

# BULGARIAN NATIONAL BANK



## ANNUAL REPORT • 2020 OF THE BANKS RESOLUTION FUND

Пансий Хилендарски 1722-1773



ПАНИЈАТИЈАХА КОГАТО ГИМЕ  
СПОНЗОРА БУЕШТА БАТАРСКОЕ  
ЛОГОТИТЕ ЗАПАЗАСТАН РЪДНА РАЗНА  
ПРЕТНЕСИТЕ ИСТОРИЈАХЕТО И ПЛАТИТЕ  
НЕТИВАМИ ПРЕТИХАТИ ПОЛУМИТИ  
ТИСАТИ ИМЕНТЕТО НАСЕНЕ ПОТЪДИ  
ПАНСИЈА ПРОИЗЛЕЧЕНА  
ХИЛЕНДАРСКА





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# Contents

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Summary.....	5
I. Economic Activity in 2020.....	8
1. External Environment.....	8
2. Economic Activity in Bulgaria.....	11
3. Condition of the Banking System.....	16
II. Scope and Allocation of Powers Concerning BRF Activities.....	20
1. Until the Entry into Force of the ECB Decision on the Establishment of Close Cooperation (August 2015–July 2020).....	20
1.1. Sources of Funding.....	20
1.2. Determination of Annual and Extraordinary Contributions.....	21
1.3. Use of the BRF Financial Means.....	21
1.4. Investment of the BRF Financial Means.....	22
2. Following the ECB Decision on the Establishment of Close Cooperation, in Force as of July 2020.....	22
2.1. Sources of Funding.....	23
2.2. Determination of Annual and Extraordinary Contributions.....	24
2.3. Use of the BRF Financial Means.....	25
2.4. Investment of the BRF Financial Means.....	26
III. Key Indicators of BRF Performance in 2020.....	28
1. Contributions in 2020.....	28
2. Transfer of the BRF Financial Means from the BDIF to the BNB.....	28
3. Transfer of the Initial Contribution of the Republic of Bulgaria from the Sub-fund for Contributions to the SRF towards the SRF.....	28
4. Investment of the BRF Financial Means.....	30
5. Use of the BRF Financial Means.....	31
6. Financial Means Available in the BRF Sub-funds as of 31 December.....	31
IV. Organisation of the Operational Implementation of the BRF-Related Activities at the BNB and Participation in the SRB Structures.....	32
1. Units Assisting the BNB Governing Council in Relation to the BRF Management Function.....	32
2. Participation in the Single Resolution Board.....	33
V. Events Occurred after the Date of the Financial Statements.....	34
VI. Projected Future Developments.....	35
VII. Financial Statements as of 31 December 2020.....	36

## List of Abbreviations

ABB	Association of Banks in Bulgaria
BDIF	Bulgarian Deposit Insurance Fund
BNB	Bulgarian National Bank
BRF	Banks Resolution Fund
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EIB	European Investment Bank
ESM	European Stability Mechanism
EU	European Union
GDP	Gross Domestic Product
GS	Government Securities
HICP	Harmonised Index of Consumer Prices
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
LBNB	Law on the BNB
LRRCIIF	Law on the Recovery and Resolution of Credit Institutions and Investment Firms
NGEU	Next Generation EU
NSI	National Statistical Institute
NSSI	National Social Security Institute
PEPP	Pandemic Emergency Purchase Programme
RCI	Resolution of Credit Institutions
SRB	Single Resolution Board
SRF	Single Resolution Fund
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
SURE	Support to mitigate Unemployment Risks in an Emergency
TLTRO	Targeted Longer-Term Refinancing Operations

## Summary

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The Banks Resolution Fund (the BRF, the Fund) was established under the Law on the Recovery and Resolution of Credit institutions and Investment Firms (LRRCIIF)<sup>1</sup> with the aim of ensuring a resolution financing mechanism for credit institutions and branches of third-country credit institutions for which the Bulgarian National Bank (BNB) is a resolution authority within the meaning of Article 2 of the LRRCIIF.

The BRF is established as a special-purpose fund. BRF financial means are raised through contributions from the banking system, intended solely to provide financing for resolution actions and to limit, to the maximum extent possible, the use of public funds.

International economic developments have an impact on the economic activity in Bulgaria, which is a determining factor for banking system performance and thereby for BRF activities in setting the total amount of annual contributions by credit institutions and in taking decisions on resolution actions and use of BRF financial means, as well as on decisions related to the management of BRF financial means – through the price of financial assets in which BRF financial means are invested.

In 2020 the global economy faced a period of recession as a result of the unprecedented anti-epidemic measures to contain the spread of the COVID-19 pandemic. In the first half of the year the central banks and the governments in both the USA and the euro area initiated large-scale monetary and fiscal policy measures to support their economies. Over the second half of the year economic activity started to recover. The increased uncertainty about the economic implications of the anti-epidemic containment measures led to a significant volatility in global financial markets. Yields and interest rates of all asset classes in which BRF financial means can be invested declined throughout the year.

The spread of COVID-19 and global containment measures in 2020 caused significant negative effects on economic activity in Bulgaria, which decreased by 4.2 per cent from the previous year. At the same time, employment declined less significantly than real GDP, which was a result of the social and economic measures of the government in response to the COVID-19 pandemic. By end-2020 consumer price inflation slowed down essentially from December 2019 to 0.0 per cent on an annual basis, reflecting mainly decreased prices of energy products.

Despite the strongly worsened macroeconomic environment in 2020, Bulgaria's banking system retained its robust liquidity position, with capital ratios remaining

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<sup>1</sup> Effective as of 14 August 2015; Darjaven Vestnik, issue 62 of 2015.

at levels significantly higher than regulatory requirements. This reflected available capital buffers accumulated before the economic shock, the BNB measures to further strengthen banks' capital and liquidity and regulatory relief introduced by Regulation (EU) 2020/873<sup>3</sup> (so-called CRR – Capital Requirements Regulation – 'quick fix'). The effects of the economic environment deterioration on the quality of bank credit portfolios were largely contained by the Procedure for Deferral and Settlement of Liabilities Payable to Banks and Their Subsidiaries – Financial Institutions<sup>4</sup> adopted by the BNB Governing Council based on the proposal of the Association of Banks in Bulgaria. As of December 2020 the gross balance sheet value of approved applications for deferral of liabilities – subject to the non-legislative moratorium – in relation to the total credit exposure was 6.6 per cent for households and 16.7 per cent for corporations.

In 2020 the Fund operated under two different legal frameworks for making and implementing decisions on its management. Until the date on which the ECB decision on the establishment of close cooperation<sup>5</sup> becomes applicable – 27 July 2020 – the BRF was managed by the Bulgarian Deposit Insurance Fund (BDIF). With effect from 27 July 2020, Fund management is performed by the BNB. Under the new management model, the Fund retains its separateness, including for the purposes of its management and accounting. The BNB prepares separate annual financial statements of the BRF, subject to an independent financial audit and publication in the *Darjaven Vestnik*.

At the beginning of 2020 the BNB set the total amount of annual contributions of credit institutions licensed in Bulgaria to the BRF along with the individual amount of each credit institution's contribution for 2020 in accordance with the legal framework in force at that time. At the end of May 2020, after the transfer by credit institutions of contributions for 2020 within the set deadline, the BRF financial means reached BGN 701,930 thousand.

On 27 July 2020, in line with the changes in the legal framework following the ECB decision, all accumulated financial means in the BRF were transferred by the BDIF to the BNB. Subsequently, in accordance with the requirements of Article 134, paragraph 1 of the LRRCIIF, the financial means were split into two dedicated sub-

<sup>2</sup> For the purposes of this Report, the concepts of 'banks' and 'credit institutions' are used as synonyms.

<sup>3</sup> Regulation (EU) 2020/873 of the European Parliament and of the Council of 24 June 2020 amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards certain adjustments in response to the COVID-19 pandemic.

<sup>4</sup> It represents a non-legislative moratorium within the meaning of EBA Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis (EBA/GL/2020/02).

<sup>5</sup> Decision (EU) 2020/1015 of 24 June 2020 of the European Central Bank on the establishment of close cooperation between the European Central Bank and Българска народна банка (Bulgarian National Bank) (ECB/2020/30) within the meaning of Article 2, item 1 of Regulation (EU) No 1024/2013.

funds: a sub-fund for branches of third-country credit institutions and a sub-fund for contributions to the Single Resolution Fund (SRF). On 5 October 2020, in relation to joining the Single Resolution Mechanism (SRM) as a direct consequence of the establishment of close cooperation with the ECB, the BNB transferred the initial contribution of the Republic of Bulgaria to the SRF, as determined by the Single Resolution Board (SRB).

In 2020 the BNB did not exercise any resolution powers, hence, no BRF funds were spent on resolution actions in respect of a credit institution within the BNB powers. The latter is a result of the sound capital and liquidity position of credit institutions licensed in Bulgaria, which preserved them from endangering of their performance despite the unprecedented economic shock caused by the measures to contain the COVID-19 pandemic.

This Report presents the BNB functions and tasks related to the Fund management. It provides an annual review of the BRF development and performance in the context of the international environment, economic activity in Bulgaria and the condition of the banking system. The Report contains also all components of the BRF financial statement as of 31 December 2020, presenting its assets and financial position, cash flows and financial performance, along with the report of the independent auditor.

The Annual Report of the Banks Resolution Fund for 2020 was adopted by the BNB Governing Council by Resolution No 77 of 30 March 2021.



## I. Economic Activity in 2020

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### 1. External Environment

In 2020 the global economy faced a period of recession as a result of the unprecedented anti-epidemic measures to contain the COVID-19 pandemic. In the first two quarters a significant GDP decline was observed in real terms in both advanced and developing market economies. Initially, China's economy was most severely affected due to the world's first COVID-19 outbreak. Subsequently, the disease has spread rapidly in Europe, the United States and other countries all over the world. Private consumption and, to a lesser extent, fixed capital investment contributed largely to the GDP decline, reflecting initiated containment measures and the significant uncertainty surrounding the development of the pandemic and the duration and size of its negative effects on the economic environment. As a result of the measures to contain the spread of the disease, US labour market underwent the largest historical negative shock, while programmes encouraging employment launched in the euro area mitigated partially the negative effects of the COVID-19 crisis. Global inflation slowed down substantially due to falling prices of goods and services in developed economies, reflecting the strong decline in energy prices caused by weak demand for fuels amid stringent social distancing and restricted movement measures.

Governments and central banks in the US and the euro area initiated large-scale monetary and fiscal policy measures to support their economies. Monetary policy measures were intended to enhance liquidity and ensure favourable financing conditions for governments, banks, corporations and households. Reflecting the rapid escalation of the crisis at end-February and March, most of monetary policy measures were adopted at extraordinary meetings of central banks' managements.

The US Federal Reserve initiated a number of extraordinary monetary policy measures and lowered the target range for the federal funds rate by 150 basis points to 0.00–0.25 per cent. The extraordinary monetary policy measures included both a resumption of programmes applied for the last time during the financial crisis in 2008–2009 and introduction of entirely new programmes to support corporate debt markets. Additional fiscal spending in the US was also significant and led to an increase in the budget deficit during the fiscal 2020 year to 14.9 per cent of GDP compared to a deficit of 4.6 per cent of GDP in 2019. US public debt rose from 79.2 per cent of GDP in 2019 to 100.0 per cent of GDP in 2020.

The ECB Governing Council left unchanged euro area interest rates<sup>6</sup>, but increased significantly asset purchases mainly under the newly established Pandemic

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<sup>6</sup> The deposit facility rate was -0.50 per cent, while interest rates on main refinancing operations stayed at 0.00 and the marginal lending facility rate at 0.25 per cent.

Emergency Purchase Programme (PEPP) and Targeted Longer-term Refinancing Operations (TLTRO III) whose conditions have improved considerably. In addition, the ECB swap lines established with the Federal Reserve System were activated in order to ensure US dollar liquidity in the euro area, and a number of temporary supervisory measures were launched, allowing euro area banks to use part of their capital and liquidity buffers.

In March 2020 the European Commission adopted a Temporary Framework<sup>7</sup> to enable Member States to use the full flexibility foreseen under State aid rules and activated the general escape clause of the EU fiscal framework as part of the Stability and Growth Pact allowing for a temporary deviation from the normal budget requirements for all Member States and supporting economies in a situation of COVID-19 epidemic. In April the Economic and Financial Affairs Council (ECOFIN) of the European Union reached agreement on joint financing by the European Commission, the European Investment Bank and the European Stability Mechanism of a package of measures composed of three immediate safety nets for workers, businesses and Member States allowing for loans and guarantees worth EUR 540 billion. The EC instrument – Support to mitigate Unemployment Risks in an Emergency, SURE – provides for financial assistance up to EUR 100 billion in the form of loans from the EU to affected Member States to address sudden increases in public expenditure for the preservation of employment. The EIB instrument envisages creation of a new Pan-European Guarantee Fund with contributions by EU Member States to the amount of EUR 25 billion each, which will provide guarantees for mostly small and medium-sized European companies, mobilizing up to EUR 200 billion of additional financing. At the same time, the Pandemic Crisis Support instrument provides a combined volume of EUR 240 billion in credit lines to euro area countries, or up to 2 per cent of each Member's GDP for 2019. In addition, a Recovery Plan for Europe, worth EUR 1.8 trillion, was agreed in July, including a multiannual financial framework for 2021–2027 along with the Next Generation EU fund – NGEU – for EUR 750 billion.<sup>8</sup> Governments of individual Member States made significant additional spending in 2020 which led to essential growth in budget deficits and debts.<sup>9</sup>

The undertaken fiscal and monetary measures, together with reduced disease incidence in the countries of the northern hemisphere during summer months of 2020 had a favourable effect on their economies, with robust growth in global economic activity reported in the third quarter.

<sup>7</sup> Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak (2020/C 91 I/01).

<sup>8</sup> The key element of the NGEU is the Recovery and Resilience Facility, worth EUR 672.5 billion, of which EUR 360 billion in the form of loans and EUR 312.5 billion in grants.

<sup>9</sup> According to the European Commission's November 2020 forecast, the euro area budget deficit will increase from 1.3 per cent of GDP in 2019 to 4.8 per cent of GDP in 2020, with the consolidated government debt to GDP ratio rising from 85.9 per cent in 2019 to 101.7 per cent of GDP in 2020.

The recovery in global economic activity continued over the fourth quarter despite the significant increase in COVID-19 cases and deaths in some of major countries with developed markets. The recovery was more pronounced in manufacturing, driven by its dynamics in large emerging market economies, mainly China, reporting lower incidence, as well as by developments in the US, irrespective of reintroduced containment measures on the back of a spike in COVID-19 infections over the review period. Preliminary estimates show that, unlike the US where real GDP quarterly growth was 1.0 per cent in the fourth quarter, euro area recorded a 0.7 per cent decline in GDP, largely due to the contraction of economic activity in the services sector, as the second wave of COVID-19 led to retightening of the containment measures. Concurrently, labour market conditions improved, but overall, unemployment and employment indicators in leading economies remained at levels quite different from pre-crisis ones. Inflation in developed economies stabilised on an annual basis at levels close to zero, reflecting comparatively weak household consumption amid persistently high uncertainties about employment prospects and temporary cuts of indirect taxes in some countries.

Over the last quarter of 2020 the US Federal Reserve System made no changes, while confirming maintenance of its accommodative monetary policy over a longer horizon. At the same time, downward inflation dynamics and a deteriorating economic environment in the euro area in the last months of 2020 were among the main motivations for the ECB Governing Council to initiate additional stimulating monetary policy measures aiming to retain favourable financing conditions in the economy. These measures involved an extended duration and increased volumes of purchases under the new PEPP, as well as further improvements in TLTRO III conditions.

The increased uncertainty surrounding the economic effects of the measures to contain the spread of COVID-19 caused a very high volatility in global financial markets. In the period from mid-January to mid-March, market participants responded to the emerging crisis through enhanced demand for low risk assets, such as gold and government securities issued by countries with the highest credit ratings, and sales of shares which led to a significant decline in global stock exchange indices. In mid-March 2020 financial markets were marked by an extremely high volatility caused by the uncertainty regarding the implications of the measures against COVID-19 on the financial stability worldwide. Market participants increased strongly their demand for available liquid funds, resulting in mass sales of all types of assets, including shares, fixed income securities, precious metals and raw materials. Subsequently, the large-scale expansionary monetary and fiscal measures launched globally from March to the end of 2020 contributed largely to the decline in the financial market uncertainty and the recovery of financial asset prices. By end-year most US and euro area stock indices reached their historical highs.

The increased excess of liquidity in the banking system of the euro area following ECB's accommodative monetary policy measures was the main factor for the fall in money market rates. In 2020 the average value of the euro unsecured overnight rate, €STR, declined to -0.55 per cent, from -0.48 per cent in 2019. Deposit rates in the interbank money market in the euro area (EURIBOR) increased significantly in March and April 2020, falling thereafter to levels below the average value for 2019. The average one-month deposit rate was -0.50 per cent (down by 10 basis points *vis-à-vis* the average value for 2019).

In 2020 German sovereign bond yields decreased across all maturities sectors, more pronounced in long-term government securities. German government bond yields with a two-year residual term dropped by 10 basis points to -0.70 per cent, with ten-year yields falling by 38 basis points to -0.57 per cent. By year's end, all German government bonds were traded at negative yields. The yield curve slope measured by the difference between ten and two-year bond yields decreased by 29 basis points to 13 basis points. Government bond yield spreads of euro area core and periphery countries expanded sharply in the first quarter of 2020 due to the spread of COVID-19 in Europe, followed by gradual and sustainable narrowing over the remainder of the year under the influence of ECB monetary policy stimuli and the agreement reached on the EU recovery fund.

Yield dynamics across the remaining asset classes, in which BRF financial means could be invested pursuant to the Law on the BNB, was also downward in 2020.

## 2. Economic Activity in Bulgaria

In 2020 the spread of COVID-19 and introduced containment measures worldwide gave rise to significant negative effects on Bulgaria's economic activity in terms of subdued external demand and restrictions imposed on the operation of firms in certain economic sectors.<sup>10</sup> In Bulgaria, more essential tightening of the containment measures occurred at the end of the first and in the second quarters of 2020, followed by their partial relaxation over the third quarter and a new tightening at the end of the year.<sup>11</sup> Reflecting this dynamics, over the first quarter of 2020 quarterly growth of real GDP decelerated to 0.4 per cent, followed by a strong decline of -10.1 per cent in the second quarter and a partial recovery in economic activity by 4.3 and 2.2 per cent in the third and fourth quarters, respectively. Overall for 2020, real GDP of Bulgaria decreased by 4.2 per cent.

<sup>10</sup> COVID-19 containment measures included closure of schools and businesses in services, cancellation of public events, restrictions in gatherings, stay-at-home recommendations, temporary restrictions on internal movements, international travel controls, *etc.*

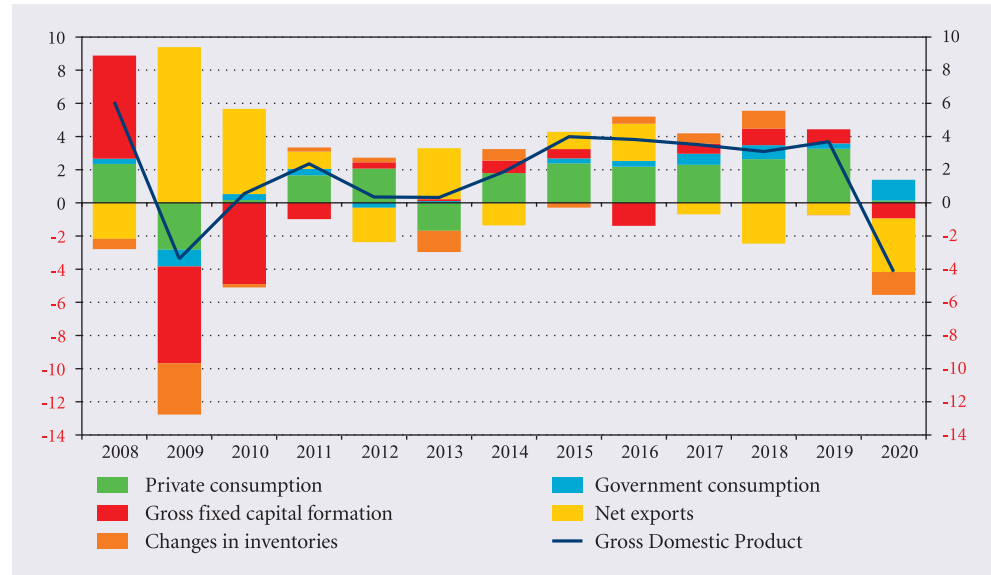
<sup>11</sup> From 13 March to 13 May 2020 the National Assembly introduced a state of emergency, and on 14 May the Council of Ministers declared an emergency epidemic situation in Bulgaria in response to the spread of the COVID-19 pandemic and existing immediate danger to the life and health of the public.



Chart 1. GDP Rate of Change in Real Terms and Contributions by Final Consumption Expenditure Component

(per cent, percentage points)

(per cent, percentage points)



Sources: the NSI, BNB calculations.

The countercyclical fiscal policy helped mitigate deceleration in domestic economic activity through both higher national and EU co-financed government expenditure on consumption and investment and increased net transfers to economic agents.<sup>12</sup> In addition, the non-legislative moratorium on loan repayments, as approved by the BNB, was a measure to alleviate liquidity problems of firms and households.

Broken by final consumption expenditure component, the decrease in real GDP for 2020 was largely driven by the negative contribution of net exports (-3.2 percentage points) reflecting the greater decline in exports of goods and services (-11.3 per cent) compared to imports (-6.6 per cent). Net exports dynamics was impacted by the strong drop in external demand for Bulgarian goods and services and the position of Bulgaria as a net exporter of tourist and transport services, which were among the sectors most severely hit by the COVID-19 pandemic. Changes in inventories were another component with a negative contribution to economic activity dynamics (-1.4 percentage points), possibly reflecting disrupted deliveries under the influence of the COVID-19 containment measures. Domestic demand had a slight positive contribution (0.4 percentage points) to the change in real GDP over 2020, due mainly to the increased government consumption (up 7.5 per cent) and, to a lesser extent,

<sup>12</sup> This includes the government measures on subsidised employment (programmes, such as '60/40', 'Short-term support for employment in response to the COVID-19 pandemic', 'Employment for you' and 'Save me'), an increase in remunerations of the workers exposed to the highest risk of COVID-19 infection, payment of allowances to pensions and other social benefits.

to private consumption growth (up 0.2 per cent), while fixed capital investment declined (by -5.1 per cent) from 2019. Government consumption increased throughout the year as a result primarily of public sector wage increases and higher healthcare expenditure reflecting also measures initiated by the government to soften the consequences of the pandemic. Growth in compensation of employees for the total economy and net fiscal transfers to households led to a 0.4 per cent increase in real disposable income of households.<sup>13</sup> This growth, coupled with accumulated savings in the pre-crisis period, cushioned the negative effects of the pandemic on the financial position of households and supported their consumption. BNB estimates<sup>14</sup> show that declines in gross fixed capital formation in real terms reflected entirely lower volumes of private investments in line with worsened prospects of demand for Bulgarian goods and services, the increased economic uncertainty and lower production capacity utilisation.

Public investment had a strong positive contribution to the change in gross fixed capital formation, underpinned by the implementation of infrastructure projects financed by the national budget and by absorption of EU funds in the 2014–2020 programme period.

As regards the trends by economic sector, the gross value added in 2020 posted a fall by -4.3 per cent compared with 2019. Lower economic activity was reported across all major sectors, with services having the strongest negative contribution. The anti-epidemic measures introduced in Bulgaria affected most strongly the sub-sectors of trade, transport and accommodation and food service activities<sup>15</sup> and also arts, entertainment and recreation<sup>16</sup>. Although no direct containment measures were imposed on companies in the industrial sector, the gross value added also declined in 2020 due mainly to manufacturing and in line with weaker external and domestic demand. The fall reported in the agricultural sector reflected the data published by

<sup>13</sup> Real household disposable income is calculated by the BNB through deflating household nominal disposable income by the private consumption deflator. Household nominal disposable income is constructed by the BNB in two steps. The first includes the calculation of gross disposable income as a sum total of the following components: (1) the wage bill adjusted for the employed to hired ratio; (2) income from employment of Bulgarian residents working temporarily abroad (net); (3) remittances from foreign residents to households in Bulgaria (mainly Bulgarian emigrants); (4) social payments from the government to households. The second step includes a decrease in gross disposable income by the amount of: (1) social contributions due by employees, and (2) personal income tax paid.

<sup>14</sup> Private and government investment is assessed on the basis of available national accounts data on overall investment in the economy, quarterly non-financial accounts data on the general government sector and the reports on consolidated fiscal programme implementation.

<sup>15</sup> It should read wholesale and retail trade; repair of motor vehicles and motorcycles; transportation and storage and mail services; accommodation and food service activities under the economic activities classification.

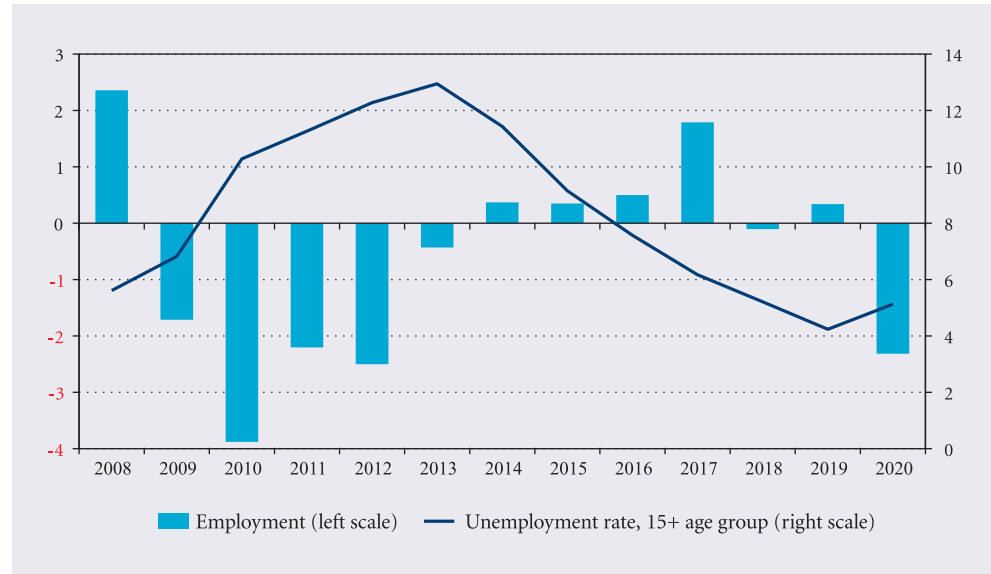
<sup>16</sup> It should read culture, sport and entertainment; other activity; activities of households as employers; non-identified activities of households producing goods and services for own use; activities of extraterritorial organisations and bodies under the economic activities classification.

the NSI on the lower agricultural harvest in 2020.<sup>17</sup> The gross operating surplus at current prices in the overall economy in 2020 recorded a slight increase of 0.2 per cent. Financial performance of companies in agriculture and industry improved, while the gross operating surplus in services posted a decline, in particular in the trade, transport and accommodation and food service activities sub-sector.

Chart 2. Rate of Change in Employment and Unemployment

(per cent, on an annual basis)

(per cent of labour force)



Source: the NSI.

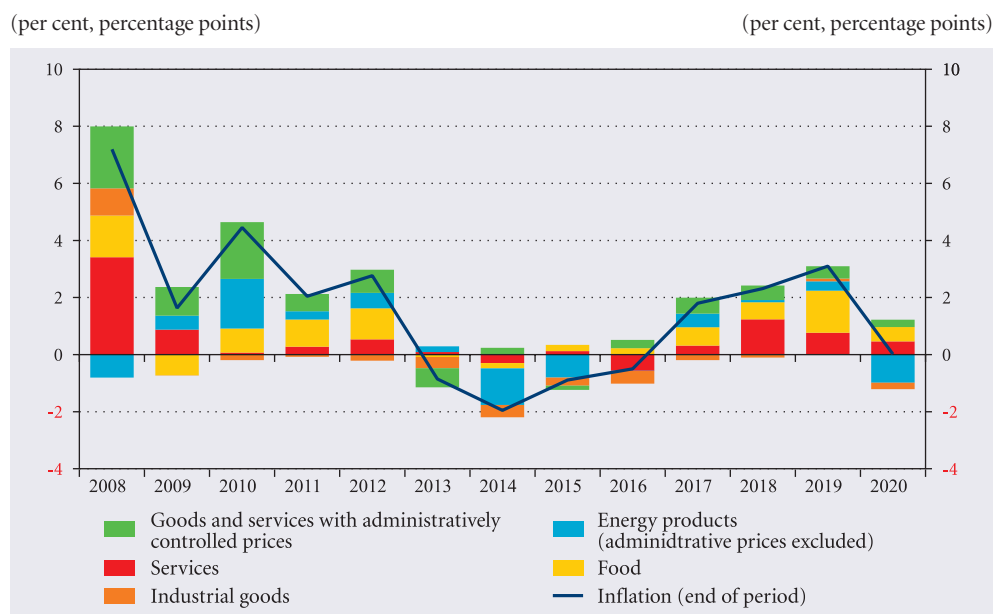
In line with the dynamics of gross value added, the number of the hours worked fell by -4.7 per cent in 2020, while employment declined less (-2.3 per cent). The lower fall in employment compared with value added reflected the social and economic measures of the government in response of the COVID-19 pandemic, with subsidised employment being the most essential one (the so-called 60/40 measure).<sup>18</sup> Across economic sectors, the services sector, in particular the trade, transport and accommodation and food service activities sub-sector, had the strongest negative contribution to the change in employment. Employment in the export-oriented industrial sector also posted a decline, which was mostly concentrated in the manufacturing sub-sector. The NSI Labour Force Survey<sup>19</sup> showed an increase in the unemployment rate to 5.1 per cent in 2020 compared with 4.2 per cent in 2019.

<sup>17</sup> According to the second NSI estimates from the Economic Accounts for Agriculture, the volume of agricultural output in 2020 was lower by 12.0 per cent than in 2019.

<sup>18</sup> Based on NSSI information on expenditure incurred on the COVID-19 containment measures, about BGN 680 million were paid on the 60/40 measure by the end of 2020.

<sup>19</sup> Data refer to the 15+ age group.

Chart 3. HICP Annual Inflation Rate



Sources: the NSI, BNB calculations.

By end-2020 consumer price inflation slowed down essentially from December 2019 to 0.0 per cent on an annual basis compared with 3.1 per cent at the end of 2019<sup>20</sup>. This reflected primarily the fall in prices of energy products (excluding those with administratively controlled prices), which exhibited a decline at the end of the year (-13.4 per cent) in line with the strong decrease in international Brent crude oil prices. The contracted positive contribution of food due mainly to lower prices in the group of unprocessed food also added to the moderation in overall inflation. Core inflation<sup>21</sup> also slowed down from the end of the previous year due mostly to the negative effects of containment measures and weaker household demand. Slower core inflation reflected primarily deflation reported in accommodation services, motor vehicles, clothing and footwear and significantly moderating growth rates in prices of package holidays. In December 2020 the decline in heating prices and, to a lesser extent, in natural gas prices curbed the annual growth rate of administratively controlled prices (including tobacco) compared with December 2019.

In 2020 non-government sector deposits in the banking sector grew at comparatively high rates (9.7 per cent at the end of 2020 matching their December 2019 growth) as a result of both the precautionary savings maintained by economic agents amid the uncertain macroeconomic environment caused by the pandemic outbreak and

<sup>20</sup> The analysis is based on the Harmonised Index of Consumer Prices (HICP).

<sup>21</sup> Core inflation includes the sub-groups of HICP services and non-energy industrial goods and does not include the sub-groups of food, energy products, goods and services with administratively controlled prices, and tobacco products.



the postponement or inability of households to consume some goods and services, and limited investment activity of corporations. The annual growth rate of loans to non-financial corporations and households slowed down to 4.5 per cent at the end of 2020 (against 7.4 per cent in December 2019), reflecting the impact of both demand and supply factors. The uncertainty surrounding future developments in the macro-economic environment and weak investment activity in Bulgaria throughout 2020 dampened private sector demand for credit. Concurrently, after the introduction of COVID-19 containment measures in Bulgaria banks tightened their credit standards and conditions, especially for corporate loans, reflecting bank risk aversion and higher risk assessments.

### 3. Condition of the Banking System

At the end of 2019 the banking system in Bulgaria was characterised by high capital adequacy and liquidity, improving asset quality and historically highest annual profit as a result of high economic growth in recent years accompanied by rising employment and income. At the end of the year the capital position was stable, capital ratios stayed at levels exceeding minimal regulatory and prudential requirements and the liquidity coverage ratio of all credit institutions exceeded the regulatory level of 100 per cent. The amount of non-performing loans and advances, as well as their share in total loans and advances declined.

In 2020 the measures of unprecedented magnitude and stringency launched to contain the spread of COVID-19 both internationally and in Bulgaria led to a broad-based decline in the economic activity, a fall in employment and household disposable income. The banking system in Bulgaria has faced this economic shock having solid capital and liquidity positions. The resilience and flexibility of the banking sector in the context of a severely deteriorated macroeconomic environment were underpinned by both recent years' policy of building up buffers and the measures adopted on 12 March 2020 by the BNB Governing Council aimed at further strengthening of banks' capital and liquidity, including:

- full capitalisation of the banking system's profit;
- cancellation of planned increases in the countercyclical capital buffer rate;
- limitation of concentration risk in banks' balance sheets with regard to their foreign assets.

The measures aimed at addressing both:

- preservation of the capital buffers already built up to ensure a capacity for absorbing losses in case of expected worsening of the credit portfolios;
- maintenance of capital above the regulatory requirements and high liquidity allowing banks to maintain their lending activity.

As a result of the economic shock, the recent years' trend of an improvement in the ratio of non-performing loans in the banking system was broken in the first six months of 2020. Banks reacted to the increased credit risk mainly through raising impairment charges which, coupled with lower operating income, impacted adversely return on assets of the banking sector. The effects of the worsened economic environment on banks' credit portfolio quality were mitigated by the decision of the BNB Governing Council of 3 April 2020 on the application of EBA Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis (EBA/GL/2020/02).

The Guidelines laid down a pan-European framework of temporary deferral of payments on creditworthy bank customers experiencing temporary difficulties due to the pandemic. Implementation of EBA rules on the moratorium on loan repayments gave the credit institutions the possibility to allow borrowers affected by the crisis to defer payments avoiding reductions of obligations and automatic reclassification of loans, falling within the moratorium scope, as forborne or non-performing exposures. The measures are aimed simultaneously at easing the burden on borrowers and preserving the capacity of banks to provide loans.

On 9 April 2020 the BNB Governing Council approved the draft of a Procedure for Deferral and Settlement of Liabilities Payable to Banks and Their Subsidiaries – Financial Institutions, presented by the Association of Banks in Bulgaria. The approved procedure for deferral and settlement of due liabilities represents the so-called non-legislative moratorium within the meaning of EBA Guidelines.

The deadlines of the moratorium were extended once based again on EBA Guidelines (EBA/GL/2020/08). On 9 July 2020 the BNB Governing Council approved a request by the Association of Banks in Bulgaria for extending by three months the deadlines of the moratorium on payments, as follows: (a) extending the deadline for filing applications by bank customers for deferral of liabilities and their approval by banks: from 30 June 2020 to 30 September 2020, and (b) extending the deadline for deferral of liabilities of bank customers: from 31 December 2020 to 31 March 2021.

Having analysed the effects of moratoria and the opportunities for normalising the economic activity and financial intermediation, on 21 September 2020 the EBA decided to phase out moratoria on payments after 30 September 2020. This automatically removed the legal basis for the BNB to approve new proposals for moratoria on bank loan repayments.

Based on discussions held in the last months of 2020, the EBA decided to reactivate Guidelines EBA/GL/2020/02 on legislative and non-legislative loan repayments moratoria with a new deadline for application of the moratorium: 31 March 2021. On the basis of Guidelines EBA/GL/2020/15 amending Guidelines EBA/GL/2020/02 and in compliance with the requirements set out in them, on 2 December 2020 the Govern-

ing Council of the BNB decided to adhere to these Guidelines and on 10 December 2020 it approved the extension of the term of validity of the procedure for deferral and settlement of due liabilities to 31 March 2021, as proposed by the Association of Banks in Bulgaria.

As of 31 December 2020, 108,211 applications of gross balance sheet value of liabilities worth BGN 8760 million were filed under the Procedure for Deferral and Settlement of Liabilities Payable to Banks and Their Subsidiaries – Financial Institutions, of which 89,478 applications with gross balance sheet value of BGN 8074 million were approved. Of all submitted applications, those of households numbered 94,705 and those of corporations 13,506. Respectively, 77,124 household applications, accounting for 81.4 per cent of the total number of applications filed in this segment were approved, while the approved applications of corporations numbered 12,354 or 91.5 per cent. The gross balance sheet value of approved household applications amounted to BGN 1709 million (out of the applications filed for BGN 1940 million) and those of corporations to BGN 6365 million (out of the applications filed for BGN 6819 million). The ratio of approved amounts to the total credit exposure is 6.6 per cent for households and 16.7 per cent for corporations.

The above measures helped increase the resilience of the banking sector to credit risk and facilitated the provision of loans to the economy. The introduction of the measures concerning the non-legislative moratorium has mitigated the effect of unfavourable economic activity developments and the subsequent deterioration in asset quality, an increase of impairments and a potential pressure on profitability and capital positions of credit institutions throughout 2020. The measures led to strengthening of the capital positions of credit institutions at levels considerably exceeding the required ones, as well as to preservation of their liquidity positions.<sup>22</sup>

Capital positions remained stable throughout the year, with total capital adequacy ratio reaching 22.7 per cent at end-December 2020 compared to 20.4 per cent at end-2019. The banking balance sheet equity amounted to BGN 15.4 billion at the end of December 2020, up by 6.6 per cent (about BGN 1 billion) compared with end-2019. Moreover, credit institutions retained their liquidity positions, and the average liquidity coverage ratio of the banking system remained stable, close to the 2019 level of 269.9 per cent (279 per cent at the end of 2020).

Banking system profit amounted to BGN 815 million as of 31 December 2020, decreasing by BGN 860 million (51.4 per cent) compared with the profit reported as of end-December 2019. The impairment costs on financial assets not measured at fair value through profit or loss were one of the main factors behind the decrease in profit, amounting to BGN 876 million at end-December 2020, up by BGN 445 million (103.4 per cent) compared to those reported a year earlier. As a result of the

<sup>22</sup> The regulatory relief introduced by CRR – Capital Requirements Regulation – ‘quick fix’ also contributed to this effect.

growth of the credit portfolio in 2020 and a simultaneous decline in non-performing loans, gross non-performing loans and advances<sup>23</sup> fell from 7.8 per cent at the end of 2019 to 7.5 per cent at the end of 2020.

Table 1. Key Indicators of the Banking System

Key indicators	December 2019	December 2020	Annual change (per cent)
Assets, BGN million	114,201	124,005	8.6
Assets as a share of GDP, per cent	95.3	104.6	-
Equity, BGN million	14,397	15,352	6.6
Profit, BGN million	1,675	815	-51.4
Total capital adequacy ratio, per cent	20.4	22.7	-
Common equity tier 1 capital ratio, per cent	19.3	21.7	-
Capital surplus/deficit relative to capital requirements, including the combined buffer requirement*, BGN million	3,264	4,619	-
Capital surplus/deficit as a ratio to the risk-weighted assets, per cent	4.9	7.2	-
Liquidity coverage ratio, per cent	269.9	279.0	-
Return on assets, per cent	1.5	0.7	-
Return on equity, per cent	11.5	5.3	-
Gross non-performing loans ratio**, per cent	7.8	7.5	-

\* A 'combined buffer requirement' means the requirement referred to in § 1, item 3 of the Additional Provisions of Ordinance No 8 of the BNB of 24 April 2014 on Banks' Capital Buffers.

\*\* A definition of loans and advances applicable as from June 2020 (cash balances at central banks and other demand deposits are excluded).

Source: the BNB.

As a result of the stable capital and liquidity positions of credit institutions and the economic activity throughout 2020, there was no need to apply resolution tools towards credit institutions and to spend funds from the BRF, accordingly.

<sup>23</sup> A definition of loans and advances applicable as from June 2020 (cash balances at central banks and other demand deposits are excluded).



## II. Scope and Allocation of Powers Concerning BRF Activities

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In 2020 the BRF operated under two different legal frameworks for making and implementing decisions on its management. Bulgaria's accession to the SRM as a result of the ECB decision<sup>24</sup> on the establishment of close cooperation with the BNB had a direct effect on the scope and allocation of responsibilities related to the BRF activity and management.

### 1. Until the Entry into Force of the ECB Decision on the Establishment of Close Cooperation (August 2015–July 2020)

Since its establishment, with the adoption of the LRRCIIF in 2015, the BRF has been managed by the BDIF Management Board, which takes decisions on its operational management. The BNB as a resolution authority of credit institutions has powers related to determination of contributions to the BRF and the use of its funds for resolution purposes.

#### 1.1. Sources of Funding

Along with the establishment of the Fund, the LRRCIIF also sets out a target level of BRF financial means, accounting for 2 per cent of the amount of covered deposits, which should be reached until 2023. The Law determines the types of sources of the Fund's financial means, the process of determining the contributions to the BRF by credit institutions and branches of third-country credit institutions, and also the powers of the respective authorities. The sources of funds to the BRF include annual and extraordinary contributions by the banks and branches of third-country credit institutions; returns on the investment of the BRF funds; reimbursement of amounts used for resolution purposes under the terms set for application of appropriate resolution tools and related income and compensation; and other sources. Where the available financial means raised from annual and extraordinary contributions are not sufficient to cover the expenses incurred to finance resolution actions, the BRF may be replenished by borrowing or other forms of support from banks, financial institutions or other third parties in case such options are immediately accessible.

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<sup>24</sup> See footnote 5.

## 1.2. Determination of Annual and Extraordinary Contributions

According to the target level of the Fund financial means and the phase of the economic cycle, the BNB Governing Council determines the total amount of annual contributions of credit institutions and branches of third-country credit institutions, and subsequently their individual annual contributions within the determined total amount. The BNB provides the BDIF with information on the total amount of the annual contributions and on the individually determined contributions, notifies banks and the respective branches of the determined amount of their individual annual contribution to the BRF and controls the performance of the obligation for its timely payment. The BNB Governing Council is also entitled to determine extraordinary contributions of banks and branches of third-country credit institutions in cases where the amount of funds accumulated in the BRF is insufficient to cover the financing of resolution actions.

## 1.3. Use of the BRF Financial Means

The BRF is established as a special-purpose fund and its financial means may be spent solely to achieve credit institution resolution objectives. Decisions on the use of BRF financial means for the purpose of applying resolution tools to institutions for which the BNB is a resolution authority on an individual basis and, correspondingly, a group-level resolution authority, are taken by the BNB Governing Council, while the implementation of the decisions is assigned to the BDIF Management Board.

Pursuant to the LRRCIIF, BRF financial means may be used for financing one or more of the following actions:

- to guarantee assets or liabilities of or to make loans to an institution under resolution, its subsidiaries, a bridge bank, a bridge investment firm or an asset management vehicle;
- to purchase assets of an institution under resolution;
- to acquire ordinary shares issued by a bridge bank, a bridge investment firm, a bridge financial holding company or an asset management vehicle;
- to pay compensations to shareholders, partners or creditors in accordance with Article 107;
- to make a contribution to an institution under resolution when the bail-in tool is applied and the resolution authority has decided to exclude certain creditors from the scope of bail-in in accordance with Article 67;
- to lend to other financing mechanisms on a voluntary basis.

#### 1.4. Investment of the BRF Financial Means

The BRF financial means are invested subject to the principles of security, liquidity and diversification of financial instruments established in the LRRCIIF. Investment decisions are taken by the BDIF Management Board in accordance with the approved framework for management of BDIF funds, including the BRF investment policy and relevant rules.

## 2. Following the ECB Decision on the Establishment of Close Cooperation, in Force as of July 2020

By Decision (EU) 2020/1015 of 24 June 2020 of the ECB (ECB/2020/30), starting from 1 October 2020, the ECB established close cooperation with the BNB. As a result, the Republic of Bulgaria joined the Single Supervisory Mechanism (SSM) and became a participating Member State within the meaning of Article 2, item 1 of Regulation (EU) No 1024/2013.<sup>25</sup> The accession to the SSM results in simultaneous joining the SRM. The SRM has uniform rules for the resolution of credit institutions which are applied by the SRB in cooperation with the national resolution authorities. The centralised resolution mechanism encompasses all banks operating in the participating Member States, and the allocation of functions and tasks between the SRB and national resolution authorities is symmetrical with the allocation of powers between the ECB and national supervisory authorities provided for in Regulation (EU) No 1024/2013. Funding of resolution actions in the SRM is also centralised by establishing a Single Resolution Fund (SRF), in which institutions of the participating Member States make *ex-ante* contributions and, where necessary, extraordinary *ex-post* contributions.

As from 27 July 2020, the date on which the ECB decision on the establishment of close cooperation took effect, the amendments to the LRRCIIF<sup>26</sup> adopted in the course of preparation for joining the SRM and providing a regulatory basis for the implementation of the new function of the BNB as a resolution authority and as a national resolution authority within the meaning of Regulation (EU) No 806/2014<sup>27</sup> came into force. The amendments concerning the BRF are aimed at providing the transition from the national arrangements to single resolution financing arrangements. Based on the amendments that have entered into force, the BRF is administered and governed by the BNB and Fund's financial means are

<sup>25</sup> Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions.

<sup>26</sup> Published in the Daržaven Vestnik, issue 37 of 2019.

<sup>27</sup> Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ, L 225/1 of 30 July 2014).

allocated in two separate sub-funds (under Article 134, paragraph 1, item 1 and under Article 134, paragraph 1, item 2 of the LRRCIIF) having different purposes and scope:

- a sub-fund established to finance the application of the resolution tools and powers in relation to branches of third-country credit institutions (a sub-fund for branches of third-country credit institutions);
- a sub-fund established to raise contributions under Articles 69–71 of Regulation (EU) No 806/2014 and their transfer to the SRF (a sub-fund for contributions to the SRF).

As a result of the changes to the legal framework, the BNB carries out tasks in relation to operational Fund governance, including raising annual and extraordinary contributions from branches of third-country credit institutions; concluding agreements for borrowing funds and other forms of support and provision of loans under the terms and conditions specified in Articles 141 and 142 of the LRRCIIF; investing the funds of the BRF; appointing a registered auditor to carry out an independent financial audit of the annual financial statements of the BRF; fulfilling the obligations arising from the LRRCIIF in relation to the application of resolution tools requiring the establishment of companies whose capital is financed through the BRF funds; adopting and publishing the annual financial statements of the BRF.

Participation in the single mechanism for financing of resolution within the SRM entails significant changes in the content and scope of the BNB mandate regarding the determination of the contributions to the BRF and the use of Fund's financial means for the purposes of resolution actions.

While the BNB fully retains its powers with regard to the sub-fund for branches of third-country credit institutions, the special purpose of the sub-fund for SRF contributions implies more limited functions and powers of the BNB.

Under the new management model, the Fund retains its separateness, including for the purposes of its management and reporting. The BNB prepares separate annual financial statements of the BRF, subject to an independent financial audit and publication in the *Darjaven Vestnik*.

## 2.1. Sources of Funding

As regards the sources of funds to the BRF, in the context of the accession to the SRM and the establishment of two dedicated sub-funds, changes occurred in relation to the target level of the Fund financial means and the determination of contributions to the individual sub-funds of the BRF, as well as the possibility to replenish the Fund by borrowings and other forms of support by banks, financial institutions or other entities, and the powers of the relevant authorities. As a result of the accession to the SRM, the SRF, respectively, the BRF target level of 2 per cent of the amount of



covered deposits in Bulgaria applicable until 1 October 2020 is no longer valid. The SRF target level, which is to be reached until 2023, is 1 per cent of the amount of covered deposits of institutions within the scope of the SRM.

## 2.2. Determination of Annual and Extraordinary Contributions

In line with the allocation of resolution powers between the SRB and the BNB, the function of determining and raising contributions from branches of third-country credit institutions remains within the exclusive competence of the BNB, and the contributions are collected in the respective sub-fund. The LRRCIIF stipulates that the terms and conditions for determining the amount of the individual contributions of branches of third-country credit institutions to the BRF are set by the BNB in an ordinance. On 25 February 2021 the BNB Governing Council adopted Ordinance No 41 on Determining the Amount of the Individual Annual Contributions by Branches of Third-country Credit Institutions to the Banks Resolution Fund.

As regards the sub-fund for contributions to the SRF, the function of determining the amount of the individual annual contributions and extraordinary contributions to the SRF is performed by the SRB and covers both credit institutions falling within the direct powers of the SRB and those for which the BNB is a resolution authority. Furthermore, the SRB also takes all decisions on the SRF budget and the use of the single fund financial means to finance specific actions and resolution tools, including decisions concerning resolution of a less significant institution, that does not fall within the SRB's direct powers.

Annual *ex-ante* contributions of credit institutions are determined by the SRB on an annual basis in consultation with the ECB or national competent authorities, and in close cooperation with national resolution authorities. This procedure also applies to the determination of extraordinary *ex-post* contributions. Principles and rules for determining the individual annual contributions by credit institutions to the SRB are laid down in Regulation (EU) No 806/2014, Commission Delegated Regulation (EU) 2015/63<sup>28</sup> and Council Implementing Regulation (EU) 2015/81<sup>29</sup>.

National resolution authorities are required to notify the credit institutions of the individual amount of annual *ex-ante* contributions to the SRF, as well as to raise and transfer the collected amounts to the SRF in accordance with the Agreement on the Transfer and Mutualisation of Contributions to the Single Resolution Fund<sup>30</sup> (SRF

<sup>28</sup> Commission Delegated Regulation (EU) 2015/63 of 21 October 2014 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to *ex-ante* contributions to resolution financing arrangements.

<sup>29</sup> Council Implementing Regulation (EU) 2015/81 of 19 December 2014 specifying uniform conditions of application of Regulation (EU) No 806/2014 of the European Parliament and of the Council with regard to *ex-ante* contributions to the Single Resolution Fund.

<sup>30</sup> Ratified by a law adopted by the 44th National Assembly on 8 November 2018, Darjaven Vestnik, issue 96 of 2018, effective as of 24 November 2018.

Agreement). In the process of determining the amount of the contributions to the SRB, the Bulgarian National Bank as a national resolution authority acts as a main contact point with the credit institutions established in the Republic of Bulgaria for the purpose of collecting the information required to determine the contributions and its submission to the SRB. In addition, the BNB notifies the credit institutions of the determined individual amount of their contributions to the SRF, collects the contributions in the sub-fund for contributions to the SRF and transfers the amounts to the SRF.

### 2.3. Use of the BRF Financial Means

In line with the power to replenish the sub-fund for branches of third-country credit institutions, the BNB takes decisions on the use of the sub-fund financial means for the purposes of the efficient application of resolution tools towards branches of third-country credit institutions (Article 137 of the LRRCIIF).

While the regime under Article 137 of the LRRCIIF remains directly applicable to the financial means of the sub-fund for branches of third-country credit institutions, the new legal framework does not provide a possibility, upon a decision of the BNB as a resolution authority for credit institutions and a body for managing the BRF, for the means of the sub-fund for contributions to the SRF to be used directly to finance resolution actions.

The financial means raised in the sub-fund for contributions to the SRF are transferred by the BNB to the SRF. Upon a decision of the SRB, the SRF financial means are used for the purposes of resolution of credit institutions, including credit institution falling within the direct powers of the BNB. Within the resolution scheme, the SRB may use the SRF financial means only to the extent necessary to ensure the effective application of the resolution tools and solely for the purposes laid down in the relevant provision of Regulation (EU) No 806/2014. The eligible purposes for which the SRF financial means may be used, are similar to those regulated at national level:

- to guarantee the assets or the liabilities of the institution under resolution, its subsidiaries, a bridge institution or an asset management vehicle;
- to make loans to the institution under resolution, its subsidiaries, a bridge institution or an asset management vehicle;
- to purchase assets of the institution under resolution;
- to make contributions to a bridge institution and an asset management vehicle;
- to pay compensation to shareholders or creditors if they incurred greater losses than they would have incurred in a winding up under normal insolvency proceedings;
- to make a contribution to the institution under resolution in lieu of the write-down

- or conversion of liabilities of certain creditors, when the bail-in tool is applied and the decision is made to exclude certain creditors from the scope of bail-in;
- to take any combination of the actions referred to in the preceding options.

The SRF financial means are used in compliance with the SRF Agreement and the principles provided for therein. Until the SRF target level of 1 per cent is reached, but not later than eight years from the establishment of the SRF and the initial date of application of the SRF Agreement (transitional period), the use of the SRF is based on dedicated national compartments, corresponding to each Member State contribution, and subject to progressive merger of the financial means raised at national level as laid down in the SRF Agreement. After the elapsing of the transitional period, all national compartments will cease to exist.

If SRF financial means need to be used in resolution, the available amount for the specific case in the transitional period is determined subject to the rules laid down in the SRF Agreement which, in practice, ensure the use of funds from compartments of Member States on whose territory the relevant failing or likely to fail institution or group operates. In case of insufficient financial means in the SRF, possibilities for replenishing the Fund are provided under the Agreement, including through extraordinary contributions by the credit institutions licensed in the respective participating Member States, activation of credit lines of the respective participating Member States, borrowing between compartments and other forms of support under the effective SRM Framework.

#### **2.4. Investment of the BRF Financial Means**

The BRF financial means are held in accounts with the BNB and are invested in accordance with the Law on the BNB. Investment decisions are taken by the BNB Governing Council, and the financial means in the individual funds are invested separately (without mixing them).

Based on the statutory requirements and with a view to organising and structuring internal processes within the BNB in implementing the function of investing the BRF financial means, the Governing Council of the BNB adopted Internal Rules for Management of the Banks Resolution Fund Financial Means (Internal Rules). These rules regulate the general terms and principles applicable to the management of the BRF financial means, the procedure for taking decisions on Fund's financial means and the interaction and tasks of the BNB structural units, performing activities related to the BRF financial means, which are managed in consistent compliance with the principles of security, liquidity and profitability.

The Internal Rules define the eligible financial instruments for the purposes of BRF financial means management, taking into account the current status and expected developments of the economy and financial markets, as well as the possible

approaches to the management of financial means in the two sub-funds, which the BNB: (a) in its capacity as a manager of the BRF may apply in accordance with the LRRCIIF, on the one hand; and (b) in its capacity as a provider of investment services to customers may offer according to the restrictions of the Law on the BNB, on the other. Considering the above, the financial instruments currently defined as eligible for investing the Fund's financial means are a current account with the BNB and a structured index account with the BNB, which are opened and serviced according to the General Terms and Conditions of the Bulgarian National Bank on Servicing Accounts of Banks, Budget Organisations and Other Customers. The financial instrument is chosen by the BNB Governing Council on a quarterly basis on a proposal from the Deputy Governor in charge of the Issue Department, accompanied by an analysis of the expected return and risk.

As regards the structured index account financial instrument, the BNB Governing Council, on a proposal from the Deputy Governor in charge of the Issue Department, takes a decision on the eligible classes of assets and investment restrictions by type of risk. This decision is reviewed at least once a year.

### III. Key Indicators of BRF Performance in 2020

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#### 1. Contributions in 2020

In March 2020 the BNB Governing Council set the total amount of the annual contributions of banks for 2020 to the BRF at BGN 157,876 thousand. In April 2020 the amount was distributed to individual banks commensurate with their risk profiles. All banks paid their due contributions into the Fund within the term set in the LRRCIIF, and as of the end of May 2020 the financial means accumulated in the BRF amounted to BGN 701,930 thousand.

#### 2. Transfer of the BRF Financial Means from the BDIF to the BNB

As from the date on which the ECB decision on the establishment of close cooperation takes effect, for the purpose of ensuring the technical transfer of the Fund financial means from the BDIF to the BNB, by a decision of the BNB Governing Council, earmarked accounts with the BNB were opened – one account for each of the two sub-funds. On 27 July 2020 in line with the requirements of § 56, paragraph 1 of the Transitional and Final Provisions of the Law on Amendments and Supplements of the LRRCIIF, the financial means available in the BRF in the amount of BGN 701,166 thousand were transferred to the BNB, and the documents provided for in the relevant provision of the Law were submitted, including interim financial statements as of the transfer date.

Based on the information presented by the BDIF, on 17 August 2020, upon a decision of the BNB Governing Council,<sup>31</sup> the BRF financial means were allocated to the accounts of the two sub-funds, as follows:

- BGN 616.5 thousand to the account of the sub-fund for branches of third-country credit institutions;
- BGN 700,263.3 thousand to the account of the sub-fund for contributions to the SRF.

#### 3. Transfer of the Initial Contribution of the Republic of Bulgaria from the Sub-fund for Contributions to the SRF towards the SRF

Pursuant to Article 8 of the SRF Agreement, where a contracting party whose currency is not the euro becomes part of the SSM and of the SRM, it transfers towards the Fund an amount of contributions raised in its territory equal to that which would

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<sup>31</sup> Under the General Terms and Conditions of the Bulgarian National Bank on Servicing Accounts of Banks, Budget Organisations and Other Customers, from the date of transfer of BRF financial means management to the BNB (27 July 2020) until 17 August 2020, the accrued and collected interest was BGN 286.3 thousand.

have been transferred by the contracting party concerned if it had participated in the SSM and the SRM since the date of enforcement of the SRF Agreement<sup>32</sup>. For the Republic of Bulgaria, these are the contributions due for the period starting from the year in which the SRF Agreement becomes applicable for the participating Member States (2016) until the year in which the close cooperation with the ECB is established (2020) inclusive. The exact amount of the contributions which are subject to a transfer to the SRF is determined by the SRB upon agreement with the contracting party.

The amount to be transferred from the national BRF to the SRB (the initial contribution of the Republic of Bulgaria to the SRB) is set by the SRB<sup>33</sup> by using reporting information for each reference year from 2016 to 2020, which through a specifically designated reporting procedure was collected by the BNB from the credit institutions and submitted to the SRB. Covered deposits data for the respective period are provided to the SRB by the BNB, with a source being the BDIF. In 2020 the covered deposit data for the reference year 2019 was directly submitted by the BDIF.

During the preparatory phase of the establishment of close cooperation between the ECB and the BNB, by Decision of the Council of Ministers of 17 June 2020, the Minister of Finance was authorised to confirm the amount of the contributions determined by the SRB for the period from 2016 until the date of enforcement of the ECB Decision on the establishment of close cooperation, which should be transferred to the SRF after consultation with the BNB as a resolution authority.

On 5 August 2020 the SRB invited the Bulgarian government, through its authorised representative – the Minister of Finance – to confirm the amount set by the SRB at EUR 81,018,259.53 to be transferred to the SRF. Within the consultation held on that matter, in line with the Decision of the Council of Ministers of 17 June 2020, the BNB gave an opinion in favour of the amount set by the SRB to be transferred to the SRF.

On 29 September 2020 by a letter of the Minister of Finance, the BNB was formally informed about the notification sent by the SRB on the amount of the initial contribution of the Republic of Bulgaria to the SRF set at EUR 81,018,259.53, subject to a transfer from the BRF to the SRF. In its payment notification, the SRB specified 7 October 2020 as a deadline for the transfer of funds given the established close cooperation, which became effective on 1 October 2020.

On 5 October 2020 the BNB transferred the initial contribution to the SRF by debiting the account of the respective dedicated sub-fund by the amount of

<sup>32</sup> *Ex-ante* contributions within the meaning of Article 3, paragraph 2 of the SRF Agreement.

<sup>33</sup> The SRB uses in its calculations a methodology stemming from Commission Delegated Regulation (EU) 2015/63 and the requirements of Directive 2014/59/EU in applying uniform rules and procedures in the framework of the SRM based on Regulation (EU) No 806/2014 and Council Implementing Regulation (EU) 2015/81.



BGN 158,457,942.54<sup>34</sup> in line with § 56, paragraph 2 of the Transitional and Final Provisions of the Law on Amendments and Supplements of the LRRCIIF. After the transfer towards the SRF was made, the amount of the financial means available in the dedicated sub-fund for contributions to the SRF exceeded BGN 540 million. The main reasons behind this balance may be summarised, as follows:

- a two-times lower target level that should be reached in the SRF: 1 per cent of the amount of the covered deposits within the SRM, compared to the BRF target level of 2 per cent of the amount of the covered deposits;
- the SRB approach applied in determining the annual contributions of small credit institutions<sup>35</sup> in the form of a lump-sum, which results in determining a lump-sum for a larger number of credit institutions licensed in the Republic of Bulgaria, compared to those determined by the BNB;
- the SRB approach applied in calculating risk adjustment<sup>36</sup> for credit institutions licensed in the Republic of Bulgaria, also in the context of their positioning in relation to institutions, for which the SRB calculates risk adjustment within the SRM;
- application by the SRB of specific adjustments in the initial period of accumulation of financial means in the SRF<sup>37</sup>.

#### 4. Investment of the BRF Financial Means

From the beginning of 2020 to the date of the transfer of the BRF funds from the BDIF to the BNB, the financial means of the Fund are held in a BDIF's current account with the BNB under the General Terms and Conditions of the Bulgarian National Bank on Servicing Accounts of Banks, Budget Organisation and Other Customers, and are remunerated at the applicable standard annual interest rate on current accounts (-0.70 per cent). For the period 1 January – 26 July 2020, interest expenses amounted to BGN 2430 thousand.

From the date of the transfer, *i.e.* 27 July 2020, to 31 December 2020 the investment strategy remained unchanged, with the BRF financial means held in current accounts with the BNB. Interest expenses for this period amounted to BGN 1554 thousand.

<sup>34</sup> Under the fixed exchange rate of the lev to the euro.

<sup>35</sup> Article 10 of Commission Delegated Regulation (EU) 2015/63.

<sup>36</sup> Within the meaning of Article 9 of Commission Delegated Regulation (EU) 2015/63.

<sup>37</sup> Article 8 of Council Implementing Regulation (EU) 2015/81 of 19 December 2014 specifying uniform conditions of application of Regulation (EU) No 806/2014 of the European Parliament and of the Council with regard to *ex-ante* contributions to the Single Resolution Fund.

## 5. Use of the BRF Financial Means

In light of the economic activity in Bulgaria in 2020 and the sound capital and liquidity position of credit institutions licensed in Bulgaria (see Section I), in 2020 the BNB exercised no resolution powers, hence, no BRF funds were spent on resolution actions in respect of a credit institution licensed in the Republic of Bulgaria or a branch of a third-country credit institution. As a result, no extraordinary contributions from the respective contribution debtors were raised.

From 1 October to 31 December 2020, the BNB did not receive any requests from the SRB neither for raising extraordinary contributions to the SRF from credit institutions licensed in the Republic of Bulgaria, nor for borrowing.

## 6. Financial Means Available in the BRF Sub-funds as of 31 December

As of 31 December 2020 the available financial means in the sub-fund for branches of third-country credit institutions amounted to BGN 615 thousand, while those in the sub-fund for contributions to the SRF were BGN 540,539 thousand.

## IV. Organisation of the Operational Implementation of the BRF-Related Activities at the BNB and Participation in the SRB Structures

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### 1. Units Assisting the BNB Governing Council in Relation to the BRF Management Function

In accordance with Article 2, paragraph 2 of the LRRCIIF, the Governing Council of the BNB has determined a dedicated structural unit, which assists it in exercising the resolution function, namely the Resolution of Credit Institutions (RCI) Directorate. In connection with the change in the BNB powers arising from the accession to the SRM, the BNB Governing Council adopted a 'Concept for Organisation of the Activities of the Bulgarian National Bank in the Single Resolution Mechanism' (the Concept), providing for structural, functional and organisational changes aiming to ensure the fulfilment of the new functions and adaptation of the existing functions of the Resolution of Credit Institutions Directorate. In line with the Concept, the BNB Governing Council adopted changes in the structure and increased the RCI Directorate total number of employees as from 1 January 2021. In regard to the performance of the BNB powers concerning the BRF, structural and functional changes involve the establishment of an Administration of the Banks Resolution Fund Division. The tasks of the newly established division include implementation and coordination of the activities that concern the BRF administration and management, including the use of specialised services provided by other units within the BNB, mainly related to accounting and investment of the BRF's financial means. In addition, the division is responsible for implementation of the commitments related to the coordination with the SRB of activities concerning the SRF, and provision of technical assistance within the framework of determining and raising annual and extraordinary contributions from banks, control over the fulfilment of banks' obligations to pay in the contributions to the BNB and the transfer of the contributions to the SRF.

The administrative costs arising from the resolution functions, including those related to the BRF management, are financed by fees collected from the credit institutions and the branches of third-country credit institutions established in the Republic of Bulgaria. The terms and procedures for determining and collecting of these fees are laid down in the BNB Ordinance No 40 of 1 December 2020 on Determining the Amount of Fees to Cover Administrative Costs of the Bulgarian National Bank Arising from Supervisory and Resolution Functions.<sup>38</sup>

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<sup>38</sup> Published in the Darjaven Vestnik, issue 105 of 11 December 2020.

## 2. Participation in the Single Resolution Board

Within the Single Resolution Mechanism, the BNB participates in SRB structures relevant to the SRF management. The Bulgarian National Bank is represented in the SRB Plenary Session and Extended Executive Session by the Deputy Governor in charge of the Issue Department, with the same rights and obligations as all other members, including voting rights.

With respect to the SRB sub-structures pertaining to the SRF, the BNB participates in the two formats of the Single Resolution Fund Committee: Contributions and Investments. These committees do not have a decision-making mandate but are established for organisational purposes, as a platform for exchange of information and technical assistance to the SRB management bodies in taking decisions on the determination of contributions to the SRF and the investment policy.

## V. Events Occurred after the Date of the Financial Statements

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The amendments to the LRRCIIF, effective as of 12 February 2021 transpose into the national legislation the requirements of Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019 amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC. The amendments mainly aim at ensuring that banks have sufficient loss-absorbing and recapitalisation capacity so that during and immediately following a resolution to continue to be able to perform their critical functions without putting public funds or financial stability at risk.

On 25 February 2021 the BNB Governing Council adopted Ordinance No 41 on Determining the Amount of the Individual Annual Contributions of Branches of Third-country Credit Institutions to the Banks Resolution Fund. The Ordinance is issued on the grounds of Article 139, paragraph 6 in connection with paragraph 3 of the LRRCIIF. It sets the terms and conditions for determining the amount of the individual annual contributions to the relevant BRF sub-fund, due by branches of third-country credit institutions licensed in the Republic of Bulgaria to operate through a branch.

## VI. Projected Future Developments

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The second sentence of § 56, paragraph 2 of the Transitional and Final Provisions of the Law on Amendments and Supplements of the LRRCIIF stipulates that after the transfer of the funds to the SRF, the remaining funds, if any, accumulated in the sub-fund for contributions to the SRF, following a decision of the BNB, are deducted from the obligations of the institutions for future contributions to the Single Resolution Fund, until they are exhausted.

The preliminary information from the SRB about the estimated total amount of contributions by credit institutions to the SRF for 2021 allows to estimate that the financial means available in the sub-fund for contributions to the SRF will be sufficient to cover this amount.



## VII. Financial Statements as of 31 December 2020

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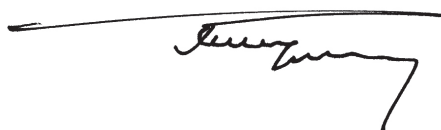
Statement of Responsibilities of the Governing Council of the Bulgarian National Bank.....	37
Independent Auditor's Report to the Governing Council of the Bulgarian National Bank .....	38
Statement of Operations for the Period Ended 31 December 2020 .....	42
Statement of Financial Position for the Period Ended 31 December 2020 .....	43
Statement of Cash Flows for the Period Ended 31 December 2020 .....	44
Statement of Changes in Net Assets for the Period Ended 31 December 2020 .....	45
Notes to the Annual Financial Statements .....	46

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

The Governing Council of the Bulgarian National Bank is responsible for preparing and approving financial statements to present the Banks Resolution Fund's financial position and performance for the period.

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

The Governing Council of the BNB is responsible for maintaining proper accounting records to disclose with reasonable accuracy at any time the financial position of the Fund. It has overall responsibility for the financial means of the Fund.



**Dimitar Radev**  
**Governor**  
**of the Bulgarian National Bank**



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## Independent auditor's report To the Governing Council of The Bulgarian National Bank

### Report on the Audit of the Financial Statements

#### Opinion

We have audited the accompanying financial statements of Banks Resolution Fund (the Fund), which comprise the statement of financial position as at 31 December 2020, and the Statement of Operations, Statement of Changes in Net Assets and Statement of Cash Flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Fund as at 31 December 2020, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU).

#### Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Fund in accordance with the International Ethics Standards Board for Accountants' International Code of Ethics for Professional Accountants (including International Independence Standards) (*IESBA Code*) together with the ethical requirements of the Independent Financial Audit Act (IFAA) that are relevant to our audit of the financial statements in Bulgaria, and we have fulfilled our other ethical responsibilities in accordance with the requirements of the IFAA and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Translation in English of the official Auditor's report issued in Bulgarian.

A member firm of Ernst & Young Global Limited

Ernst & Young Audit OOD, with seat and address of management in Sofia, Triaditsa district  
47A, Tsarigradsko Shose Blvd., fl. 4  
UIC: 130972874, VAT # BG130972874;  
BGN IBAN: BG48 UNCR 7000 1520 6686 91,  
BIC: BPBIBGSF with Unicredit Bulbank AD.



## Other matter

The financial statements of the Fund for the year ended 31 December 2019 were audited by another auditor who expressed an unmodified opinion on those financial statements on 23 March 2020.

## Information Other than the Financial Statements and Auditor's Report Thereon

Management is responsible for the other information. The other information comprises the management report, prepared by management in accordance with Chapter Seven of the Accountancy Act, but does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon, unless and to the extent explicitly specified in our report.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

## Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and presentation of the financial statements that give a true and fair view in accordance with IFRS as adopted by the EU and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Fund or to cease operations, or has no realistic alternative but to do so.

## Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Translation in English of the official Auditor's report issued in Bulgarian.



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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Fund's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Fund to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves true and fair presentation.

We communicate with management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

## Report on Other Legal and Regulatory Requirements

### *Additional Matters to be Reported under the Accountancy Act*

In addition to our responsibilities and reporting in accordance with ISAs, described above in the *Information Other than the Financial Statements and Auditor's Report Thereon* section, in relation to the management report, we have also performed the procedures added to those required under ISAs in accordance with the Guidelines on New and Expanded Auditor's Reports and Auditor's Communication of the professional organisation of certified public accountants and registered auditors in Bulgaria, i.e. the Institute of Certified Public Accountants (ICPA). These procedures refer to testing the existence, form and content of this other information to assist us in forming an opinion about whether the other information includes the disclosures and reporting provided for in Chapter Seven of the Accountancy Act applicable in Bulgaria.

Translation in English of the official Auditor's report issued in Bulgarian.



*Opinion in connection with Art. 37, paragraph 6 of the Accountancy Act*

Based on the procedures performed, our opinion is that:

- a) The information included in the management report referring to the financial year for which the financial statements have been prepared is consistent with those financial statements.
- b) The management report has been prepared in accordance with the requirements of Chapter Seven of the Accountancy Act.

Audit Firm Ernst & Young Audit OOD:

Nikolay Garnev  
Legal Representative and  
Registered Auditor in charge of the audit

Milka Natcheva-Ivanova  
Legal Representative and  
Registered Auditor in charge of the audit

Sofia, Bulgaria  
1 April 2021





## Statement of Operations for the Period Ended 31 December 2020

(BGN'000)

	Notes	31 December 2020	31 December 2019
Annual contributions	7	157,876	137,258
Transfer to the account of the Single Resolution Fund	9	(158,458)	-
Interest expense on deposits and current accounts	8	(3,984)	(1,373)
<b>Result for the year</b>		<b>(4,566)</b>	<b>135,885</b>

The accompanying notes on pages 46 to 58 form an integral part of the Financial Statements.

**Statement of Financial Position for the Period Ended 31 December 2020**

(BGN'000)

	Notes	31 December 2020	31 December 2019
<b>ASSETS</b>			
Cash at bank	9	541,154	545,720
<b>TOTAL ASSETS</b>		<b>541,154</b>	<b>545,720</b>
<b>LIABILITIES</b>		-	-
<b>NET ASSETS</b>		<b>541,154</b>	<b>545,720</b>

The accompanying notes on pages 46 to 58 form an integral part of the Financial Statements.

## Statement of Cash Flows for the Period Ended 31 December 2020

(BGN'000)

	Notes	31 December 2020	31 December 2019
<b>Cash flows from operating activities</b>			
Cash receipts from banks as annual contributions		157,876	137,258
Transfer to the account of the Single Resolution Fund		(158,458)	-
<i>Net cash flow from operating activities</i>		(582)	137,258
<b>Cash flows from investing activities</b>			
Payments related to cash		(3,984)	(1,373)
<i>Net cash flow from investing activities</i>		(3,984)	(1,373)
Increase/(decrease) in cash flows during the year		(4,566)	135,885
<b>Cash and cash equivalents at beginning of period</b>		<b>545,720</b>	<b>409,835</b>
<b>Cash and cash equivalents at the end of period</b>	<b>9</b>	<b>541,154</b>	<b>545,720</b>

The accompanying notes on pages 46 to 58 form an integral part of the Financial Statements.

## Statement of Changes in Net Assets for the Period Ended 31 December 2020

(BGN'000)

Statement of changes in net assets	Net assets
<b>Balance as at 1 January 2019</b>	<b>409,835</b>
Result for the year	135,885
Total comprehensive result	135,885
<b>Balance as at 31 December 2019</b>	<b>545,720</b>
Result for the year	(4,566)
Total comprehensive result	(4,566)
<b>Balance as at 31 December 2020</b>	<b>541,154</b>

The accompanying notes on pages 46 to 58 form an integral part of the Financial Statements.

## Notes to the Annual Financial Statements

### 1. General Information

The Banks Resolution Fund (the BRF, the Fund) was established under the Law on the Recovery and Resolution of Credit Institutions and Investment Firms (LRRCIIF), that entered into force on 14 August 2015.

The address of the BRF is:

1, Knyaz Alexander I Square  
Sofia 1000  
Bulgaria

The activities of the Banks Resolution Fund are stipulated in the LRRCIIF and the Law on the Bulgarian National Bank.

Until the date on which the ECB decision on the establishment of close cooperation<sup>1</sup> becomes applicable, *i.e.* 27 July 2020, the BRF was managed by the Management Board of the Bulgarian Deposit Insurance Fund (BDIF). With effect from 27 July 2020, the management of the BRF is performed by the Governing Council of the BNB, and the decisions related to the BRF management are taken by the BNB Governing Council.

The members of the BNB Governing Council as of 31 December 2020 are as follows:

- Dimitar Radev – Governor of the Bulgarian National Bank;
- Kalin Hristov – Deputy Governor, in charge of the Issue Department and Member of the Governing Council of the Bulgarian National Bank;
- Nina Stoyanova – Deputy Governor, in charge of the Banking Department and Member of the Governing Council of the Bulgarian National Bank;
- Radoslav Milenkov – Deputy Governor, in charge of the Banking Supervision Department and Member of the Governing Council of the Bulgarian National Bank;
- Elitsa Nikolova – Member of the Governing Council of the Bulgarian National Bank;
- Lyudmila Elkova – Member of the Governing Council of the Bulgarian National Bank;
- Prof. Nikolay Nenovsky – Member of the Governing Council of the Bulgarian National Bank.

According to the information disclosed by the Bank Deposit Insurance Fund, the composition of the Management Board as of 31 December 2019 is as follows:

- Matey Matev – Chair of the Management Board of the BDIF;

<sup>1</sup> Decision (EU) 2020/1015 of the European Central Bank of 24 June 2020 on the establishment of close cooperation between the European Central Bank and Българска народна банка (Bulgarian National Bank) within the meaning of Article 2, item 1 of Council Regulation (EU) No 1024/2013.

- Nelly Kordovska – Deputy Chair of the Management Board of the BDIF;
- Irina Martseva – Member of the Management Board of the BDIF;
- Borislav Stratev – Member of the Management Board of the BDIF;
- Prof. Valery Dimitrov – Member of the Management Board of the BDIF.

The BRF is not an autonomous legal entity and the Bulgarian National Bank as a resolution authority of credit institutions within the meaning of Article 2, paragraph 1 of the LRRCIIF manages the BRF without controlling it within the meaning of the requirements of Article 7 of IFRS 10 Consolidated Financial Statements.

The Banks Resolution Fund is designed as a special-purpose fund. BRF financial means are raised through contributions from the banking system and are intended solely to provide financing for resolution actions and to limit, to the maximum extent possible, the use of public funds.

According to Article 134, paragraph 1 of the LRRCIIF<sup>2</sup>, the Fund consists of two sub-funds with different purposes and scope:

- a sub-fund established to finance the application of the resolution tools and powers in relation to branches of third-country credit institutions (a sub-fund for branches of third-country credit institutions);
- a sub-fund established to raise contributions under Articles 69–71 of Regulation (EU) No 806/2014 and their transfer to the SRF (a sub-fund for contributions to the SRF).

The financial means of the BRF are reported on accounts with the BNB and are invested in accordance with the Law on the BNB. With effect from 27 July 2020, investment decisions are taken by the BNB Governing Council and the financial means in the individual sub-funds are invested separately, with no mixture being allowed.

Over the reporting period the BRF is financed by annual contributions from banks as determined by the Bulgarian National Bank and collected by the Bank Deposit Insurance Fund.

## 2. Applicable Standards

The financial statements of the Banks Resolution Fund have been prepared in accordance with the International Financial Reporting Standards (IFRS) as issued by the International Financial Reporting Interpretations Committee and adopted by the European Commission.

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<sup>2</sup> According to amendments entering into force as from the date of enforcement of Decision (EU) 2020/1015 of the European Central Bank of 24 June 2020 on the establishment of close cooperation between the European Central Bank and Българска народна банка (Bulgarian National Bank) (ECB/2020/30) within the meaning of Article 2, item 1 of Regulation (EU) No 1024/2013.



### **3. Basis of Preparation**

The financial statements are drawn up in Bulgarian leva rounded to the nearest thousand (BGN'000), which is the functional currency of the Fund.

The financial statements of the BRF are prepared in compliance with the following principles:

- in accordance with the historical cost principle;
- in compliance with the going concern principle, implying that the Fund will continue to exist in the foreseeable future.

### **4. New and Amended Standards and Clarifications as of 1 January 2020**

#### ***IFRS 3 Business Combinations (Amendments): Definition of a Business***

The amendments are effective for annual periods beginning on or after 1 January 2020, with earlier application permitted. These amendments issued on 22 October 2018, adopted by the EU on 21 April 2020, are published in the Official Journal of the EU on 22 April 2020. These amendments have no effect on the financial position or performance of the Fund.

#### ***Amendments to IAS 1 Presentation of Financial Statements and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors: Definition of 'Material'***

The amendments adopted by the EU on 29 November 2019 and published in the Official Journal of the EU on 10 December 2019 are effective for annual periods beginning on or after 1 January 2020, with earlier application permitted. These amendments has no material effect on the financial position and performance of the Fund.

#### ***The Conceptual Framework for Financial Reporting***

The Conceptual Framework for Financial Reporting adopted by the EU on 29 November 2019 and published in the Official Journal of the EU on 6 December 2019 is effective for periods beginning on or after 1 January 2020. After analysing and assessing the impact of these amendments, the BNB Governing Council considers that they have no material effect on the financial position or performance of the Fund.

#### ***Interest Rate Benchmark Reform: Amendments to IFRS 9, IAS 39 and IFRS 7***

The amendments are effective for annual periods beginning on or after 1 January 2020, and must be applied retrospectively. Earlier application permitted. These amendments were adopted by the EU on 15 January 2020 and published in the Official Journal of the EU on 16 January 2020. After analysing and assessing the amendments, the BNB Governing Council considers that they have no material effect on the financial position or performance of the Fund.

## **5. New Standards and Clarifications Issued but not yet Effective and not Early Adopted**

Already published standards which are not yet in effect or have not been previously applied by the BRF at the date of these financial statements are briefly presented below. It is disclosed how reasonably they are expected to impact disclosures, the financial position or performance when the Fund adopts these standards for the first time. It is expected to happen when they come into force.

### ***IFRS 17: Insurance Contracts, Including Amendments to IFRS 17***

On 25 June 2020 the IASB issued Amendments to IFRS 17 together with Amendments to IFRS 4, so that insurers which meet the requirements continue applying IFRS 9 along with IFRS 17. The amendments are effective for reporting periods beginning on or after 1 January 2023, and retroactive application is required. Earlier application permitted. The standard has not been yet endorsed by the EU. The standard is not applicable to the BRF.

### ***Amendments to IAS 1 Presentation of Financial Statements: Classification of Liabilities as Current or Non-current and Classification of Liabilities as Current or Non-current – Deferral of Effective Date***

On 15 July 2020 the IASB published an exposure draft Classification of Liabilities as Current or Non-current – Deferral of Effective Date (Proposed Amendment to IAS 1) proposing to defer the effective date of the amendments to IAS 1 by one year and to apply to annual reporting periods beginning on or after 1 January 2023. The standard has not been yet endorsed by the EU. The BNB Governing Council will analyse and assess the impact of these amendments on the financial position or performance of the BRF.

### ***Amendments to IFRS 3 Business Combinations; IAS 16 Property, Plant and Equipment; IAS 37 Provisions, Contingent Liabilities and Contingent Assets; Annual Improvements 2018–2020***

On 14 May 2020 the IASB published amendments to:

1. IFRS 3 Business Combinations;
2. IFRS 16 Property, Plant and Equipment;
3. IAS 37 Provisions, Contingent Liabilities and Contingent Assets; Annual Improvements 2018–2020;
4. Annual Improvements 2018–2020.

The amendments, which are all effective for annual periods beginning on or after 1 January 2022, have not yet been endorsed by the EU.

***Interest Rate Benchmark Reform – Phase 2, Amendments to IFRS 9, IAS 39, IFRS 7 and IFRS 4***

The amendments are effective for annual periods beginning on or after 1 January 2021. The amendments have not yet been endorsed by the EU. The BNB Governing Council will analyse and assess the impact of the amendments on the financial position or performance of the BRF.

***Amendments to IFRS 4 Insurance Contracts – Deferral of IFRS 9***

These amendments were adopted by the EU on 15 December 2020 and published in the Official Journal of the EU on 16 December 2020. These amendments are not applicable to the BRF.

**6. Significant Accounting Policies**

Significant accounting policies applied by the BRF in preparing financial statements are disclosed below.

**a) Income**

The main sources of income from the BRF's activity are:

1. annual and extraordinary contributions from the banks and branches of third-country credit institutions;
2. returns on the investment of the BRF financial means;
3. reimbursement of amounts used for resolution purposes under the terms set for the application of appropriate resolution tools and related income and compensation;
4. proceeds from borrowings and other forms of support and loans provided under the terms and conditions specified in Articles 141 and 142 of the LRRCIIF;
5. other sources.

Income is recognised in the statement of operations on the date of occurrence of the event.

The Fund reports the income from contributions as 'other operating income'. In case of failure to pay an annual contribution within a period prescribed by law, the BNB charges interest for the period of delay on the amount due at the statutory rate. Accrued and repaid interest is presented as 'other net income' in the statement of operations.

Where the available financial means accumulated in the BRF are not sufficient to cover the costs associated with the financing of the resolution, extraordinary contributions are raised from the banks, which have to be paid in full and within a period set up by a resolution of the BNB Governing Council. In 2020 there are no extraordinary contributions from banks and branches of third-country credit institutions. With effect from 1 October 2020, the BNB may determine extraordinary contributions only for the branches of third-country credit institutions.

Interest income and expenses are recognised in the statement of operations using the effective interest rate method. In its calculation, all commissions, received or paid, or discounts that are a component part of the effective interest rate are included.

The effective interest rate is determined on the initial recognition of the financial instrument and does not change thereafter.

#### **b) Expenses**

The main expenses from the BRF activity are related to:

1. investment of the financial means of the Fund in accordance with the Law on the BNB and the Internal Rules for Management of the BRF financial means;
2. application of resolution tools in accordance with Article 137 of the LRRCIIF;
3. transfer of financial means to the Single Resolution Fund from the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF in accordance with Article 8 of the Agreement on the Transfer and Mutualisation of Contributions to the Single Resolution Fund. Following the transfer of the financial means, the remaining financial means raised in the sub-fund under Article 134, paragraph 1, item 2 are deducted from the obligations of institutions for future contributions to the Single Resolution Fund upon a decision of the BNB Governing Council until their exhaustion.
4. other expenses.

Expenses are recognised when incurred on an accrual basis.

#### **c) Investment income**

Investment income includes interest income and income from sale and revaluation of financial instruments carried at fair value.

Financial means of the Banks Resolution Fund may be invested in accordance with the Law on the BNB.

#### **d) Financial instruments**

IFRS 9 introduces a new approach to the classification of financial assets based on contractual cash flow characteristics and the business model for managing them. All recognised financial assets within the IFRS 9 scope must be subsequently carried at amortised cost or fair value, depending on the business model and the characteristics of their cash flows.

#### ***Classification***

The BRF financial instruments are classified depending on the nature and purpose of the financial assets and liabilities at the date of their acquisition and determines the classification at the date of their initial recognition in the statement of financial position.

Depending on the nature and purpose of financial assets, the Fund uses the following business models:

- financial assets held to collect contractual cash flows;

- financial assets held to collect contractual cash flows and for sale.

The cash flows under the models applied by the Fund are solely payments of principal and interest.

In accordance with IFRS 9 when classifying financial assets, the Fund uses the following categories:

1. *Financial assets measured at amortised cost*: including cash and cash equivalents; contributions under Article 137, paragraph 1, item 5 and receivables under Article 57, paragraph 6 of the LRRCIIF;
2. *Financial assets measured at fair value through profit or loss*: in case of a purchase and acquisition of assets or ordinary shares under Article 137, paragraph 1, items 2 and 3 of the LRRCIIF;
3. *Financial assets measured at fair value through other comprehensive income*: in case of a purchase and acquisition of assets or ordinary shares under Article 137, paragraph 1, items 2 and 3 of the LRRCIIF.

Financial liabilities arise as a result of BRF's assumed obligations for contributions in accordance with the funding plans in resolution of credit institutions; under loan agreements and other arrangements, whereby the BRF is obliged to pay amounts or transfer funds. Following the initial recognition, the Fund classifies its financial liabilities in the category '*financial liabilities measured at amortised cost*'.

Regarding the BRF, adoption of IFRS 9 requirements with respect to classification and subsequent reporting of its financial instruments has not resulted in significant changes to its accounting policy and, therefore, had no material impact on the statement of financial position.

As of 31 December 2020 financial instruments of the BRF are cash on accounts with the BNB (31 December 2019: a current account with the BNB). Cash is qualified as financial assets measured at amortised cost under IFRS 9, amounting to BGN 541,154 thousand (31 December 2019: BGN 545,720 thousand). As of 31 December 2020 and as of 31 December 2019 the Fund does not have and, therefore, does not account financial liabilities.

### ***Recognition and Subsequent Measurement***

Financial instruments are recognised in the statement of financial position on 'the date of settlement' when the BRF becomes a party to a financial instrument-related contract. Initially, financial instruments are recognised at the acquisition price, which is the fair price paid/received at acquisition. Transaction costs are included in the acquisition cost of financial assets.

Following the initial recognition, financial assets are measured at fair or amortised cost depending on their business model for managing them and their initial classification.

1. *Financial assets measured at amortised cost*: current assets are carried at amortised cost in the statement of operations, using the effective interest rate method;

2. *Financial assets measured at fair value through other comprehensive income:* they are recognised as another component of BRF net assets in the statement of operations and are included in the ‘comprehensive result’ item disclosed in the statement of changes in net assets for the respective period. In case of a sale and/or write-off of financial assets, the accumulated effects are recognised currently in the statement of operations as ‘investment income’.
3. *Financial assets measured at fair value through profit or loss:* current assets are revalued and the effect of revaluation is included in the statement of operations.

Financial liabilities arising from BRF’s assumed obligations for contributions to the funding plans in resolution of a credit institution are measured at amortised cost under the effective interest rate method.

### ***Impairment***

Financial assets, which are not measured at fair value, are reviewed at each reporting date to determine whether there is evidence of impairment. Where a significant and/or permanent decrease in the fair value of a certain asset exists compared to its initially recognised value, impairment is recognised.

The Fund uses judgements based on historical experience of losses on assets with an inherent credit risk and on objective circumstances of impairment in calculating future cash flows.

The Fund recognises in profit or loss the effect of impairment, the amount of expected credit losses or their reversal in order to adjust the loss allowance at the reporting date to the amount that is to be recognised by the Fund in accordance with the IFRS 9.

### ***Derecognition***

Financial assets or a part of them are derecognised from the statement of financial position, when the Fund:

- realises economic gains from contractual rights; or
- loses control over the right to realise economic gains from the contract; or
- the time period of this right expires; or
- waives that right.

Financial liabilities or a part of them are derecognised from the BRF statement of financial position, when:

- the obligation is repaid; or
- the obligation is cancelled; or
- the time period to perform the obligation expires.

### ***Cash and Cash Equivalents***

In the statement of financial position, cash and cash equivalents are presented at amortised cost calculated on an effective interest basis, *i.e.* including accrued interest.

For the purpose of the statement of cash flows, cash and cash equivalents consist of current accounts and accounts with agreed maturities of up to three months.

### ***Property, Plant, Equipment and Intangible Assets***

The Banks Resolution Fund uses property, plant, equipment and intangible assets presented in the consolidated financial statements of the Bulgarian National Bank.

### ***Taxation***

The BRF is not an autonomous legal entity and, therefore, tax obligations arising from its activities are obligations of the legal entity that manages it. According to the Law on Bank Deposit Guarantee, operations of the BDIF related to financing resolution activities are exempt from paying state or local taxes. As of 27 July 2020, the date as of which the BRF management is performed by the BNB, taxation of the BRF activities complies with the Law on the Bulgarian National Bank.

## **7. Annual Contributions**

In its Resolution of 22 April 2020, the BNB Governing Council set the individual annual bank contributions to the BRF for 2020 at the total amount of BGN 157,876 thousand (2019: BGN 137,258 thousand). Annual contributions are paid up within the defined deadline. In 2020 no extraordinary contributions from the respective contribution debtors were determined and raised.

## **8. Expenses**

As of 31 December 2020 the interest expenses on current accounts with the BNB, as defined in the General Terms and Conditions of the Bulgarian National Bank on Accepting Cash Deposits and Servicing Bank Accounts, budget organisations and other customers, amounted to BGN 3984 thousand (31 December 2019: BGN 1373 thousand).

Costs related to the BRF management are financed by fees collected in relation to the resolution function of the BNB under Article 59a of the Law on the Bulgarian National Bank.

The administrative costs arising from the resolution functions, including those related to the BRF management, are financed by fees collected from credit institutions and branches of third-country credit institutions established in the Republic of Bulgaria. The terms and procedures for determining and collecting these fees are laid down in BNB Ordinance No 40 of 1 December 2020 on Determining the Amount of Fees to Cover Administrative Costs of the Bulgarian National Bank. The administrative costs for the period from 1 January to 26 July 2020 should be disclosed in the annual financial statements of the BDIF as of 31 December 2020. For the period from 27 July to 31 December 2020 the administrative costs of the BRF arising from supervisory and resolution functions will be disclosed in the annual financial statements of the BNB for the year ended 31 December 2020<sup>3</sup> (with effect from 1 January 2021).

<sup>3</sup> Published in the Darjaven Vestnik, issue 105 of 11 December 2020.



## 9. Cash and Cash Equivalents

(BGN'000)

	31 December 2020	31 December 2019
Cash in levs	541,154	545,720
	<b>541,154</b>	<b>545,720</b>

As from the date on which the ECB decision on the establishment of close cooperation takes effect, for the purpose of ensuring the technical transfer of the financial means of the Fund from the BDIF to the BNB, the BNB Governing Council decided to open earmarked accounts with the BNB, one account for each of the two sub-funds. On 27 July 2020, in line with the requirements of § 56, paragraph 1 of the Transitional and Final Provisions of the Law on Amendments and Supplements of the LRRCIIF, the financial means available in the BRF in the amount of BGN 701,166 thousand were transferred to the BNB, including individual annual contributions for 2020 in the amount of BGN 157,876 thousand.

On 5 October 2020 the BNB transferred the initial contribution of the Republic of Bulgaria to the Single Resolution Fund<sup>4</sup>, by debiting the account of the respective earmarked sub-fund by the amount of BGN 158,458 thousand<sup>5</sup> (EUR 81,018 thousand) in line with § 56, paragraph 2 of the Transitional and Final Provisions of the Law on Amendments and Supplements of the LRRCIIF.

As of 31 December 2020 the BRF financial means of BGN 541,154 thousand allocated to sub-funds are as follows:

- BGN 615 thousand reported in the sub-fund for branches of third-country credit institutions; and
- BGN 540,539 thousand reported in the sub-fund for contributions to the SRF.

Allocation to the sub-funds is made in 2020 as a result of the ECB decision on the establishment of close cooperation.

## 10. Financial Risk Management

Financial means of the Banks Resolution Fund are invested in compliance with the Law on the Recovery and Resolution of Credit institutions and Investment Firms and the Internal Rules for Management of the Financial Means of the Banks Resolution Fund adopted by the BNB Governing Council.

<sup>4</sup>The amount is set by a decision of the Single Resolution Board (SRB) of 18 September 2020 and represents an initial contribution to the SRF equal to the amount which would have been transferred by the Republic of Bulgaria if it had participated in the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM) since 2016, the year, in which the Agreement on the Transfer and Mutualisation of Contributions to the Single Resolution Fund becomes applicable.

<sup>5</sup>Under the fixed exchange rate of the lev to the euro.

The BNB Governing Council takes decisions regarding the investment of the financial means of the BRF in accordance with the principles of security, liquidity and profitability.

The structure of BRF financial assets and liabilities as of 31 December 2020 by category is as follows:

(BGN'000)

	31 December 2020	31 December 2019
<b>Financial assets</b>		
The financial assets measured at amortised cost category		
<i>Cash and cash equivalents</i>	541,154	545,720
	<b>541,154</b>	<b>545,720</b>

As of 31 December 2020 and as of 31 December 2019 the Banks Resolution Fund has no financial liabilities.

### **Market risk**

#### **1. Currency risk**

Currency risk exists where there is a mismatch between the currency structure of assets and that of liabilities.

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

The Banks Resolution Fund has no currency risks as of 31 December 2020, as the financial instruments possessed by it are in Bulgarian levs.

#### **2. Price risk**

As of 31 December 2020 and as of 31 December 2019 the Banks Resolution Fund has no financial instruments exposed to a price risk.

#### **3. Interest rate risk**

Interest risk relates to the risk of interest rate fluctuations, which may impact the future cash flows of assets (investments) and interest-bearing liabilities.

The structure of the financial instruments depending on the nature of agreed cash flows is presented in the table below.

(BGN'000)

	Floating rate instruments	Fixed rate	Interest-free	Total
<b>31 December 2020</b>				
<b>Financial assets</b>				
Cash and cash equivalents	541,154	-	-	541,154
	<b>541,154</b>	<b>-</b>	<b>-</b>	<b>541,154</b>
<b>31 December 2019</b>				
<b>Financial assets</b>				
Cash and cash equivalents	545,720	-	-	545,720
	<b>545,720</b>	<b>-</b>	<b>-</b>	<b>545,720</b>

### ***Credit and liquidity risk***

**Credit risk** is mostly the risk for the BRF of being unable to collect its receivables within an appropriate time frame. When determining how much the credit risk is increased compared to the initial recognition of the asset, the BNB Governing Council uses all reasonable and supportable information that is available.

Loss on non-performance is a judgement for damages that the Fund would suffer in the event of default. It is based on the difference between the contractual cash flows and the cash flows that the Fund expects to receive.

The BRF maximum exposure to credit risk is equivalent to the book value of cash on current accounts and deposits.

**Liquidity risk** is primarily manifested in two aspects: the first aspect is the risk for the Fund of being unable to meet its obligations when due and the second aspect comprises the risk of being unable to sell an asset on international markets at a fair value within an appropriate time frame in compliance with the respective market conventions.

In March 2020 the World Health Organisation declared the spread of the COVID-19 virus a global pandemic. The pandemic poses serious challenges to both human health and the global economy, including international financial markets. As of the date of present statements, there are no events related to COVID-19 that impose additional disclosure.

As of 31 December 2020 cash of the Banks Resolution Fund is available on the accounts at the Bulgarian National Bank.

The Fund's financial instruments, analysed by residual term to maturity from the date of the statement of financial position to the date of maturity, are as follows:

(BGN'000)

	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
<b>31 December 2020</b>						
<b>Financial assets</b>						
Cash and cash equivalents	541,154	-	-	-	-	541,154
	<b>541,154</b>	-	-	-	-	<b>541,154</b>
<b>31 December 2019</b>						
<b>Financial assets</b>						
Cash and cash equivalents	545,720	-	-	-	-	545,720
	<b>545,720</b>	-	-	-	-	<b>545,720</b>

### 11. Events Occurred after the Reporting Date

On 12 February 2021 amendments to the Law on the Recovery and Resolution of Credit Institutions and Investment Firms came into force. The BNB Governing Council assesses the amendments to the Law as a non-adjusting event as regards the financial statements for the year ended 31 December 2020.

On 25 February 2021 the BNB Governing Council adopted Ordinance No 41 on Determining the Amount of the Individual Annual Contributions of Branches of Third-country Credit Institutions to the Banks Resolution Fund. The Ordinance is issued in compliance with Article 139, paragraph 6 in connection with paragraph 3 of the LRRCIIF. It sets forth the terms and conditions for determining the amount of the individual annual contributions to the relevant BRF sub-fund, due by branches of third-country credit institutions licensed in the Republic of Bulgaria to operate through a branch. The BNB Governing Council assesses the amendments introduced by Ordinance No 41 as a non-adjusting event as regards the financial statements for the year ended 31 December 2020.

There are no events after the reporting date that require additional disclosure or adjustments to the annual financial statements of the Banks Resolution Fund.

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Elements of the 2 lev banknote, issues 1999 and 2005 are used in cover design.