit domestic demand. As a result, investment and private consumption grew less than in 2012. Slower export growth also contributed to weaker economic growth. Unemployment continued falling to 7.4 per cent, new private sector jobs contributing most.

¹ International Monetary Fund data. World Economic Outlook, April 2014.

² CPB Netherlands Bureau for Economic Policy Analysis data of 22 March 2014.

³ International Monetary Fund data. World Economic Outlook, April 2014.

⁴ Preliminary data for Greece.

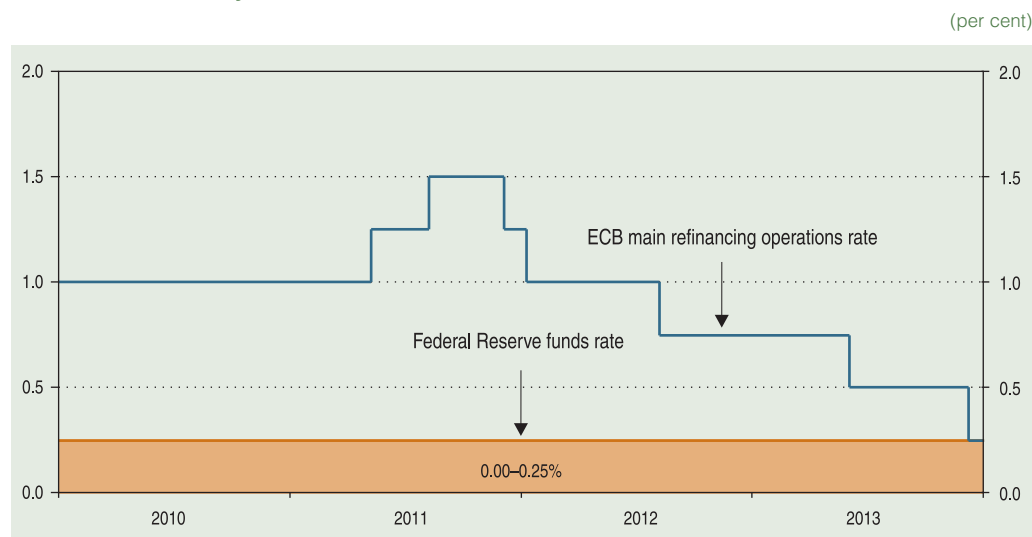
By the end of 2013 global inflation fell to 3.3 per cent on an annual basis from 3.8 per cent a year earlier.⁵ This reflected lower major commodity and raw material prices on international markets and slightly lower economic growth. Brent crude fell 2.8 per cent in USD and 5.8 per cent in EUR on 2012. Prices began falling in early 2013 from USD 116.5 a barrel in February to USD 103.1 in June, mainly due to higher production and rising US inventories. A brief rise to USD 111.6 followed in September as OPEC production and deliveries faltered, falling to USD 110.7 in December. World prices of major goods groups fell in 2013. Food and cereals fell 7.5 per cent and 8.1 per cent. Metals fell some 5.5 per cent, with nickel, aluminium, and non-ferrous metals leading at 14.3 per cent, 8.7 per cent, and 8.3 per cent.⁶

Annual inflation moderated to 1.2 per cent from 1.7 per cent in late 2012 in developed countries and 5.4 per cent from 6.0 per cent in emerging economies and developing countries.⁷ Euro area inflation was 0.9 per cent from 2.2 per cent, core inflation (excluding food, energy, alcohol and tobacco) declining from 1.5 per cent at the end of 2012 to 0.7 per cent.⁸ Estonia and Austria led annual euro area inflation with 2.0 per cent, Finland following at 1.9 per cent; Portugal had the lowest euro area inflation at 0.2 per cent. Greece, Cyprus, and Latvia recorded deflation at -1.8 per cent, -1.3 per cent, and -0.4 per cent.

US inflation moderated to 1.5 per cent from 1.7 per cent at the end of 2012, core inflation (excluding food and energy) falling from 1.9 per cent to 1.7 per cent.⁹ Measured by the private consumption deflator, it also fell to 1.1 per cent from 1.8 per cent.

Economic activity and inflation trends determined ECB and Federal Reserve monetary policy. Low economic activity and falling inflation prompted the ECB Governing Council to keep interest low and cut its main refinancing operations rate by 25 basis points and marginal lending rate by 50 and 25 basis points on 2 May and 7 November. This cut main refinancing operations interest from 0.75 per cent to 0.25 per cent and lending facility interest from 1.5 per cent to 0.75 per cent. The 0.0 per cent deposit facility rate is unchanged since 5 July 2012.¹⁰

Federal Reserve System and ECB Interest Rates



Sources: ECB, Federal Reserve System.

⁵ International Monetary Fund data. World Economic Outlook, April 2014.

⁶ Based on ECB data.

⁷ International Monetary Fund data. World Economic Outlook, April 2014.

⁸ Euro area inflation measured by the Harmonised Index of Consumer Prices (HICP).

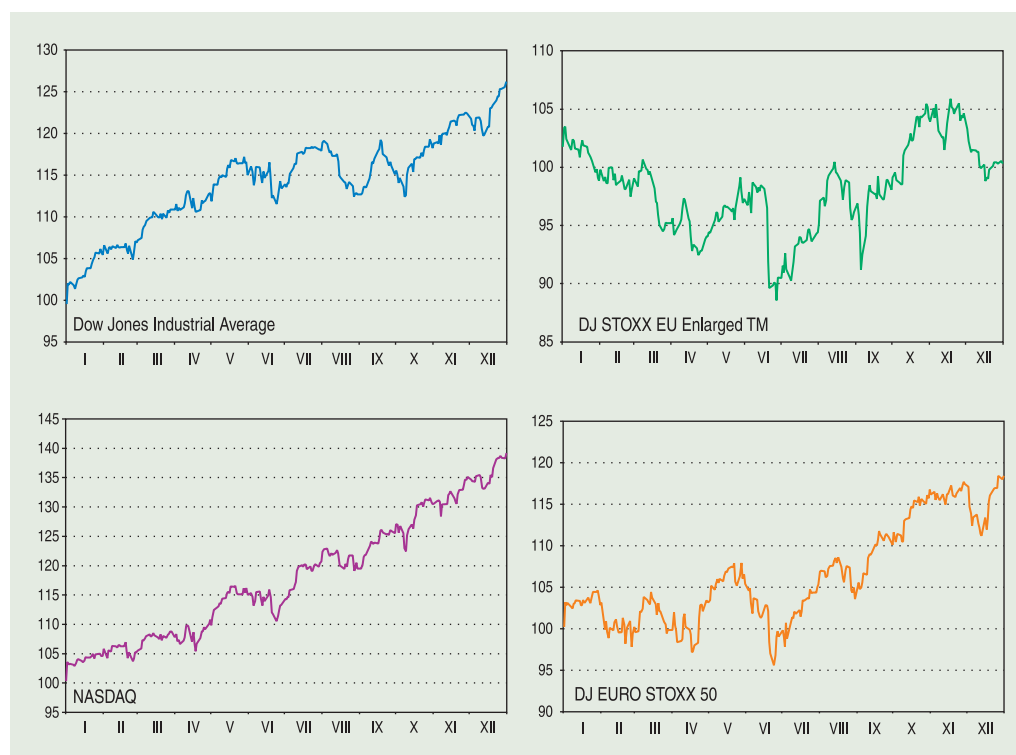
⁹ Measured by the Consumer Price Index (CPI).

¹⁰ For details on the ECB monetary policy see Chapter II.

The Federal Reserve kept federal funds interest unchanged at 0.00–0.25 per cent. Monthly asset purchases of USD 45 billion of long-term US government bonds and USD 40 billion of mortgage backed securities continued. In May the authority stated it might reduce government bond purchases later in the year given continuing economic activity and labour market recoveries. The Open Market Committee at its session of 17–18 December cut monthly asset purchases by USD 10 billion from January 2014.¹¹

US stock markets rose greatly on 2012 as economic recovery expectations rose.

Main Stock Exchange Indices in 2013



Note: US dollars, December 2012 = 100.

Europe saw divergent index dynamics. Share prices dropped in the first half year reflecting the Cyprus financial crisis and continuing euro area recession. In the second half year, the May ECB main refinancing operations interest drop and signs of growth recovery helped stabilise indices, boosting them slightly by the year's close. In December 2013 the US Dow Jones and NASDAQ rose 22.5 and 35.8 per cent on average on a year earlier, the European EURO STOXX 50 and EURO STOXX EU Enlarged TM rising slightly 14.8 per cent and 0.6 per cent.¹²

2. The Bulgarian Economy

The gradual improvement in external economic environment in 2013 had a positive effect. Real GDP growth accelerated to 0.9 per cent from 0.6 per cent in 2012. Net exports contributed most to real GDP growth. Goods and services exports rose 8.9 per cent, imports growing less at 5.7 per cent due to weak domestic demand. Continuing economic agent uncertainty subdued economic activity, private demand and investment in fixed assets decreasing in real terms on last year. Government demand made a low positive contribution to real GDP growth.

¹¹ For details on the US Federal Reserve monetary policy see Chapter II.

¹² For details on international financial markets see Chapter II.

Real GDP Growth Rate and Contribution by Component of Final Consumption

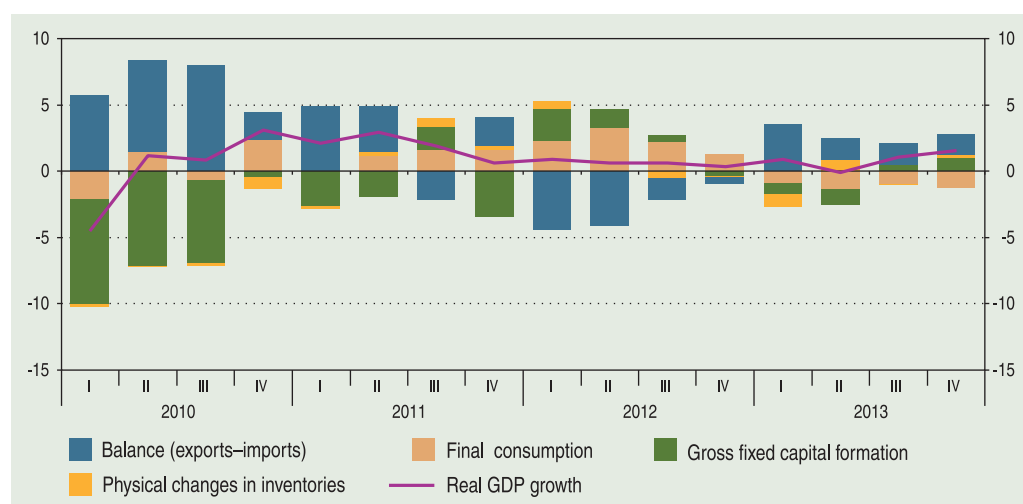
(on the corresponding period of 2012, non-seasonally adjusted data)

	2012		2013	
	Change (per cent)	Contribution, percentage points	Change (per cent)	Contribution, percentage points
GDP	0.6	-	0.9	-
Final consumption	2.9	2.3	-1.4	-1.1
Household consumption	3.7	2.3	-2.3	-1.5
NPISH consumption	17.9	0.1	-1.5	0.0
Final consumption expenditure of the general government sector	-1.2	-0.1	2.1	0.2
Collective consumption	0.3	0.0	2.9	0.2
Gross fixed capital formation	4.0	0.9	-0.3	-0.1
Physical changes in inventories	-	0.0	-	0.0
Exports (goods and services), net	-	-2.5	-	2.0
Exports (goods and services)	-0.4	-0.3	8.9	6.0
Imports (goods and services)	3.3	-2.2	5.7	-3.9

Sources: NSI, BNB.

Real GDP Growth Rate and Contribution by Component of Final Consumption

(per cent, percentage points on corresponding
quarter of previous year, non-seasonally adjusted data)



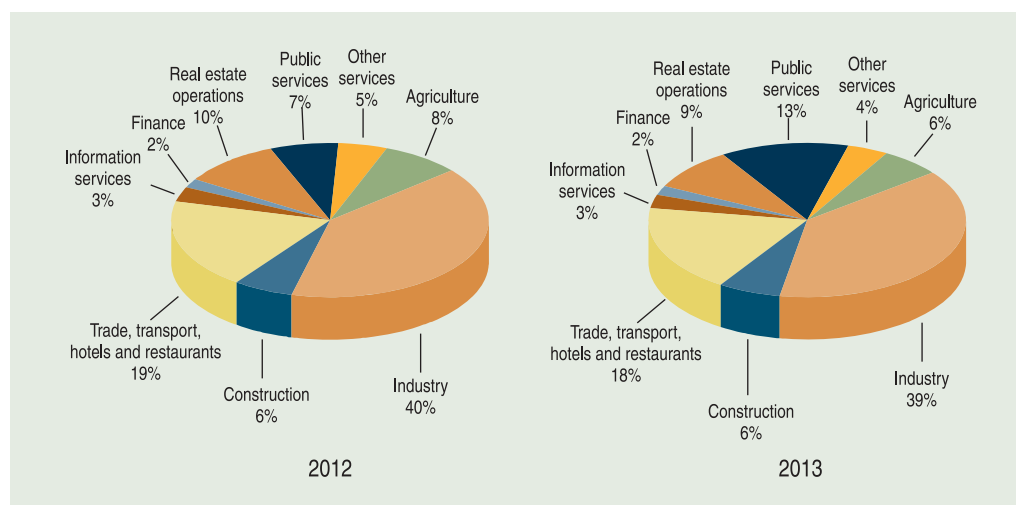
Sources: NSI, BNB.

The persistently adverse labour market and continuing future income uncertainty kept consumer savings high. While retail demand dropped 2.3 per cent, the savings rate rose from 2012.

Government demand grew 2.5 per cent in real terms from 0.5 per cent in 2012 from increased public sector pay and rising operating expenditure due to higher EU funds absorption.

Fixed capital investment reported 0.3 per cent and 3.2 per cent real and nominal drops. Weak home demand and slightly worsened economic expectations kept corporate investing conservative. Preliminary NSI data show nominal fixed asset expenditure in the total economy dropping 7.8 per cent. Investment declines hit almost all sectors, led by mining, quarrying, manufacturing and other industry, water supply, sewerage, waste management and remediation, and property. Public service fixed asset spending rose greatly.

Fixed Asset Acquisition Spending by Economic Activity



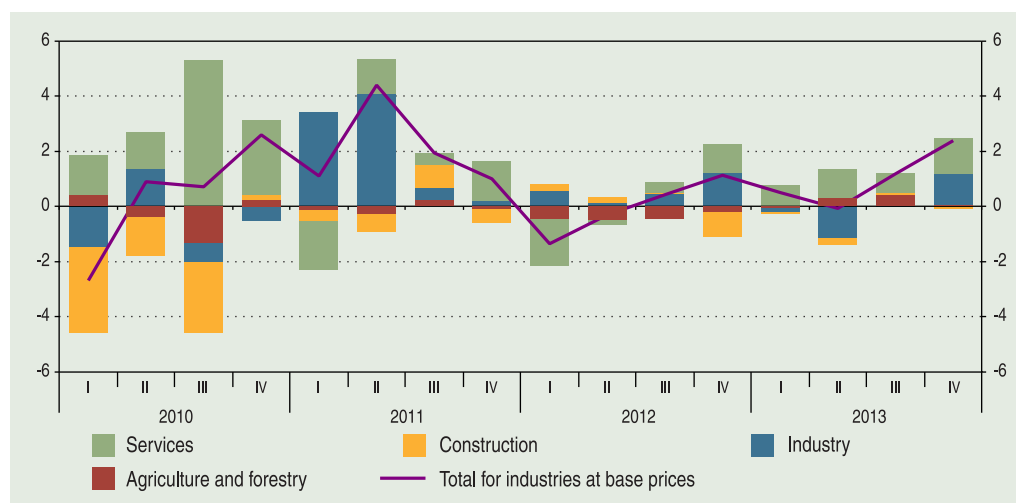
Note: Preliminary data for 2013.

Sources: NSI, BNB.

After falling slightly in the first half-year, gross value added grew 1.1 per cent in real terms in the year. Services and to a lesser extent agriculture, forestry and fisheries contributed most. Among services subsectors, the finance and insurance and general government, education, healthcare and social sectors saw pronounced growth. Services sectors reporting marginal drops were retail, car and motorcycle repairs, transport, storage and mail services, and hotels and restaurants. Gross value added in industry contracted 0.1 per cent. Recent years' downward trend in construction value added continued, slightly moderating to 1.0 per cent from 1.8 per cent in 2012. This made industry's contribution to gross value added change in the economy slightly negative.

Gross Value Added Change in Real Terms and Contribution by Industry

(per cent, percentage points on corresponding quarter of previous year, non-seasonally adjusted data)



Sources: NSI, BNB.

Gross Value Added Change in Real Terms and Contribution by Industry

	2012		2013	
	Change (per cent)	Contribution, percentage points	Change (per cent)	Contribution, percentage points
Gross Value Added	0.1	-	1.1	-
Agriculture and forestry	-7.2	-0.4	3.4	0.2
Industry*	1.6	0.5	-0.2	-0.1
Services	0.0	0.0	1.5	1.0

* Manufacturing and construction.

Sources: NSI, BNB

The overall labour market remained poor. The number of employed people fell just 0.4 per cent after a 2.5 per cent fall in 2012. Dynamics differed by sector, those with gradual gross value added drops and relatively high employee numbers shedding most jobs. These included manufacturing, power, gas and steam, water supply, sewerage, waste management and remediation, to a lesser extent construction, and retail, car and motorcycle repairs, transport, storage and mail services, hotels and restaurants. Agriculture, forestry and fisheries and professional services and scientific research, administrative and ancillary activities created jobs.

The NSI Labour Force Survey showed unemployment dropping slightly from 12.3 per cent to 12.9 per cent. Despite continuing recruitment restrictions and limited job creation, demand for labour boosted the economic activity ratio of 15 to 64s to 68.4 from 67.1 per cent in 2012. The number of discouraged persons continued falling from 227,000 to 209,000. Higher unemployment thus reflected more previously inactive job seekers chasing limited vacancies. Long-term unemployment (over a year) continued rising to 57.4 per cent of all unemployed people.

Labour cost rises matched sectoral gross value added rises. Overall pay rises moderated to 5.3 per cent from 5.8 per cent in 2012, up 5 per cent in real terms from 3.3 per cent in 2012.¹³ Amid relatively stable employment, sectoral pay dynamics reflected mainly slower growth of employee compensation. This slowed to 6.6 per cent from 7.8 per cent in 2012. National accounts show lower paid subsector employee wage growth in construction, agriculture, forestry and fisheries. General government, education, human health and social work outpaced the average. Employee compensation grew more in sectors with higher productivity rises.¹⁴ Finance and insurance stood out, nominal employee compensation there falling 20.1 per cent after a 25.9 per cent rise in 2012, while productivity rose 6.8 per cent. In 2013 productivity in the overall economy rose 1.3 per cent from 3.2 per cent in 2012, finance and insurance contributing most.

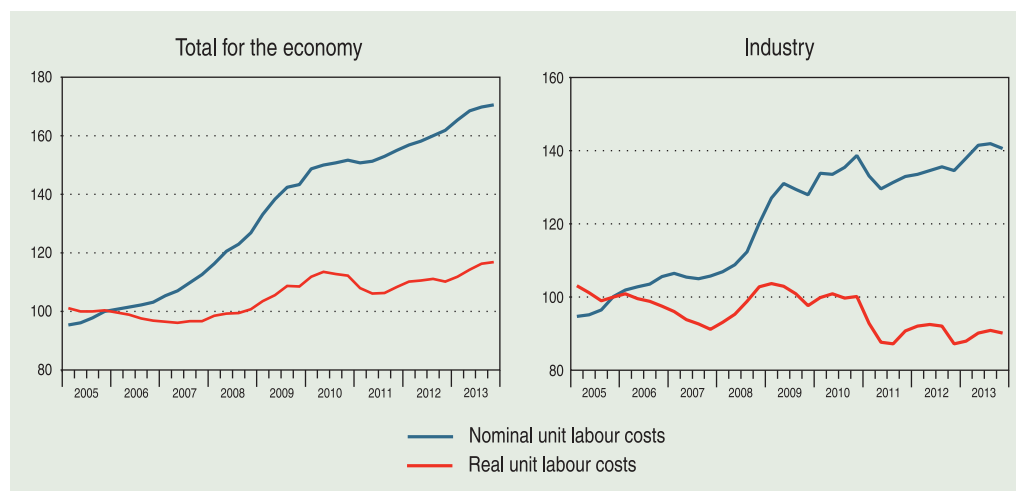
Nominal wage growth rising faster than real productivity pushed nominal unit labour costs in the total economy up 5.2 per cent from 4.4 per cent in 2012. Construction and agriculture, forestry and fisheries reporting higher rises, while finance and insurance and property reported falls. Unlike in 2010 to 2012, businesses did not offset nominal wage growth by raising prices. This pushed real unit labour costs up 6.1 per cent in the overall economy. At 3.8 per cent, rises were less in export-oriented industry but still fell 7.3 per cent on a cumulative basis between 2009 and 2013.

Domestic goods and services prices followed a downward trend. The GDP price deflator fell 0.8 per cent on an annual basis. By component of final use, goods and service import and export deflators fell, as did consumer final demand expenditure and fixed capital investment, while the government demand deflator rose.

¹³ Based on the Harmonised Index of Consumer Prices (HICP).

¹⁴ Real GDP measures labour productivity in the overall economy. Sectoral real terms added value measures sectoral productivity.

Unit Labour Costs (moving average, 2005 = 100)



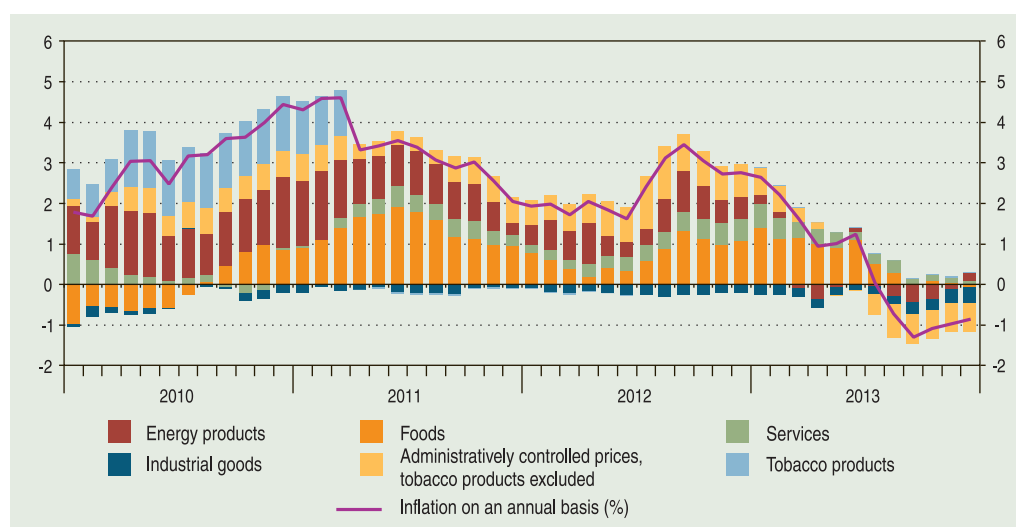
Sources: NSI, BNB

Consumer price inflation fell significantly in 2012, turning negative between August and December.¹⁵ By the year's end the HICP contracted 0.9 per cent on an annual basis from 2.8 per cent in 2012 and average annual inflation was 0.4 per cent from 2.4 per cent in 2012.

Overall inflation reflected both internal and external factors. Administratively controlled prices drove inflation down most in late 2013, household electricity price cuts in March and August adding up to 11.1 per cent. Lower world food and fuel prices and a euro appreciation against the US dollar depressed home food and transport fuel prices. This pushed accumulated food inflation to -0.3 per cent from 4.2 at the end of 2012. After falling between March and November, transport fuel prices rose 2.8 per cent by December on the same period last year due to the base effect (6.0 per cent inflation for this group at the end of 2012).

Annual Inflation and Contributions by Major Goods and Services

(per cent, percentage points)



Sources: NSI, BNB

¹⁵ The analysis employs HICP data.

Inflation Accumulated since the Year's Start and Major Goods and Services Groups' Contributions

	2012		2013	
Inflation (per cent)	2.8		-0.9	
	Rate of inflation by group (per cent)	Contribution, percentage points	Rate of inflation by group (per cent)	Contribution, percentage points
Food	4.2	1.09	-0.3	-0.09
Processed food	2.2	0.39	0.1	0.01
Unprocessed food	8.3	0.69	-1.1	-0.10
Services	2.1	0.54	0.4	0.09
Catering services	3.5	0.18	1.9	0.10
Transportation services	3.9	0.17	0.3	0.01
Telecommunication services	-1.1	-0.06	-0.7	-0.03
Other services	2.3	0.25	0.1	0.01
Energy products	6.3	0.54	2.2	0.20
Transport fuels	6.0	0.49	2.8	0.24
Industrial goods	-1.1	-0.21	-2.1	-0.39
Administratively controlled prices	5.0	0.81	-3.9	-0.71
Tobacco products	0.1	0.00	0.9	0.03

Note: This structure corresponds to the Eurostat classification; see separate presentation of tobacco product and goods and services with administratively controlled prices. The administratively controlled price index is calculated by weighting relevant elementary aggregates level in the consumer basket.

Sources: NSI, BNB

Core inflation (including services and non-food prices) followed a downward trend, turning negative by -0.7 per cent by December 2013 from 0.7 per cent at the end of 2012.¹⁶ This was largely due to moderating services inflation and to a lesser extent to falling non-food prices. Transportation price falls driven by fuel prices, and slower catering and vehicle maintenance rises were key to curbing services inflation. Holiday packages and accommodation curbed overall inflation more. The non-food goods index dipped 2.1 per cent from 1.1 per cent in December 2012. Deepening deflation in this group reflected cheaper furniture and household appliances and continuing falls in vehicle, television, and computer prices. At the same time, the price rises for non-durable goods moderated, limiting non-food goods' overall price dynamics.

The overall current and capital account balance was in surplus by EUR 1217.7 million (3 per cent of GDP) from EUR 207.1 million (0.5 per cent of GDP) in 2012. The current account contributed most through the narrowing trade deficit, while the improved balance of net current transfers and lower deficit on the income account helped. The trade deficit was EUR 2353.3 million from EUR 3460.3 million in 2012. Falls here reflected external and domestic factors. Recovering export demand from the EU had a positive effect, while low home demand restricted imports. The services balance surplus was EUR 2108.1 million, down EUR 272 million on 2012. The income account deficit rose EUR 57.1 million to EUR 1385.4 million, mainly through stronger outflows (mainly reinvested earnings) than inflows (mainly portfolio investment). Net current transfers rose EUR 307.3 million to EUR 2381.9 million, reflecting primarily EUR 329.6 million greater transfers to the general government sector. EU fund capital transfers to government fell on 2012, limiting the rise in the balance of payments current and capital account surplus.

Nominal exports grew 7.0 per cent from 2.5 per cent in 2012. This reflected higher volumes, while falling prices restricted nominal growth. Animal and plant products,

¹⁶ Core inflation is based on HICP by excluding food, energy commodities, controlled price goods and services, and tobacco.

foods, drinks and tobacco (3.5 percentage points) and machines, vehicles, appliances, instruments and weaponry (2.4 percentage points) boosted growth most, with only the mineral products and fuels group reporting a slight decline. Nominal imports grew significantly less by 1.5 per cent largely due to lower prices. By end use of imports, raw materials (1.6 percentage points) and consumer goods (1.4 percentage points) contributed most, while mineral fuels, oils and electricity (-1.5 percentage points) and investment goods (-0.2 percentage points) restricted goods imports' nominal growth.

Preliminary balance of payments data show EUR 1092.4 million (2.7 per cent) of foreign direct investment inflows into Bulgaria from EUR 1070.3 million (2.7 per cent of GDP) in 2012. Sectoral structure data show highest net receipts in transport, storage and communications (EUR 412.2 million), retail (EUR 215.9 million), and manufacturing (EUR 188.5 million). Financial intermediation (EUR 64.3 million) and property operations, leasing and business services (EUR 44.1 million) received the largest net sums.

The balance of payments financial account was in a EUR 1465.6 million deficit from a EUR 1466.2 million surplus in 2012. Bank transactions¹⁷, foreign direct investment and November issues of EUR 900 million of corporate bond loans drove balance of payments financial account flows.¹⁸ Payments on euro-denominated Bulgarian global bonds maturing in January 2013 affected the balance of payments financial account less in its non-resident part. This turned portfolio investment into general government liabilities negative by EUR 301.4 million.

Gross external debt fell by EUR 441.3 million to EUR 37.3 billion (93.5 per cent of GDP) in December. Decreased bank and general government debt (EUR 697.0 and 140.0 million) contributed most. Public and publicly guaranteed debt fell EUR 516.5 million to EUR 4.1 billion. Non-bank intercompany loans rose EUR 121.6 million to EUR 15.9 billion. The increase mainly reflects funds attracted from manufacturing, transport, storage and communications; retail and financial intermediation reported falls. Other sectors' debt rose EUR 274.1 million. There were loans and deposits worth EUR 5995.1 million¹⁹ (including EUR 2412.7 million for other sectors and EUR 1836.9 million of intercompany loans), and repayments of EUR 6436 million of principal obligations.

Balance of payments data show all external current, capital, and financial transactions in 2013 cutting BNB international reserves by EUR 599.2 million, valuation adjustments and price revaluations excluded. Taking into account changes in international foreign reserves on the BNB Issue Department balance sheet, including valuation adjustments and price revaluations, the fall is some EUR 1126.6 million.

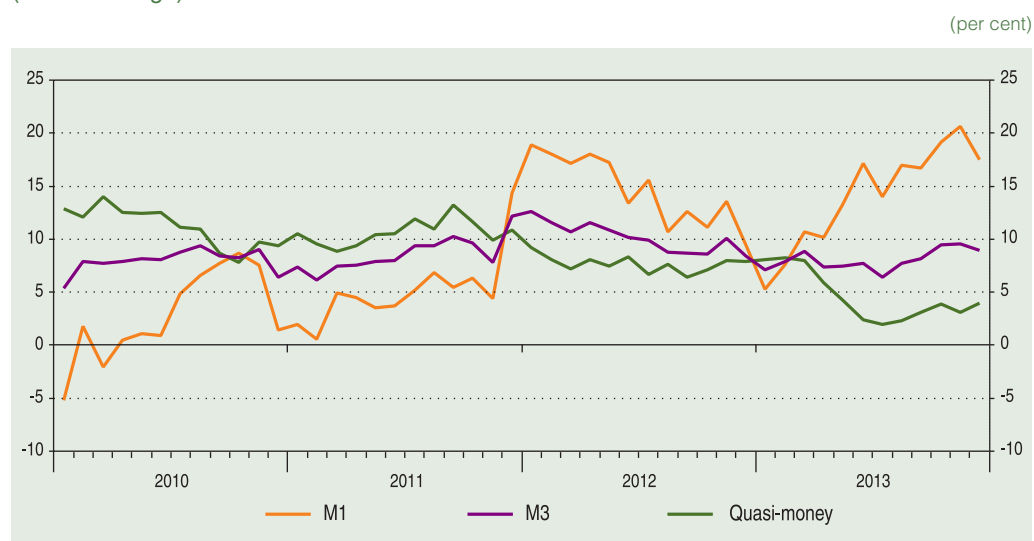
Uncertainty kept consumers saving, mainly into bank deposits. Annual broad money grew 8.9 per cent from 8.4 per cent in 2012. Overnight and up to three-month deposits contributed most by 6.9 percentage points and 5.6 percentage points, while the contribution of deposits with agreed maturity was negative (-4.4 percentage points). The structural change of consumer deposits reflected the new time deposit interest tax introduced in early 2013. Overnight and up to three month deposits exempt from the tax grew, deposits with agreed maturity continued falling.

¹⁷ In 2013 banks boosted assets by EUR 1861.8 million (total portfolio and other investment) and cut liabilities by EUR 631.8 million (total portfolio and other investment).

¹⁸ In November the Bulgarian Telecommunications Company EAD and the Bulgarian Energy Holding EAD issued EUR 400 and 500 million of corporate bonds.

¹⁹ Revolving and trade credit excluded.

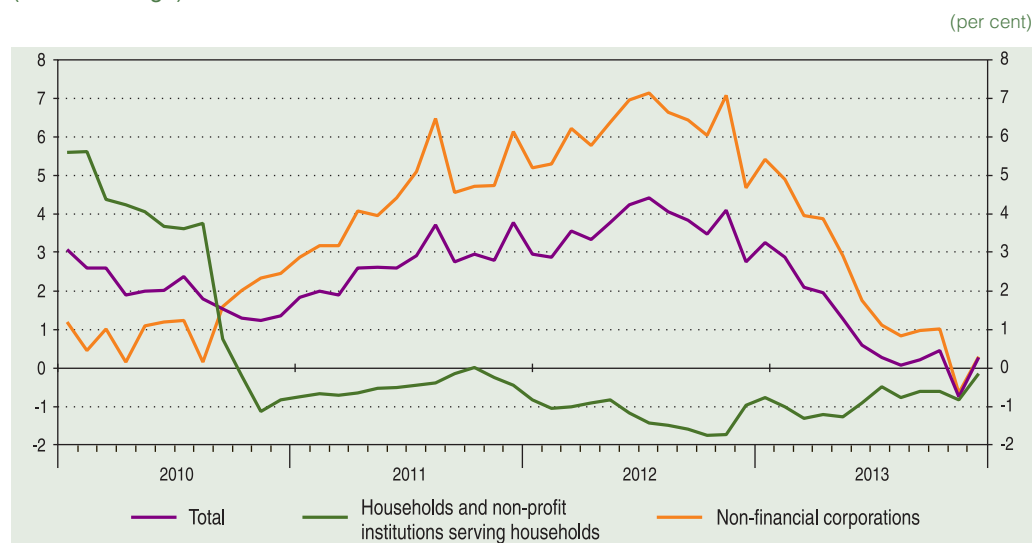
Monetary Aggregates (annual change)



Source: BNB

The M1 monetary aggregate displayed clearly outlined upward dynamics in 2013, rising 17.5 per cent from 9.5 per cent in 2012. Overnight deposits contributed most, while money outside monetary financial institutions hovered close to 2012 levels.

Claims on the Non-government Sector (annual change)



Source: BNB

Low credit demand in the still weak economy and continuing high household saving rate drove domestic lending. The growth of claims on the non-government sector moderated throughout 2013, coming to 0.3 per cent from 2.8 per cent in 2012. Private sector credit reflected corporate borrowing curbs. Sectoral breakdowns show that energy²⁰ curbed the annual growth of claims on corporates in the second quarter due to a base effect. Claims on corporates slowed to 0.3 per cent on an annual basis. Claims on consumers continued declining through the year to -0.2 per cent from -1 per cent in 2012. Household lending reflected mostly low consumer credit growth of 2.2 per cent by December; housing loans declined 1.2 per cent for the first time since the crisis began.

²⁰ Production and distribution of power, heating, and gas.

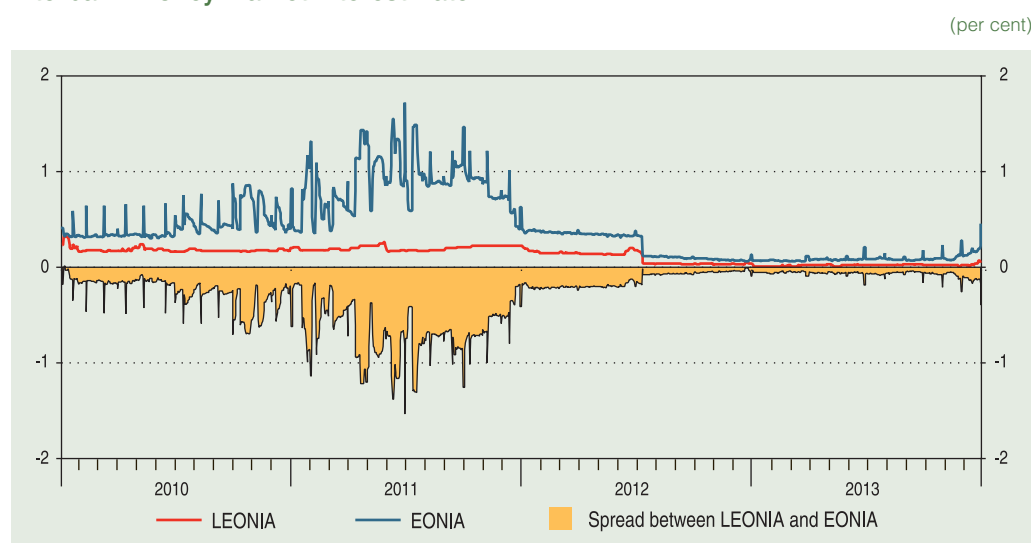
The BNB quarterly lending survey showed banks easing corporate credit by lowering short- and long-term lending criteria. In the first three quarters, banks also eased consumer and housing lending criteria, followed by a slight fourth quarter tightening. Competition, rising inflows of cheaper attracted funds, and declines in alternative investment yields contributed eased lending.

Bulgarian banks continued financing lending by deposits from resident households and non-financial corporations. Household deposits, the main source of finance, rose BGN 3.2 billion in 2013. Corporate and overall resident deposits rose BGN 1.2 and 4.7 billion over the year. Continuing attracted fund rises and relatively low credit demand predetermined ample liquidity, the liquid asset ratio reaching 27.0 per cent. This allowed banks to invest into foreign assets and cut foreign liabilities, reaching a positive net external assets balance in August, rising to BGN 1.55 billion for the year. Some liquidity went into Bulgarian government securities.

Banks managed lev liquidity mainly by trading foreign currency (euro) with the BNB. This took advantage of the main function of the currency board: buying and selling national currency on demand against euro at the Law on the Bulgarian National Bank fixed exchange rate.²¹ The EUR 245 billion of foreign currency traded by the BNB and banks fell EUR 52 million from 2012.

Total foreign currency market turnover in 2013 was EUR 545 billion, down 16.6 per cent on 2012.²² The drop was mainly because of EUR 312.6 million less turnover between banks, excluding the BNB. Interbank foreign currency market trading saw a 3 per cent drop in euro transactions, almost entirely in favour of USD transactions. The share of interbank euro transactions (excluding the BNB) was 93.4 per cent, USD and others coming to 6.3 per cent and 0.3 per cent.

Interbank Money Market Interest Rate



Sources: BNB, ECB

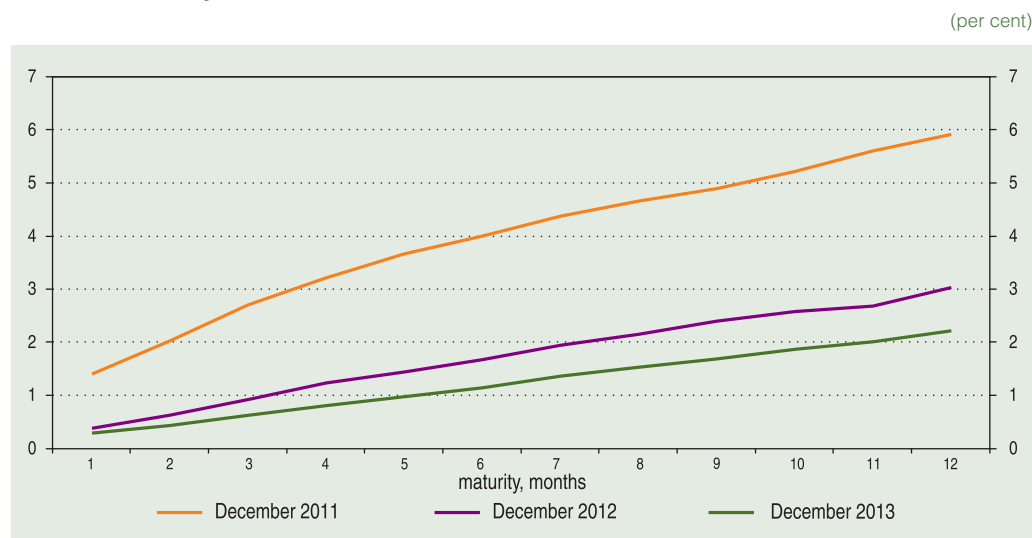
Ample banking liquidity continued affecting interbank money market trading, fuelling the downward trend in interest levels, especially in long-term maturities. The average interbank deposit and repo rate fell to 0.04 per cent from 0.12 per cent in 2012. The LEONIA/EONIA spread was negative throughout the year, reaching 7 basis points on average from 13 basis points in 2012. The narrowing of the negative spread reflected a higher average value decrease in EONIA than LEONIA at 14 and 8 basis point on 2012. ECB main refinancing operations rate cuts of 25 basis points in May and No-

²¹ See Chapter II.

²² This comprises transactions by banks and the BNB in foreign currency against levs with a spot value date of up to two business days and includes the double volume of trade between the BNB and banks, as well as interbank trading.

vember contributed to the EONIA fall. Quotations in long-term maturity sectors fell 53 basis points within the six-month horizon and 80 basis points within the annual horizon.

Interbank Money Market Yield Curve



Note: Average SOFIBOR/SOFIBID Index.

Source: BNB

Interbank money market transactions totalled BGN 54.7 billion, up 16.7 per cent on 2012. Deposits comprised 69.6 per cent of turnover and repo operations in government securities 30.4 per cent. Overnight transactions dominated deposit operations at 86 per cent.

The consolidated fiscal programme cash balance rose BGN 1450.3 million (1.9 per cent of GDP) on 2012 to BGN 1091.5 million (1.4 per cent of GDP). The budget position reflected weak home demand limiting tax revenue growth, and increased social support and public sector compensation of employees.

In 2013 total government revenue and grants reached BGN 28,977 million, tax revenue contributing 3.1 percentage points to the 5.5 per cent annual growth. Tax revenue grew mainly through social and health insurance contributions, including a 20 percentage point police and the armed forces. Pension Fund contributions rise. Indirect taxes contributed less to tax revenue, their annual growth slowing to 2.2 per cent from 6.8 per cent in 2012. Direct tax revenue rose 3.3 per cent. This was entirely down to early 2013 tax legislation on calculating obligations and payment deadlines²³ and the new deposit interest tax.²⁴ Revenue from non-tax income and grants, primarily EU Cohesion and Structural Funds, rose 10.6 per cent and 12.2 per cent.

Overall government expenditure, including the EU budget contribution, grew 9.3 per cent to BGN 30,428 million. Social and health insurance expenditure and public sector compensation of employees contributed most to the growth at 3.2 and 2.2 percentage points. Capital expenditure rose 11.6 per cent, largely due to rising EU fund absorption.²⁵ As in the last few years, public investment and operating expenditure fell BGN 1290 and BGN 177 million under target.

A gross government securities issue on the domestic market worth BGN 2323 million, BGN 1400 million of fiscal reserve funds and new external loans of BGN 1119 million financed the budget deficit and government debt payments. At the end of 2013 fiscal reserves amounted to BGN 4680.6 million.

²³ Under the Corporate Income Tax Law and Income Taxes on Natural Persons Law.

²⁴ This renders direct tax revenue non-comparable with prior years in this tax group.

²⁵ Including government reserve growth.

In 2013 the Ministry of Finance offered government securities in all maturity curve segments on the domestic market. Demand for Bulgarian government securities in the primary market remained high, bid-to-cover ratio reaching 2.21 (against 2.75 in 2012) despite a doubling of new government debt instruments from 2012. Average annual yields attained in the primary market fell on the prior year in all maturity segments except for ten-year bonds whose yield rose slightly in the last quarter. The rise had no significant effect on secondary market bond prices, Bulgarian long-term interest²⁶ dropping 1 basis point in December 2013 on the end of the prior year to -3.43 per cent.²⁷

Bulgarian Eurobonds maturing in 2017 traded at a premium, their price reaching 108.2 per 100 units nominal value, corresponding to an annual yield of 1.8 per cent, from an issue price of 99.2. USD-denominated global bonds maturing in 2015 quoted at 107.6 per cent, a 0.8 per cent yield and USD-denominated ZUNK bond prices hovered around nominal.²⁸

The leading Bulgarian Stock Exchange SOFIX and BG40 indices tended upwards. By December the SOFIX rose 44.3 per cent on December 2012 and the BG40 27 per cent.

Bulgarian Stock Exchange Indices in 2013 (December 2012 = 100)



Sources: BNB, Bulgarian Stock Exchange.

Secondary market share trading expanded 240 per cent to BGN 1285 million. Stock exchange bond turnover rose 121 per cent to BGN 211.3 million. Over the counter deals accounted for BGN 392.6 million of equity and BGN 90.1 million of bonds.²⁹ Market capitalisation of the Bulgarian Stock Exchange, Sofia, was BGN 9.96 billion or 12.8 per cent of GDP, from 12.6 per cent of GDP at the close of 2012.

²⁶ The long-term interest rate for assessing degree of convergence is based on the secondary market yield to maturity of a long-term security (benchmark) denominated in national currency and issued by the Ministry of Finance (central government).

²⁷ For more information on the government securities primary and secondary market see Chapter VIII.

²⁸ Reuters data on USD global bonds.

²⁹ Major floor and over the counter transactions involved, *inter alia*, Kaolin AD (almost BGN 200 million), Petrol AD, the Corporate Commercial Bank AD, the ELARG Agricultural Land Opportunity Fund REIT (in liquidation), Bulgartabac Holding AD, Sopharma AD, and Agro Finance REIT.

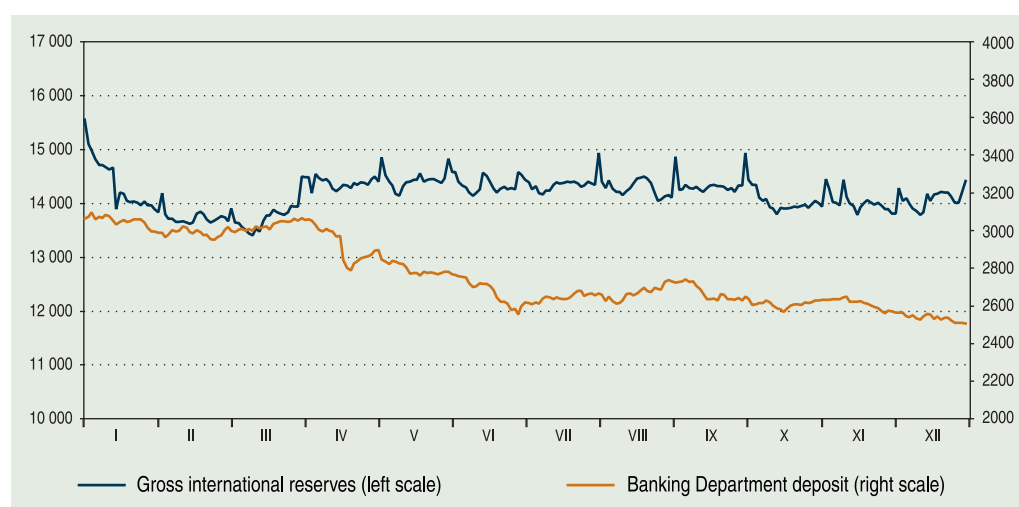
II. Gross International Reserves

The BNB manages its gross international reserves in line with the Law on the Bulgarian National Bank, investment constraints, business procedures and methodologies, and opportunities offered by international financial markets. The BNB gross international reserves comprise the Issue Department balance sheet assets, and their role is to provide complete coverage for monetary liabilities at the BGN/EUR fixed exchange rate set by the Law on the Bulgarian National Bank.³⁰ The excess of gross international reserves over monetary liabilities forms the Banking Department deposit item or the net value of the Issue Department's balance sheet.³¹

Gross International Reserves and Banking Department Deposit in 2013

(EUR million)

(EUR million)



Note: The chart shows the daily movements of the Issue Department balance sheet figure and the Banking Department Deposit in the Issue Department balance sheet.

Source: BNB.

1. The Amount and Structure of Gross International Reserves

By the end 2013 the market value of gross international reserves was EUR 14,425.9 million: a fall of EUR 1126.6 million (7.24 per cent on the end of 2012).³² Two factors contributed to the fall: a EUR 493.7 million drop in the value of gold after a 31 per cent fall in the euro price of gold by end-2013, and EUR 429 million of foreign currency outflows mainly through net bank sales of reserve currency and reduced bank reserves with the BNB.

³⁰ The Law on the BNB Article 28, paragraph 2 defines the Bank's monetary obligations as all circulating banknotes and coins issued by the BNB, and all balances of others' BNB accounts except the IMF. Article 28 Paragraph 3 defines what assets may comprise gross international reserves: monetary gold; Special Drawing Rights; banknotes and coins in freely convertible foreign currency; funds in freely convertible foreign currency held by the BNB at 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 on accounts receivable and payable on BNB forward or repo agreements with (or guaranteed by) foreign central banks, public international financial organisations or other foreign financial institutions with one of the two highest ratings from two internationally recognised credit agencies; and BNB futures and options which bind non-residents and are payable in freely convertible foreign currency. The Law on the BNB stipulates that these assets be estimated at market value.

³¹ According to Article 28, paragraph 1 of the Law on the BNB, 'the aggregate amount of monetary liabilities of the BNB shall not exceed the lev equivalent of gross international reserves,' with the lev equivalent determined on the basis of the fixed exchange rate.

³² Further in this Chapter, the two tranches totalling SDR 611 million received by the BNB in August and September 2009 upon general SDR allocation by the IMF with the total income on them and balances on commercial bank accounts in the TARGET2-BNB national system component to the amount of EUR 309 million are not included in the analysis of changes in BNB gross international reserves by December 2013. For details, see BNB Annual Report 2009, p. 25.

External Cash Flows in Foreign Currency

(EUR million)

	2012	2013
I. Purchases and sales of euro		
at tills	-10	-21
in banks	-307	-1,408
bank purchases	46,550	35,169
bank sales	-46,856	-36,577
Subtotal I	-317	-1,429
II. Currency flows with banks, the MF, etc.		
Minimum Required Reserves	40	-92
Government and other depositors (total)	1,804	1,091
Subtotal II	1,844	1,000
Total I+II	1,527	-429

Notes: End of day period averages. Figures may not add up due to rounding.

Source: BNB.

Banks sold EUR 1408 million net of reserve currency against EUR 307 million cash outflows in 2012. To maintain minimum reserves with the BNB, commercial banks refunded EUR 92 million into their accounts, unlike 2012 when net funds amounted to EUR 40 million. Receipts of EUR 1091 million into government and other depositors' foreign currency accounts (against EUR 1804 million in 2012) contributed positively to external foreign currency flows. The Ministry of Finance and the European Commission were the main beneficiaries.

The gold price decline depressed gold's share in reserves to 10.61 per cent on average from 13.04 per cent in 2012, boosting the share of euro assets to 89.04 per cent on average.

Currency Structure of Gross International Reserves

(per cent)

Currency	Issue Department Balance Sheet	
	2012	2013
EUR	86.44	89.04
USD	0.19	0.04
XAU	13.04	10.61
XDR	0.31	0.30
CHF	0.01	0.01

Notes: End of day period averages. Figures may not add up due to rounding.

Source: BNB.

The structure of assets by financial instrument changed with the share of bond investment rising 10 percentage points to 76.58 per cent of the market value of assets at the expense of investment in short-term deposits and cash with first-class foreign banks. The change largely reflected slight growth in the yield of short-term government securities and low short-term deposit interest.

Gross International Reserves by Financial Instrument

(per cent)

Financial instruments	2012	2013
Vault cash*	6.79	4.76
Deposits**	25.65	18.66
Securities**	67.55	76.58

Notes: End of day period averages. Figures may not add up due to rounding.

* Account balances, payments, and monetary gold.

**Including instruments in foreign currency and gold.

Source: BNB.

As regards residual terms to maturity, in 2013 most assets continued to be in the under a year maturity sector (current accounts, short-term deposits in foreign currency and gold, and short-term securities), their share averaging 59.85 per cent. This was 5 percentage points less than in 2012, in favour of one to three year maturity investments whose share rose to 36.88 per cent.

Gross International Reserves by Residual Term to Maturity

(per cent)

Maturity Sectors	2012	2013
Up to a year	64.85	59.85
One to three years	31.95	36.88
Three to five years	1.92	2.45
Five to ten years	1.15	0.81
Over ten years	0.13	0.01

Notes: End of day period averages. Figures may not add up due to rounding.

Source: BNB.

2. Gross International Reserves Risk and Yield

The Market Environment

International financial markets continued improving into early 2013, as they had since mid-2012. Decreased tensions reflected weaker than expected US fiscal consolidation measures and early repayment of higher operation volumes on ECB long-term financing for euro area banks in December 2011 and February 2012.³³ In February and March 2013 markets worsened after euro area growth data signalled continuing sluggishness. Financial assistance for Cyprus and early parliamentary elections in Italy increased the uncertainty. In response to the worsening economic environment and euro area uncertainty, on 2 May the ECB Governing Council cut the main refinancing rate to 0.50 per cent, the marginal lending facility rate to 1.0 per cent. It left the deposit facility rate unchanged at 0.0 per cent, announcing readiness to cut it to negative values.

In the second quarter financial market tensions diminished gradually driven by the Cyprus rescue plan, formation of an Italian cabinet, extended loan maturities to Portugal and Ireland, and improved US macroeconomic indicators.

Data signalling an end to euro area recession, the ECB policy of maintaining monetary stimulus (including low interest rates for an extended period) and the end of the Irish and Spanish financial assistance programmes helped stabilise and reduce financial market tensions in the second half of 2013. The ECB Governing Council decision of 4 July on forward guidance for future monetary policy rates, *i.e.* its expectations of their developments, aimed to increase monetary policy predictability and counteract money market interest rate fluctuations. The ECB stated it expected key interest rates to stay at prevailing or lower levels for an extended period, subsequently confirming these expectations and thus affecting market agents' sentiment.

At its 7 November meeting, the ECB Governing Council again cut the main refinancing operations rate and the marginal lending facility rate by 25 basis points to 0.25 per cent and 0.75 per cent, leaving the deposit facility rate at 0.0 per cent. The ECB stated the euro area might experience prolonged low inflation followed by gradual rises to rates below, but close to, 2 per cent. The same meeting continued the fixed rate tender procedure with full allotment for all main refinancing operations, special term refinancing operations, and regular longer-term refinancing operations at least until July 2015. It preserved the fixed rate on main refinancing and special term monthly operations and fixing the rate on three-month refinancing operations, to be allotted until mid-2015, at the average rate of the MROs for the period of reserve maintenance.

³³ The two longer-term refinancing operations (LTROs) had three-year maturities. The first on 21 December 2011 allotted EUR 489.2 billion and the second on 29 February 2012 allotted EUR 529.5 billion.

Early repayment of ECB long-term financing to euro area banks also propped market sentiment. In net/gross terms, 62/30 per cent of funds allotted through the two three-year long-term refinancing operations returned in the first half of 2013, this reaching 89/44 per cent by the year's end. Improvements in banks' access to market financing and the reduced need to maintain liquid buffers helped euro area banks redeem obligations on the two three-year operations early. Excess liquidity of the banking system declined to EUR 200 billion from 612 billion in late 2012 and the ECB balance sheet figure shrank 24.3 per cent on the end of 2012.

Action on the preparations of integrated financial framework based of the single supervisory mechanism (SSM) for euro area banks added positive effect. The regulation conferring specific tasks on the ECB in prudential supervision came into force in November 2013.³⁴ Agreement on general principles for a single supervisory mechanism as an element of the euro area banking union came at the end of the year.

EONIA reference overnight rates moved between 0.06 per cent and 0.45 per cent, their average annual value at 0.09 per cent from 0.23 per cent in 2012. EURIBOR, the average interest at which euro area banks exchange time deposits in euro, rose most for short-term maturities. Compared with 2012, one- and three-month rates picked up some 10 basis points to 0.22 per cent and 0.29 per cent, six- and 12-month rates rising 7 basis points and 1 basis point to 0.39 per cent and 0.56 per cent. Credit and liquidity risk premia, measured by the spread between EURIBOR and OIS, changed insignificantly with three- and six-month segments reaching 13 basis points and 24 basis points to 1 basis point and -2 basis points over 2012.

Throughout 2013 the United States Federal Reserve System kept the federal funds reference interest rate unchanged at 0.00–0.25 per cent. It continued reinvesting earnings from maturing US government bonds it held into new US government bonds and earnings from government debt and mortgage backed securities into new mortgage bonds. At the end of 2012 the Federal Reserve System announced unemployment and inflation monetary policy thresholds to be used as a base for monetary policy decisions. Unemployment of some 6.5 per cent and one to two year inflation of 2–2.5 per cent and stable long-term inflationary expectations would prompt no changes in the federal funds rate. These are not specific objectives and form part of a macroeconomic context characterising the recovery of the US economy and labour market.

The Federal Reserve stated that if the economy and the labour market continued recovering, it might reduce monthly government bond purchases later in the year. This sharply boosted US government bond yields across the curve, especially in the long-term segments. Euro area periphery (and core to a lesser extent) debt yields also rose abruptly. Markets saw the statement as signalling a tapering of monetary stimuli. It was not until the year's end that the Federal Reserve Open Market Committee decided to cut the volume of monthly purchases of assets by USD 10 billion on its 17–18 December 2013 meeting, effective as of January 2014.³⁵ The Committee would keep the federal funds rate at its current low level for an extended period, even if unemployment falls below 6.5 per cent, with a possible slow increase in late 2015.

Euro Area and US Sovereign Bond Yield Curve

In the first half of 2013 German government bond yields fluctuated driven by diverse factors. Ongoing euro area economic doldrums, political uncertainty in Spain and Italy, and the uncertainty surrounding Cyprus financial crisis depressed yields, while early repayments on ECB three-year long-term refinancing operations and successful long-term debt issues by Ireland and Portugal boosted them. By late June, yields picked up significantly with the Federal Reserve intention to cut US monetary stimuli, while the May ECB interest rates cut depressed them transiently.

³⁴ For details see Chapter IX.

³⁵ From early 2014 mortgage backed securities purchases fell USD 5 billion to 35 billion a month and US treasury securities by USD 40 billion to 75 billion a month.

Long-term German government bond yields rose strongly from mid-July as market strains weakened. This reflects also the stronger investor interest in debt of euro area periphery countries.

Two-year German benchmark bond yield rose 23 basis points to 0.21 per cent, fluctuating between -0.03 per cent and 0.33 per cent. The increase in the ten-year maturity segment was 61 basis points to 1.93 per cent, yields varying from 1.17 per cent to 2.05 per cent.

Government bond yield spreads of euro area periphery countries compared to the reference German bonds followed a volatile downward trend throughout 2013. In the two-year maturity sector, spreads fell most in Spain (172 basis points to 129), Ireland (146 basis points to 74), and Italy (96 basis points to 104). In the ten-year segment, the strongest decline was in Spain (173 basis points to 232), Portugal (149 basis points to 414), and Ireland (124 basis points to 179).

Ireland and Portugal affected spreads favourably by re-entering the market with successful bond issues. Political instability in Italy and the Cyprus crisis had the opposite effect. The Cyprus rescue plan in early April and the new Italian cabinet gradually cut market tension, narrowing periphery country spreads. Extensions of European Financial Stability Mechanism and European Financial Stability Facility loans to Portugal and Ireland from 12.5 to 19.5 years and the Fitch upgrade of the Greek credit rating to B-minus/stable outlook backed the positive trend. Early repayment of ECB longer-term refinancing to euro area banks also had a favourable effect. The approaching integrated financial framework of the single supervisory mechanism for euro area banks narrowed spreads yet further.

Spread dynamics in some euro area periphery countries continued to be volatile into the second half of 2013. Portuguese bond yields rose greatly in the summer. In early July Standard & Poor's downgraded the outlook of Portugal's rating from stable to negative due to political uncertainty. In September that agency put its rating under watch, pending a possible downgrade in case of deviation from the country's economic programme. Portuguese bond spreads narrowed after publication of improved macroeconomic data, political stabilisation, and especially the successful replacement of domestic government securities in early December. Moody's upgraded Portugal's credit rating in November from negative to stable.

For a while in the summer, Italian bond yield spreads widened amid political and economic worries. On 9 July Standard & Poor's downgraded Italy's long-term rating in one step to BBB. Political settlement by Christmas cut Italian bond yields.

Spanish yield spreads followed a broadly downward trend as macroeconomic indicators improved. Data showing a stable recovery and lessening risk of capital market financing led ratings agencies to upgrade the outlook from negative to stable. Spread narrowing accelerated late in the year after banking sector stabilisation terminated the European Stability Mechanism credit line. Decreased Italian and Spanish yields at the end of 2013 reflected growing investor interest in their debt.

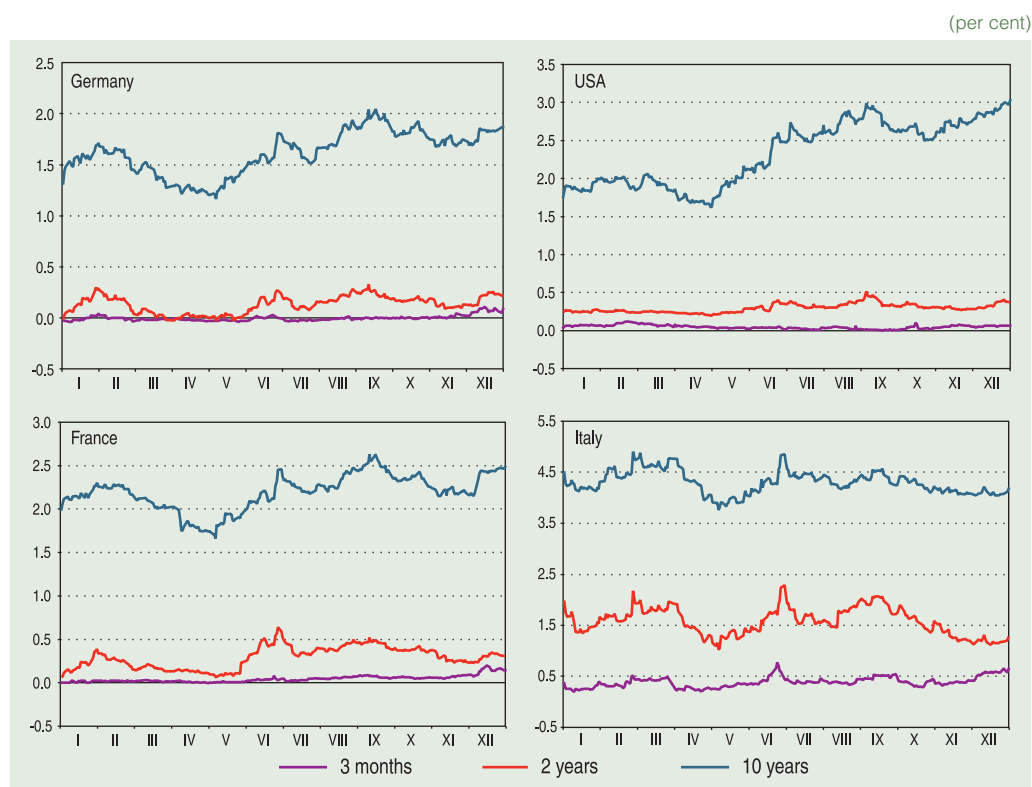
Irish yield spreads narrowed steadily in the second half of 2013 after the successful bailout and the EUR 25 billion NTMA liquidity buffer covering the country's entire 2014 financial needs.

Signals of worsening French and Dutch macroeconomic indicators broadened government bond spreads compared with German ones. On 12 July Fitch downgraded its prime rate for France, aligning itself with Moody's and Standard & Poor's. High government debt and worsened economic outlook were the factors behind Fitch's rating. In the fourth quarter, Standard & Poor's downgraded France's credit rating in one step to AA/stable and that of the Netherlands to AA+/stable, citing lower than expected growth prospects.

US bond yields moved within wide bands, most pronounced in over five-year maturities. Yields in the two-year sector fluctuated between 0.2 per cent and 0.52 per cent, with those in the ten-year sector significantly wider at 1.63 per cent and 3.03 per cent. In the first quarter US bond yields moved within a narrow range before a strong second quarter rise after the Federal Reserve's May announcement of cuts to government bond purchases. Volatility was most pronounced in the third quarter as markets digested the

Federal Reserve intention. Intense debate over fiscal consolidation and social reform in late 2013 led to a federal government shutdown that brought the USA to the edge of technical insolvency in early October. This propelled short-term yields up at the expense of long-term ones. The late 2013 Federal Reserve decision to cut monthly asset purchases by USD 10 billion and continue cuts into late 2014 boosted yields across the curve significantly.

Government Bond Yields in 2013



Gold and Exchange Rates

The gold price fell 28.3 per cent and 31.02 per cent in US dollars and euro, down to USD 1201.6 and EUR 875.9 *per* troy ounce. It moved within the wide band of USD 1188.7 to USD 1692.8³⁶ and EUR 866.9 to EUR 1279.4.

The first significant drop was in mid-April when within two consecutive business days (12 and 15 April) it fell 13.6 per cent and 13.2 per cent in US dollars and euro. Closures of exchange traded fund positions and expectations that the central bank of Cyprus would sell a portion of its gold reserves to raise EUR 400 million for the bailout plan drove depreciation. This caused expectations of copying across the euro area. Technical sales exerted an additional downward pressure following a dip under USD 1500 *per* troy ounce. A second decline came in May and June when the Federal Reserve System announced it would cut or reduce asset purchases, hitting gold demand. In two months after late April gold depreciated by another 16.4 per cent and 15.4 per cent in US dollars and euro. After a short rally by late August, prices continued falling until the year's end driven by good US and euro area data and expectations of prolonged low inflation and weak physical demand in India and China which form 40 per cent of global demand.

In 2013 the US dollar depreciated cumulatively by 4.2 per cent against the euro, more in the second half. The USD/EUR rate moved within the wide range of 0.72 to 0.78 with strong fluctuations. The US dollar reached a high against the euro late in the first quarter, followed by sustained declines. The main driver of US dollar appreciation in early 2013 were unfavourable euro area data raising expectations of an ECB response. The Federal

³⁶ Composite spot price, Bloomberg.

Reserve's announcement of asset purchase cuts had the opposite effect in the second quarter. Euro appreciation in the second half of the year accompanied signs of recovering euro area growth and capital flows from emerging markets to the USA and the euro area.

2013 USD/EUR Exchange Rates



2013 Troy Ounce Gold Price in US Dollars



2013 Troy Ounce Gold Price in Euro



Major Risk Types

In 2013 BNB gross international reserves were invested in line with the risk tolerance set by the BNB Governing Council as regards the net value of the Issue Department balance sheet.³⁷ The Bank's strategic risk budget depends on value-at-risk (VaR) and maximum loss thresholds set by reference to the net value of the Issue Department balance sheet. In 2013 net value risk in the Issue Department balance sheet measured by value-at-risk (VaR) came to -5.99 per cent on an annual basis.³⁸

In 2013 international reserve **interest rate risk** measured by reserves' average modified duration was 0.93 years. The maintained duration was a bit higher than the average one for 2012 which was 0.82 years.

The Law on the Bulgarian National Bank constrained international reserve **currency risk** by limiting the sum of the absolute values of open foreign currency positions³⁹ in currencies other than the euro, SDR, and monetary gold to 2 per cent of the market value of monetary liabilities in these currencies. There were minimal open currency positions in currencies, except funds earmarked for larger budget payments in Japanese yen and US dollars, the open gold position posing the major currency risk to the Bank.

Dynamic financial market developments in 2012 entailed retention of recent years' constraints, plus early 2013 changes to some major **credit risk** management principles, involving more effective use of investment opportunities under the Law on the BNB and further fine tuning of existing rules, constraints and limits to curb risk to the BNB. The Bank continued controlling credit risk in government debt investment and retained constraints on sovereign issuers which are conditionally divided into three inherent risk groups. The minimum 35 per cent share of international reserves for the least risky Group I remained. Early in the second half year the maximum term to maturity for Group III issuers rose from one to three years. New EU members and Asian countries meeting criteria entered the list of eligible issuers. The list of eligible issuers increased to diversify asset classes and financial instruments, the maximum term of mortgage bond investment rising from three to five years. Pursuing its main objectives of high international reserve security and liquidity, the BNB continued investing the main part of assets into German and French sovereign bonds with up to three-year maturities and short-term deposits. By the end of 2013 some 64 per cent of the international reserve was invested into assets with the highest AAA long-term credit rating.

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

Profitability and Efficiency

Net income from assets in euro comprises (i) income from investing gross international reserves in original currency; (ii) currency imbalance yield, and (iii) expenditure on liabilities.⁴⁰ Income from international reserve investment was EUR 28.05 million or 0.23 per cent yield. The currency imbalance yield was EUR 509.85 million, almost entirely due to the 31.02 per cent fall in the euro price of monetary gold (see charts p. 38).⁴¹ Interest on Issue Department balance sheet liabilities was EUR 0.05 million.⁴² The three components brought net return from international reserve management to EUR -481.86 million, a -3.63 per cent net rate of return.

³⁷ Net value means the Banking Department Deposit item in the Issue Department balance sheet.

³⁸ Net value risk measured by $VaR = -X\%$ ($X > 0$) at 95 per cent confidence level and allowing for normal yield allocation means that 95 per cent of the time maximum net value loss would not exceed X per cent. Maximum loss threshold is the highest loss where adverse scenarios have materialised in the past.

³⁹ An open foreign currency position is the difference between the value of assets and liabilities in any currency other than the euro.

⁴⁰ Currency imbalance income is the result of exchange rate movements and price revaluations on assets' and liabilities' open foreign currency positions.

⁴¹ The BNB does not buy and sell monetary gold.

⁴² Data on the Issue Department liabilities are not entered directly into the information system of international reserve management; they enter the system via the accounting system interface.

2013 International Reserves Income and Profitability

Quarter	Net income (1)+(2)+(3)	Investment income (1)	Currency imbalance yield (2)	Expenditure (interest) on liabilities (3)
First quarter	-22.25	8.12	-30.34	-0.03
Second quarter	-391.52	-9.10	-382.40	-0.02
Third quarter	61.95	19.56	42.39	0.00
Fourth quarter	-130.05	9.46	-139.50	0.00
Total income, EUR million	-481.86	28.05	-509.85	-0.05
Total rate of return, per cent	-3.63	0.23	-3.85	0.00

Source: BNB.

For operational management purposes, international reserves are split into portfolios by currency and investment goal, each with a benchmark, investment goals, and investment limits. The table below shows major BNB portfolios and the results from their management.

2013 Portfolio Return and Risk

Portfolio	Return		Volatility (risk)		Information ratio ³
	Absolute (per cent)	Relative ¹ (b.p.)	Absolute (b.p.)	Relative ² (b.p.)	
Investment 1, EUR	0.16	2	38	8	0.27
Investment 2, EUR	0.14	0	38	8	-0.05
Investment 3, EUR	3.15	-	150	-	-
External manager A, EUR	0.07	5	46	6	0.77
External manager B, EUR	-0.09	-12	48	10	-1.13
Liquidity, EUR	0.06	6	2	2	-
Liquidity, USD	0.05	4	2	2	-

¹ A portfolio's positive relative return is profit attained against benchmark yield. Portfolio management interprets a negative sign before relative yield as an opportunity cost.

² Relative volatility (relative risk) against benchmark indicates the degree of deviation of portfolio risk characteristics from benchmark through active portfolio management. Risk is calculated annually.

³ The information ratio indicator is the ratio between portfolio relative yield and its relative risk (on an annual basis). It is calculated only for actively managed portfolios.

Source: BNB.

To diversify management styles and reduce operational risk, most euro-denominated assets continued to be distributed in two investment portfolios with identical benchmarks and investment limits, managed by different BNB teams. Securities in Investment 3 Portfolio are less liquid as they are intended to be held to maturity. They are thus not managed actively and there is no portfolio benchmark. In 2013 some 7 per cent of gross international reserves were managed by external managers at international financial institutions. Beside additional diversification, using external managers helped exchange international market investment expertise. Liquid portfolios mainly assist immediate BNB currency payment needs.

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 major goals are curbing systemic risk and integrating Bulgarian payment systems into the European payment infrastructure.

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.

Bulgarian euro settlement systems are:

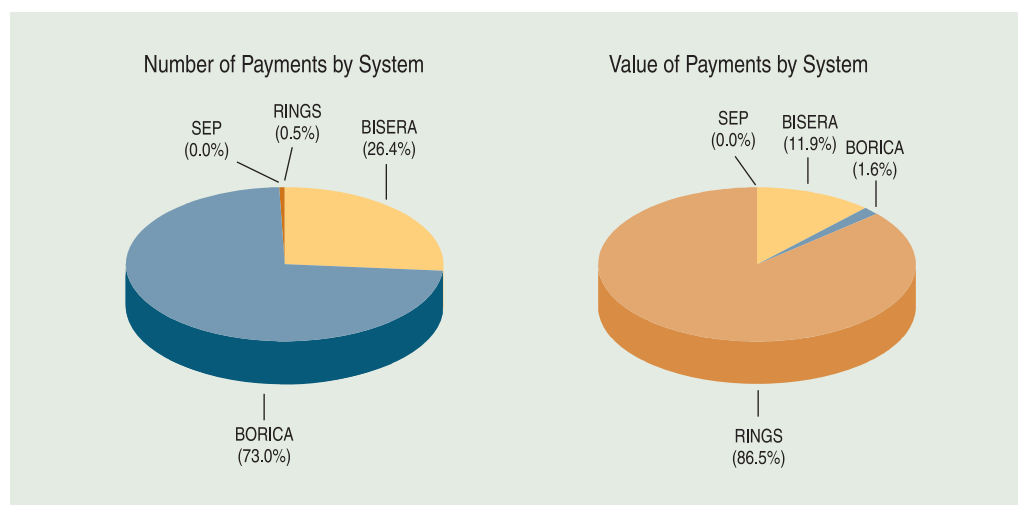
- The TARGET2 national system component, TARGET2-BNB, run by the BNB.
- The TARGET2-BNB ancillary system:
 - BISERA7-EUR, a system for servicing customer transfers to be settled at a designated time, operated by BORICA–Bankservice AD;

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 2013 RINGS processed 86.5 per cent of payment value in Bulgaria. Values around 80 per cent are deemed optimal for the operation of real-time gross settlement systems. RINGS also processed 0.5 per cent of lev non-cash payments.

Distribution of Lev Payments in Bulgaria by Payment System in 2013



Source: BNB.

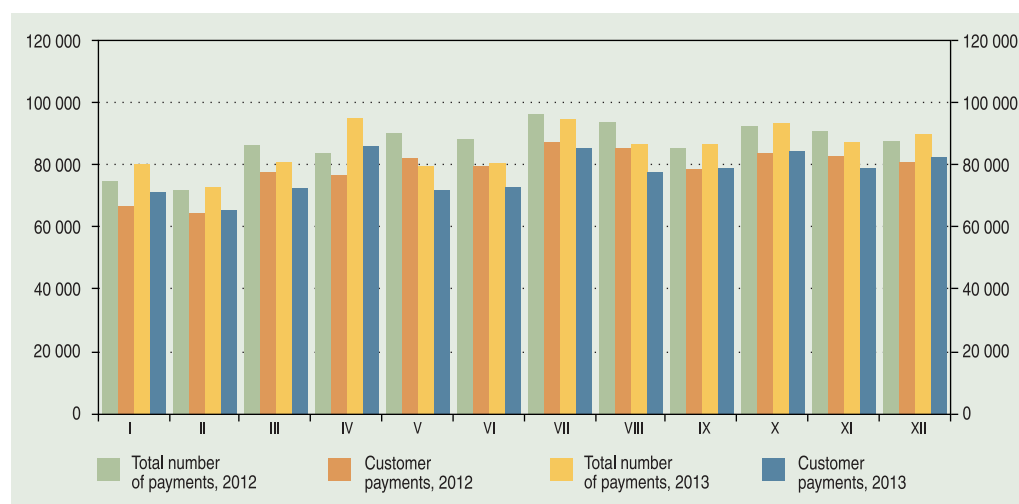
In 2013 BORICA transaction value rose 10.5 per cent and number 11.5 per cent on 2012. ATM cash withdrawal value and number rose 8.2 and 3.6 per cent. BORICA-authorized POS terminal transaction value fell 2.9 per cent and rose 0.8 per cent in number. BISERA payment value grew 6.3 per cent and dropped 4.9 per cent in number.⁴³ By the end of 2013 seven domestic banks participated in SEP, processed transactions declining 74.3 per cent in value and 84.2 per cent in number from the prior year. Central Depository transaction grew 56.2 per cent in value and 26.7 per cent in number on 2012.

1. Payment Systems and Securities Settlement Systems

RINGS Real-Time Gross Settlement System

In 2013 RINGS processed the bulk of lev payment value in Bulgaria. There were 1,027,556 transactions for BGN 797 billion: down 1.3 per cent in number and 8.5 per cent in value on 2012. Customer payments numbered 927,733 (90.3 per cent of the total) for BGN 176 billion (22.1 per cent of the total). There were 4078 payments for BGN 3163 million *per average day*. Over the period 69.5 per cent of payments were processed by noon and 87.8 per cent by 2:30 pm. As regards system traffic, 82.7 per cent of the number of RINGS payments went through by 2:30 pm. By 31 December 2013, 31 banks participated in RINGS.

RINGS Payment Numbers in 2012 and 2013



Source: BNB.

In 2013 no payments were rejected by the close of a RINGS' system day due to insufficient funds on participants' accounts, indicating good liquidity management by banks. There was no recourse to the Reserve Collateral Pool: an interbank mechanism guaranteeing settlement of payment and securities' system orders. RINGS offered 99.97 per cent availability.⁴⁴

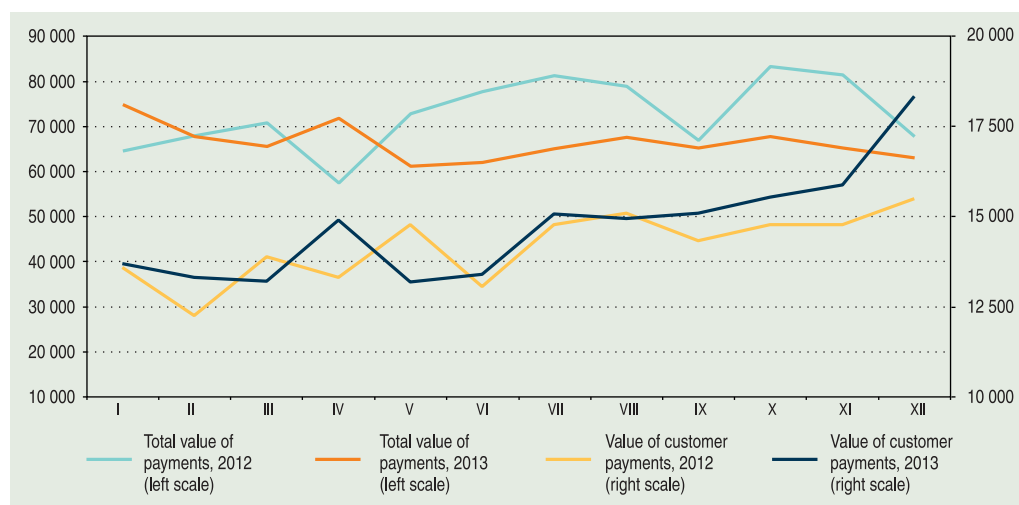
⁴³ The 1 January launch of a single account for National Revenue Agency tax and social insurance payments was a factor in the decline.

⁴⁴ The ratio of operational to scheduled operating time.

RINGS Payment Value in 2012 and 2013

(BGN million)

(BGN million)



Source: the BNB.

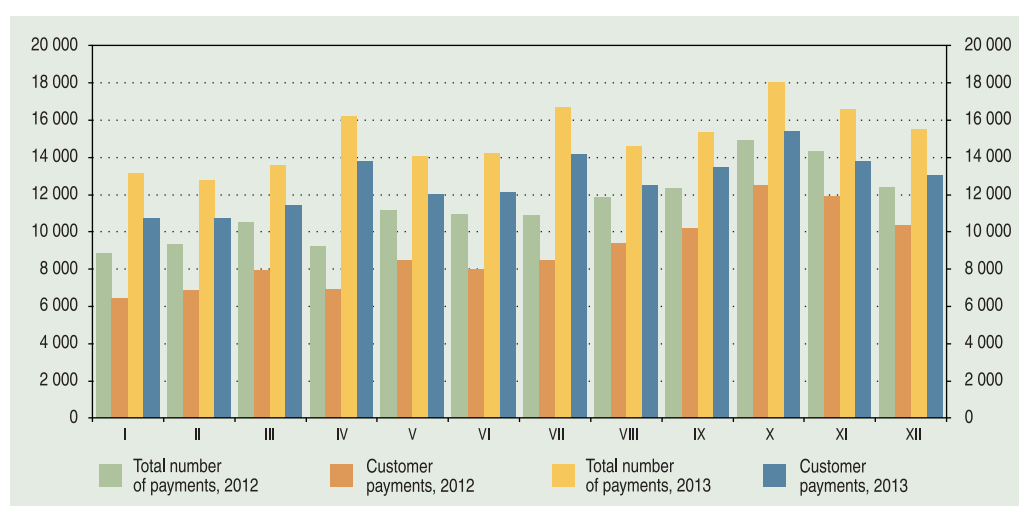
TARGET2-BNB National System Component

TARGET2 settles gross euro payments in real time using central bank money. It is a Single Shared Platform (SSP), participating central banks running system components. TARGET2-BNB is the BNB's national system component. The Bank is responsible for business relations between its participants and coordination with the European Central Bank and participating central banks. By 31 December 2013 the ECB and 23 EU central banks were in TARGET2.

The TARGET2 national system component includes the BNB, 23 direct participant banks, three addressable BIC holders, and the BISERA7-EUR and the BNBGSSS government securities settlement system ancillary systems.⁴⁵

With BNBGSSS inclusion in TARGET2-BNB, the Delivery *versus* Payment (DvP) principle applies to primary and secondary market government bond transactions denominated and payable in euro *via* cash settlement on TARGET2 bank accounts.

TARGET2-BNB Payment Numbers in 2012 and 2013



Source: BNB.

⁴⁵ For a current list of TARGET2 participants in TARGET2-BNB, see the BNB website: <http://www.bnb.bg/PaymentSystem/PSTARGET2/PSTARGETList/index.htm>. On 31 December 2013 BISERA7-EUR included 15 of 23 TARGET2-BNB direct participant banks.

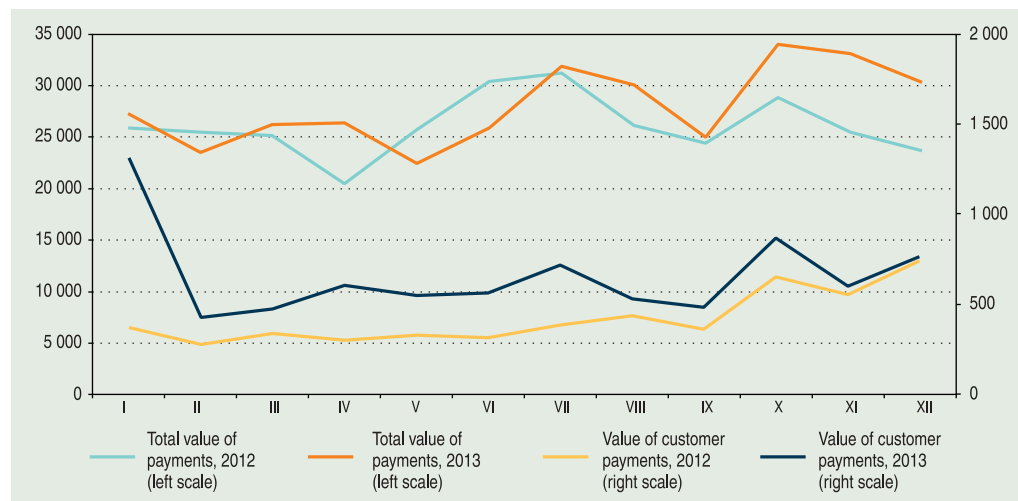
Since 2013 a contingency network between central banks and TARGET2 enables banks to pay on behalf of participants and ancillary systems during SWIFT outages. The TARGET2 legal framework reflects this from 1 January 2014.

In 2013 TARGET2-BNB processed 180,856 payments for EUR 335.8 billion, including 153,232 customer payments for EUR 7.9 billion. Numbers rose 32.2 per cent and value 7.5 per cent on 2012.

TARGET2-BNB Payment Value in 2012 and 2013

(EUR million)

(EUR million)



Source: BNB.

Payments by other system components to banks were 88.9 per cent of the number and 89.2 per cent of the value of TARGET2-BNB payments. The daily average number of system payments was 709, their value reaching EUR 1.3 billion. The daily number peak was 1186, with a daily value peak of EUR 2.7 billion.

The BISERA7-EUR ancillary system processed 25,537 payments for EUR 303 million, up 23.4 per cent in number and 27 per cent in value on the prior year.

Bulgarian Payment and Settlement System Development

The Single Euro Payments Area (SEPA) is the most significant move to harmonise EU small payment practice and standards. A key SEPA element are new pan-European payment instruments transforming divergent and fragmented small payments infrastructures into a single euro payments area. SEPA credit transfers and card payments launched in early 2008, payment service end users enjoying SEPA direct debits since late 2009.

By late 2013 almost all banks and foreign bank branches in Bulgaria handled SEPA credit transfers. The share of such payments in Bulgaria was some 51 per cent of all customer euro payments under 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.

BORICA–Bankservice AD's BISERA7-EUR system processes only SEPA credit transfers and direct debits. To ensure bank reachability⁴⁶ in SEPA payments to and from banks in other countries, BISERA7-EUR connected with SEPA Clearer and Equens. This allows SEPA credit transfers between bank communities in Bulgaria and other EU countries, mainly Germany, Greece, Italy, the Netherlands, and Poland, and Switzerland. From 1 January 2014, a link with Poland's EuroELIXIR expanded Bulgarian banks' SEPA reachability.

⁴⁶ Reachability means that SEPA payments may be effected from and into each bank account in SEPA participant countries.

By 31 December 2013, 86.7 per cent of Bulgarian cards, including 85.5 per cent of debit and 98.2 per cent of credit cards were to the EMV standard.⁴⁷ Card payments infrastructure EMV migration was practically complete, with 100 per cent of ATMs and 96.5 per cent of POS terminals compatible.

2. Payment System Oversight

Payment systems overseers sought to limit system risk and improve Bulgarian payment system reliability and efficiency. 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.

Over 2013 the Bank inspected five payment institutions and one credit institution for compliance with the Law on Payment Services and Payment Systems. The Bank also checked two companies under Article 114, items 2 and 4, Article 115, paragraph 3, and Article 120 of this Law.

Relevant registers kept by the BNB saw these changes:

- 176 agents listed and 80 agents delisted onto/from the public register of licensed payment institutions and their branches and agents under Article 17 of this Law;
- five agents listed and one agent delisted onto/from the public register of licensed electronic money institutions and their branches and agents under Article 17 of this Law;
- 60 payment institutions from elsewhere in the EU and providing payment services in Bulgaria and 133 agents of payment service providers went onto the public register under Article 7 of BNB Ordinance No 16 of 16 July 2009;
- 13 electronic money institutions licensed elsewhere in the EU and issuing, distributing, and redeeming electronic money in Bulgaria, and an agent of an electronic money company, listed onto the public register under Article 39 of Ordinance No 16.

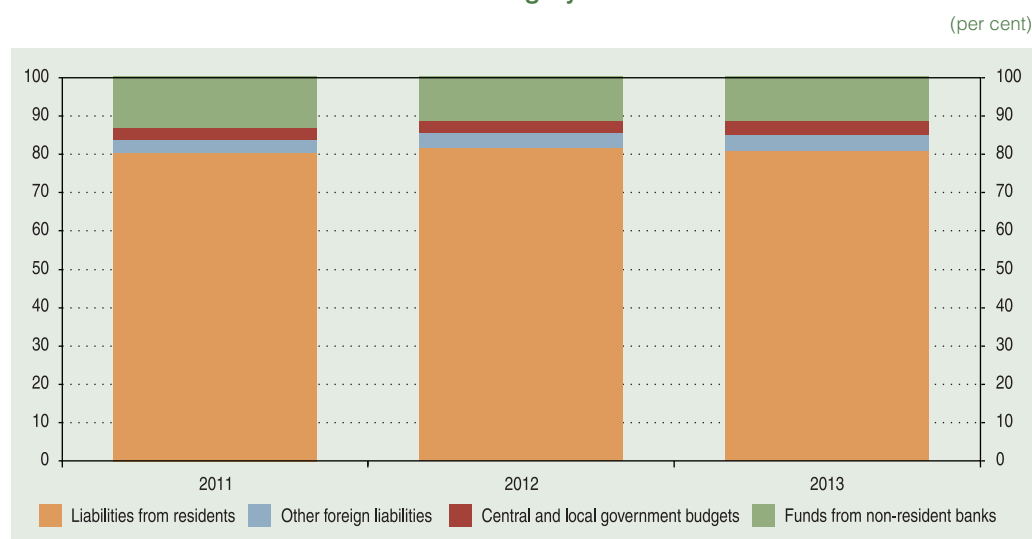
The year saw enquiries into 174 payment service user complaints submitted to the BNB and falling within its purview under the Law on Payment Services and Payment Systems. In addition, 30 requests to check observance of payment services regulations were reviewed.

⁴⁷ EMV is a global smart or chip credit and debit card standard developed by Europay, Mastercard and Visa to boost card payment security and limit abuse and misuse.

IV. Banks' Reserves at the BNB

In 2013 the average daily value of banks' minimum required reserves (excluding central government and local budget funds) rose 7.2 per cent on 2012: 11.2 per cent and 3.8 per cent in lev and foreign currencies. Average daily funds attracted from residents (excluding central and local government) rose 6.6 per cent and from non-residents 10.5 per cent. Bank central and local government liabilities grew 25.4 per cent. The effective implicit ratio of minimum required reserves remained at its 2012 level of 8.9 per cent.⁴⁸

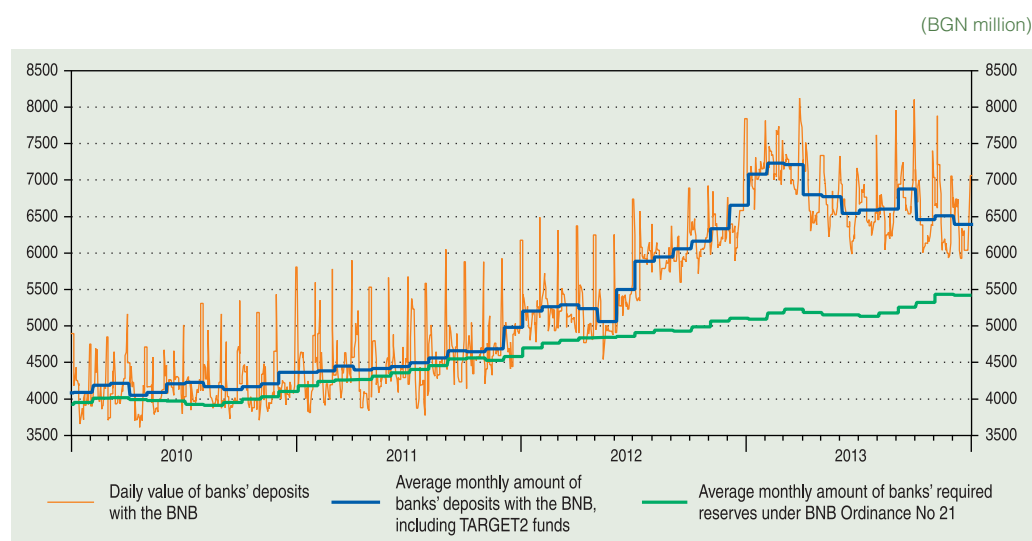
Structure of Attracted Funds in the Banking System*



* Average daily value for reserve calculation purposes.

Source: BNB.

Banks' Reserves at the BNB



Source: BNB.

⁴⁸ BNB Ordinance No 21 sets 10 per cent of banks' domestic deposit base as minimum required reserves except 5 per cent of their foreign deposit base, and nil on government and local budget funds.

Reserve assets include funds in banks' BNB accounts (7.8 percentage points) and half of cash balances recognised as reserve assets (1.1 percentage points). In 2013 average daily lev assets rose 3.7 per cent after a 4 per cent fall in 2012. The rise in euro assets slowed from 62.6 per cent to 12.8 per cent. This changed reserves' currency structure, the euro rising to an average of 35.8 per cent from 33.8 per cent in 2012.

In 2013 excess reserves fell, banks' Ordinance No 21 accounts with the BNB exceeding minima by 7.2 per cent from 8.7 per cent in 2012. Alongside excess reserves, banks kept significant funds in TARGET2-BNB national system component accounts.⁴⁹ These gradually declined after a February high. Excess liquidity in the euro area money market, deposit base growth, relatively low credit demand, and prudent lending boosted excess reserves and TARGET2-BNB funds. The fall in TARGET2-BNB funds, more pronounced in the last quarter of 2013, mirrored improving euro area financial markets and new investment opportunities.

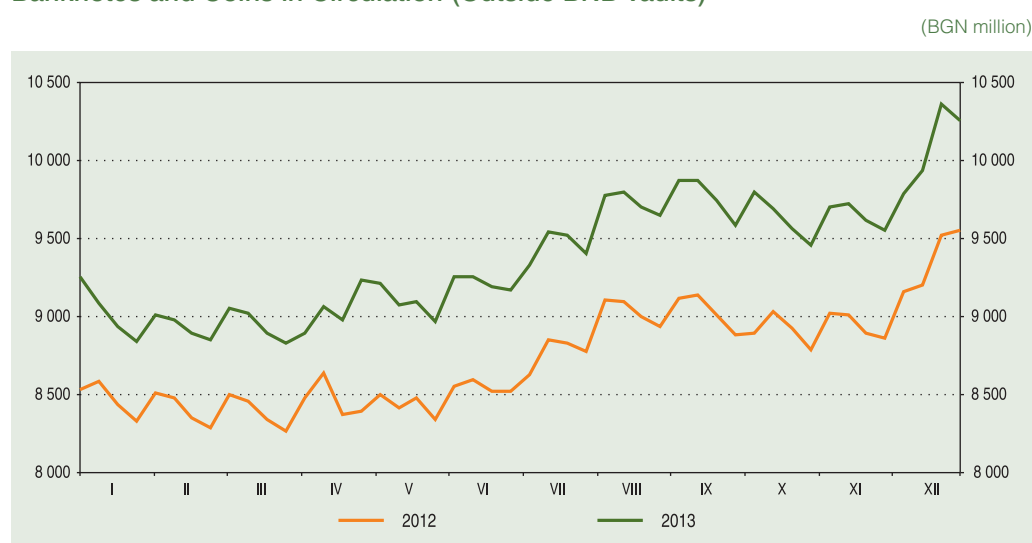
⁴⁹ The Issue Department Balance Sheet shows banks' funds in the TARGET2-BNB national system component as liabilities to banks.

V. Currency in Circulation

The Bulgarian National Bank holds the Bulgarian currency monopoly.⁵⁰ Its currency is mandatorily acceptable as legal tender at face value without restriction. The Bank prints banknotes, mints coins, and keeps and scraps uncirculated or withdrawn currency.

At the end of 2013 circulating currency⁵¹ was worth BGN 10,253.7 million, up BGN 703.8 million or 7.37 per cent on the end of 2012. Banknotes accounted for 97.93 per cent of this, and circulating and commemorative coins 2.01 per cent and 0.06 per cent. The share of banknotes fell 0.03 percentage points.

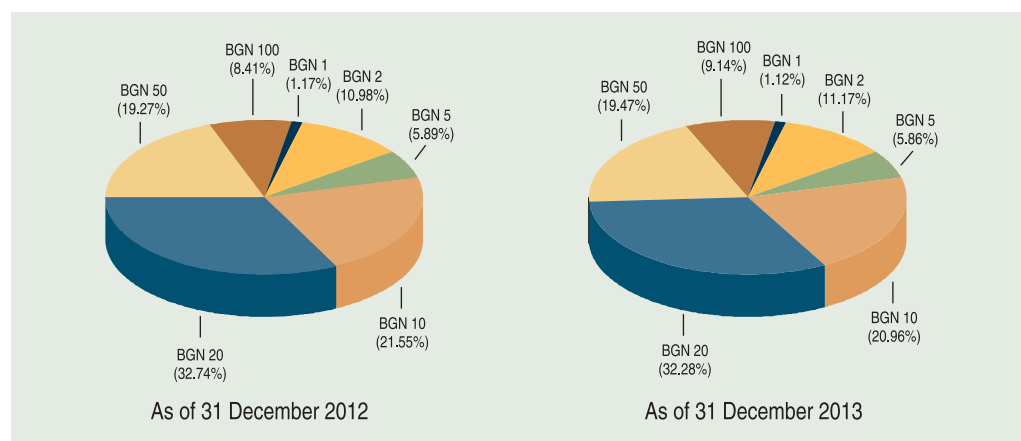
Banknotes and Coins in Circulation (Outside BNB Vaults)



Source: BNB.

The number of circulating banknotes was 359.2 million worth BGN 10,041.4 million. This grew 16.2 million or 4.73 per cent. Their value grew BGN 686.7 million or 7.34 per cent. Banknotes grew faster in 2012 at 7.45 per cent in number and 9.43 per cent in value.

Denomination Shares in Circulating Banknote Numbers

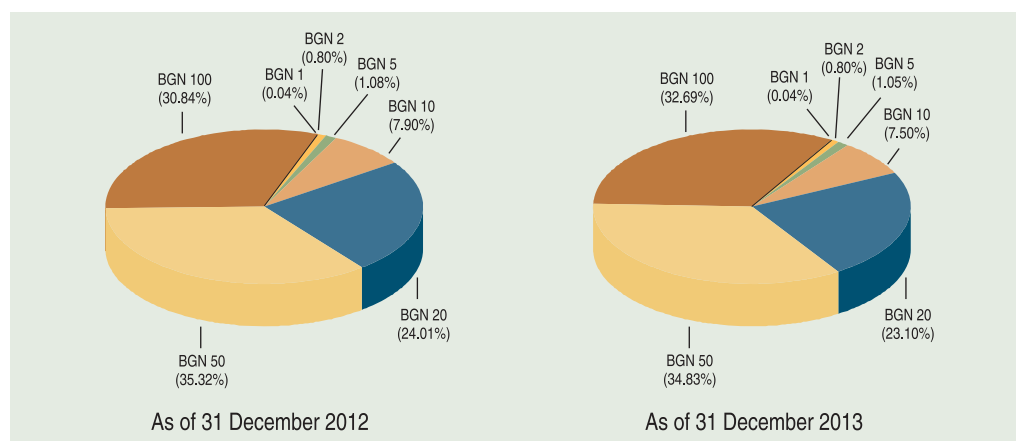


Source: BNB.

⁵⁰ The Law on the BNB Article 2, paragraph 5 and Article 25.

⁵¹ Banknotes and circulating and commemorative coins issued after 5 July 1999.

Denomination Shares in Circulating Banknote Value



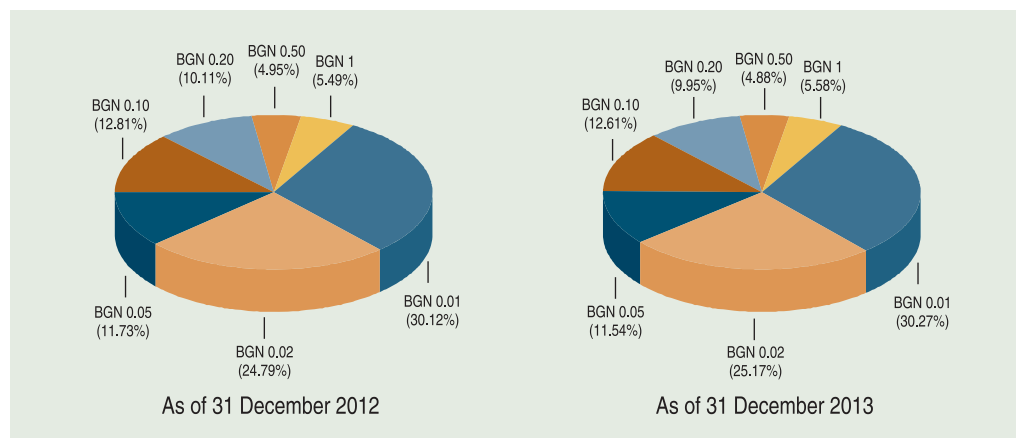
Source: BNB.

The BGN 20 banknote led at 32.28 per cent or 116 million bills. In the past two years the BGN 50 and 100 shares rose steadily as those of BGN 10 and 20 fell. The BGN 5 and 10 shares also fell 0.03 percentage points and 0.5 percentage points. Year on year, the BGN 2, 50 and 100 shares grew 11.17 per cent, 19.47 per cent and 9.14 per cent or 0.19 percentage points, 0.20 percentage points and 0.72 percentage points. By the end of 2013 the BGN 50 banknote led by share at 34.83 per cent, followed by the BGN 100 and 20 at 32.69 per cent and 23.10 per cent.

The average banknote circulating at the end of 2013 was worth BGN 27.95: up BGN 0.68 or 2.49 per cent in a year, mainly due to faster growth of the highest bills (BGN 50 and 100).

By 31 December 2013 coins were worth 2.01 per cent of the value of circulating currency. At the end of 2013 1626.7 million coins circulated, worth BGN 205.9 million. Numbers grew by 131.4 million or 8.79 per cent and value BGN 16.8 million or 8.88 per cent. The steady annual growth in the number of circulating coins abated slightly. Shares of low value coins (BGN 0.01 and 0.02) continued rising fast, as did the BGN 1 coin. The BGN 1 rose most at 10.75 per cent. The BGN 0.01 and 0.02 numbers grew 40.2 million or 9.23 per cent and 38.8 million or 10.47 per cent. BGN 0.05 and 0.50 numbers rose 6.99 per cent and 7.26 per cent.

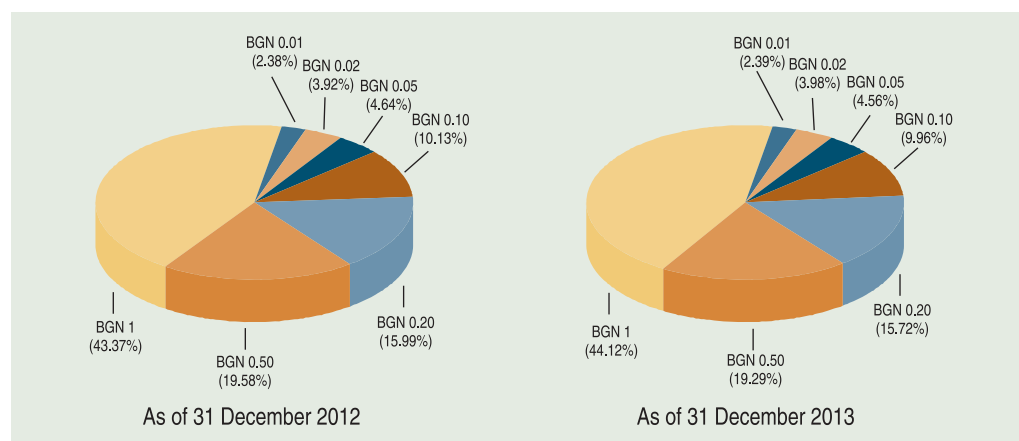
Denomination Shares in Circulating Coin Numbers



Source: BNB.

At the end of 2013 the shares of BGN 0.01 and 0.02 coins rose 0.15 and 0.38 percentage points respectively, while that of the BGN 1 rose 0.10 percentage points on 2012. The shares of other denominations fell, the BGN 0.10 leading at 0.20 percentage points and BGN 0.05, BGN 0.20, and BGN 0.50 falling 0.19 percentage points, 0.16 percentage points and 0.07 percentage points. BGN 0.01, BGN 0.02, and BGN 0.05 coins' share was 66.98 per cent. At the end of 2013 the BGN 1 coin value share led at 44.12 per cent, followed by the BGN 0.50 and BGN 0.20 at 19.29 per cent and 15.72 per cent.

Denomination Shares in Circulating Coin Value



Source: BNB.

At the end of December 2013 the average coin in circulation matched its 2012 value at BGN 0.13.

Commemorative coins also held their share in circulating currency at 0.06 per cent.

Non-genuine Banknotes and Coins

In 2013 the BNB National Analysis Centre retained 2238 non-genuine Bulgarian banknotes. Of them 2197 had entered circulation: 362 more than in 2012. The share of retained non-genuine Bulgarian banknotes remained very low at 0.000623 per cent of circulating banknotes on 0.000547 per cent at the end of 2012. BGN 20 banknotes led at 46.20 per cent, followed by BGN 10s and 50s at 31.95 per cent and 18.81 per cent. The 68 non-genuine BGN 2, 5, and 100 banknotes comprised 3.04 per cent of retained non-genuine banknotes.

There were 624 non-genuine retained coins: 24 BGN 1 coins, 553 BGN 0.50 coins and 44 BGN 0.20 coins. Their share was also very low at 0.000038 per cent of retained coins.

The National Analysis Centre also retained 1942 euro banknotes, 1812 US dollar banknotes, and 131 sundry foreign banknotes.

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 scrapping unfit Bulgarian banknotes and coins.

In 2013 producers supplied 30.5 million new banknotes and 110 million new coins worth BGN 1327.5 million. The Bank launched the six commemorative coins planned in its Law on the BNB Article 25, paragraph 1 2013 minting programme.⁵²

⁵² See the BNB website for banknote and circulating and commemorative coin issues.

Banknote and coin deposits and withdrawals totalled BGN 29,783.7 million. Banks deposited BGN 14,540.8 million of cash, up BGN 1239.4 million or 9.32 per cent on 2012. Bulgarian banknotes and coins worth BGN 15,242.9 million were withdrawn from the BNB: up BGN 1120.6 million or 7.94 per cent on the prior year.

Banknotes recirculated through BNB tills an average of 2.44 times a year. High value banknotes returned less often: BGN 100 banknotes and BGN 50 banknotes returned 0.46 and 1.11 times. BGN 10 and 20s, most used by commercial banks and dispensed by ATM terminals, returned 3.28 and 4.25 times.

In 2013 BNB and Cash Services Company⁵³ banknote processing machines tested 818.1 million banknotes and 163.9 million coins. Banknote numbers rose 8.26 per cent and coins fell 4.74 per cent on 2012. BGN 10 and BGN 20 banknotes and BGN 0.20 and BGN 1 coins were most often processed by value.

The Bank maintains circulating currency quality and integrity through authenticity and fitness standards. Banknotes retained as unfit numbered 77.1 million: down 7.3 million or 8.62 per cent on 2012. Their share in total processed banknotes was 9.43 per cent. There were 1 million unfit coins retained: up 18.76 per cent on 2012. Their share in total processed coins was 0.61 per cent.

In 2013 the BNB bought EUR 0.5 million of reserve currency: EUR 0.4 million from budget organisations and EUR 0.1 million from individuals. The Bank sold EUR 21.1 million of reserve currency: EUR 6.3 million to budget organisations and EUR 14.8 million to individuals.

The BNB performed eight full and 28 spot checks into credit institution and service provider observance of cash handling and recycling regulations. These covered cash handling procedures, ATM banknote quality, sorting and customer operated equipment, and recognition and fitness standards under Ordinance No 18 on Quality Control of Banknotes and Coins in Circulation.

⁵³ The Cash Services Company AD is a BNB Ordinance No 18 cash handler and service supplier owned by the BNB and four commercial banks.

VI. Maintaining Banking Stability and Protecting Depositor Interests

1. The Banking System

In 2013 Bulgarian banking continued reflecting complex external and internal developments. Lending remained low. Attracted funds continued growing alongside household savings, the share of domestic financing rising further and liabilities to parent banks falling. Dynamics in individual credit portfolio segments diverged in different months.⁵⁴ Consumer credit grew a tad for the first time since 2009. Housing mortgage loans contracted, however. Banks invested free funds into securities.

Credit risk management helped cut classified loans. Falling net interest income and continuing loan impairment pressured profitability. Conservative BNB policy and timely bank management action preserved high capital adequacy. High system liquidity encouraged investment of cash into profitable financial instruments, cutting the share of cash in banks' assets.

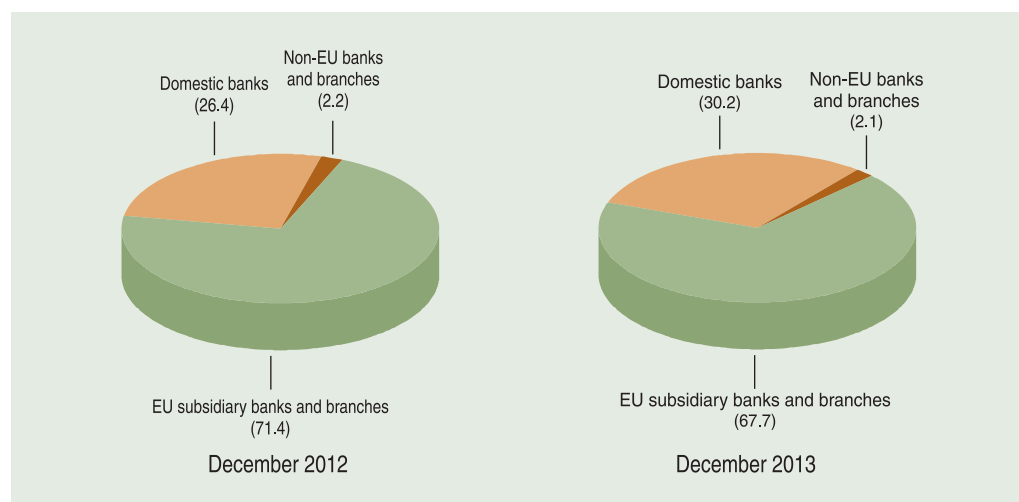
Structural Changes in the Banks' Balance Sheet

Banks ended 2013 with BGN 85.6 billion of assets. They grew less (3.9 per cent) than in the 2011–2012 period because attracted funds grew less (4.5 per cent). Banking's balance sheet indicators reflected limited lending activity and greater reliance on domestic resource. Credit portfolio growth picked up late in the year, also reflecting repurchased loans. Free funds went into non-resident credit institutions and other low-risk investment. Rising deposits of individuals and households (by BGN 3.4 billion) offset a BGN 1.6 billion fall in funds attracted from credit institutions.

Loans and advances rose from 73 to 73.6 per cent of assets. Claims on credit institutions (placements) rose to 11.2 per cent of total assets, while loans (excluding those to credit institutions) fell from 64.6 per cent in 2012 to 62.3 per cent in 2013. Cash fell BGN 560 million, down from 11.5 per cent to 10.4 per cent. Securities portfolios rose BGN 898 million to 12.2 per cent from 11.6 per cent in 2012. This was due mainly to the increase in debt instruments of non-resident issuers throughout the year, comprising almost the four-fifths of securities portfolio annual growth.

Domestic and Foreign Bank Market Shares

(per cent)



Source: BNB.

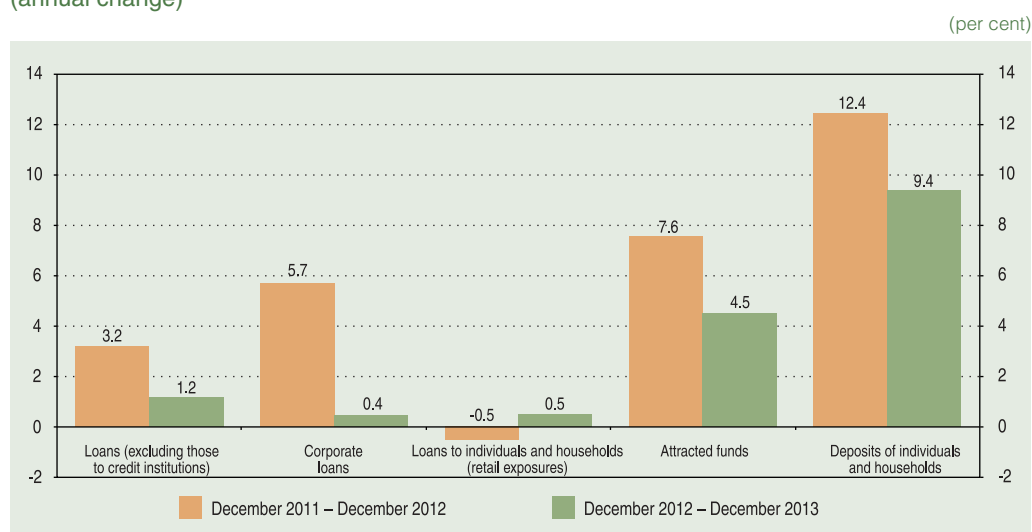
⁵⁴ Minor credit growth discrepancies between this chapter, the Summary, and Section I, show methodological differences in determining credit portfolio scopes for statistical and supervisory purposes.

Resident resource rose from 80.5 to 83.6 per cent at the expense of non-resident. Domestic banks' share rose to 30.2 per cent, contributing most to the asset increase.⁵⁵ While EU subsidiary banks' assets also grew, their share in the banking system assets fell to 62.1 per cent. EU bank branches' share also fell to 5.5 per cent. Non-EU banks' and branch share moved little at 2.1 per cent. The five largest banks' assets comprised 49.6 per cent of the system's balance sheet figure at the year's end.

Lending

Lending remained weak. Loans (except ones to credit institutions) grew 1.2 per cent from 3.2 in 2012, domestic banks contributing most. Growth in this group offset contracting credit portfolio by EU bank subsidiaries and branches. Non-EU banks and branches lent 1.4 per cent (BGN 10 million) more. The 116.7 per cent (BGN 310 million) increase in exposures to central governments comprised almost half the annual lending growth (excluding those to credit institutions). Unlike 2012's retail exposure fall, 2013 saw them rise 0.5 per cent (BGN 88 million) through consumer credit rising 1.6 per cent (BGN 142 million). Housing mortgage loans fell 0.6 per cent (BGN 53 million). Corporate loans rose 0.4 per cent (BGN 164 million). Exposures to non-credit institutions rose 10.7 per cent (BGN 108 million). Claims on credit institutions rose 39.8 per cent (BGN 2.7 billion), funds going mostly into non-resident banks. As in retail exposures, corporate portfolio growth boosted the lev share of loans to 36.3 per cent at the expense of euro's 58.9 per cent. Loans in other currencies rose to 4.8 per cent due to rising advances.

Selected Balance Sheet Indicator Movements (annual change)



Source: BNB.

Attracted Funds

In 2013 attracted funds rose BGN 3.2 billion to BGN 73.9 billion. Average annual growth was weaker at 4.5 per cent against 7.6 per cent in 2012. Unlike in the prior year, resource attracted from credit institutions fell 14.9 per cent (BGN 1.6 billion) as repayments of obligations to parent companies cut the share of non-resident funds in total banks' attracted funds to 16.4 per cent from 19.5 per cent a year earlier. Deposits of individuals and households rose BGN 9.4 per cent (BGN 3.4 billion). Though growth was slower than in 2012, their share in total attracted funds rose to 53.1 per cent. The share of funds from institutions other than credit institutions also rose to 32 per cent through 7 per cent growth. Growing funds attracted from institutions other than credit institutions and those from individuals boosted the share of lev funds to 49.7 per cent

⁵⁵ The acquisition of 100 per cent of the shares of MKB Unionbank EAD by First Investment Bank AD was approved by order of the Deputy Governor of the BNB of 18 September 2013. Unionbank is included in the market share of domestic banks calculated by 31 December 2013.

from 48.1 per cent in 2012, depressing euro to 43.6 per cent (mostly because of a drop in funds attracted from credit institutions), other currencies reaching 6.7 per cent.

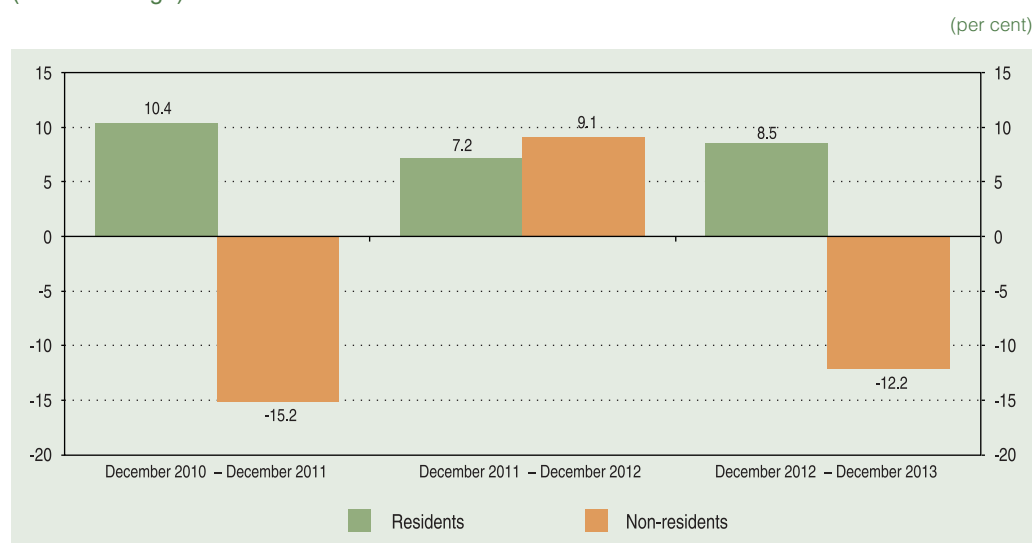
Structure of Attracted Funds



Note: Totals do not add up to 100 because of rounding.

Source: BNB.

Dynamics of Funds Attracted from Residents and Non-residents (annual change)



Source: BNB.

Balance Sheet Equity

Balance sheet equity rose BGN 180 million to BGN 11.0 billion. BGN 109 million greater premium reserves, BGN 185 million greater reserves (including retained profit) and BGN 54 million more issued capital contributed most. Revaluation reserves and the current year income dropped BGN 147 million and BGN 21 million. Audited annual banking profit was BGN 21 million less than in 2012 at BGN 504 million.

Banking System Risk Profile

Credit risk continued dominating, actively managed by renegotiating, restructuring, and writing off loans. Growth in the balance sheet figure was due to domestic funding sources. Lending continued reflecting limited demand rather than impeded supply. Loan repurchases, stronger in volume than sales, also boosted the credit portfolio. Preserved banking capital and liquidity buffers offer capacity to meet further credit portfolio deterioration. Banks succeeded in keeping profitability acceptable. The liquidity position remained adequate to the structure of attracted funds.

Asset Quality

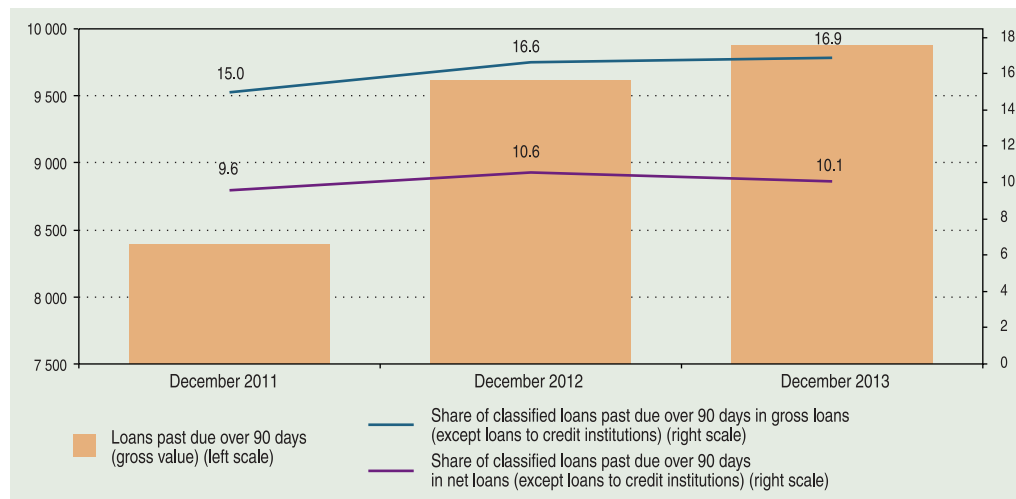
Sales and write-offs cut classified loans 1.2 per cent. The classified portions of corporate and retail exposures fell 1.2 per cent and 0.4 per cent respectively. Classified housing mortgage loans rose 1.2 per cent and classified consumer loans fell 3 per cent.

Gross loans past due over 90 days grew less at 2.7 per cent from 14.6 a year earlier. The rise was higher than that of the credit portfolio, which brought their share in gross loans (excluding those to credit institutions) to 16.9 per cent from 16.6 per cent in 2012. Their net value diminished to 10.1 per cent from 10.6 per cent due to higher impairment.⁵⁶

Loans Past Due over 90 Days

(BGN million)

(per cent)



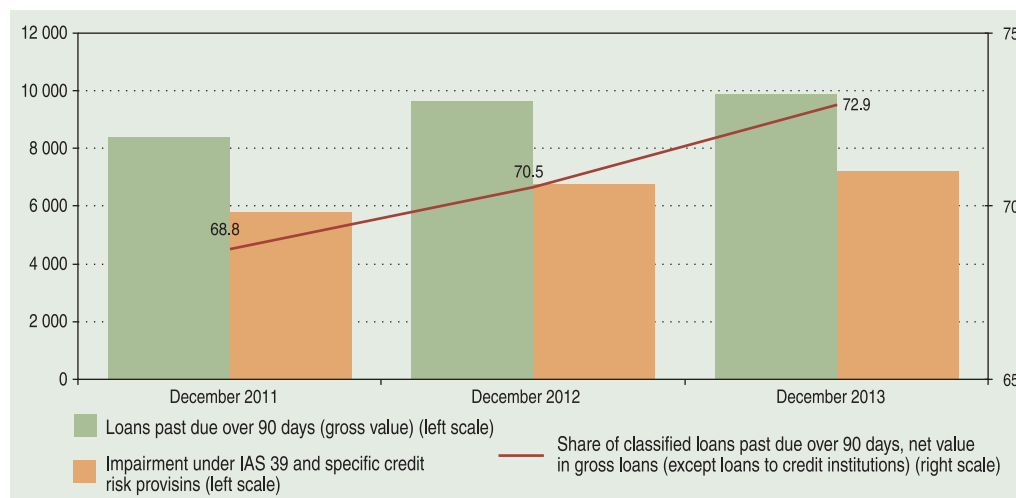
Source: BNB.

Impairment charges grew 12.4 per cent from 12.9 per cent in 2012. Specific credit risk provisions fell BGN 153 million (7 per cent). Measures against credit risk contributed to classified exposure provisioning rising to 49.6 per cent from 46.1 per cent in 2012. The coverage ratio of loans past due over 90 days (including ones classified as loss) rose to 72.9 per cent from 70.5 per cent.

Cover of Loans Past Due over 90 Days

(BGN million)

(per cent)



Source: BNB.

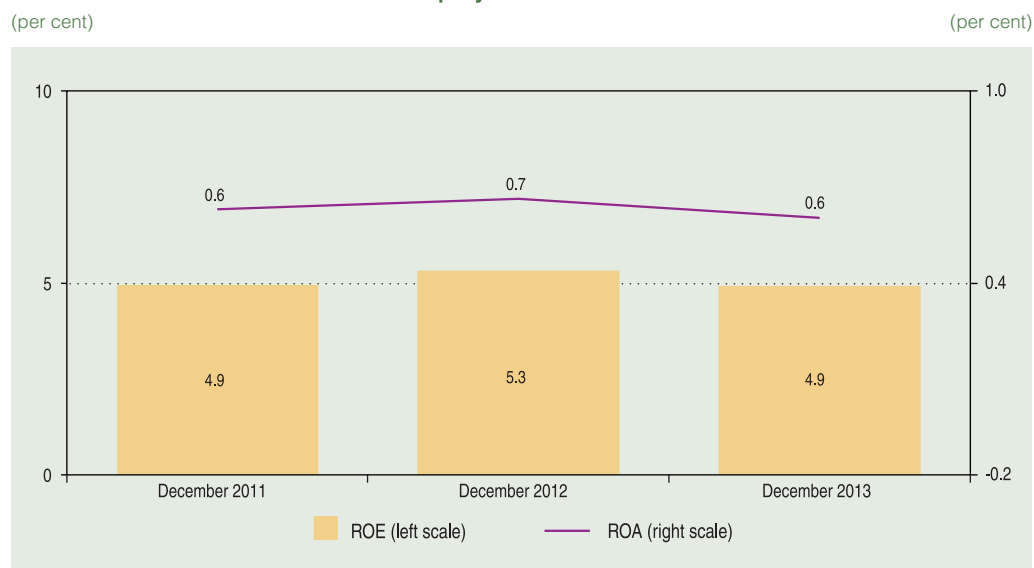
⁵⁶ Net non-performing loan value is the difference between gross loan value and impairment costs.

Free funds went into securities portfolios, boosting their share in assets. The growth also reflected asset transformation. Cash declined while foreign issuers' debt instruments posted the strongest absolute increase, their share in total capital and debt instruments rising to 38.9 per cent. Despite a BGN 147 million rise in investment into Bulgarian government securities, their share in the securities portfolio fell to 53.3 per cent from 56.8 per cent by end-2012.

Profitability

By the end of 2013 banking made BGN 504 million of audited profits or BGN 21 million less than in 2012. Return on assets was 0.60 per cent from 0.66 per cent in December 2012 and return on equity was 4.90 per cent from 5.29 per cent in December 2012.

Return on Assets and Return on Equity



Source: BNB.

Factors influencing banks' capacity to generate income from core operations in 2013 reflected structural changes in credit institutions' balance sheets. The share of standard loans went down at the expense of the share of liquid instruments providing lower yields (mainly securities). Growth rates of loans to and deposits from individuals and households slowed down. Interest fell on all assets, its net margin reaching 3.34 per cent from 3.61 a year earlier. Return on interest-bearing assets fell to 6.07 per cent from 6.62 per cent in 2012. Pressure on profitability from impairment charges weakened greatly, but despite efforts to cut spending and staff (down to branch level) administrative costs continued creeping up.

Lower interest rates on interest-bearing assets (loans, placements in banks, and securities) and interest liabilities (attracted funds and hybrid instruments) cut net interest income by BGN 87 million (3.3 per cent). Net financial instrument income fell BGN 69 million (24.5 per cent) through lower interest rate instrument and foreign exchange trade earnings in 2013. Net fee and commission income grew BGN 37 million (4.8 per cent), mainly from higher fees and commissions income on securities transactions.

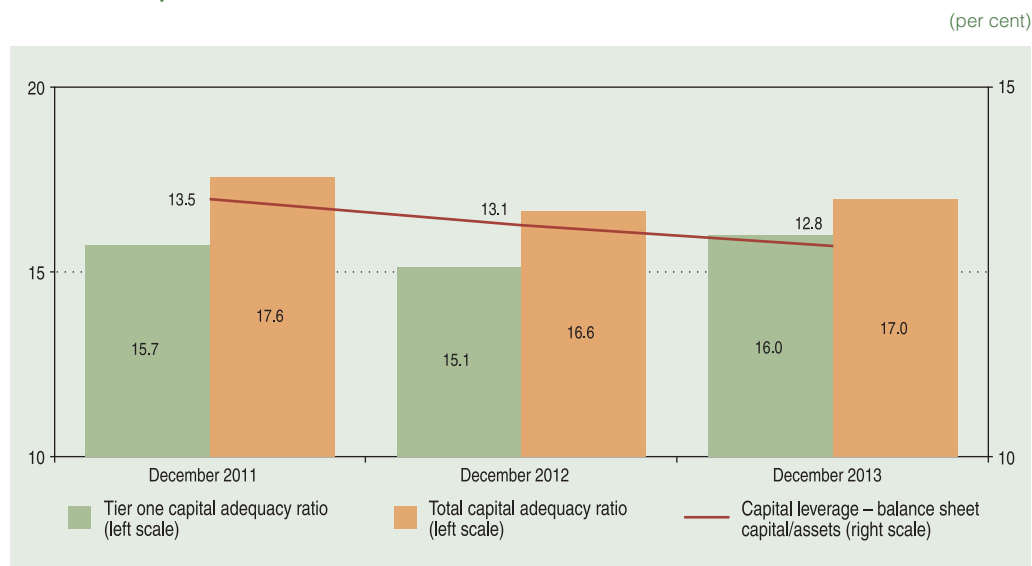
Equity

Total capital adequacy rose from 16.6 per cent by end-2012 to 17 per cent by end-2013. Capital surplus also rose to BGN 2.8 billion, adding resource to cover classified exposures with worsened quality.

Rising issued capital, premium reserves, reserves, and hybrid instruments, coupled with falling credit risk provisions boosted equity. In turn, reduced property revaluation reserves and subordinated term debt cut banks' equity. Tier-one capital adequacy rose from 15.1 per cent to 16 per cent by end-2013. Higher registered and paid-in capital, premium reserves, and reserves and hybrid instruments boosted the share of primary capital to 94.3 per cent of own funds.

Slower balance sheet capital than asset growth depressed leverage ratio to 12.8 per cent from 13.1 per cent by end-2012.⁵⁷ The structure of capital requirements for credit, market, and operational risk changed little. The share of position, foreign exchange, and commodity risk rose to 0.9 per cent at the expense of lower credit risk (57.9 per cent). The share of operational risk remained almost unchanged at 7.8 per cent.

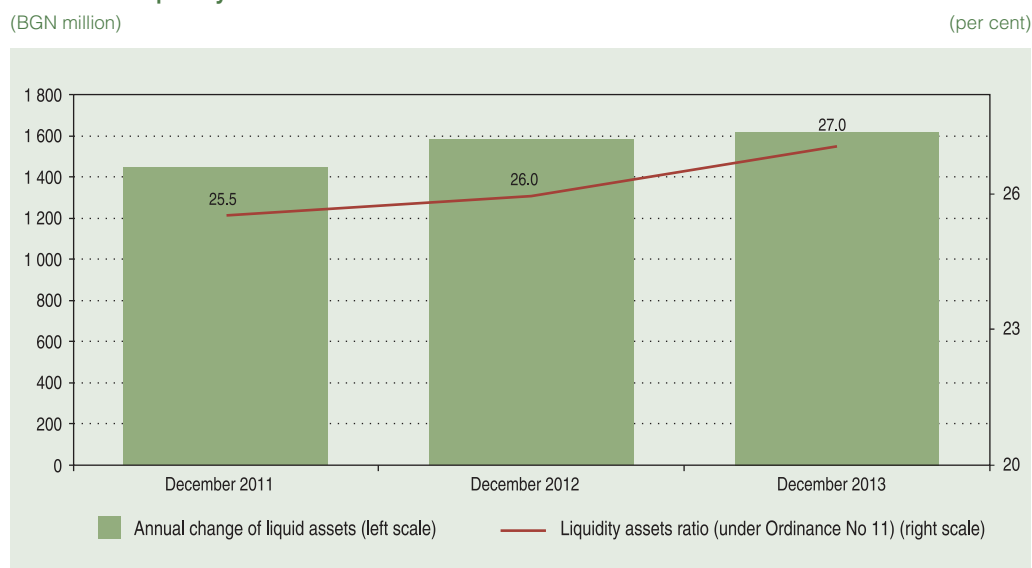
Selected Capital Indicators



Source: BNB.

The liquid assets ratio moved between 25 per cent and 27 per cent, reaching the latter by year-end. Liquid assets rose 8.8 per cent (BGN 1.6 million) to BGN 20 billion. BGN 2.1 billion mainly non-resident funds into current accounts offset a BGN 560 million cash contraction. Marketable debt securities issued by institutions (BGN 312 million) also increased. The share of cash in liquid assets fell to 44.4 per cent, while that of balances on current accounts rose to 37.1 per cent. Liabilities (outflow) increased by BGN 3.1 billion (4.4 per cent) to BGN 74.1 billion.

Selected Liquidity Indicators



Source: BNB.

⁵⁷ Leverage is the ratio between balance sheet equity and assets at book value.

2. Assessment of the Financial Performance of Financial Institutions Registered under Article 3, Paragraph 4 of the Law on Credit Institutions

By the end of 2013, 289 financial institutions were registered and operating. Of them, 130 lent from own funds and 66 were financial lessors. Voluntary deletions from the Register of Financial Institutions and transformations from financial leasing companies to lenders continued.

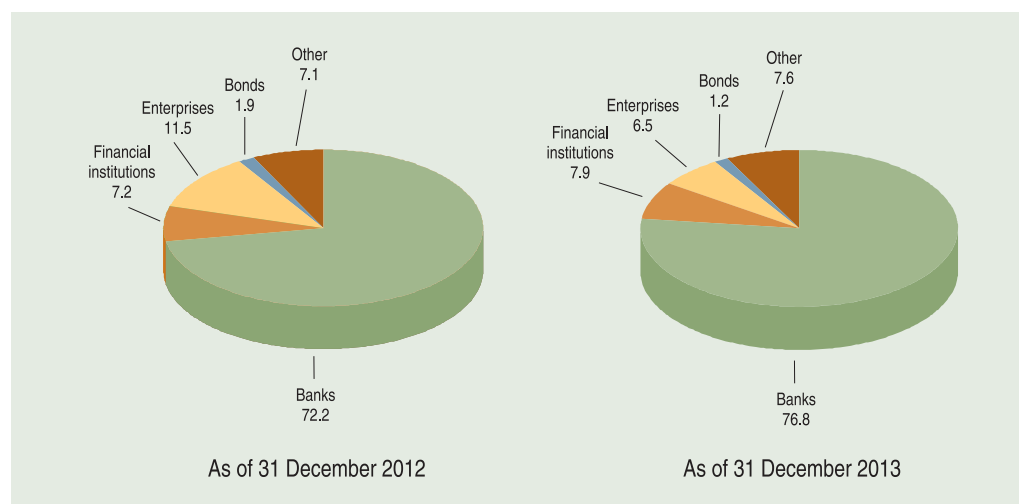
Their asset share reached 7.7 per cent (BGN 86 billion) of banking system assets. The 5 per cent fall to BGN 6.6 billion in sector assets reflected BGN 4.5 billion falls at the top 20 institutions.⁵⁸ Their share in total assets fell to 68.9 from 70.8 per cent in 2012. Leasing companies' market share remained largest at 56 per cent of total sectoral assets, followed by lending companies at 26.6 and factoring companies at 5.4.

The last two years' falls in loans and receivables (including financial leasing) continued, but they remained dominant at 72.8 per cent of assets. Within loans and receivables, receivables on financial leasing and business loans contracted to 55.2 and 18.3 per cent in favour of consumer loans rising to 17.6 per cent. The currency breakdown shows euro and other currencies falling to 52.7 per cent in favour of the lev.

Gross credit portfolio (including financial leasing) fell 3 per cent to BGN 5.4 billion. Gross impaired loans reached 48.2 per cent (BGN 2.6 billion) of the total portfolio.

Attracted funds fell 10.2 per cent from BGN 5.5 billion in December 2012 to BGN 4.9 billion. Short-term resource attracted from banks fell 4.5 per cent to BGN 3.8 billion through 7.4 per cent less foreign bank financing. Corporate customers' funds fell greatly from BGN 629 million to BGN 318 million by end-2013. Euro financing continued its fall, from 72.8 to 70.7 per cent.

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



Source: BNB.

The BGN 160 million 2013 profits rose BGN 41 million on 2012. Good profitability at lenders, companies acquiring interests and providing factoring services offset leasing companies' losses. The leverage ratio⁵⁹ was 19.2 per cent on 15.67 per cent in 2012. The current liquidity ratio rose from 14.3 to 15.6 per cent.⁶⁰ Steady balance sheet

⁵⁸ The balance sheet includes 261 companies' financial reports for supervisory purposes.

⁵⁹ Financial leverage is the ratio between the paid-up capital and financial liabilities reported at amortised cost.

⁶⁰ Current liquidity is the ratio between liquid assets and liquid liabilities.

figure declines and higher profit kept return on assets (ROA) and return on equity (ROE) high at 2.4 and 12 per cent by December 2013.

By the close of 2013 these financial institutions' equity rose 11 per cent to BGN 1.3 billion on 2012. Growth was mostly down to newly registered companies.

3. Banking Supervision

Supervisory Policy

The BNB supervisory policy in 2013 focused on the CRD IV/CRR legislative package replacing the Capital Requirements Directive with Directive 2013/36/EU establishing the access to the activity of credit institutions, and Regulation (EU) No 575/2013 establishing prudential requirements for major bank risks and capital adequacy management to be met by credit institutions in their daily work. This package of acts published on 27 June by the Official Journal of the European Union set the requirements of the Third International Agreement of the Basel Committee on Banking Supervision on the capital standards and measures or Basel III. The new legal framework came into force on 1 January 2014. The directly applicable regulation entailed great changes to national law, particularly the Law on Credit Institutions and BNB Ordinances Nos 9 and 11, and revocation of key BNB instruments such as Ordinance No 8 of the BNB on the Capital Adequacy of Credit Institutions and Ordinance No 7 of the BNB on Large Exposures of Banks. Most changes involved transposing Directive 2013/36/EU into the Law on Credit Institutions and statutory instruments. New statutory instruments cover areas like bank risk management and capital buffers.

Macro-prudential Analyses and Strategies

Supervisory macroprudential analyses and strategies continuously monitored and assessed banking system stability. Monitoring banking system structural and dynamic characteristics supplemented credit institution financial parameter analyses. This involved various methods alongside periodical and specially required target information to cover systemic risk and identify problem areas promptly.

New questions and topics supplemented regular surveys of credit institutions' expectations of major financial indicators developments in 2013. There was advice on credit risk management measures tackling continuing home and world economic uncertainty.

Regular examinations assessed sectoral and individual sensitivity to actual and hypothetical shocks, results prompting supervisory action and recommendations. Tools for assessing effects and conducting stress tests expanded. In addition to common risks (credit and liquidity), shock hypotheses now include potential vulnerability ensuing from the relatedness between credit institutions. Analyses encompass not only actual and hypothetical risk, but also thematic overviews relating to banks' corporate management styles or evolution of Bulgarian banking business models.

Macroprudential supervisors' publications on the state of the banking system also kept the public abreast of developments. Monthly press releases supplemented standard supervisory and financial data on paper and online.

Providing qualitative and timely information for analysing banking risk trends was a priority. Implementing the new regulatory framework and changing supervisory and financial reporting should improve data quality and boost its volume.

Supervisory Monitoring of Credit Institutions

Supervisory reviews and assessments of credit institutions through off-site monitoring and on-site inspections are a key aspect of banking supervision. Regular financial and supervisory reporting lay at the base of quarterly analyses and CAEL ratings reflecting bank risk degrees and developments and individual credit institutions' current risk profiles. Continuous monitoring of credit institutions' financial performance

and on-site inspections give CAMELOS ratings of risk acuity and operational management in 2013. Measures to improve risk management followed findings of breaches and malpractice at a credit institution.

The major focus of on-site inspections was on economic environmental effects, mechanisms for managing problem risk exposures and collectability efficiency, and internal policies for renegotiating, restructuring, and evaluating of collateral. The year saw 17 supervisory inspections. Some looked at banks' own risk management models. Others focused on risk monitoring and control system adequacy, profitability, capital adequacy and liquidity risk management, and compliance with the regulatory framework. In addition, a qualitative review was carried out of credit institutions' internal capital adequacy analysis for the previous year checking the sufficiency of the capital to cover current and future bank risks.

Banks using internal credit and operational risk evaluating models got recommendations to improve internal controls, including risk operations reporting and control mechanisms.

Cooperation and information exchanges continued among colleges of supervisors involving the BNB as competent authority supervising subsidiaries of European bank groups. It involved risk and internal capital adequacy assessments as part of aggregate information for joint establishing of group equity.

Special Supervision

Special supervision focused on implementing changes to the international framework on preventing money laundering and terrorist financing through banks. There were debates on the draft fourth directive on preventing money laundering and terrorist financing reflecting changes in international standards. Interinstitutional cooperation drafted a plan on implementing the national strategy. Inspections showed credit institutions observing BNB instructions for minimising the risk of money laundering.

Periodical analyses of the legal and financial status of bank shareholders resulted in changes in the structure of a bank to maintain capital transparency. Examinations of banks' contributions to the Deposit Insurance Fund showed a trend towards detailed statutory compliance procedures.

There were joint inspections with the State National Security Agency Financial Intelligence Directorate and assistance to judiciary authorities and Ministry of the Interior offices. Cooperation continued with the Ministry of Foreign Affairs on UN resolutions and the status of representations of countries subject to restrictive regimens.

The fourth round of the evaluation of banking supervision and banking activities under the Recommendations of the Financial Action Task Force (FATF) was completed.

There were debates on European practice on unregulated (parallel or shadow) banking. This addressed problems with bank product and service usability and loan servicing, and crowdfunding (direct gathering of funds from individuals over the internet). The growing popularity of virtual currencies prompted the BNB to publish an EBA warning issued to users on a series of risks deriving from buying, holding or trading virtual currencies.

Actions to maintain credit institutions' equity and analyse its origins strengthened market discipline and customer confidence.

**Licensing,
Permits, and
Approvals,
Micro and
Macropruden-
tial Supervi-
sory Actions**

There were no new credit institution licensing procedures in 2013. Most banks saw no significant changes in their shareholder structures. The First Investment Bank took over MKB Unionbank and renamed it by deleting the former owner's abbreviation due to the follow-up merger of the subsidiary bank into the parent bank. The Municipal Bank opted to leave the list of Social Security Code trustees.

Pending enforcement of the new capital framework for credit institutions created interest in issuing capital instruments and repaying existing instruments early. Investbank, Crédit Agricole, the First Investment Bank and International Asset Bank issued instruments recognised as tier-one capital, the Central Cooperative Bank and Raiffeisenbank issuing tier-two capital ones. ProCredit Bank and the United Bulgarian Bank repaid capital instruments partially or fully.

The Bulgarian Development Bank management saw more substantial changes, with three new executive directors and two managing board members. Unionbank had all its supervisory board and most of its managing board replaced. Another 15 credit institutions made management changes.

Bank supervisors from 18 Member States notified the BNB of intent to provide cross-border services in Bulgaria, boosting such institutions to 230. No new EU Member State credit institution branches opened. Latvia's Regional Investment Bank closed its branch and Bulgarian operations. The Central Bank of Ireland notified the BNB that the Citibank (New York) branch would transfer to Citibank Europe plc in Dublin on 1 January 2014. The First Investment Bank opted to conduct cross-border operations in other EU Member States by taking deposits in Germany.

Inspections found 36 legislation and regulation breaches concerning incorrect descriptions of risk degree in individual risk exposures and impairment to accounting and supervisory standards. More than half the 236 recommendations addressed the lending process.

Law on the BNB supervisory powers to maintain banking stability and protect depositors do not extend to financial service user protection. In 2013 the Bank continued receiving complaints about banks and financial institutions. Most fell in the Consumer Protection Commission's purview and the BNB referred them there.

VII. The Central Credit Register

The Bulgarian National Bank runs an information system on debt to Bulgarian banks, financial, payment, and electronic money institutions. This is governed by Ordinance No 22 on the Central Credit Register (CCR). The CCR provides uniform centralised borrowing information to participants, including the BNB. It lists all bank, financial, payment, and electronic money institution loans, except those to government and the BNB and 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.

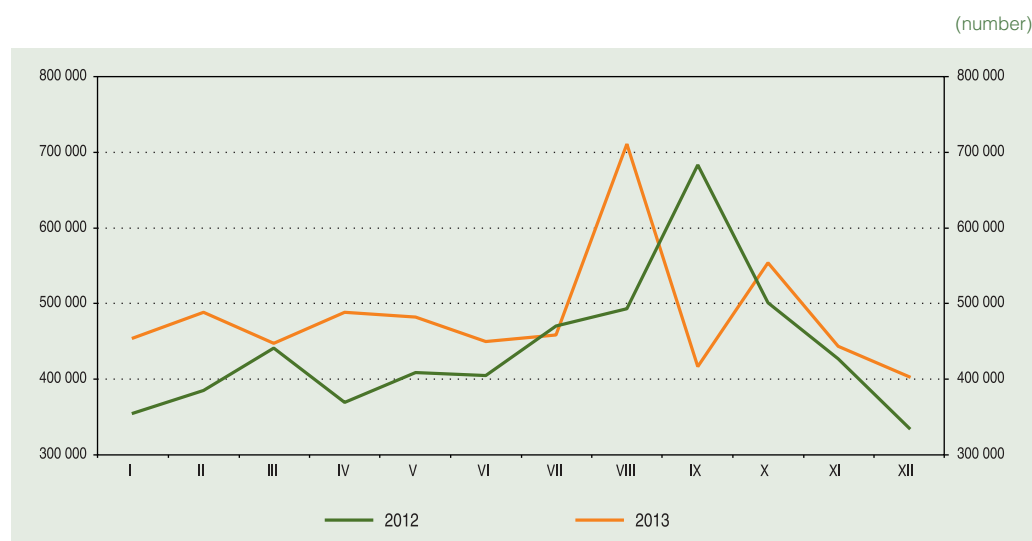
On 31 December 2013, the CCR had 214 reporting units: 30 banks, 183 financial institutions, and one payment institution. In 2013, 26 new financial institutions entered the CCR and seven left under Ordinance No 22 Article 8 in relation to Ordinance No 26 Article 9. The Register logged 2,138,000 borrowers: 2,033,000 individuals, 94,000 legal entities, 4000 non-residents, and 7000 self-employed people. The CCR listed 4,110,000 loans with a balance sheet exposure of BGN 63,025 million. Residual debts up to BGN 5000 predominated with individuals (66.40 per cent), while debts of BGN 5000 to 50,000 predominated with legal entities (36.33 per cent).

Real time customer debt information includes loan status, arrears, and repaid loans for five years back, plus borrower histories.

Credit history is crucial in assessing creditworthiness and mitigating the risk of bad loans in creditors' portfolios. Data help CCR participants identify reliable borrowers and facilitate more accurate credit assessment. This cuts credit risk, protects customers' funds at banks, and boosts financial stability.

In 2013 banks, financial, payment, and electronic money institutions conducted 5,799,000 digital certificate searches on 4,585,000 individuals and 1,214,000 legal entities: 522,000 more than in 2012's 5,277,000. The average monthly searches were 483,000.

CCR Searches

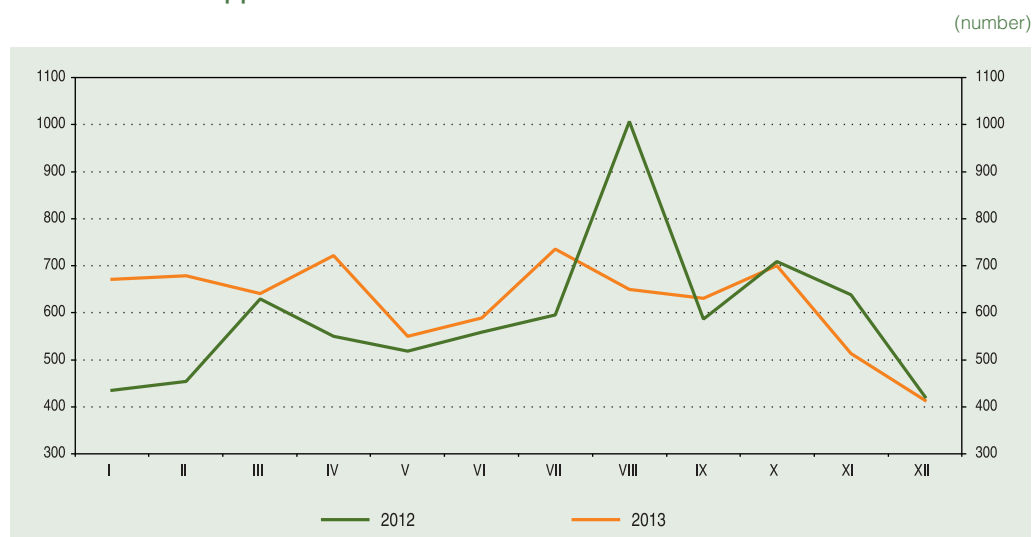


Source: BNB.

Ordinance No 22 Articles 21 and 22 govern disclosure of individual and legal entity debt. Access involves applying and remitting a published fee. The CCR allows individuals one free statement a year.

In 2013 there were 7493 applications for statements: 7296 from individuals and 197 from legal entities.

CCR Statement Applications



Source: BNB.

The CCR maintains a state-of-the-art information system. Changes and updates boost data quality and reliability. In July 2013, the system migrated to new hardware and technological environment to boost performance and cut data exchange time.

Information exchanges with other European credit registers improve CCR technological and methodological performance. Data collection and handling follow European good practice. The CCR is not part of the Memorandum of Understanding on the exchange of information among national credit registers, but its organisation, operation, and data coverage mostly tally with its requirements.

VIII. The Fiscal Agent and State Depository Function

The Law on the BNB names the Bulgarian National Bank as Bulgaria's fiscal agent and official depository. Under market condition and price contracts with the Ministry of Finance (MF), the BNB submits to the MF statements of budget entities' accounts with domestic banks and acts as government debt agent.

These duties call for continuing improvement of 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.

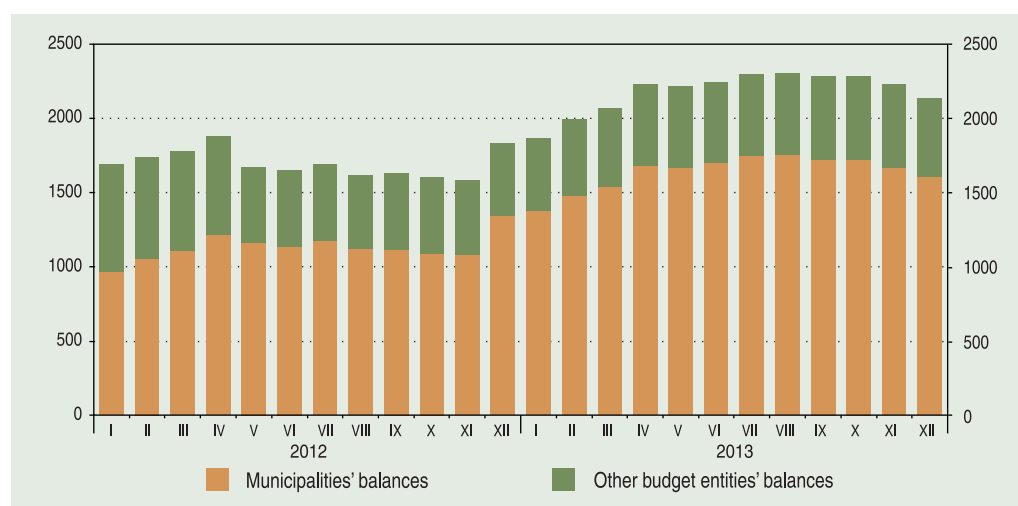
In line with the MF requirements for the system development, fees paid by the MF under Article 43, paragraph 1 of the Law on the BNB increased in 2013, boosting the generated income by 7.7 per cent on 2012. Prices to other participants did not change, fee and commission revenue rising 65.7 per cent because of a great rise in primary market auction, government securities registration and settlement, and issue maturity paperwork. Agency revenue was BGN 2,258,400, 37.2 per cent up on 2012's BGN 1,646,600.

Information Service

Servicing state budget information under the MF agreement involved submitting daily and periodical statements on budget entities' (municipalities included) budget, extra budgetary, deposit, foreign currency, and letter of credit levys and foreign currency accounts at the BNB and other Bulgarian banks *via* IOBFR. The Bank also tallied the State Budget Law security pledged by banks with reported balances daily for the MF.

Budget Entities' Accounts with Domestic Banks (BNB Excluded)

(BGN million)



Source: BNB.

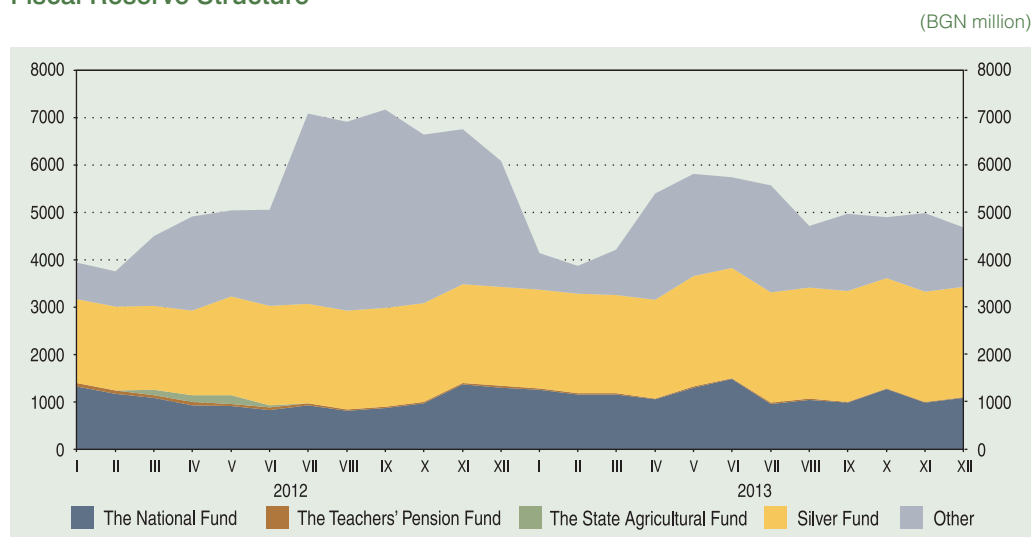
By the close of 2013 there were 23 budget servicing banks, including the BNB, with access to the IOBFR. The overall balance of budget entities' accounts was BGN 6552.1 million, down 14 per cent on 2012.⁶¹ Almost 70 per cent (BGN 4418.7 million) was in BNB accounts and the rest with domestic banks. Account balances

⁶¹ Foreign currency account balances are recalculated in levys at the BNB exchange rate on 31 December 2013.

rose 16 per cent on 2012, mainly through increased municipal balances. As in 2012, five banks held some 60 per cent of the balances outside the central bank.

Approximately 72 per cent of budget funds was in fiscal reserve bank accounts.⁶² On 31 December 2013 it came to BGN 4680.6 million. BGN 3432.8 million of this was in dedicated Silver Fund (State Fund for Guaranteeing the Stability of the State Pension System), MF National Fund, Agricultural State Fund, and Teachers' Pension Fund accounts.

Fiscal Reserve Structure



Source: BNB.

BNB duties to the MF and standing joint instructions by the Minister of Finance and the BNB Governor involved preparing 913 statistical budget reporting forms, including 308 for the fiscal reserve, up 3 per cent on 2012. The rise reflected MF needs for daily statements of municipal accounts at set times each month. There were also 213 summarised quarterly statements on first level budget spending entities certified.

The AS ROAD system maintains up-to-date information on the government's foreign financial obligations on which the BNB is calculating and paying agent.⁶³ The MF requested the system to log the fourth and fifth tranches of the European Investment Bank credit facility worth EUR 94.6 million and EUR 100.7 million and the ratified contracts on transferable fixed-interest loans between Bulgaria as borrower and Deutsche Bank Aktiengesellschaft as creditor and paying agent, signed on 4 November for a total of EUR 290 million. There were 34 regular payments of EUR 1036.7 million in coordination with the MF: EUR 857.5 million principal and EUR 179.2 million interest.⁶⁴ On 31 December obligations in AS ROAD came to EUR 3031.3 million from EUR 3443.5 million a year earlier.⁶⁵ Euro-denominated debt continued occupying the largest share at 73.6 per cent, followed by USD and JPY at 26 and 0.4 per cent.

Servicing Government Securities Trading

Thirty MF government securities auctions offered two each short, medium and long-term issues.⁶⁶ The average-weighted term to maturity of sold issues was three years and nine months. The early 2013 seven-year euro-denominated and 10.5-year lev-denominated issues had most openings (eight).

⁶² The MF sets the scope of bank accounts whose 31 December 2013 balances are in the fiscal reserve under Council of Ministers' Decree No 1 of 2013 on the 2013 State Budget.

⁶³ Under the government debt agency agreement between the BNB and MF.

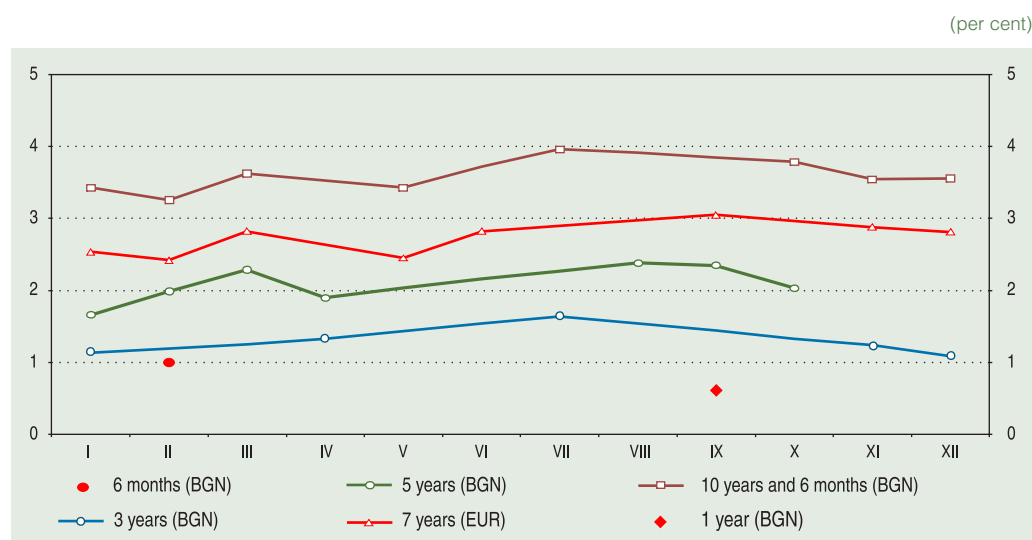
⁶⁴ The payments total was recalculated in euro at the BNB rate for 31 December 2013.

⁶⁵ The debt total was recalculated in euro at the BNB rate for 31 December 2013.

⁶⁶ In 2013 the issuer introduced a series of changes to the issuing calendars, cancelling two auctions for three-month securities and one for three-year bonds in the first half-year. The Ministry announced an extraordinary auction for six-month government securities and inserted a one-year bond auction not scheduled in the indicative calendar into the September issuing calendar.

The total nominal value of government securities offered by the MF was BGN 2347.7 million. Almost 75 per cent of bids were on behalf of banks: BGN 4022.6 million compared with BGN 1387.7 million on behalf of non-bank institutions. Pension funds were among the most active investors with 9.2 per cent of bids, followed by the Bulgarian Deposit Insurance Fund with 8.7 per cent and the National Insurance Institute with 1.9 per cent. The government securities sales volume was BGN 2329.1 million, including the lev equivalent of EUR 165 million, or 99.2 per cent of the scheduled volume.⁶⁷ Of this, 13.9 per cent (BGN 322.7 million) was denominated in euro. Almost two thirds of all sold bonds were acquired by primary and non-primary dealer banks.⁶⁸ The average annual yield of lev-denominated six-month, three-, five-, and 10.5-year issues was 1, 0.6 per cent, 1.25 per cent, 2.10 per cent, 3.52 per cent, that of euro-denominated seven-year issues reaching 2.73 per cent.

Average Annual Yield Attained at the Auctions for Sale of Domestic Government Securities in 2013



Note: The average annual yield of offered volumes is shown for the 10.5 year bond auction of 22 July 2013 at which the MF rejected all bids.

Source: BNB.

ESROT registered BGN 1243.1 million of matured issue payments for and from the issuer.⁶⁹ Principal repayments at maturity of BGN 1015.4 million and larger volumes of new domestic bonds brought the nominal amount of circulating tradable government bonds to BGN 6289.6 million by the end of 2013.

The nominal volume of ESROT registered government securities transactions was BGN 38,237.9 million, up 35.3 per cent on 2012. Repos had the largest share at 85.1 per cent, followed by sales and purchases (8 per cent), and operations between participants and customers or between ESROT participants' customers (6.9 per cent).

Repos with a flow of funds on current accounts dominated at 93 per cent, those concluded for one day leading at 45.7 per cent. Overall, the average-weighted yield of repo agreements was extremely low at around 0 per cent, reaching negative values for certain maturities in individual months. Two to three-day transaction yields fluctuated more.

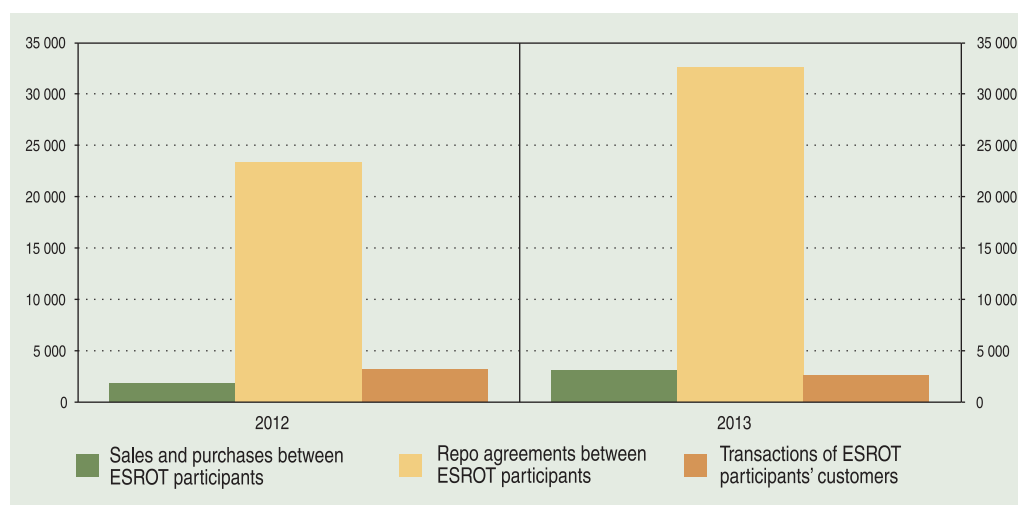
⁶⁷ The MF rejected all bids at the July auction and increased the initially announced volume at the December auction.

⁶⁸ Primary dealers selected under MF and BNB Ordinance No 15 numbered 13.

⁶⁹ The lev equivalent of payments on foreign currency denominated government securities issues was calculated at the BNB rate on the date of payment.

Volume of Transactions in Tradable Government Securities

(BGN million)

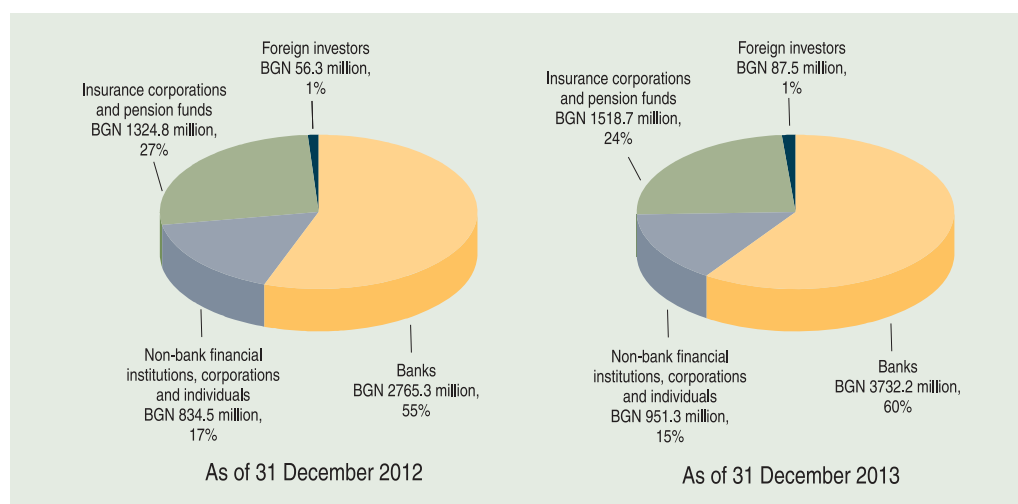


Source: BNB.

Bond sales and purchases rose 70 per cent on 2012 from BGN 1786.2 million to BGN 3043.7 million. Securities traded across the entire yield curve. Sold volumes of medium-term issues exceeded long-term ones despite their much smaller share in the circulating volume. The average annual yield of the long-term benchmark issue (10.5 years) moved within a narrow band from 3.27 to 3.43 per cent compared with 5.30 per cent in January to 3.44 per cent in December 2012.

Operations with or between ESROT participants' customers came to BGN 2634.9 million, down 17 per cent on 2012. The most liquid issues were those denominated in levs and euro and residual terms of five and more years. The secondary government securities market liquidity ratio was 6.08 from 5.67 in 2012 despite the strong increase in circulating bonds.⁷⁰

Holders of Government Securities Issued in the Domestic Market



Source: BNB.

Government securities in bank portfolios rose by BGN 967 million. Bond investment by insurance corporations and pension funds increased by BGN 193.9 million, some 90 per cent in long-term government debt instruments. This changed the structure of

⁷⁰ The ratio between the volume of secondary market government bond transactions concluded for a year and the volume of circulating government securities by the year's end.

government securities to 60 per cent with banks, 24 per cent with insurance corporations and pension funds, 15 per cent with non-bank financial institutions, corporations and individuals, and 1 per cent with foreign investors (from 55 per cent, 27 per cent, 17 per cent and 1 per cent on 31 December 2012).

Over the year ESROT offered 99.9 per cent availability,⁷¹ with no call for contingency rules for interaction between systems operated by the BNB. There were 29 system participants: 26 government securities subdepository banks, an international central securities depository (Clearstream Banking, Luxembourg), the Reserve Collateral Pool, and the MF.

On 31 December 2013 there were 1387 accounts in the government securities settlement system under BNB Ordinance No 31 on Government Securities Settlement. Of them, 27 were for government securities of the issuer (the MF), 567 for participants' government securities, 416 for participants' customers, and 377 for encumbered bonds. Nominals on these accounts tallied with the amount of outstanding issues at BGN 6289.6 million.

Under MF and BNB Ordinance No 15 on Control over Transactions in Government Securities and a joint MF and BNB order, there were on-site inspections of 26 ESROT participants acting as subdepositories for customers. They found no breaches.

System Development

In the last quarter it became possible to settle primary and secondary market government bond transactions denominated and payable in euro through bank accounts in TARGET2. Banks can transact euro government securities on the home market on the Delivery *versus* Payment principle (DvP, model 1), minimising credit and liquidity risk. Inclusion of the BNB ancillary government bond settlement and registration system (BNBGSSS) into TARGET2-BNB on 25 November 2013 launched a new GSAS functionality supporting initial offering auctions of euro-denominated bonds.

There were amendments to Ordinance No 5 of 2007 of the MF and the BNB on the Terms and Procedure for Acquisition, Registration, Redemption and Trade in Government Securities and to Ordinance No 31 of the BNB on Government Securities Settlement. They address mainly euro cash settlement for bonds denominated and payable in euro. A change to Ordinance No 5 addresses the possibility of domestic banks performing cross-border currency transfers of government securities, irrespective of denomination, into other EU central depositories. This facilitates access to international financial institution credit lines and facilitates foreign investment into Bulgarian debt. The amendments ushered the 2 December direct link between the BNB Government Securities Depository and the Clearstream Banking international central securities depository in Luxembourg.

In addition, the BNB amended the Tariff of Fees and Commissions Charged on Processing Government Securities Transactions to reflect European Code of Conduct for Clearing and Settlement price, service transparency and securities depositories' compatibility requirements. A new Tariff section lists services and operations included in fees and commissions, whose amount remains unchanged.

⁷¹ See footnote 45.

IX. Participation in the ESCB and in the Activities of EU Institutions

Ensuring EU financial stability remained the top priority for EU bodies in 2013. There was agreement on a number of the European Commission proposals for EU financial sector regulation, including elements of the banking union. In the ESCB, the European Commission, the EU Council, the European Systemic Risk Board, and the Council for European Affairs committees and working groups, the BNB helped formulate Bulgarian standpoints on financial regulation priorities.

European System of Central Banks

The BNB Governor sits on the ECB General Council with EU central bank governors and the ECB President and Vice President. In 2013 the Governor took part in the five sessions of the ECB General Council which focused on the following issues: the ECB Convergence Report, decisions on the non-euro area national central banks' ECB shares, economic development, and the EU financial sector.

BNB representatives sit on 12 ESCB committees, 32 working groups, and the Human Resources Conference (HRC).⁷² BNB experts are also part of the ESCB Competitiveness Research Network. Through representatives in ESCB bodies the Bank helps elaborate ECB legal instruments on monetary and banking policy, payment and settlement systems, statistical reporting and research, and other central banking issues. The Bank also took part in drawing up ECB opinions on written consultations with EU member states on legislative bills within ECB competence.

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

The BNB Governor is member of the ESRB General Board.⁷³ In 2013 the Governor took part in the three sessions of the ESRB General Board. Alongside the regular exchange of views on systemic risks in the EU financial system and the formulation of measures to address these risks, the Board addressed the Single Supervisory Mechanism's effects on the EU's macroprudential policies framework and ESRB business. The ESRB's General Board also discussed long-term guarantee package assessment, correlation between banking sector size and financial service provision, and the macroprudential aspects of central counterparties' business. BNB representatives sat on more than ten ESRB structure meetings.⁷⁴

Implementing the CRD IV legislative package including the directive and regulation on credit institutions capital requirements (the CRD IV/CRR package), BNB experts worked in European Banking Authority (EBA) working groups and in bodies enforcing the new European bank capital standards. The mandatory capital conservation buffer, discretionary counter cyclical buffer, discretionary buffers for systemically important international and domestic institutions, and liquidity and leverage requirements being added to prudential supervision rules and techniques will make supervisory authorities more flexible on adequate banking system capitalisation.⁷⁵

⁷² 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 Eurosystem/ESCB Human Resources Conference.

⁷³ The ESRB's General Board comprises: the ECB President and the Vice-President, the Governors of EU Member State central banks, European Commissioner, the Chairs of the three European supervisory authorities, the ESRB Advisory Scientific Committee Chair and two Vice-Chairs, the Advisory Technical Committee Chair, a senior representative from each member state competent national supervisory authority, and the President of the Economic and Financial Committee.

⁷⁴ The Bank is on the ESRB General Board, Advisory Technical Committee, and three working groups.

⁷⁵ To transpose CRD IV requirements into Bulgarian law a Law on Amendment of the Law on Credit Institutions was drawn up and tabled in the National Assembly. National Assembly adoption will lead to changes in some BNB Ordinances.

The BNB contributed to debate on EBA development of regulatory and technical standards stemming from the CRD IV/CRR legislative package, providing a detailed description of the practical implementation of specific provisions in own funds, risk-weighted assets, supervisory review and assessment, liquidity, leverage, disclosure, supervisory college cooperation, and remuneration. BNB experts participated in EBA completing the FINREP and COREP standards by the close of 2013. After their official publication, these will provide a uniform European format for credit institution information disclosure and its supervisory aspects.

In the first half of 2013 the EBA published guidelines on assessing management body member and key executive suitability. BNB experts helped elaborate the guidelines, which address insufficient commercial law harmonisation, different management structures, the specific scope of existing EU directives, and inconsistencies in current procedures. The guidelines set out criteria, minimum requirements, and policies to be used by the responsible persons in commercial banks and national central banks in assessing the suitability of the members of the management bodies of credit institutions and key executives.

EBA member national authorities assessed draft technical standards on exchanging information between home and host supervisors of EU bank groups trading in other member states through branches or through the freedom to provide services. Information falls into the two categories of going concern and liquidity stress situations. Anticipated flows are mainly from home to host supervisors.

In the run up to implementation of the directive on the recovery and resolution of credit institutions and investment firms, the BNB published EBA recommendations on drawing up adverse development reaction and recovery plans to help banks evolve structures, policies, and rules for the 2016 launch of the uniform European legal framework in this area.

In the second half of 2013 BNB experts contributed to EBA preparations for the Single Supervisory Mechanism and the delegation of supervisory powers to the ECB. Local supervisory authorities assisted on key issues such as preparing the EU banks Asset Quality Review, scheduling 2014 stress tests, cooperating and sharing information between the EBA and the ECB, and relations between EBA participant and non-participant countries in the Single Supervisory Mechanism.

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

The regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions came into force in November 2013. This main element of the banking union established a Single Supervisory Mechanism (SSM) for euro area credit institutions. The ECB assumes its supervisory duties in November 2014. SSM membership is voluntary for non-euro area member states. The BNB position, shared by government, is that Bulgaria should not join before euro area entry, as this would transfer significant supervisory powers to the ECB. Joining non-euro area central banks do not enjoy ECB and SSM support instruments and do not participate in single supervision decisions. The BNB expects SSM to affect supervisory cooperation on international bank and financial groups on the local market directly.

In December 2013 the EU Council confirmed political agreement with the European Parliament on the directive on recovery and resolution of credit institutions and investment firms after June agreement on the general approach. Trialogue negotiations in the second half of the year greatly converged European Parliament and Council views on the crisis prevention framework, early intervention, resolution and other legal protection, and balancing home and host country interests. The directive comes into force on 1 January 2015 and bail-in resolution tools become available in 2016, two years earlier than envisaged in the general principles agreed by the Council. Bulgaria

supported the flexible framework freeing Member States to define national resolution authorities. Negotiations overturned Bulgarian positions on balancing harmonisation and flexibility in equity holders and creditors paying for bail-ins, and on the date this tool comes into force. The Bulgarian side accordingly appended a declaration to the minutes of the 20 December 2013 COREPER meeting at which Member States supported the legislative proposal for adoption at first reading in the regular legislative procedure.

Debate on the European Commission's single supervisory mechanism (SSM) proposal, the other element of euro area banking union, began in July 2013. At its 18 December meeting Ecofin agreed its general principles, which differ substantially from the initial proposal. Euro area member states also agreed to hold an intergovernmental conference to elaborate the establishment of a single resolution fund. This would involve the progressive mutualisation and pooling of national contributions over eight years.

In 2013 the Bank took part in the debate on the proposed directive on credit agreements for consumers relating to residential immovable property. During the trialogue in the first half of 2013 the positions of the European Parliament and the Council converged significantly and the European Parliament adopted it at second reading on 11 December.

Negotiations on the proposed deposit guarantee schemes directive reopened in the second half of 2013 following agreement on the recovery and resolution directive. Bulgaria favours using deposit guarantee scheme funds for credit institution prevention and support, given adherence to directive terms, conditions, and guarantees, and relevant authority approval.

The BNB participated in the Economic and Financial Committee which focused on economic management and financial sector regulation. The Committee also looked at member state fiscal and macroeconomic policy surveillance for the third European semester and EU positions on G-20, IMF and Financial Stability Council issues.

X. International Issues

International Financial Institutions

The Law of the BNB entitles the Bank to financial and organisational participation in international organisations furthering cooperation in exchange, monetary, and credit policy. Where Bulgaria participates in international financial institutions, the BNB is government fiscal agent and depository.

The Bulgarian National Bank holds equity in the Bank for International Settlements (BIS). The BNB Governor sat on BIS central bank governors' bimonthly meetings: a major forum for cooperation and debate on world economic developments and international financial markets. At the Annual General Shareholder Meeting in late June 2013, the BIS Governors allocated net profit, the BNB receiving a EUR 2.9 million dividend. Central and Eastern European and ECB representatives attended the 2013 BIS international workshop in Sofia.

The BNB Governor represents Bulgaria on the IMF Board of Governors. On 21 February 2013 the National Assembly approved the proposed increase in the IMF general quota, fulfilling Bulgaria's commitment to back the IMF reform package (resolution No 66-2 of the Board of IMF Governors of 15 December 2010 on Executive Board changes and member countries' quotas). BNB representatives took part in the late May 2013 meeting of the World Bank's Netherlands Constituency in Tbilisi, Georgia. Discussions focused on euro area banking union, economic growth prospects and challenges, and the World Bank Group strategy to prevent the spread of poverty. The BNB Governor sat on the 11 to 13 October 2013 International Monetary Fund and World Bank Annual Meetings in Washington.

A BNB Deputy Governor is a European Bank for Reconstruction and Development (EBRD) Alternate Governor for Bulgaria. Bulgaria's Finance Minister chaired the May 2013 EBRD Annual Meeting in Istanbul, Turkey for the first time as Governor for Bulgaria. On 4 July 2013 the National Assembly increased Bulgaria's EBRD capital subscription by EUR 71,130,000.

In January 2013 the BNB paid its USD 8500 annual contribution to the International Accounting Standards Committee Foundation.

Cooperation and Technical Assistance with Central Banks

The BNB continued broadening cooperation with Western Balkan central banks preparing for EU accession. The Bank boosted its regional technical assistance capacity through EU financed and ECB managed technical assistance projects.

The two-year ECB technical cooperation project on Strengthening the Institutional Capacity of the Central Bank of Serbia ended in January 2013. One of 21 EU central banks in the project, the BNB fulfilled its commitments successfully. Bank experts helped the National Bank of Serbia draft a pre-accession action plan, implement a direct reporting system for balance of payments statistical purposes, and align external debt statistics with the IMF External Debt Statistics Guide. These successes led to the Bank being one of the 10 EU central banks invited to a project extension as key financial stability partner. The project ended on 31 December 2013.

The ECB technical cooperation programme with the National Bank of the Republic of Macedonia ended on 31 July 2013. The meetings under the programme addressed Macedonian legislative harmonisation with EU requirements.

In June 2013 representatives of the National Bank of Ukraine visited the BNB to exchange experience on implementing the new Financial Action Task Force (FATF) Recommendations setting standards for the prevention of money laundering and terrorist financing.

Stepping up regional cooperation, the Bank also participated in the Central Bank Governors' Club of the Central Asia, the Black Sea Region and Balkan Countries, and the Group of Banking Supervisors from South Eastern Europe.

XI. Statistics

The BNB collects, compiles, and publishes statistics under the Law on the Bulgarian National Bank Article 42 and the Statute of the ESCB and the ECB Article 5. Alongside implementing 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 provides statistics to the European Systemic Risk Board. An ESCB member, the BNB has a duty to provide reliable and sound statistics.

Monetary and interest rate statistics continued to implement 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 the ECB 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-a-vis* households and non-financial corporations (ECB/2009/7) methodological guidelines. They broaden economic analysis information from MFIs with detail on counterparties and their financial operations.

Preparations for new ECB methodological guidelines on monetary and financial statistics progressed alongside work on the new European System of Accounts (ESA 2010) expected in 2014 and new statistical information user requirements.

The Bank is helping harmonise the insurance statistics regulatory framework. Work included an ECB survey of reporting agents on expected new costs. Regular data submissions continued to the ECB Register for Institutions and Affiliates Database. The ECB project to extend and augment the RIAD financial institution register involved analysing additional requirements for its structure and content, sources of information about individual characteristics, and possible action. The Bank took part in a successful RIAD test data submission to the ECB.

The BNB continued reporting balance of payments and international investment position statistics from information collected directly from residents alongside work on launching the sixth edition of the Balance of Payments Manual (IMF, 2008) by 2014. Preparations are complex because the new methodology has to harmonise with ESA '2010 and the fourth edition of the OECD's methodological document Benchmark Definition of Foreign Direct Investment (2008). The sixth edition of the Balance of Payments Manual introduces greatly changed definitions and presentations of balance sheet and international investment position items. Related work on amending BNB Ordinance No 27 on the Balance of Payments Statistics and related guidelines continued.

The importance of securities information quality put the stress on the ESCB Centralised Securities Database project and a Bulgarian securities database. The BNB worked on the ESCB Securities Holdings Statistics project, of significance to other statistics and financial stability analyses.

The Bank continued compiling data on quarterly financial accounts of the General Government sector under Regulation (EC) No 501/2004 of the European Parliament and of the Council of 10 March 2004 and reporting data on government finance statistics under Guideline ECB/2009/20. It compiled and submitted data on quarterly financial accounts on all institutional sectors under Guideline ECB/2002/7 (recast) on the statistical reporting requirements of the European Central Bank in the field of quarterly financial accounts.

Constructive collaboration with the National Statistical Institute (NSI) on IAS'2010 implementation continued. Joint working parties focused on elaborating and aligning the methodology on quarterly and annual financial accounts.

A BNB proposal led to the NSI including a new quarterly statistical survey of non-financial corporations' financial indicators in its National Statistical Programme. The BNB will use the information in sectoral quarterly financial accounts, financial stability analyses, and European Systemic Risk Board commitments.

With NSI assistance, the Bank continued sending regular macroeconomic indicator information to the ECB and the Bank for International Settlements. There were updates and metadata certification under the Special Data Dissemination Standard with NSI and MF participation to IMF requirements and schedules.

Work advanced on an integrated statistical information system to automate electronic receipt, control, processing, and dissemination of statistical information more reliably and at higher quality. Electronic reporting will relieve reporting agents greatly. Implementation of the new SDMX-ML statistical representation standard continued with testing changes in data transmission to the ECB.

XII. Research

Bulgarian economic analyses, macroeconomic forecasts, and specialised economic research by BNB experts support the Bank's management in making decisions and formulating economic policy. In 2013 research focused on financial sector modelling and pricing, Bulgarian competitiveness, alternative economic modelling approaches, the macroeconomic effects of fiscal policy, and macroeconomic forecasting models.

Specialised economic research followed the 2013 and 2014 BNB Research Plan. It involved analysing individual economic processes and issues to improve forecasting and modelling tools. In 2013 particularly, work addressed Bulgarian export competitiveness, corporate indebtedness in Bulgaria's economy, the dynamic stochastic general equilibrium model, inflation sensitivity to demand, alternative economic modelling approaches, fiscal multipliers, post-2008 EU output, and relations between monetary aggregates and inflation. Research results featured in technical papers and seminars held by the Bank for experts from relevant bodies, academia, and non-governmental organisations.

Testing and honing the basic model for BNB macroeconometric forecasting continued.

In June 2013 the BNB and the Bank of England Centre for Central Banking Studies held a training session on econometric modelling. Delegates from the Albanian, Macedonian, Romanian, Russian, Turkish, Ukrainian, and Montenegrin central banks attended alongside BNB people.

The Guest Researcher Programme supports BNB research and helps establish fruitful cooperation with experts from Bulgaria and abroad on subjects of interest to the Bank. In 2013 two guest researchers participated.

Through its Discussion Papers research series, the BNB continued to encourage the research potential of Bulgarian economic science and practice in macroeconomics and finance. In 2013 the Discussion Papers Editorial Board reviewed seven submissions, clearing three for publication.

The BNB quarterly Economic Review presents short-term Bulgarian economic forecasts, analyses of the balance of payments flows dynamics, monetary aggregates, and their effect on price stability in the real economy. External developments directly affecting the Bulgarian economy were also analysed. The Review contains quantitative assessments of short-run developments in major macroeconomic indicators like inflation, growth, exports, imports, trade balance, and the balance of payments current account. The results of BNB analyses of particular economic issues are presented briefly. Major 2013 highlights included an analysis of non-financial corporation indebtedness, fiscal policy and growth, deflationary factors in Bulgaria in the third quarter of 2013 and possible effects on domestic economic activity.

XIII. Information Systems

In 2013 the BNB continued focusing on information system functionality and security.

New licenses allowing centralised workstation management and specialised software and hardware management prevent system downtime. Financial information systems were kept up to date.

New applications and development to existing ones ensured business continuity and compliance with legislative changes and evolving user requirements. A new cash reporting, control, and management system automated banknote and coin handling using highly productive equipment and packaging lines. Systems migrated to a new architecture and base software. A new version of the CCR information system went live after architecture optimisation to serve external users. The BNBGSSS ancillary government bond settlement and registration system successfully integrated with TARGET2-BNB, allowing the inclusion of the Government Securities Depository as an ancillary system in the BNBGSSS and of Clearstream Banking S.A., Luxemburg as a direct participant. To migrate the Single Data Depository/Banking Supervision Reports to a new technical and system architecture, new hardware and software platforms, production, reserve and test environments were configured, and new functionalities added.

The second stage of the integrated statistical information system project began to match international methodology and standards and optimise and develop new subsystems.

System development and obsolete equipment decommissioning continued as part of updating and maintaining the Bank's communication and information infrastructure and optimising system architecture and links between them. BNB voice communication internal infrastructure also upgraded.

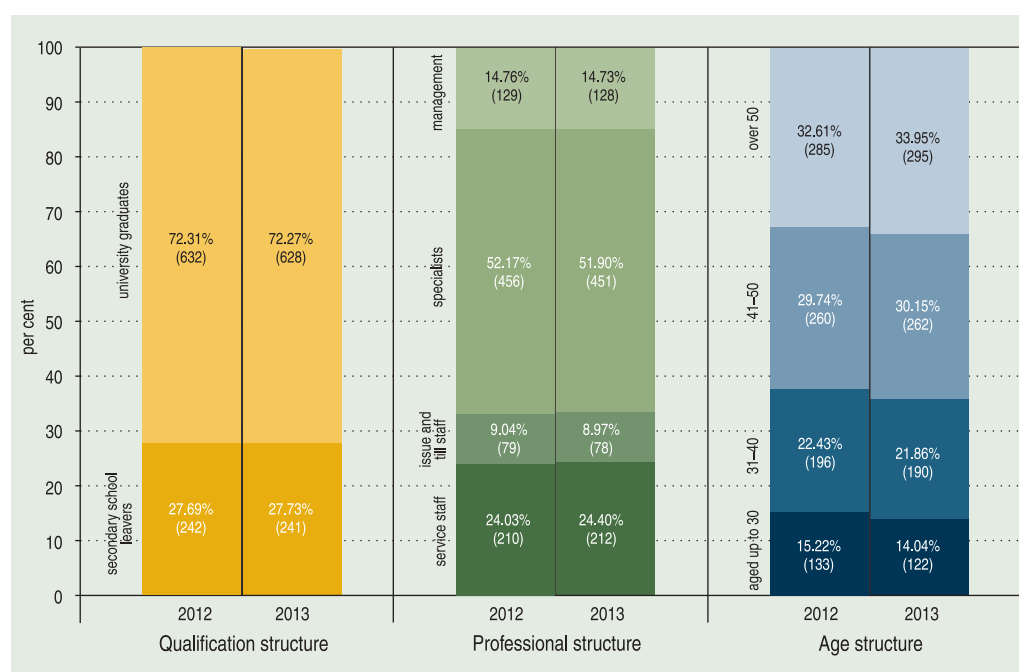
XIV. Human Resources Management

Priorities for BNB human resource management are boosting staff performance through training and career development, maintaining and boosting analytical and administrative capacity, applying performance-related pay, maintaining a sociable environment, and promoting health and safety.

At the end of 2013 the BNB had 869 employees from 874 a year earlier. Thirty six joined (46 in 2012), over half aged under 30. Forty four left (33 in 2012), 11 to retire (7 in 2012). Low staff turnover reflected the established organisational culture and traditions, motivating working environment, effective teamwork, training and professional advancement opportunities, and the sociable environment. The state of the labour market also influenced workforce movement.

Staff Structure on 31 December

(per cent, number)



Source: BNB.

The BNB continued attracting candidates with relevant degrees, as required by its policy of recruiting properly qualified people. Graduates made up 72 per cent of staff, of them 504 masters and 105 bachelors. Another 19 were reading for doctorates.

There were no major changes in staff categories. Specialists held the largest share at 51.9 per cent, followed by support staff at 24.4 per cent and management at 14.7 per cent. BNB internal job classification age and professional structure changed little from 2012. Women made up 65 per cent of staff.

The Bank promoted different forms of mobility to boost skills and professional qualifications. Thirteen employees moved between units (11 in 2012). Three took on short-term ECB appointments.

Pay continued reflecting individual performance and contribution.

Employees enjoyed plentiful opportunities to improve professional qualifications. An annual schedule enabled them to take a variety of national and international training and qualification improvement programmes, distant learning, language and information technology courses and vocational training. Induction training developed further appropriate means for familiarising new employees with the Bank's corporate culture, topical tasks, internal rules, and general administrative procedures. Employees from various structural units attended specialised courses on, *inter alia*, banking and financial legislation, administrative procedures, labour and social security legislation, health and safety at work, and public tendering. More than 80 attended foreign language courses. Those in English drew most interest. Information technology training provided and updated specialised technical, organisational, and management skills. There was also training in operating, servicing, and maintaining equipment.

The Bank continued cooperating with European central banks and international institutions offering specialised professional training in central banking and supervision. More than 270 staff attended courses, seminars, and conferences abroad. These focused on banking supervision and financial stability, financial operations and reserve management, monetary policy, and financial programming. Employees continued participating in seminars, training courses, and workshops on ESCB committees and working groups and European supervisory authorities.

Over the review year 26 employees, six reading for doctors' and eleven for masters' degrees, boosted their educational attainments without discontinuing work. Strong interest continued in distance learning and certification programmes.

The Bank held mandatory health and safety at work sessions, developed safety at work programmes, rules and instructions, assessed risk, and monitored work environment parameters. This improved management and monitoring of work related risks.

As a responsible institution with a positive attitude to youth education and professional development, the Bank continued providing career opportunities and encouraging research and sound academic knowledge. The annual scholarship programme continued enjoying great interest. The BNB awarded two masters' and one doctor's degree scholarships. Interest in the traineeships programme remained high, with more than 160 candidates. The year saw 40 traineeship awards. The Bank promoted its career development programmes (internships, scholarships, and guest researcher programmes) and staff recruitment procedures at student and graduate career fora.

XV. Facilities Management

The BNB operates from owned premises and properties. This provides the degree of independence, security and protection required of an institution of national importance.

Spending was in line with the BNB budget approved for 2013. It included construction, refurbishment and modernisation, deliveries and equipment, maintenance (transformers, power supply, distribution boards, diesel generators, backup power supply, plant rooms, pressure boilers, lifts, HVAC installations and heaters), vehicles, supplying assets and cash processing consumables, and optimising power, heating, and water use at BNB premises.

The year saw launch of a joint BNB and BORIKA–Bankservice AD project for a Plovdiv Cash and Information Centre. The new establishment will follow all public premise requirements as well as those relating to bank tills and information technologies.

XVI. BNB Internal Audit

Internal Audit worked to an annual programme approved by the Governing Council. This comprised ten major and subsidiary area audits, set after a risk evaluation of major BNB functions. There were three audits to the ESCB Internal Auditor Committee Programme and three monetary policy and asset management audits:

- Banknote conceptual and detail design, security, quality control, and preproduction control system efficiency and risks: reviewing processes and control system efficiency and risks;
- Gross international reserve management risk control and analysis: an assessment of the effective attainment of aims and tasks, obtaining reasonable assurance of adequate and effective control, corporate governance and risk management. Further examination of workflows and planning efficiency;
- Gross international reserve management: obtaining reasonable assurance of adequate and effective control, corporate governance and risk management. Assessing significant information reliability and integrity, legal compliance, the internal framework, and workflow and planning efficiency.

Human resource management and social policy audits reviewed functions, assessed risks, and sought reasonable assurance of management and control efficiency.

An information and communication technology audit addressed strategic planning, project management and prioritising, processes, organisation and connections. It looked at how the organisational framework helped synchronise business and IT objectives, whether business and IT priorities coordinated well in achieving adequate resource allocation, whether IT and business requirements aligned, whether procurement and retirement decisions were timely, and whether IT investment had due return and effect on operations.

Under the financial accounting and financial statements function, BNB consolidated financial statements by 30 June 2013 were audited to assess information accuracy and integrity and obtain reasonable assurance of reliability, compliance with Bank accounting policy, and control system adequacy.

An audit of internal services assessed the organisation and conduct of tenders, the execution of deliveries, works, and services. The organisation and conduct of public tenders and the implementation of supply agreements, works, and services contracts were also audited to assess risks and get reasonable assurance of management and control efficiency.

An audit on cash processing and scrapping in the BNB Cash Centre strategic stock maintenance assessed legal compliance and obtained reasonable assurance of control system efficiency.

An audit on the supervision and financial stability function addressed special supervision. It examined the accomplishment of supervision tasks and objectives and obtained reasonable assurance of adequate and effective control, corporate governance, and risk management. It also assessed workflow and planning efficiency, the reliability and integrity of significant information related to special supervision, and legal compliance.

Also audited was the implementation of recommendations from earlier BNB Internal Audit programme audits to assess the adequacy, effectiveness, and timeliness of resulting management action.

BNB Internal Audit Programme Audits

Functions	Audits
Monetary policy and asset management	Banknote conceptual and detail design, security, quality control, and preproduction
Monetary policy and asset management	Risk control and analysis in managing gross international reserves
Monetary policy and asset management	Gross international foreign reserve management
Human resource management and social policy	BNB social policy
Information and communication technologies	Strategic planning, project management and prioritising, processes, organisation, and connections
Financial Accounting and Financial Statements	Consolidated financial statements for the year ended 30 June 2013
Internal services	Organising and conducting tenders. Delivery of supplies, works, and services.
Banknotes and coins	Cash processing and scrapping in the BNB Cash Centre. Strategic stock maintenance
Supervision and financial stability	Special supervision
BNB Internal Audit	Progress on recommendations from earlier audits

Source: BNB

There were three audits under the ESCB Internal Auditors Committee Programme for 2013 and the Internal Audit Programme approved by the BNB Governing Council.

An audit of payment and securities settlement addressed the SWIFT system and service. It obtained reasonable assurance of organisation adequacy and efficiency, including SWIFT component management and functions subject to ESCB central bank oversight. An information and communication technologies audit addressed IT corporate management in the Eurosystem/ESCB. Special attention went on security and information system policy risk management. The audit obtained reasonable assurance of adequate and efficient governance of the information system policy framework, security, and IT risks.

An audit followed up implementation of recommendations from earlier ESCB Internal Auditor Committee programme audits.

ESCB Internal Auditors Committee Programme Audits

Functions	Audits
Payment and Securities Settlement systems	SWIFT system and service
Information and communication technologies	Information technology corporate management in the Eurosystem/ ESCB
BNB Internal Audit	Progress on recommendations from earlier audits

Source: BNB

The Chief Auditor organised and 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 for 2012 owed to the state budget and in reporting the 2012 BNB budget performance.

External auditors Deloitte Audit OOD assessed BNB Internal Audit quality, concluding that the Unit acted competently, with professional care, and in keeping with Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing and its Code of Ethics.

XVII. BNB Budget Implementation

The Governing Council adopted the BNB budget by Resolution 82 of 22 November 2012. Under the Internal Rules on Drafting, Implementing, and Reporting the BNB Budget, this report has sections on Operating Expenditure and the Investment Programme.

1. Operating Expenditure

In 2013 the BNB spent BGN 69,424,000 or 87.4 per cent of budget.

Currency circulation cost BGN 9,604,000 or 90.4 per cent of budget and 13.8 per cent of operating expenditure. New banknotes and coins cost BGN 9,098,000, of which BGN 3,700,000 for banknotes and BGN 5,398,000 for coins, including BGN 4,746,000 for circulating coins. The Governing Council commemorative coin programme cost BGN 652,000. New banknotes and coin design cost BGN 28,000, including four competitions for 2014 commemorative coins. Machines for servicing circulating cash cost BGN 168,000. Cash processing consumables cost BGN 120,000. Premise rentals at the Cash Services Company AD and the State Mint cost BGN 162,000.

Materials, services, and depreciation cost BGN 32,748,000 or 82.8 per cent of budget and 47.2 per cent of operating expenditure. Materials cost BGN 968,000 or 1.4 per cent of operating expenditure. Vehicle fleet fuel and spares (BGN 385,000) and office consumables (BGN 251,000) occupied the largest share in this group. The Bank spent BGN 118,000 on inventories.

External services cost BGN 15,409,000 or 22.2 per cent of operating expenditure. Significant items were software maintenance subscriptions at BGN 3,223,000, mandatory TARGET2 modules at BGN 1,083,000, Bloomberg, Reuters, internet and other systems at BGN 965,000, and Bankservice subscriptions at BGN 545,000 or 37.7 per cent of external service spending. Software maintenance subscriptions cost BGN 1,335,000. Property and refuse collection levies were BGN 982,000 and modernising mail, telephone, and telex services cost BGN 724,000. Electric bills were BGN 824,000, and heating and water BGN 231,000. Property insurance cost BGN 94,000. The Bank spent BGN 2,350,000 on security and fire protection. Major buildings maintenance cost BGN 2,052,000. Consultancy services for BGN 203,000 included, *inter alia*, obtaining technical passports for BNB premises, information security, property valuations and cadastral amendments, legal services, external assessment of internal audit, and running the Banking and Financial History Research and Publications Programme Council. Planned external services for the international reserves information system, IT aspects of the European Commission regulatory package of banking supervision legislative changes technical standards, and cash issuing equipment repair were not used, explaining the underspend.

Depreciation was BGN 16,371,000 or 23.6 per cent of operating spend.

Payroll, social, and healthcare spending was BGN 21,971,000 or 98.4 of budget and 31.6 per cent of operating expenditure. The Bank reported BGN 343,000 of current retirement obligations and unused paid leave under IAS 19, Income of Hired Persons.

Social expenditure was BGN 2,168,000 or 96.2 per cent of budget and 3.1 per cent of operating expenditure.

Miscellaneous administrative costs were BGN 1,230,000 or 62.6 per cent of budget and 1.8 per cent of operating expenditure. Inland travel worth BGN 79,000 involved mainly regional cash centre logistics and checks. Foreign travel unrelated to the ESCB and other EU bodies cost BGN 269,000.

The annual BNB Staff Education and Professional Training Programme sent staff on specialised courses at the ESCB, the European Commission and EU bodies, banks, and international financial institutions. Staff training cost BGN 630,000.

Participating in the ESCB and other EU bodies cost BGN 1,703,000 or 61.3 per cent of budget and 2.5 per cent of operating expenditure. BNB representatives on ESCB committees and working groups and other EU bodies cost BGN 715,000. Telecommunication line rental cost BGN 285,000. Staff training cost BGN 37,000. The annual fee for European Banking Authority membership was BGN 666,000.

2. The Investment Programme

The BNB approved investment programme budget for 2013 of BGN 14,038,000 and invested BGN 6,608,000 or 47.1 per cent of budget.

In construction, refurbishment and modernisation, BGN 49,000 or 8.7 per cent went on a joint project between the BNB and BORIKA–Bankservice AD⁷⁷. The BNB Building's technical passport priorities called for consultations on a conceptual design competition, postponing refurbishment and modernisation and resulting in an underspend.

Machine and equipment, vehicle, and sundry equipment investment came to BGN 601,000 or 19.5 per cent of programme.

Currency circulation machines cost BGN 177,000, including BGN 84,000 on protection sensors for two cash handling machines, BGN 83,000 on a banknote storage container, BGN 8000 on four coin counters, and BGN 2000 on sundry cash operations equipment.

The Bank invested BGN 146,000 into air conditioning, BGN 131,000 into special equipment, BGN 68,000 into staff recreation homes and canteen equipment, and BGN 35,000 into office equipment. A Public Procurement Law procedure for currency circulation and pilot vehicles worth BGN 1,604,000 was deferred for 2014.

Information system investment was BGN 5,933,000 or 58.2 per cent of programme and 89.8 per cent of all investment. Funds went mostly into keeping the information and communication infrastructure modern. The Bank continued optimising investment funds by changing priorities and reordering projects.

Hardware cost BGN 4,443,000 of which BGN 3,108,000 for computers and BGN 1,335,000 for communications equipment. Software cost BGN 1,490,000 of which BGN 1,017,000 for licences and BGN 473,000 for improving functionality.

Investment into the BNB's participation in the ESCB was BGN 25,000, including the BGN 8000 increase of BNB subscription to ECB equity.

BNB Budget Implementation as of 31 December 2013

Indicator	Report 31 December 2013 (BGN'000)	Budget 2013 (BGN'000)	Implementation (per cent)
Section I. Operating Expenditure	69 424	79 475	87.4
Currency circulation	9 604	10 622	90.4
Materials, services, and depreciation expenditure	32 748	39 533	82.8
Staff	21 971	22 320	98.4
Social	2 168	2 254	96.2
Other administrative	1 230	1 966	62.6
ESCB membership	1 703	2 780	61.3
Section II. Investment Programme	6 608	14 038	47.1
Construction, refurbishment, and modernisation	49	565	8.7
Machines, vehicles, and other equipment	601	3 077	19.5
Information technology	5 933	10 200	58.2
ESCB membership	25	196	12.8

Source: BNB.

⁷⁷ See Chapter XV.

XVIII. Bulgarian National Bank Consolidated Financial Statements as of 31 December 2013

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**INDEPENDENT AUDITORS' REPORT
TO THE GOVERNING COUNCIL
BULGARIAN NATIONAL BANK**

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Bulgarian National Bank and its subsidiaries ("the Bank") which comprise the consolidated statement of financial position as at 31 December 2013, 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 Bank'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 Bank's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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



Opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Bank and its subsidiaries as at 31 December 2013 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 2013. 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 24 April 2014.

Gergana Mantarkova
Authorized representative

Margarita Goleva
Registered auditor

KPMG Bulgaria OOD
Sofia, 24 April 2014

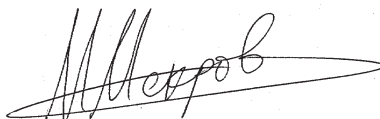


Statement of Responsibilities of the Governing Council of the Bulgarian National Bank

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 Bulgarian National Bank 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 'Ivan 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 2013

(BGN'000)

	Note	2013	2012
Interest income	7	435,316	420,601
Interest expense	7	(1,201)	(1,931)
Net interest income		434,115	418,670
Fee and commission income		9,052	8,291
Fee and commission expense		(4,144)	(6,343)
Net fee and commission income		4,908	1,948
Net gains/(losses) from financial assets and liabilities at fair value through profit or loss	8	(1,362,089)	10,212
Other operating income	9	45,064	47,408
Total income from banking operations		(878,002)	478,238
Administrative expenses	10	(99,169)	(106,328)
Profit for the period		(977,171)	371,910
Other comprehensive income			
Other comprehensive income		(4,854)	(276)
Other comprehensive income, total		(4,854)	(276)
Total comprehensive income for the period		(982,025)	371,634
Profit attributable to:			
Equity holder of the Bank		(977,214)	371,804
Non-controlling interest		43	106
Profit for the period		(977,171)	371,910
Total comprehensive income attributable to:			
Equity holder of the Bank		(982,068)	371,528
Non-controlling interest		43	106
Total comprehensive income for the period		(982,025)	371,634

The accompanying notes on pages 89 to 114 form an integral part of the Consolidated Financial Statements.

Consolidated Statement of Financial Position as of 31 December 2013

(BGN'000)

	Note	31 December 2013	31 December 2012
ASSETS			
Cash and deposits in foreign currencies	11	6,318,854	9,376,167
Gold, instruments in gold and other precious metals	12	2,228,481	3,207,354
Financial assets at fair value through profit or loss	13	19,623,926	17,801,193
Financial assets available for sale	14	1,454,171	1,515,709
Tangible assets	15	190,068	223,558
Intangible assets	16	4,729	6,368
Other assets	17	87,048	62,004
Total assets		29,907,277	32,192,353
LIABILITIES			
Banknotes and coins in circulation	18	10,253,722	9,549,921
Due to banks and other financial institutions	19	7,063,410	7,845,160
Liabilities to government institutions and other liabilities	20	5,905,707	6,952,197
Borrowings against Bulgaria's participation in international financial institutions	21	2,659,865	2,775,165
Other liabilities	22	143,270	100,748
Total liabilities		26,025,974	27,223,191
EQUITY			
Capital	23	20,000	20,000
Reserves	23	3,857,063	4,944,965
Non-controlling interest	24	4,240	4,197
Total equity		3,881,303	4,969,162
Total liabilities and equity		29,907,277	32,192,353

The accompanying notes on pages 89 to 114 form an integral part of the Consolidated Financial Statements.

Consolidated Statement of Cash Flows for the Year Ended 31 December 2013

(BGN'000)

	Note	2013	2012
OPERATING ACTIVITIES			
Net (loss)/profit		(977,171)	371,910
<u>Adjustments:</u>			
Dividend income		(8,796)	(8,621)
Depreciation and amortisation	15, 16	22,828	24,667
Loss on disposal of tangible assets		28,614	825
Loss/(Profit) on financial assets and liabilities arising from market movements		1,004,115	(251,774)
(Profit) of associates		(145)	(325)
Other adjustments		81	(45)
Net cash flow from operating activities before changes in operating assets and liabilities		69,526	136,637
Change in operating assets			
(Increase) in gold, instruments in gold and other precious metals		(4,039)	(2,740)
(Increase) in financial assets at fair value through profit or loss		(1,898,494)	(1,428,212)
(Increase)/Decrease in other assets		(16,622)	209
Change in operating liabilities			
Increase in currency in circulation		703,801	821,171
(Decrease)/increase in due to banks and other financial institutions		(781,750)	1,665,562
(Decrease)/increase in due to government institutions and other liabilities		(1,046,490)	1,718,165
Increase/(Decrease) in other liabilities		42,522	(63,879)
Net cash flow (used in)/from operating activities		(2,931,546)	2,846,913
INVESTING ACTIVITIES			
Acquisition of tangible and intangible assets		(20,299)	(22,338)
Dividends received		8,796	8,621
Other investments		(8)	(4)
Net cash flow (used in) investing activities		(11,511)	(13,721)
FINANCING ACTIVITIES			
Payments to the Government		(105,834)	(180,528)
Net cash flow (used in) financing activities		(105,834)	(180,528)
Net (decrease)/ increase in cash and cash equivalents		(3,048,891)	2,652,664
Cash and cash equivalents at beginning of period		9,417,131	6,764,467
Cash and cash equivalents at end of period	11, 17	6,368,240	9,417,131

The accompanying notes on pages 89 to 114 form an integral part of the Consolidated Financial Statements.

Consolidated Statement of Changes in Equity for the Year Ended 31 December 2013

(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
Balance as of 1 January 2012	20,000	138,773	4,615,192	4,773,965	4,091	4,778,056
Profit for the period	-	-	371,804	371,804	106	371,910
Other comprehensive income:						
other income	-	(235)	(41)	(276)	-	(276)
Other comprehensive income, total	-	(235)	(41)	(276)	-	(276)
Total comprehensive income for the period	-	(235)	371,763	371,528	106	371,634
Other movements	-	-	-	-	-	-
Contributions by and distributions to owners:						
contribution to the budget of the Republic of Bulgaria	-	-	(180,528)	(180,528)	-	(180,528)
Transactions with owners, total	-	-	(180,528)	(180,528)	-	(180,528)
Balance as of 31 December 2012	20,000	138,538	4,806,427	4,964,965	4,197	4,969,162
Balance as of 1 January 2013	20,000	138,538	4,806,427	4,964,965	4,197	4,969,162
Profit/loss for the period	-	-	(977,214)	(977,214)	43	(977,171)
Other comprehensive income:						
other income	-	(4,929)	75	(4,854)	-	(4,854)
Other comprehensive income, total	-	(4,929)	75	(4,854)	-	(4,854)
Total comprehensive income for the period	-	(4,929)	(977,139)	(982,068)	43	(982,025)
Other movements	-	-	-	-	-	-
Contributions by and distributions to owners:						
contribution to the budget of the Republic of Bulgaria	-	-	(105,834)	(105,834)	-	(105,834)
Transactions with owners, total	-	-	(105,834)	(105,834)	-	(105,834)
Balance as of 31 December 2013	20,000	133,609	3,723,454	3,877,063	4,240	3,881,303

The accompanying notes on pages 89 to 114 form an integral part of the Consolidated Financial Statements.

Notes to the Consolidated Financial Statements

1. Statute and Principal Activities

The Bulgarian National Bank (the 'Bank') is 100 per cent owned by the Bulgarian state and is the central bank of the Republic of Bulgaria. The operation of the Bank is governed by the Law on the Bulgarian National Bank (LBNB), which has been effective 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 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 thought purchase of debt instruments, to the Council of Ministers, municipalities, as well as to other government and municipal institutions, organizations 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 acts as the fiscal agent and depository for the State.

The Governing Council of the BNB approved the Consolidated Financial Statements, set out on pages 81 to 114, on 24 April 2014.

2. Applicable Standards

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

3. Basis of Preparation

The Financial Statements are presented in Bulgarian levs rounded to the nearest thousand (BGN'000), 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.

The Bank has adopted the following new standards and amendments to standards, including all resulting amendments to other standards, with a date of initial application 1 January 2013:

- Disclosures – Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7 Financial Instruments: Disclosures) (see (i));
- IFRS 13 Fair Value Measurement (see (ii));
- Presentation of Items of Other Comprehensive Income (Amendments to IAS 1 Presentation of Financial Statements);
- IAS 19 Employee Benefits (2012).

(i) Offsetting financial assets and financial liabilities

As a result of amendments to IFRS 7, the Bank has expanded the scope of its disclosures in relation to financial assets and financial liabilities.

(ii) Fair value measurement

IFRS 13 provides a single framework for measuring fair value and disclosures of fair value measurements where such measurements are required or permitted by other standards. The standard unifies the definition of fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The standard replaces and increases the disclosure requirements about fair value measurement in other standards, including those according to IFRS 7. As a result, the Bank has made additional disclosures in this relation.

In line with the transitional provisions in IFRS 13, the Bank applied the new guidelines on fair value measurement prospectively and no comparative information on new disclosures was presented. Nevertheless, the change had no significant impact on the measurements of the Bank's assets and liabilities.

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 presented in the statement of profit or loss include:

- interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis;
- interest on available-for-sale investment securities calculated on an effective interest basis.

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 gains/losses from financial assets and liabilities at fair value through profit or loss includes net gains from operations in securities, net gains from operations in foreign

currency, net revaluation gains on securities, net gains from gold revaluation, net gains from revaluation of futures, and net gains from revaluation of assets and liabilities denominated in foreign currencies.

(b) Financial instruments

(i) Classification

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

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

Loans and receivables are instruments 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 receivables, 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, and for those financial instruments which are not recognised at fair value through profit or loss the amount recognised includes directly attributable acquisition costs.

(iii) Amortised cost measurement

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

(iv) Fair value measurement and disclosure principles

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the principal market and, if no such market is available, then in the most advantageous and accessible market on the measurement date. The fair value of a liability reflects the effect of non-performance risk.

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

If no quoted price in an active market is available, the Bank uses the most relevant observable inputs and makes minimum use of unobservable data. The aim of using a valuation technique is to estimate the price that would be obtained in an orderly transaction between market participants. 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 determining 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. When the Bank finds a difference between the fair value at initial recognition and the transaction price, and the fair value is neither evidenced by quoted price in an active market for identical assets or liabilities, nor based on a valuation technique based only on data from observable markets, then the financial instrument is initially recognised at fair value adjusted with the difference between the fair value at initial recognition and the transaction price. This difference 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.

The Bank recognises assets and long positions at a bid price and liabilities and short positions at an ask price when assets or liabilities measured at fair value have a bid and an ask price.

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the Bank on the basis of the net exposure to either market or credit risk are measured on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure. Those portfolio-level adjustments are allocated to the individual assets and liabilities on the basis of the relative risk adjustment of each of the individual instruments in the portfolio.

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.

The Bank recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

(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 the substantial risks and rewards of the transferred assets or a part of them. If a part of or all substantial risks and rewards are retained, then the transferred assets are not derecognised from the statement of financial position. Transfers of assets with retention of a part of or all substantial risks and rewards are, for instance, securities lending or repurchase agreements.

In transactions where the Bank neither retains nor transfers all substantial 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, the Bank has a legal right to offset the recognised amounts and intends to settle the asset or the liability on a net basis.

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 future cash flows which can be reliably estimated.

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 individual and group level. All individually significant loans and investments held to maturity are evaluated for specific impairment. All individually significant loans and investments held to maturity on which no specific impairment losses have been charged are evaluated on a portfolio basis. Loans and held-to-maturity investments that are not individually significant are collectively assessed for impairment by grouping together loans 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 receivables. Interest on the impaired asset continues to be recognised through unwinding of the discount. When a subsequent event reduces impairment loss, the reduction in the 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 as a whole with the purpose of short-term profit.

Initially, financial assets and liabilities for trading are recognised at fair value in the statement of financial position and transaction costs recognised in profit or loss. All changes in the fair value are recognised as net income from trading operations in profit or 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 on the basis of an effective interest rate method. In case of sale or reclassification of more than an insignificant part of the assets held to maturity that are not falling due in the immediate future, there should be a reclassification of the entire portfolio of investments held to maturity in the group of available for sale investments. As a result of this reclassification, the Bank may not classify investments as 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 equity until the investment is sold or fully impaired when the cumulative gains and losses recognised in equity are recognised in profit or loss.

(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 London Bullion Market fixing in euro 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 re-valued amount as per the alternative approach allowed in IAS 16 Property, Plant and Equipment. The other groups of property, plant, equipment and intangible assets are measured in the statement of the financial position at 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 is 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*

Impairment losses of tangible fixed assets are reversed when a change occurs in the estimates used to determine the recoverable amount and may be reversed only up to that carrying amount of the asset before recognising impairment losses.

(f) **Foreign exchange**

Gains and losses arising in foreign currencies are translated to Bulgarian leva 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 2013 and 31 December 2012 are as follows:

Currency	31 December 2013	31 December 2012
US dollars	1 : BGN 1.41902	1 : BGN 1.48360
Euro	1 : BGN 1.95583	1 : BGN 1.95583
Special Drawing Rights	1 : BGN 2.18529	1 : BGN 2.28017
Gold	1 troy ounce : BGN 1708.92	1 troy ounce : BGN 2463.73

(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 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. As at the date of the statement of financial position, the Bank's Management estimates the approximate amount of the potential expenditures for every employee based on an actuarial report 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, are disclosed in note 10 of the Financial Statements.

Termination benefits

Termination benefits are recognised as an expense when the Bank is committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan to either terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognised as an expense if the Bank has made an offer of voluntary redundancy, 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 endorsed for adoption by the European Commission may be adopted earlier – for the year ended 31 December 2013. These amendments to IFRS were not adopted when preparing these Consolidated Financial Statements and the Bank does not intend to apply them earlier.

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

- 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) which are to be applied no later than from the start date of the first financial year beginning on or after 1 January 2014. The Bank is in the process of updating the amendments; however, no significant impact on the financial statements is expected.
- Amendments to IAS 32 Offsetting Financial Assets and Financial Liabilities shall be applied no later than from the start date of the first financial year beginning on or after 1 January 2014. The Bank is in the process of analysing the amendments; however, it does not expect that they would have any significant impact on the financial statements as it does not apply offsetting of its financial assets and financial liabilities.

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 new or revised standards, new interpretations and amendments to existing standards, already issued by the International Accounting Standards Board (IASB) as at the reporting date, were not yet endorsed for adoption by the European Commission and therefore were not applied in preparing these Financial Statements. The actual effective dates for their adoption 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 be applied as of 1 January 2015 and are expected to change the classification and measurement of financial instruments.

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 in 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 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 assets of very low credit risk such as discount and coupon securities issued by highly rated issuers (governments, government agencies or supranational financial institutions), and short-term foreign currency or 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 of international reserve management are handled by an independent risk management unit. It is directly responsible for strategic asset structuring and setting up of the benchmark for the international reserves, preparing and submitting investment management limits for approval. 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 may invest, are specified in internal documents. The documents define the main portfolios and the respective model portfolios (benchmarks), all limits for credit, interest rate, currency and operational risk, and give a list of the foreign financial institutions which are counterparties of the Bank.

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 LBNB.

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 BNB counterparties, including central banks or supranational financial institutions;
- Deposits in gold (time deposits and funds on current accounts) with BNB counterparties, including central banks or supranational financial institutions;
- Commercial securities (of up to one 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 financial 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 which are calculated based on the market value of foreign currency reserves i) maximum or minimum limits on the weight of each asset class and ii) 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 is primarily manifested in two aspects: the first aspect is the risk for the Bank of being unable to meet its obligations when due and the second aspect comprises the risk of its being unable to sell an asset on international markets at a fair value within an appropriate timeframe in compliance with the respective market conventions.

The instruments for attracting funds, which are provided to customers on the liability side, 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
As of 31 December 2013							
Financial assets							
Cash and deposits in foreign currencies	5,985,684	185,958	147,212	-	-	-	6,318,854
Gold, instruments in gold, and other precious metals	1,320,493	-	-	-	-	907,988	2,228,481
Financial assets at fair value through profit or loss	1,611,734	2,081,718	5,612,763	10,092,365	225,346	-	19,623,926
Financial assets available for sale	74,521	-	-	-	-	1,379,650	1,454,171
Other assets	17,902	9,000	22,484	-	-	-	49,386
Total financial assets	9,010,334	2,276,676	5,782,459	10,092,365	225,346	2,287,638	29,674,818
Financial liabilities							
Banknotes and coins in circulation	-	-	-	-	-	10,253,722	10,253,722
Due to banks and other financial institutions	7,063,410	-	-	-	-	-	7,063,410
Liabilities to government institutions and other borrowings	5,884,193	21,514	-	-	-	-	5,905,707
Borrowings against Bulgaria's participation in international financial institutions	-	-	-	-	-	2,659,865	2,659,865
Total financial liabilities	12,947,603	21,514	-	-	-	12,913,587	25,882,704
Asset-liability maturity mismatch	(3,937,269)	2,255,162	5,782,459	10,092,365	225,346	(10,625,949)	3,792,114
As of 31 December 2012							
Financial assets							
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
Total financial assets	11,957,298	903,795	5,723,506	10,328,839	281,573	2,746,376	31,941,387
Financial liabilities							
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
Total financial liabilities	14,615,329	21,514	160,514	-	-	12,325,086	27,122,443
Asset-liability maturity mismatch	(2,658,031)	882,281	5,562,992	10,328,839	281,573	(9,578,710)	4,818,944

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

(BGN'000)

	Book value	Gross nominal outgoing cash flow	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years
As of 31 December 2013							
Banknotes and coins in circulation	10,253,722	10,253,722	-	-	-	-	10,253,722
Due to banks and other financial institutions	7,063,410	7,063,410	7,063,410	-	-	-	-
Liabilities to government institutions and other borrowings	5,905,707	5,905,707	5,884,193	21,514	-	-	-
Borrowings against Bulgaria's participation in international financial institutions	2,659,865	2,659,865	-	-	-	-	2,659,865
	25,882,704	25,882,704	12,947,603	21,514	-	-	12,913,587
As of 31 December 2012							
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
	27,122,443	27,122,552	14,615,331	21,514	160,621	-	12,325,086

(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. Market risk exposure is managed in accordance with the risk limits specified in the document *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.

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

(BGN'000)

	As of 31 December 2013	Average	Maximum	Minimum
Currency risk	(50,188)	(48,700)	(107,536)	(11,312)
Interest rate risk	(5,723)	(5,351)	(11,587)	(702)
Correlation (per cent)	0.19	0.14	0.60	(0.41)
Overall risk	(52,305)	(50,104)	(105,977)	(9,121)
	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)

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 model portfolio (benchmark) 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 2013					
Interest-earning assets					
Cash and deposits in foreign currencies	6,298,511	1,951,740	4,013,791	185,804	147,176
Gold, instruments in gold and other precious metals	1,320,448	-	1,320,448	-	-
Financial assets at fair value through profit or loss	19,632,459	575,065	1,507,000	2,029,141	15,521,253
Financial assets available for sale	74,521	-	74,521	-	-
Other interest-earning assets	49,368	8,423	9,461	9,000	22,484
Total	27,375,307	2,535,228	6,925,221	2,223,945	15,690,913
Interest-bearing liabilities					
Due to banks and other financial institutions	7,063,410	-	7,063,410	-	-
Liabilities to government institutions and other borrowings	3,401,011	-	3,379,497	21,514	-
Borrowings against Bulgaria's participation in international financial institutions	1,334,940	1,334,940	-	-	-
Total	11,799,361	1,334,940	10,442,907	21,514	-
Interest-bearing assets/liability gap	15,575,946	1,200,288	(3,517,686)	2,202,431	15,690,913
As of 31 December 2012					
Interest-earning assets					
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
Total	29,085,273	4,772,719	8,122,218	904,303	15,286,033
Interest-bearing liabilities					
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	-	-	-
Total	12,375,608	1,392,900	10,800,816	21,514	160,378
Interest-bearing assets/liability gap	16,709,665	3,379,819	(2,678,598)	882,789	15,125,655

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 are 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 parallel shifts in the yield curves of the relevant assets, is as follows:

(BGN'000)

	100 b.p. instant parallel increase	100 basis points parallel decrease	50 b.p. parallel increase in the beginning of the period	50 basis points parallel decrease in the beginning of the period
As of 31 December 2013	(228,912)	228,912	64,204	53,969
As of 31 December 2012	(230,899)	230,899	30,313	27,870

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 pegging 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 minimize currency risk, there is a limit to the mismatches between the currency structure of assets and that of liabilities. According to Article 31, paragraph 3 of the Law on the BNB, the total market value of assets in a 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 2013	31 December 2012
Assets		
Bulgarian lev and euro	24,941,471	26,120,887
US dollar	7,468	29,355
Japanese yen	36	131
Pound sterling	267	232
SDR	2,757,605	2,876,171
Gold	2,197,242	3,162,928
Other	3,188	2,649
	29,907,277	32,192,353
Liabilities, Capital and Reserves		
Bulgarian lev and euro	27,235,293	29,384,535
US dollar	7,671	29,235
Japanese yen	-	-
Pound sterling	16	3
SDR	2,661,050	2,775,978
Other	3,247	2,602
	29,907,277	32,192,353
Net position		
Bulgarian lev and euro	(2,293,822)	(3,263,648)
US dollar	(203)	120
Japanese yen	36	131
Pound sterling	251	229
SDR	96,555	100,193
Gold	2,197,242	3,162,928
Other	(59)	47

(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. The availability of actual market prices and information varies depending on products and markets and changes because of specific events and the general conditions of financial markets. The Bank determines the fair values of all other financial instruments for which there are no current market quotes by using 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: checking the actual price information; 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
31 December 2013			
Cash and deposits in foreign currency	6,318,854	-	6,318,854
Gold, instruments in gold and other precious metals	2,228,481	-	2,228,481
Financial assets at fair value through profit or loss	19,164,306	459,620	19,623,926
Total	27,711,641	459,620	28,171,261
31 December 2012			
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
Total	30,286,918	97,796	30,384,714

Financial instruments not measured at fair value, but by applying a level of the fair value hierarchy where a fair value measurement is categorised, are analysed in the table below:

(BGN'000)

	Level 1 Quoted market prices on active markets	Level 2 Observable inputs other than quoted prices	Total
31 December 2013			
Due to banks and other financial institutions	-	7,063,410	7,063,410
Liabilities to government institutions and other borrowings	-	5,905,707	5,905,707
Borrowings against Bulgaria's participation in international financial institutions	-	2,659,865	2,659,865
Total	-	15,628,982	15,628,982
31 December 2012			
Due to banks and other financial institutions	-	7,845,160	7,845,160
Liabilities to government institutions and other borrowings	-	6,952,197	6,952,197
Borrowings against Bulgaria's participation in international financial institutions	-	2,775,165	2,775,165
Total	-	17,572,522	17,572,522

The fair value of due to banks and other financial institutions and of liabilities to government institutions is approximately equal to the reporting value as they are short-term.

The fair value of the liabilities for participation in international financial institutions is approximately equal to their reporting value as they are interest-free and of no definite maturity.

7. Interest Income and Expense

(BGN'000)

	2013	2012
Interest income		
– securities	427,772	407,822
– deposits	7,542	12,777
– other	2	2
	<u>435,316</u>	<u>420,601</u>
Interest expense		
– deposits	1,201	1,931
– other	-	-
	<u>1,201</u>	<u>1,931</u>

Interest paid on foreign currency government deposits as at 31 December 2013 is BGN 2 thousand.

Interest paid on foreign currency deposits of other organisations as at 31 December 2013 is BGN 107 thousand.

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

(BGN'000)

	2013	2012
Net (losses) from operations in securities	(357,056)	(232,416)
Net gains from operations in foreign currency	386	465
Net revaluation gains on futures	0	266
Net revaluation (losses)/gains on securities	(19,287)	134,869
Net revaluation (losses)/gains on foreign currency assets and liabilities	(3,220)	(1,392)
Net revaluation (losses)/gains on gold	(982,912)	108,420
	<u>(1,362,089)</u>	<u>10,212</u>

Net losses from financial assets and liabilities carried at fair value through profit or loss as at 31 December 2013 with the largest loss from gold revaluation of BGN 982,912 thousand resulting from the drastic fall in the price of gold. The market price of gold determined based on the London Bullion Market fixing in euro fell by 30.6 per cent from BGN 2463.73 per troy ounce as at 31 December 2012 down to BGN 1708.92 as at 31 December 2013.

The primary factor behind the net losses from securities transactions of BGN 357,056 thousand and from securities revaluation of BGN 19,287 thousand was the significant increase (between 6 and 77 basis points across sectors and issuers) of the market yield on the securities in which the BNB invests, leading to a fall in their prices. An additional contributing factor is that the market yield on securities is still behind its coupon yield, therefore they are sold at a premium above their par value.

9. Other Operating Income

(BGN'000)

	2013	2012
Income from subsidiaries	31,620	36,603
Income from associated companies	145	325
Income from sale of coins	901	735
Dividend income	8,796	8,621
Other income, net	3,602	1,124
	<u>45,064</u>	<u>47,408</u>

Dividend income includes dividends from BNB's participation in BIS Basle amounting to BGN 5696 thousand and from BNB's participation in BORICA–Bankservice of BGN 3100 thousand.

10. Total Administrative Expenses

(BGN'000)

	2013	2012
Personnel costs	31,839	31,298
Administrative expenses	40,762	46,538
Depreciation	22,828	24,667
Other expenses	3,740	3,825
	<u>99,169</u>	<u>106,328</u>

Personnel costs include salaries, social and health insurance costs charged under the local legislation provisions as of 31 December 2013, and social activities costs, respectively for the BNB: BGN 24,139 thousand, for the Printing Works of the BNB Corp.: BGN 4808 thousand, and for the Bulgarian Mint EAD BGN 2892 thousand. The number of employees of the Bank and its subsidiaries is 1170 as of 31 December 2013 (31 December 2012: 1237), including the BNB staff of 869 as of 31 December 2013 (31 December 2012: 874).

Based on actuarial calculations, the Bank has accrued compensation liabilities for personnel on retirement and for unused paid annual leave at BGN 343 thousand (31 December 2012: BGN 492 thousand). The retirement and unused paid annual leave compensation for the Bank's subsidiaries as of 31 December 2013 are BGN 122 thousand (31 December 2012: BGN 134 thousand).

Administrative expenses include the BNB's currency circulation expenses of BGN 9604 thousand for the as of 31 December 2013 (31 December 2012: BGN 11,866 thousand).

11. Cash and Deposits in Foreign Currencies

(BGN'000)

	31 December 2013	31 December 2012
Cash in foreign currencies	19,363	61,274
Current accounts in other banks	1,945,825	3,708,545
Deposits in foreign currencies	4,353,666	5,606,348
	<u>6,318,854</u>	<u>9,376,167</u>

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

(BGN'000)

	31 December 2013	31 December 2012
Euro area residents		
In EUR	2,717,094	4,988,011
In other currencies	1	2
	<u>2,717,095</u>	<u>4,988,013</u>
Non-euro area residents		
In EUR	2,254,172	2,969,733
In other currencies	1,347,587	1,418,421
	<u>3,601,759</u>	<u>4,388,154</u>
	<u>6,318,854</u>	<u>9,376,167</u>

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

	31 December 2013		31 December 2012	
	'000 troy ounces	BGN'000	'000 troy ounces	BGN'000
Gold bullion in standard form	513	876,749	513	1,263,999
Gold deposits in standard form	773	1,320,493	771	1,898,930
Gold in other form	16	27,563	16	39,882
Other precious metals		3,676		4,543
		<u>2,228,481</u>		<u>3,207,354</u>

Gold in standard form includes gold held for safekeeping with a depository and deposits. Deposits in gold are held with banks whose liabilities are rated with one of the two highest ratings given by two internationally recognised rating agencies and bear interest between 0.07 per cent and 0.35 per cent annually.

Gold in other form includes commemorative gold coins of BGN 23,275 thousand.

Other precious metals include silver commemorative coins of BGN 561 thousand and platinum commemorative coins of BGN 3115 thousand.

13. Financial Assets at Fair Value through Profit or Loss

(BGN'000)

Securities at fair value through profit or loss	31 December 2013	31 December 2012
Foreign treasury bills, notes and bonds	19,623,926	17,801,193
	<u>19,623,926</u>	<u>17,801,193</u>

Securities comprise both coupon and discount securities denominated in euro. The maximum coupon interest of the EUR-denominated securities was 2.41 per cent in 2013 (31 December 2012: 2.43 per cent).

As at 31 December 2013 there were no securities pledged as collateral on futures transactions

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

(BGN'000)

Investment graded securities by the emission/ issuer credit rating	Issuer's credit rating	31 December 2013	31 December 2012
	AAA	14,491,901	15,329,029
	AA+	1,506,276	554,126
	AA	229,419	322,808
	AA-	2,627,478	1,492,674
	A+	587,776	81,710
	A	181,076	20,846
		<u>19,623,926</u>	<u>17,801,193</u>

14. Financial Assets Available for Sale

(BGN'000)

	31 December 2013	31 December 2012
Republic of Bulgaria's quota in the IMF	1,399,023	1,459,765
Equity investments in international financial institutions	28,751	29,693
Investments in Associates	26,397	26,251
	<u>1,454,171</u>	<u>1,515,709</u>

The Republic of Bulgaria's quota in the IMF is SDR 640,200 thousand. BGN 74,521 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 0.08 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 2013 the current value of 10,000 thousand shares in SDR amounts to BGN 21,853 thousand while as of 31 December 2012 it was BGN 22,802 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 2013, with the Croatian National Bank joining the ESCB, a change was made in the ECB capital whereby the BNB contribution to the ECB's capital was increased as of 31 December 2013 to EUR 3509 thousand or BGN 6863 thousand.

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

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

Associated companies	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

15. Tangible Assets

(BGN'000)

	Land and buildings	Plant and equipment	IT equipment	Office equipment	Other equipment (including motor vehicles)	Tangible assets in progress	Total
As of 1 January 2013	184,256	113,635	37,397	9,538	6,695	13,059	364,580
Additions	1,375	11,835	19	29	8	5,517	18,783
Disposals	(4,601)	(39,801)	(399)	(49)	(25)	(10,931)	(55,806)
Transfers	83	465	4,592	240	-	(5,380)	-
As of 31 December 2013	181,113	86,134	41,609	9,758	6,678	2,265	327,557
Depreciation and Impairment loss							
As of 1 January 2013	(28,677)	(71,917)	(28,901)	(6,014)	(5,513)	-	(141,022)
Charge for the period	(5,729)	(8,051)	(4,691)	(877)	(325)	-	(19,673)
On disposals	761	21,974	399	48	24	-	23,206
As of 31 December 2013	(33,645)	(57,994)	(33,193)	(6,843)	(5,814)	-	(137,489)
Net book value as of 31 December 2013	147,468	28,140	8,416	2,915	864	2,265	190,068
Net book value as of 31 December 2012	155,579	41,718	8,496	3,524	1,182	13,059	223,558

In applying IAS 16 Property, Plant and Equipment and BNB's Internal Rules for Financial Statements and Accounting Policy, as of December 2013 a review was made of the book value of tangible fixed assets stated in the Bank's balance sheet. The fair value of land and buildings was determined by an external, independent and licensed assessor of recognised professional qualification and experience in assessing property of location and category similar to the assessed ones. As of 31 December 2013, the fair value of land and buildings did not differ materially from their book value as at the same date; therefore it is considered that the present book value of land and buildings on the Bank's balance sheet fairly reflects their market value. The fair value of land and buildings is categorised as Level-3 fair value based on the input data for the given assessment technique.

For the remaining asset classes Plant and Machinery, Equipment, Vehicles, Fixtures and Fittings, the fair value is considered to be their present value on the Bank's balance sheet as most of them were bought in the last four years and their book value is close to their fair value.

When revaluating tangible fixed assets the Bank derecognises the accrued depreciation at the expense of the gross book value of the assets and their net value is recalculated against the revalued amount.

(BGN'000)

	Land and buildings	Plant and equipment	IT equipment	Office equipment	Other equipment (including motor vehicles)	Tangible assets in progress	Total
As of 1 January 2012	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
Depreciation and Impairment loss							
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)
Net book value as of 31 December 2012	155,579	41,718	8,496	3,524	1,182	13,059	223,558
Net book value as of 31 December 2011	161,547	47,126	8,638	4,000	1,565	2,343	225,219

16. Intangible Assets

(BGN'000)

	Software	Other intangible assets	Development costs	Total
As of 1 January 2013	44,265	152	-	44,417
Additions	-	8	1508	1,516
Disposals	(33)	-	-	(33)
Transfers	1,374	1	(1375)	-
As of 31 December 2013	45,606	161	133	45,900
Depreciation and Impairment loss				
As of 1 January 2013	(37,948)	(101)	-	(38,049)
Charge for the period	(3,128)	(27)	-	(3,155)
On disposals	33	-	-	33
As of 31 December 2013	(41,043)	(128)	-	(41,171)
Net book value as of 31 December 2013	4,563	33	133	4,729
Net book value as of 31 December 2012	6,317	51	-	6,368

Software includes, as of 31 December 2013, licenses purchased by the BNB to the total amount of BGN 1017 thousand (31 December 2012: BGN 995 thousand), and software products to the amount of BGN 473 thousand (31 December 2012: BGN 1823 thousand).

(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
Depreciation and Impairment loss				
As of 1 January 2012	(33,717)	-	-	(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)
Net book value as of 31 December 2012	6,317	51	-	6,368
Net book value as of 31 December 2011	7,609	78	-	7,687

Software includes, as of 31 December 2012, licenses acquired 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).

17. Other Assets

(BGN'000)

	31 December 2013	31 December 2012
Cash held by subsidiaries with local banks	49,386	40,964
Investments of subsidiary undertakings in joint ventures and associates	19,034	-
Commemorative coins for sale	359	353
Inventories	14,143	15,581
Accounts receivable	2,091	2,762
Deferred charges	1,235	1,712
Other receivables	800	632
	87,048	62,004

Cash held by subsidiaries with local banks comprise BGN 40,955 thousand of Printing Works of the BNB Corp. and BGN 8431 thousand of Bulgarian Mint EAD.

Investments of subsidiary undertakings in joint ventures and associates include a non-monetary contribution in the form of banknote production equipment to the capital of François-Charles Oberthur Group with which Printing Works of the BNB Corp. has established a joint venture for banknote production.

18. Banknotes and Coins in Circulation

(BGN'000)

	31 December 2013	31 December 2012
Banknotes in circulation	10,041,360	9,354,746
Coins in circulation	212,362	195,175
	10,253,722	9,549,921

19. Due to Banks and Other Financial Institutions

(BGN'000)

	31 December 2013	31 December 2012
Demand deposits from banks and other financial institutions		
- in BGN	4,868,900	5,082,592
- in foreign currency	2,194,510	2,762,568
	<u>7,063,410</u>	<u>7,845,160</u>

The Bank does not pay interest on demand deposits from banks and other financial institutions. Demand deposits include BGN 5,329,979 thousand representing the required reserves, which all local banks are required to maintain on accounts with the BNB (31 December 2012: BGN 5,007,673 thousand).

20. Liabilities to Government Institutions and Other Liabilities

(BGN'000)

	31 December 2013	31 December 2012
Current accounts:		
- in BGN	1,043,314	1,742,186
- in foreign currency	1,461,382	2,072,463
Time deposit accounts:		
- in BGN	2,983,000	2,684,000
- in foreign currency	418,011	453,548
	<u>5,905,707</u>	<u>6,952,197</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. The government deposits in euro and in leva bear 0.00 per cent interest.

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

The borrowings against Bulgaria's participation in the IMF as of 31 December 2013 amount to BGN 1,321,004 thousand: SDR 604,475 thousand (as of 31 December 2012: BGN 1,385,694 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 and account No 2 of the IMF in leva amounting to BGN 3689 thousand (as of 31 December 2012: BGN 3721 thousand).

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

22. Other Liabilities

(BGN'000)

	31 December 2013	31 December 2012
Funds of EU institutions and bodies	84,300	80,678
Salaries and social security payable	3,262	2,430
Deferred income	1,474	1,052
Other liabilities	54,234	16,588
	<u>143,270</u>	<u>100,748</u>

'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 2013 the funds on these accounts were BGN 84,296 thousand. The Bank opened accounts with the European

Investment Bank (EIB) for the purposes of a financial arrangement between the Government of the Republic of Bulgarian and the EIB with the funds on these accounts amounting to BGN 4 thousand as of 31 December 2013.

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 comprises 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.

As of 31 December 2013 profit distribution in accordance with the profit distribution policy disclosed in note 5 (h) is as follows:

(BGN'000)

	2013	2012
(Loss)/Profit for the period	(977,171)	371,910
Allocation to special reserve under Article 36 of the Law on the BNB:		
Unrealised loss/(gains) from gold revaluation	982,912	(108,420)
Unrealised loss/(gains) from revaluation of financial assets at fair value through profit or loss	75,761	(120,042)
Unrealised foreign currency valuation loss	3,220	1,392
Other unrealised (gains)	-	(266)
Result after allocation to special reserve	84,722	144,574
incl.		
Allocation to Reserve Fund under Article 8 of the Law on the BNB	20,766	35,278
Result from consolidation and non-controlling interest	1,656	3,462
Allocation to a special-purpose fund under Article 8 of the Law on the BNB	-	-
Planned contribution to the state budget	62,300	105,834

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 2013	31 December 2012
Gross international reserves		
Cash and deposits in foreign currencies	6,318,854	9,376,167
Monetary gold and other instruments in gold	2,197,242	3,162,928
Security investments	19,623,926	17,801,193
Equity investments and quota in the IMF	74,521	77,757
	28,214,543	30,418,045
Monetary liabilities		
Currency in circulation	10,253,722	9,549,921
Due to banks and other financial institutions	7,063,308	7,843,045
Liabilities to government institutions	4,418,743	5,811,193
Other liabilities	1,571,366	1,223,797
	23,307,139	24,427,956
Surplus of gross international reserves over monetary liabilities	4,907,404	5,990,089

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 2013, 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 2013, the par value of the government securities held in custody was BGN 6290 million (31 December 2012: BGN 4981 million).

27. Subsidiaries

(per cent)

Ownership interest	31 December 2013	31 December 2012
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 540 thousand from the Bulgarian Mint EAD (31 December 2012: BGN 736 thousand) and BGN 971 thousand from the Printing Works of the BNB Corp (31 December 2012: BGN 2401 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 2013 is BGN 65,559 thousand (31 December 2012: BGN 68,405 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 1,364,763 thousand.

(iii) Capital commitments

As of 31 December 2013 the Bank has committed to BGN 465 thousand to purchase non-current assets (31 December 2012: BGN 184 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 Occurred 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 2013

31 January	The BNB Governing Council awarded the BNB scholarships for 2013.
21 February	<p>The BNB Governing Council adopted Ordinance on Amendment to BNB Ordinance No 18 on the Control over Quality of Banknotes and Coins in Cash Circulation.</p> <p>The BNB Governing Council approved an amendment to the RINGS Tariff.</p> <p>As of 25 March 2013 the Bulgarian National Bank put into circulation a partially gold-plated silver commemorative coin 'Tsar Samuil' of the 'Medieval Bulgarian Rulers' series with a nominal value of BGN 10, issue 2013.</p>
19 March	The BNB Governing Council approved the Report on the BNB Budget Implementation as of 31 December 2012.
9 April	As of 20 May 2013 the Bulgarian National Bank put in circulation a gold commemorative coin 'St. Constantin and St. Helena' of the 'Bulgarian Iconography' series with a nominal value of BGN 100, issue 2013.
25 April	The BNB Governing Council approved the BNB Annual Report for 2012.
6 June	The BNB Governing Council approved the Report on Budget Implementation of Administrative Expenditure of the Bulgarian Deposit Insurance Fund for 2012.
27 June	As of 29 July 2013 the Bulgarian National Bank put in circulation a silver commemorative coin '110th Anniversary of the Ilinden-Preobrazhenie Uprising' with a nominal value of BGN 10, issue 2013.
17 September	<p>The BNB Governing Council approved the Report on the BNB Budget Implementation as of 30 June 2013.</p> <p>As of 14 October 2013 the Bulgarian National Bank put in circulation a copper commemorative coin '110 Years since the Birth of Zlatyu Boyadzhiev' of the 'Bulgarian Artists' series with a nominal value of BGN 2, issue 2013.</p>
31 October	<p>Ordinance on Amendment to Ordinance No 5 of 2007 of the Ministry of Finance and the BNB on the Terms and Procedure for Acquisition, Registration, Redemption and Trade in Government Securities was adopted.</p> <p>Ordinance on Amendment to BNB Ordinance No. 31 of 2007 on Government Securities Settlement was adopted.</p> <p>A new Tariff of Fees and Commissions Charged on Processing Government Securities Transactions, in force from the date of enforcement of the Ordinance on Amendment to Ordinance No 5 of the Ministry of Finance and the BNB and the Ordinance on Amendment to BNB Ordinance No. 31 was adopted.</p> <p>As of 18 November 2013 the Bulgarian National Bank put into circulation a silver commemorative coin 'Bachkovo Monastery' of the 'Bulgarian Churches and Monasteries' series with a nominal value of BGN 10, issue 2013.</p>

- 14 November** The BNB Governing Council approved the Report of the Bulgarian National Bank for the January–June 2013 period.
- The budget of the Bulgarian National Bank for 2014 was approved.
- 27 November** As of 13 December 2013 the Bulgarian National Bank put in circulation a copper commemorative coin '90 Years since the Birth of Apostol Karamev' of the 'Bulgarian Artists' series with a nominal value of BGN 2, issue 2013.
- 17 December** The BNB Governing Council approved the Report on Budget Implementation of Administrative Expenditure of the Bulgarian Deposit Insurance Fund for 2014.