Banks Resolution Fund Annual Report 2022

BULGARIAN NATIONAL BANK

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OF THE BANKS RESOLUTION FUND

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List of Abbreviations

APP	Asset Purchase Programme
ABRF	Administration of the Banks Resolution Fund
BNB	Bulgarian National Bank
BRF	Banks Resolution Fund
ECB	European Central Bank
EU	European Union
GDP	Gross Domestic Product
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
NSI	National Statistical Institute
PEPP	Pandemic Emergency Purchase Programme
SRB	Single Resolution Board
SRF	Single Resolution Fund
SRM	Single Resolution Mechanism

Summary

The Banks Resolution Fund (the BRF, the Fund) was established in 2015 under the Law on the Recovery and Resolution of Credit Institutions and Investment Firms[1] (LRRCIIF) as a national resolution financing scheme 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 not an autonomous legal entity.

The Fund consists of two sub-funds having different purposes and scope: a sub-fund established to finance the application of the resolution tools and powers under the LRRCIIF in relation to branches of third-country credit institutions; and a sub-fund established to raise contributions under Articles 69 to 71 of Regulation (EU) No 806/2014[2] and their transfer to the Single Resolution Fund (SRF).

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 related to raising and using its funds, as well as on the decisions regarding the management of BRF financial means through the profitability of financial assets in which these means are invested.

In 2022, global economic activity slowed due to the negative economic effects of the stringent anti-epidemic measures in China to contain the spread of COVID-19, the geopolitical uncertainty resulting from the war in Ukraine and associated lower supplies of energy products and other commodities in Europe, the upward global inflation dynamics and the tightening of central banks' monetary policies. Global inflation accelerated significantly in 2022, due to continued relatively strong consumer demand for goods and services and rising energy and food prices as a result of the war in Ukraine. In the context of surging and more broad-based inflation, US and euro area central banks took rapid steps to normalise their monetary policies. The measures taken by the Federal Reserve and the ECB, as well as market participants' expectations of the need for additional restrictive monetary policy measures to curb inflation, led to significant rises in yields and interest rates on all asset classes, in which BRF financial means can be invested.

In 2022, Bulgaria's real gross domestic product (GDP) growth stood at 3.4 per cent, with private consumption making the largest positive contribution, supported by higher wage growth than inflation, in the context of increasing labour shortages, strongly negative real interest rates on loans and deposits, and increased net fiscal transfers to households. Annual inflation in Bulgaria, measured by the Harmonised Index of Consumer Prices (HICP) accelerated, reaching 14.3 per cent in December

[1] Published in the Darjaven Vestnik, issue 62 of 14 August 2015.

[2] 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).

2022. Higher prices of energy and agricultural goods in international markets exerted the strongest upward pressure on consumer prices. The main factors of the domestic macroeconomic environment that contributed to the formation of high inflation throughout 2022 included strong growth in unit labour costs and higher household consumption.

Despite the slowdown in economic activity, high inflation and elevated uncertainty in the economic environment, Bulgaria's banking sector continued to be characterised by an accelerated growth of loans and total assets, and, at the same time, by a decline in non-performing receivables. Banking sector's capital ratios and liquidity position remained stable. Taking into account the stability of the banking system and the fading-out of the negative effects of the COVID-19 pandemic, in February 2022 the BNB Governing Council decided to lift the measures introduced in March 2020 to mitigate the effects of the COVID-19 pandemic. However, the BNB continued implementing macroprudential policy aiming at enhancing the resilience of the banking system to losses stemming from credit risk, and mitigating the negative effects of a possible materialisation of cyclical and structural risks.

In April 2022, the BNB Governing Council set the total amount of the annual contributions to the sub-fund for branches of third-country credit institutions to the BRF for 2022 at BGN 98 thousand. As of 31 December 2022, the available financial means in this sub-fund amounted to BGN 780 thousand.

In April 2022, the BNB Governing Council decided that the contributions of credit institutions licensed in the Republic of Bulgaria set by the Single Resolution Board (SRB) and due to the Single Resolution Fund for 2022, amounting to a total of BGN 34,362 thousand to be deducted from the financial means available in the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF, earmarked to raise contributions by credit institutions to the SRF. As of 31 December 2022, financial means in the sub-fund dedicated for contributions to the SRF amounted to BGN 472,209 thousand.

In 2022, no resolution powers were exercised in respect of credit institutions or branches of third-country credit institutions licensed in the Republic of Bulgaria and therefore no BRF funds were spent on resolution actions or transfer of extraordinary contributions to the SRF.

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 Fund financial statement as of 31 December 2022, presenting its assets and financial position, cash flows, financial performance and change in net assets, along with the report of the independent auditor.

The Banks Resolution Fund Annual Report for 2022 was adopted by the BNB Governing Council by Resolution No 149 of 13 April 2023.

I. Economic Activity in 2022

1. External Environment

In 2022, global economic activity slowed down, with lower growth rates observed in both developed and emerging market economies. The main factors behind the deceleration included the negative economic effects of the stringent anti-epidemic measures put in place in China to contain the spread of COVID-19, the geopolitical uncertainty stemming from the war in Ukraine and the associated reduced supplies of energy products and other commodities in Europe, the upward global inflation dynamics as well as the tightening of central banks' monetary policies. In 2022, annual global GDP growth[3] in real terms stood at 0.7 per cent (6.0 per cent in 2021). The dynamics of global economic indicator (global PMI[4]) also signalled a slowdown in global economic activity in the first seven months of the year, while between August and December the index declined. Overall, these developments were typical of both economic activity in the services and manufacturing. Manufacturing was negatively impacted by disruptions of supplies from China due to the anti-epidemic measures put in place, coupled with higher costs of energy and other commodities as a consequence of the war in Ukraine and the deterioration in financial conditions. The phasing out of anti-epidemic measures in the countries of the northern hemisphere resulted in some recovery of the services sector in the first half of the year driven by tourism growth. In the second half of 2022, the consumption of services declined due to lower real household income as a result of high inflation.

In 2022, US GDP rose by 2.1 per cent in real terms (compared with 5.9 per cent in 2021), with private consumption and changes in inventories contributing most to growth. The slowdown in the upward trend in 2022 compared to the previous year largely reflected the deceleration in private consumption and business investment growth as well as the fall in residential investment. The main reason for the slowdown in US economy' s annual growth was the fading effect of the fiscal stimulus measures adopted in 2021, as well as the start of the Federal Reserve's monetary policy tightening cycle.

In China, economic activity slowed significantly, from real GDP growth of 8.1 per cent in 2021 to 3.0 per cent in 2022, mainly owing to the policy of strict anti-epidemic measures implemented for most of the year. Economic activity was mainly supported by external demand, industrial production and investment in infrastructure, while the services sector was negatively affected by anti-epidemic measures.

[3] Based on World Bank data as of 13 March 2023.

[4] *Purchasing Managers' Index* – the US Institute for Supply Management's Purchasing Managers' Index.

In 2022, annual real GDP growth in the euro area remained historically high, despite slowing down to 3.5 per cent. By final consumption expenditure component, private consumption which was favoured by the removal of anti-epidemic measures and higher demand for tourist services along with the accommodative monetary policy of the ECB during most of the year made the largest positive contribution to the economic activity growth in the euro area. Investment, government consumption and changes in inventories also contributed positively to real GDP growth. Euro area economic indicators showed a downward trend in manufacturing and services in 2022, with economic activity in both sectors declining in the second half of the year. Over the review period, Germany's real GDP, which is the main trading partner of Bulgaria, rose by 1.8 per cent on an annual basis, while for Italy, the other Bulgaria's major trading partner in the euro area, the growth rate was higher: 3.7 per cent. Labour market conditions in the euro area continued to improve throughout the year, with the unemployment rate coming down to 6.7 per cent on average from 7.7 per cent in 2021.

Annual global inflation continued to accelerate in the first seven months of 2022, stabilising over the rest of the year and reaching 9.0 per cent at year-end compared to 5.6 per cent by end-2021. The main contributors to the acceleration in global inflation were continued relatively strong consumer demand for goods and services, higher prices of energy products as a result of the interruption of a large part of energy supplies from Russia to Europe as well as food price rises due to suspension of Ukrainian cereal exports and price hikes in energy products and fertilisers. The slowdown in inflation in the second half of the year was ascribable to a significant deceleration in inflation in energy products. The rapid tightening of monetary policies of major central banks had an additional effect on inflation in the second half of the year. In 2022, US annual inflation measured by the personal consumption expenditure price index remained significantly above the target of 2.0 per cent set by the Federal Open Market Committee (FOMC). Its dynamics was upward until June, when it reached 7.0 per cent (the peak since December 1981) and then decreased, amounting to 5.3 per cent by the end of 2022. The main contributor to the slowdown in US inflation was the fall in transportation fuels and lower inflation for cars and financial services. Annual inflation in the euro area increased significantly until October, standing at 10.6 per cent (highest since the creation of the euro area in 1999), before slowing to 9.2 per cent by the end of 2022 (5.0 per cent in December 2021). The increase in prices of consumer goods and services throughout the year was broad-based, with higher prices of food *i.e.* meat, bakery and diary products and of natural gas and electricity, as well as catering services, contributing most to euro area inflation growth. The moderation in inflation in the last months of the year reflected the significant decline in annual inflation in transportation fuels.

In 2022, the market environment was affected mainly by major central banks' measures to curb accelerating inflation and negative economic effects of the military conflict in Ukraine. The US Federal Open Market Committee raised the federal funds rates by a total of 425 basis points and started the process of reducing the Federal Reserve's balance sheet. US federal funds rate was raised in seven steps: by 25 basis points in March, 50 basis points in May, 75 basis points in June, July, September and November and 50 basis points in December. The Governing Council of the ECB kept the reference rates unchanged in the first half of 2022, but raised them in the second half of the year by a total of 250 basis points: by 50 basis points in July, 75 basis points in September and October, and 50 basis points in December. Eurosystem's net asset purchases under the Pandemic Emergency Purchase Programme (PEPP) were discontinued at the end of March, and those under its Asset Purchase Programme (APP) at the end of June. The measures taken by the Federal Reserve and the ECB, as well as market participants' expectations of the need for additional restrictive monetary policy measures, led to a significant increase in US and euro area government bond yields. The onset of the military conflict in Ukraine briefly boosted demand for US and German government securities used as low-risk assets and lowered market expectations for the future pace of Federal Reserve and ECB interest rate hikes. In the middle of the year, there were growing concerns among market participants that the actions of major central banks and negative economic implications of the war in Ukraine will lead to an economic recession in the United States and the euro area and as a result US and German government bond yields declined. Between August and October, US and euro area government bond yields tended to increase, reflecting the main priority adopted by the leading central banks to counter inflation, despite a possible deterioration in economic activity. In the first nine months of 2022, US and euro area stock exchange indices fell significantly due to concerns that deterioration in financing conditions and slowdown in economic growth would adversely affect financial results of corporations. The fourth quarter saw some recovery in stock markets, reflecting expectations of a decline in the pace of interest rate hikes by the ECB and the Federal Reserve. In 2022, US and European financial market volatility indices rose compared to 2021.

The increase in the ECB deposit facility rate and the reduction of excess liquidity in the euro area banking system in the second half of 2022 were the main factors driving the significant increase in the euro unsecured overnight rate (*€STR*) and unsecured deposit rates in the interbank money market (EURIBOR) in 2022. The average value of €STR rose to -0.01 per cent in 2022, from -0.57 per cent in 2021. The trade volume of overnight deposits on the euro area unsecured money market in 2022 increased, with its daily average over the year coming to EUR 55.9 billion (compared to EUR 45.9 billion in 2021). *EURIBOR* rates increased significantly in 2022. The average three-month deposit interest rate in 2022 was 0.35 per cent (compared to -0.55 per cent in 2021) and the average six- and twelve-month deposit rates were 0.68 per cent and 1.10 per cent (compared to -0.52 per cent and -0.49 per cent in 2021).

In 2022, German government bond yields rose substantially across all maturity sectors. Compared to the end of 2021, German government bond yields with a two-year residual term increased by 338 basis points to 2.76 per cent, with ten-year yields rising by 275 basis points to 2.57 per cent. Germany's yield curve measured by the difference between ten and two-year bond yields inverted, decreasing by 64 basis points to -19 basis points. A major factor behind the increase in German government bond yields in 2022 was the monetary policy tightening measures taken by the ECB as a result of the very high inflation in the euro area. The ECB Governing Council raised key interest rates by a total of 250 basis points, ended net asset purchases under the *PEPP* and the *APP*, changed the conditions of the third series of targeted longer-term refinancing operations (*TLTRO III*) and announced that it would start reducing the *APP* portfolio from early March 2023 by limiting reinvestments of maturing securities. Higher yields on US and UK government bonds driven by monetary policy tightening in these countries was another factor behind the depreciation of German government bonds. The increase in German government bond yields was briefly interrupted by end-February following the outbreak of the war in Ukraine and in June and July due to growing concerns among market participants about a forthcoming economic recession in the United States and the euro area. Data on the slowdown in inflation in the euro area and the United States in November and December raised expectations of an imminent reduction in the pace of interest rate hikes by the ECB and the Federal Reserve and also limited the increase in German government bond yields. Information provided by the ECB following its Governing Council meeting on 15 December 2022 reversed this trend, strengthening market participants' expectations of raising policy rates by 50 basis points each in both February and March 2023, and of reaching the final level to which key interest rates will be raised in the near future. At the end of December 2022, all German government bonds traded at positive annual yield. Over 2022, euro area and German government bond spreads widened. The main factor behind spreads dynamics was the gradual change in ECB monetary policy and its forward guidance, both in terms of asset purchases under the APP and PEPP and in terms of key interest rates. Rising geopolitical uncertainty as a result of the war in Ukraine further increased the risk premium on euro area sovereign debt. In the fourth quarter of the year yield spreads between euro area countries' and Germany's government bonds narrowed somewhat, reflecting a consolidation of market participants' expectations that the Federal Reserve and the ECB would slow the pace of monetary policy tightening.

Yield dynamics across the remaining asset classes, in which BRF financial means could be invested pursuant to the Law on the BNB (LBNB)[5], was also predominantly upward over 2022, following the increase in ECB's key interest rates.

2. Economic Activity in Bulgaria

In 2022, Bulgaria's real GDP growth stood at 3.4 per cent. The main factors supporting the economic activity increase were related to strong domestic and external demand for Bulgarian goods and services, as well as to firms' policies to maintain higher stocks of commodities, raw materials and finished products. The fiscal policy continued to support the economic growth through government consumption and increased net transfers to households as well as through compensations to firms for high electricity prices. By final expenditure component, real GDP growth in 2022 mainly reflected the increase in private consumption, the positive contribution of changes in inventories in the economy and government consumption growth, while net exports and investment in fixed capital contributed negatively to GDP dynamics.

In 2022, nominal wage growth tended to accelerate significantly and was higher than the rate of increase in consumer prices. The main factors weighing on wage growth were elevated inflation expectations, stronger labour demand in the context of growing economic activity and increasing labour shortages, as well as an increase in the minimum wage since April 2022. Private consumption rose by 4.8 per cent in real terms in 2022, underpinned by wage growth, the rise in the number of persons employed and the decline in household savings rate[6]. Lower households' propensity to save reflected the impact of high inflation, the persistence of nominal interest rates on deposits at low levels and the improvement in households' perceptions of labour market situation. Increased net fiscal transfers to households and lending growth also supported private consumption growth. Government consumption increased by 6.5 per cent in real terms in 2022 with Consolidated fiscal programme performance data indicating that it was probably driven by higher public expenditure on intermediate consumption and higher expenditures on wages of the public sector employees. Investment in fixed capital fell by 4.3 per cent in real terms, both public and private investment contributing to this effect according to BNB estimates[7]. Factors having a dampening effect on investment activity were the sustained high degree

[5] Published in the Darjaven Vestnik issue 46 of 10 June 1997.

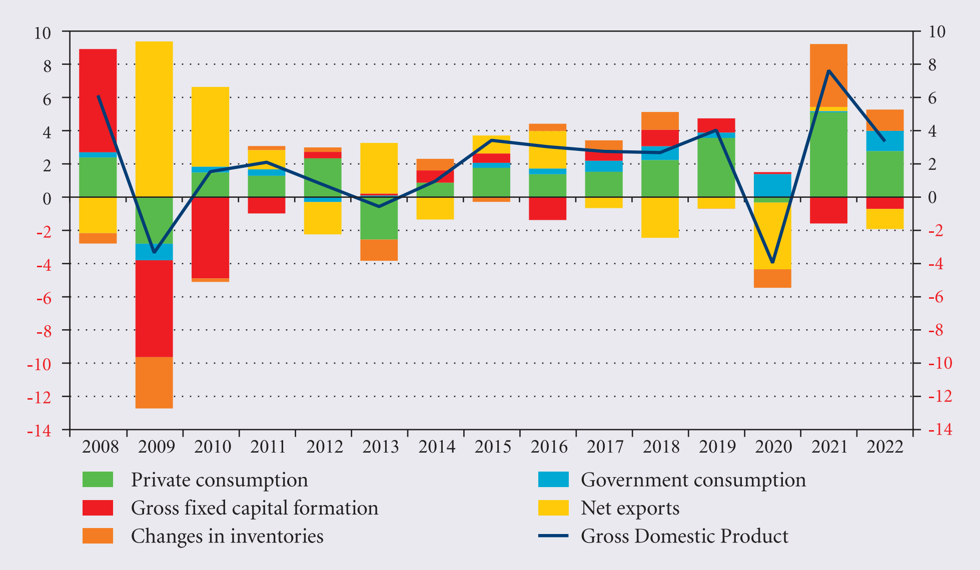
[6] To assess the household savings rate, the analysis employs data from the regular NSI Household Budget Survey.

[7] The NSI does not provide official data on the breakdown of total investment into private and public in the economy. The series on private investment is constructed by the BNB as a difference between total investment and the estimated amount of public investment on an accrual basis in real terms. Public investment estimates for the period from January to September 2022 are based on quarterly non-financial accounts data on the general government sector as published by the NSI, while for the fourth quarter of 2022 data from the Consolidated Fiscal Programme are used.

of economic uncertainty, the shortage of some raw materials (mainly in manufacturing and construction) as a result of the war in Ukraine, the significant price increase in investment goods, and the delay in the implementation of large public infrastructure projects. Potential factors behind the rise in inventories in the economy were building up expectations of a continued rise in commodity prices in international markets and uncertainty regarding the efficient functioning of global supply chains. Net exports contributed negatively to the change in GDP in 2022, driven entirely by trade in goods and reflecting stronger growth in imports than exports of goods in line with the increase in final consumption expenditure and inventories, which have a large import content. Trade in services contributed positively to economic activity growth.

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

(per cent; percentage points) (per cent; percentage points)

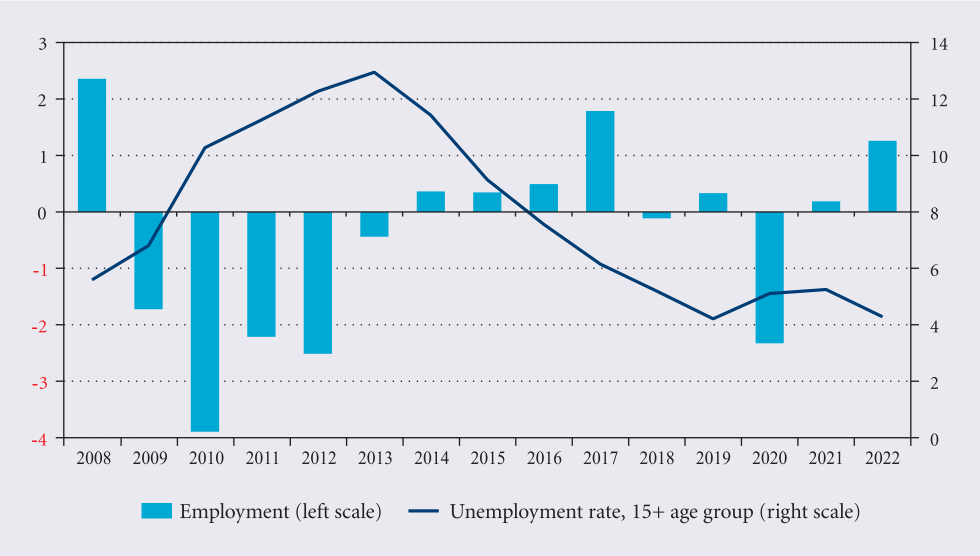


Sources: NSI, BNB calculations.

Gross value added increased by 3.4 per cent in 2022 and, as regards developments across economic sectors, the industry sector contributed most to the growth. The increase in the value added in industry was entirely driven by manufacturing subsector, which was supported by the growth of exports of goods and domestic demand, while the value added in construction declined for third consecutive year. Gross operating surplus at current prices for the total economy increased by 17.6 per cent in 2022, mainly reflecting the improvement in the financial performance of firms in the manufacturing sector. Gross operating surplus growth in the manufacturing sector (78.8 per cent on an annual basis) was largely driven by the strong increase in firms' nominal turnover in energy product sub-sectors[8] amid significant energy price rises and sales growth in real terms both in international and domestic markets. Gross operating surplus in agriculture and construction also increased, while a decline was reported in the services sector as a whole.

Chart 2. **Rate of Change in Employment and Unemployment Rate**

(per cent, on an annual basis) (per cent of labour force)



Source: NSI.

Increased economic activity in Bulgaria had a favourable effect on the labour market in 2022, with the number of employed and hours worked *per* person increasing by 1.3 and 1.2 per cent, respectively. Employment growth was entirely due to the services sector, in particular trade; repair of motor vehicles and motorcycles; transportation and storage; accommodation and food service activities. The number of employed in the construction sector also picked up, while those in agriculture and manufacturing decreased. The NSI Labour Force Survey data showed a decline in the unemployment rate to 4.3 per cent[9] in 2022 (5.3 per cent in 2021).

Annual growth of non-government sector's deposits accelerated to 14.3 per cent in December 2022, driven by corporate deposits, which rose by 26.6 per cent. Trade and manufacturing sectors were the main contributors to the growth of non-financial corporations' deposits. Following the reported slowdown in household deposit growth in late 2021 and early 2022, this trend was reversed since the beginning of the

[8] The sub-sectors related to the production of energy products include extraction of coal, extraction of oil and natural gas, production of coke and refined petroleum products, and production and distribution of electricity, heat and gas.

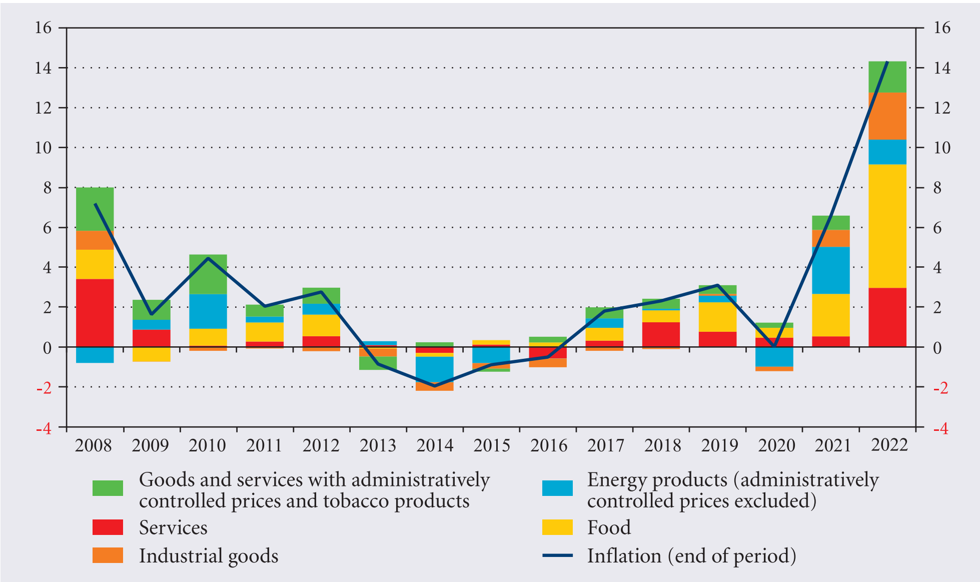
[9] Data refer to the age group of persons aged 15 and older.

third quarter of 2022, potentially driven by the removal by major commercial banks of the fee for cash holdings above a certain amount.

In the context of strongly negative levels of real interest rates, a significant volume of attracted funds and high liquidity in the banking system, the annual growth of credit to the non-government sector remained high in 2022. Demand for corporate loans was mainly intended to provide financial resources for working capital and accumulation of inventories. The reported decline in inventories after the high levels reached in the first half of 2022 contributed to some deceleration of corporate credit growth in the last months of the year, its rate reaching 10.4 per cent in December (4.6 per cent in December 2021). Stronger wage growth relative to inflation and negative real interest rates supported demand for consumer and housing loans. Growth in housing loans (17.8 per cent as of December 2022 against 16.5 per cent at the end of 2021) reflected also households' maintained preferences for real estate purchases as an alternative form of saving or investment. In December 2022 consumer loans increased by 12.4 per cent year on year (12.2 per cent at the end of 2021).

Chart 3. **Annual HICP Inflation Rate**

(per cent; percentage points) (per cent; percentage points)



Notes: This structure corresponds to the Eurostat classification; tobacco products and goods and services with administratively controlled prices are presented separately. The index of goods and services with administratively controlled prices is calculated through weighing of the elementary aggregates in the consumer basket.

Sources: NSI, BNB calculations.

Annual inflation, measured by the HICP, accelerated to 14.3 per cent in December 2022 (from 6.6 per cent in December 2021). The acceleration of the price increase rate was broad-based by components of the consumer basket, reflecting the simultaneous effect of pro-inflationary factors stemming from both external and internal macroeconomic environment. The most significant upward pressure on consumer prices came from price rises in major energy sources (natural gas, oil, electricity for business consumers) and agricultural products in international markets, whose upward dynamics has been increasing substantially since the outbreak of the war in Ukraine. Depreciation of the euro against the US dollar (by 11.5 per cent year on year as of December 2022), acceleration of inflation in durable goods in the EU and the persistence of global supply bottlenecks in the first half of 2022 were other factors with a pro-inflationary import-related effect. The main factors of the domestic macroeconomic environment contributing to the formation of high inflation throughout 2022 involved the growth in unit labour costs[10] and the increased household final consumption expenditure. Fiscal policy has had a divergent impact on inflation across individual HICP groups. In 2022 a number of discretionary measures were implemented in the form of subsidies for individual products and cuts in indirect taxes (excise rates and VAT) focused mainly on energy commodities and food to mitigate the pro-inflationary effect of the international environment. Concurrently, higher (on an annual basis) net fiscal transfers to households and higher wages in the budget sector supported private consumption growth, appearing to be a prerequisite for accelerated inflation in more demand-sensitive HICP components, such as services. Strongly negative real interest rates on deposits and loans were another factor with a pro-inflationary impact, as they further supported private consumption growth. By HICP sub-component, the highest positive contribution to inflation in 2022 came from food prices, which registered a rise of 25.0 per cent at the end of the year. Core inflation increased significantly to 11.9 per cent (up from 3.2 per cent at the end of 2021), driven by upward developments in services prices and, to a lesser extent, by increases in non-energy industrial goods prices. Energy product prices (excluding those with administratively controlled prices) recorded a year-on-year rise of 15.9 per cent in December 2022, while end-year inflation in the group of goods and services with administratively controlled prices and tobacco products was 6.9 per cent.

3. State of the Banking System

In 2022, Bulgaria's banking sector continued to operate in an environment of high inflation and a significant uncertainty. Loans and total assets of the banking system recorded accelerated growth, while non-performing loans and advances declined throughout the year. At the same time, the capital and liquidity positions of the banking system remained stable.

Measures for mitigating effects of the COVID-19 pandemic, first introduced in March 2020 and subsequently extended in January 2021, were phased out in 2022.

- On 23 February 2022, the BNB Governing Council decided to lift the re-

[10] In 2022, the annual growth of nominal unit labour costs total for the economy accelerated to 16.0 per cent, according to national accounts data.

striction on the banking sector's profit distribution for 2019 and 2020. An approach was taken to move towards consideration of individual capital plans through a supervisory dialogue. The approach takes into account the achieved positive effect on the capital position of the sector, as well as the lifting of the containment measures related to the COVID-19 pandemic. The suspension of the macroprudential profit-distribution restriction measure was in line with the decision of the ECB and the European Systemic Risk Board (ESRB) not to renew distribution restrictions based on Recommendation ESRB/2020/7 on restriction of distributions during the COVID-19 pandemic. The BNB, as the competent supervisory authority, required less significant banks intending to pay dividends or to undertake redemptions and other distributions, including from the profit for 2021, to submit distribution plans that are subject to the supervisory dialogue.

- With a decision of the BNB Governing council from 23 February 2022 the measure for individual and aggregate limits on banks' foreign exposures, aiming to constraint credit and concentration risks on their balance sheets, was suspended from 1 April 2022. The measure, introduced in March 2020 and extended in January 2021, has contributed to a sustained improvement in the liquidity position of the banking system. The BNB suspended the measure with positive effect of its implementation reported, while continuing to analyse the relevant risks on a regular basis and standing ready to apply an appropriate macroprudential measure, where necessary.

In 2021, the BNB Governing Council raised the countercyclical capital buffer applicable to domestic credit risk exposures to 1.0 per cent with effect from 1 October 2022 and to 1.5 per cent from 1 January 2023. Given the accelerated credit growth rates and the uncertainty in the economic environment, in September 2022 the countercyclical capital buffer rate was raised to 2.0 per cent, with effect from 1 October 2023. These decisions aimed to strengthen the resilience of the banking system to credit risk losses and mitigate the effects of potential materialisation of cyclical and structural risks.

Banks in Bulgaria also maintained a systemic risk buffer set by the BNB Governing Council at 3 per cent of risk exposures in order to increase their resilience to structural risks to the stability of the Bulgarian financial system.

In November 2022, under the annual review of the buffer for other systemically important institutions (OSII), the BNB Governing Council identified eight banks, for which the buffer rates would range from 0.5 to 1.0 per cent in 2023.

In 2022, the capital position of the banking system remained stable on the back of growth in risk-weighted assets. By end-December 2022, the total capital adequacy ratio was 20.9 per cent, compared to 22.6 per cent by end-2021. The reported leverage ratio for the banking sector of 9.4 per cent at the end of 2022 continued to indicate a high capital coverage of the total exposure, with its level in all credit institutions significantly exceeding the minimum regulatory requirement of 3.0 per cent. At end-December 2022, the banking system's balance sheet equity was BGN 17.3 billion, up by 4.5 per cent (BGN 740 million) on an annual basis. The liquidity position of the credit institutions remained stable, underpinned by the significant share of assets with a high liquidity quality. The average liquidity coverage ratio was 235.0 per cent by end-2022 (with a minimum requirement of 100 per cent), decreasing in comparison to its level of end-2021 (274.0 per cent). In 2022 all banks complied with the requirement for a net stable funding ratio (NSFR), with banking sector's average level at the year end (162.4 per cent) significantly exceeding the regulatory minimum of 100 per cent.

The downward trend in gross non-performing loans and advances continued in 2022 along with their shares in the total loans and advances. Write-off activities, sales of loans and growth of the credit portfolio contributed to this trend. Given the accelerated lending during the year, which led to a rise in the gross loans and advances, the ratio of non-performing loans[11] to total loans and advances decreased to 4.6 per cent as of 31 December 2022 (compared to 5.9 per cent a year earlier).

The banking system's profit was BGN 2.1 billion as of 31 December 2022 (BGN 1.3 billion by end-2021). The increase in net interest income and, to a lesser extent, in net fee and commission income contributed mostly to the higher financial result realised over the year. At the end of 2022, total net operating income of the banking system reached BGN 5.3 billion, up BGN 755 million (16.7 per cent) compared to the end of 2021. Impairment costs on financial assets not measured at fair value through profit or loss decreased by BGN 149 million, or 20.3 per cent compared to end-2021, amounting to BGN 584 million as of 31 December 2022. At the same time, banks' expenses on resolution funds and deposit guarantee schemes rose by BGN 39 million (24.8 per cent) to BGN 196 million by end-2022.[12]

[11] A definition of loans and advances applicable from June 2020 (cash balances at central banks and other demand deposits are excluded).

[12] According to the item 'cash contributions to resolution funds and deposit guarantee schemes' in supervisory statements of profit or loss of banks.

Table 1. **Key Indicators of the Banking System**[13]

Key indicators	December 2021	December 2022	Annual change (per cent)
Assets, BGN million	135,341	155,405	14.8
Assets as a share of GDP, per cent	97.4	94.0	-
Equity, BGN million	16,540	17,280	4.5
Profit, BGN million	1,342	2,075	54.6
Total capital adequacy ratio, per cent	22.6	20.9	-
Common equity tier 1 ratio, per cent	21.7	20.0	-
Capital surplus/deficit relative to capital requirements, including the combined buffer requirement*, BGN million	4,818	2,868	–
Capital surplus/deficit as a ratio to the risk-weighted assets, per cent	7.1	3.8	-
Liquidity coverage ratio, per cent	274.0	235.0	-
Return on assets, per cent	1.0	1.3	-
Return on equity, per cent	8.1	12.0	-
Gross non-performing loans ratio**, per cent	5.9	4.6	-

* A 'combined buffer requirement' is a concept referred to in Article 2, paragraph 3 of the BNB Ordinance No 8 of 27 April 2021 on Banks' Capital Buffers.

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

Source: BNB.

[13] Based on updated supervisory statements on an individual basis as of end-December 2022, submitted by 21 February 2023.

II. Management of the Banks Resolution Fund

1. BNB Powers

The Banks Resolution Fund was established in 2015 under the Law on the Recovery and Resolution of Credit Institutions and Investment Firms as a national resolution financing arrangement. The BRF is not an autonomous legal entity.

From the moment of its establishment to 27 July 2020, the date on which the ECB decision on the establishment of close cooperation with the BNB[14] became applicable, the Management Board of the Bulgarian Deposit Insurance Fund took decisions on the operational management of the BRF. Over this period, the BNB as a resolution authority of credit institutions had powers related to determination of contributions to the BRF and the use of its financial means for resolution purposes.

Since 27 July 2020, as a result of established close cooperation with the ECB and joining the Single Resolution Mechanism (SRM), the BNB in its capacity as a resolution authority is fully responsible for BRF administration and management, and collected financial means are allocated in two separate sub-funds 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 (Article 134, paragraph 1, item 1 of the LRRCIIF): a sub-fund for branches of third-country credit institutions.

  This sub-fund ensures a mechanism to finance resolution of branches of third-country credit institutions (outside the scope of the SRM). Its purpose is to limit to the maximum extent possible the use of public funds in case additional financing of resolution is needed.

- a sub-fund established to raise contributions under Articles 69–71 of Regulation (EU) No 806/2014 and their transfer to the SRF (Article 134, paragraph 1, item 2 of the LRRCIIF): a sub-fund for contributions to the Single Resolution Fund.

  This sub-fund is earmarked for raising contributions from the credit institutions licensed in the Republic of Bulgaria that fall within the scope of the SRM, and for their transfer to the SRF.

[14] 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 the Bulgarian National Bank (ECB/2020/30) (OJ L 224 I, of 13 July 2020, p 1–3).

BNB decisions as a resolution authority for credit institutions, including those concerning administration and management of the Fund, are taken by the Governing Council of the BNB.

Pursuant to the LRRCIIF, the BNB is responsible for the following main activities in relation to operational Fund governance: determining and 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; 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; appointing a registered auditor to carry out an independent financial audit of the annual financial statements of the BRF; adopting and publishing the annual financial statements of the BRF.

The Bulgarian National Bank as a national resolution authority within the meaning of Regulation (EU) No 806/2014 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 in the SRF and its submission to the SRB. In addition, the BNB is obliged to notify the credit institutions of the determined individual amount of their contributions to the SRF, to collect the contributions in the earmarked sub-fund of the BRF and to transfer the collected amounts to the SRF.

2. Sources of Funding

Sources of funding of the BRF include: annual and extraordinary contributions by 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 on reasonable terms.

3. Determination of Annual and Extraordinary Contributions

Contributions to resolution financing arrangements may be annual individual contributions which each credit institution and a branch of a third-country credit institution is obliged to pay on an annual basis, as well as extraordinary contributions.

The contributions are determined and raised under the procedure set out below for each of the two sub-funds, according to the powers of the authorities under the relevant resolution financing arrangement.

3.1. Sub-fund for Branches of Third-country Credit Institutions

Contributions to the sub-fund for branches of third-country credit institutions are determined by the BNB.

Individual annual contributions to this sub-fund are one-off annual fixed sums calculated by the BNB on the basis of the amount of covered deposits of branches of third-country credit institutions and available financial means in the sub-fund under Article 134, paragraph 1, item 1 of the LRRCIIF. The terms and conditions for determining the amount of individual annual contributions of branches of third-country credit institutions to the BRF and their collection by the BNB are provided for in Ordinance No 41 of the BNB.[15]

Where the amount of the financial means accumulated in the sub-fund is not sufficient to cover the costs associated with the financing of the resolution, the BNB determines and raises extraordinary contributions from branches of third-country credit institutions pursuant to the provisions of the LRRCIIF.

3.2. Sub-fund for Contributions to the SRF

Individual annual contributions and extraordinary contributions to the SRF for all credit institutions licensed in the Republic of Bulgaria are determined by the SRB.

Principles and rules for determining the individual annual contributions and extraordinary *ex-post* contributions of credit institutions to the SRF are laid down in Regulation (EU) No 806/2014, Commission Delegated Regulation (EU) 2015/63[16] and Council Implementing Regulation (EU) 2015/81.[17] Annual contributions are calculated in accordance with the type, size and risk profile of an institution, as well as the target level of the funds which should be reached until 1 January 2024, *i.e.* 1 per cent of the amount of covered deposits of all credit institutions licensed in participating Member States. Credit institutions have the opportunity to meet their obligations as regards annual *ex-ante* contributions by both cash and partially by

[15] Ordinance No 41 of 25 February 2021 on Determining the Amount of the Individual Annual Contributions of Branches of Third-country Credit Institutions to the Banks Resolution Fund, published in the Darjaven Vestnik, issue 23 of 19 March 2021.

[16] Commission Delegated Regulation (EU) 2015/63 of 21 October 2014 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regards to *ex-ante* contributions to resolution financing mechanisms (OJ, L 11 of 17 January 2015, p 44–64).

[17] 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 (OJ, L 15 of 22 January 2015, p 1–7).

undertaking irrevocable payment commitments[18] that are guaranteed entirely by a collateral of low risk assets.

It is a responsibility of the BNB, as a national resolution authority, to notify the credit institutions of the contributions determined by the SRB, 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.[19]

4. Use of the BRF Financial Means

4.1. Use of Financial Means of the Sub-fund for Branches of Third-country Credit Institutions

Symmetrically to the power to determine the contributions in the sub-fund for branches of third-country credit institutions, the BNB takes decisions on using the financial means of the sub-fund for the purposes of the efficient application of resolution tools towards branches of third-country credit institutions.

4.2. Use of Financial Means of the Sub-fund for Contributions to the SRF

Financial means which are raised in this sub-fund are intended solely for a transfer to the SRF. Upon a decision of the SRB, SRF financial means are used for the purposes of resolution of credit institutions, including credit institutions 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 Regulation (EU) No 806/2014.

5. 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 in consistent compliance with the principles of security, liquidity and profitability. Investment decisions are taken by the BNB Governing Council, and financial means in individual funds are invested separately (without mixing them).

The procedure under which the BNB as a resolution authority manages the BRF financial means and the interaction and tasks of the BNB structural units in relation

[18] The share of irrevocable payment commitments is specified in a decision of the SRB and may not exceed 30 per cent of the amount of annual contributions.

[19] Ratified by a law adopted by the 44th National Assembly on 8 November 2018, published in the Darjaven Vestnik, issue 96 of 2018, effective as of 24 November 2018.

to this activity are laid down in the Internal Rules for Management of the Banks Resolution Fund Financial Means[20] (Internal Rules).

The Internal Rules define 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 LBNB, on the other hand. Considering the above, the financial instruments 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.

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.

The financial instrument, in which financial means of each of the two sub-funds may be invested, is chosen on a quarterly basis by the BNB Governing Council on a proposal from the Deputy Governor in charge of the Issue Department, accompanied by an analysis of the expected return and risk.

[20] Adopted by Resolution No 446 of the BNB Governing Council of 17 December 2020.

III. Key Indicators of BRF Performance in 2022

1. Contributions to the BRF in 2022

1.1. Contributions to the Sub-fund for Branches of Third-country Credit Institutions

In April 2022, the BNB Governing Council determined the total amount of annual contributions to the BRF sub-fund for branches of third-country credit institutions for 2022 at BGN 98 thousand and informed the contribution debtors. Funds were paid up to the sub-fund's account within the statutory time-limit (30 days from the date of notification).

In 2022 no circumstances have occurred that require extraordinary contributions to be raised from branches of third-country credit institutions in the sub-fund under Article 134, paragraph 1, item 1 of the LRRCIIF.

1.2. Contributions to the Sub-fund for Contributions to the SRF

In 2022 no funds were raised in the sub-fund for contributions to the SRF.

Pursuant to § 56, paragraph 2 of the Transitional and Final Provisions of the Law on Amendment of the LRRCIIF, funds available in the sub-fund were used for fulfilment of the obligations of the credit institutions licensed in the Republic of Bulgaria for annual contributions to the SRF for 2022 (for further information see 3.2. Use of Financial Means of the Sub-fund for Contributions to the SRF).

In 2022 the BNB did not receive any request from the SRB for raising extraordinary contributions to the SRF from credit institutions licensed in the Republic of Bulgaria.

2. Investment of the BRF Financial Means

Taking into account the current state and trends in the development of the economy and financial markets as well as the results of the quarterly analyses of the expected return and risk in determining the financial instrument in which the BRF funds to be invested, in 2022 the BNB Governing Council maintained the implemented investment strategy, and the financial means of the sub-fund for branches of third-country credit institutions and of the sub-fund for contributions to the SRF continued to be held in current accounts with the BNB. These accounts are subject to the General Terms and Conditions of the Bulgarian National Bank on Servicing Accounts of Banks, Budget Organisations and Other Customers, and are remunerated at the applicable standard annual interest rate on current accounts valid for the relevant periods. In 2022 the funds were remunerated at the following interest rates:

- -0.70 per cent for the 1 January – 26 July period;
- -0.20 per cent for 27 and 28 July;
- 0.00 per cent for the 29 July – 13 September period;
- 0.50 per cent for the 14 September – 1 November period;
- 1.25 per cent for the 2 Novermber – 20 December period;
- 1.75 per cent for the 21 – 31 December period.

As a result of the negative interest rates for the 1 January – 28 July 2022 period, interest expenses amounting to BGN 2026 thousand were paid from the Fund, of which BGN 3 thousand on the sub-fund for branches of third-country credit institutions and BGN 2023 thousand on the sub-fund for contributions to the SRF.

As a result of the positive interest rates for the 14 September – 31 December 2022 period, the interest income accrued and received on Funds' financial means amounted to BGN 1377 thousand, of which BGN 2 thousand on the sub-fund for branches of third-country credit institutions and BGN 1375 thousand on the sub-fund for contributions to the SRF.

Interest rate movements in 2022 generated negative net yield for the year in the amount of BGN -649 thousand, including BGN -1 thousand on the sub-fund for branches of third-country credit institutions and BGN -648 thousand on the sub-fund for contributions to the SRF.

By 31 December 2022 Fund's assets consist entirely of cash in levs held in current accounts with the BNB.

3. Use of the BRF Financial Means

3.1. Use of Financial Means of the Sub-fund for Branches of Third-country Credit Institutions

In 2022 the BNB exercised no resolution powers in respect of branches of third-country credit institutions, hence, no funds of this sub-fund were spent. In addition, over the period under review no requests for loans to other resolution financing arrangements were received.

3.2. Use of Financial Means of the Sub-fund for Contributions to the SRF

In relation to the contributions to the SRF, set by the SRB for 2022, due by the credit institutions licensed in the Republic of Bulgaria, in April 2022 the BNB Governing Council decided contributions amounting to BGN 34,362 thousand (EUR 17,569 thousand) to be deducted from the financial means available in the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF. The decision stems from the possibility provided for in § 56, paragraph 2 of the Transitional and Final Provisions of the Law on Amendment to the LRRCIIF[21] and the availability of the necessary funds in the BRF earmarked sub-fund. In 2022 funds from the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF in the amount of BGN 34,082 thousand (EUR 17,426 thousand) were transferred to the SRF representing the difference between the total amount of annual contributions due to the SRF and the amount of annual contribution partially executed by one credit institution by undertaking an irrevocable payment commitment to the SRB[22]. In 2021 the funds transferred from the sub-fund to the SRF came to BGN 29,560 thousand (EUR 15,114 thousand).

Over the reporting period the BNB did not receive any request from SRB for raising and transferring extraordinary contributions to the SRF.

4. Financial Means Available in the BRF Sub-funds as of 31 December 2022

The financial means of the BRF as of 31 December 2022 amounted to BGN 472,989 thousand, including BGN 780 thousand in the sub-fund for branches of third-country credit institutions and BGN 472,209 thousand in the sub-fund for contributions to the SRF.

The outstanding amount in the sub-fund for contributions to the SRF is due to changes in the legal framework in 2020 related to Bulgaria's participation in the SRM, the direct application of Regulation (EU) No 806/2014 and the resulting change in resolution financing arrangements. The main differences in the regulatory requirements before and after joining the SRM, leading to the outstanding amount, are as follows:

- two times lower target level of financial means in the SRF: 1 per cent of the amount of the covered deposits within the SRM, compared to the BRF target level prior to the amendments to the legal framework - 2 per cent of the amount of the covered deposits;
- the SRB approach applied in determining the annual contributions of small credit institutions 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;

[21] 'Upon a relevant notification by the Single Resolution Board with regard to an initial contribution, the resolution authority under Article 2, paragraph 1 shall order a transfer to the Single Resolution Board of a sum from the sub-fund under Article 134, paragraph 1, item 2 in accordance with Article 8 of the Agreement on the transfer and mutualisation of contributions to the SRF. After the transfer of the funds, the remaining funds generated in the sub-fund under Article 134, paragraph 1, item 2, if any, shall be deducted from the obligations of the entities for future contributions to the Single Resolution Fund following a decision of the resolution authority until they are exhausted.'

[22] Irrevocable payment commitment is fully collateralised by the funds of the credit institution taking advantage of this opportunity. The LRRCIIF does not provide a possibility funds in the respective earmarked sub-fund to be used for collateralisation of irrevocable commitments.

- the SRB approach applied in calculating risk adjustments 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 adjustments within the SRM;
- application by the SRB of specific adjustments in the initial period of accumulation of financial means in the SRF.

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

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 BNB Governing Council has determined a dedicated structural unit, which assists it in exercising the resolution function, namely Resolution of Credit Institutions Directorate. Administration of the Banks Resolution Fund (ABRF) Division to the Directorate implements and coordinates all activities that concern BRF administration and management, including the use of specilised services provided by other units within BNB, mainly related to reporting and investment of BRF financial means. The division supports the processes related to decision-making by the BNB Governing Council for determining and collecting contributions to the sub-fund for branches of third-country credit institutions and their spending, where necessary, in line with the financing of resolution measures. In addition, the ABRF 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 function, 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 these fees are laid down in the BNB Ordinance No 40[23].

2. Participation in the Single Resolution Board

Within the Single Resolution Mechanism, the BNB, as the resolution authority, 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.

[23] 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, published in the Darjaven Vestnik, issue 105 of 11 December 2020.

With respect to SRB sub-structures pertaining to the SRF, the BNB participates in the Single Resolution Fund Committee. The Committee does not have a decision-making mandate but is 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

There are no events after the date of preparation of the annual financial statements of the BRF that require additional disclosure or adjustments to them.

VI. Projected Future Developments

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 in the SRF, following a decision of the BNB, are deducted from the obligations of the institutions for future contributions to the SRF, until they are exhausted.

The preliminary information from the SRB about the estimated total amount of contributions by credit institutions licensed in the Republic of Bulgaria that fall within the scope of the SRM to the SRF for 2023 provides grounds for expecting that the financial means available in the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF will be sufficient to cover this amount.

VII. Financial Statements as of 31 December 2022

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 in the European Union.

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 2022, 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 2022, 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.

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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.

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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.

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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

20 April 2023

Statement of Operations for the Year Ended 31 December 2022

(BGN'000)

	Notes	31 December 2022	31 December 2021
Annual contributions, including	7	98	73
in the sub-fund under Article 134, paragraph 1, item 1 of the LRRCIIF		*98*	*73*
in the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF		-	-
Transfer from the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF to the account of the Single Resolution Fund	8	(34,082)	(29,560)
Interest expense on accounts, including	8	(2,026)	(4,045)
in the sub-fund under Article 134, paragraph 1, item 1 of the LRRCIIF		*(3)*	*(5)*
in the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF		*(2,023)*	*(4,040)*
Interest income on accounts, including	8	1,377	-
in the sub-fund under Article 134, paragraph 1, item 1 of the LRRCIIF		*2*	-
in the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF		*1,375*	-
Net interest expenses		(649)	(4,045)
Result for the year		**(34,633)**	**(33,532)**

The accompanying notes on pages 42 to 56 form an integral part of the Financial Statements.

Statement of Financial Position for the Year Ended 31 December 2022

(BGN'000)

	Notes	31 December 2022	31 December 2021
ASSETS			
Cash at bank, including	9	472,989	507,622
in the sub-fund under Article 134, paragraph 1, item 1 of the LRRCIIF		*780*	*683*
in the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF		*472,209*	*506,939*
TOTAL ASSETS		**472,989**	**507,622**
LIABILITIES		-	-
NET ASSETS		**472,989**	**507,622**

The accompanying notes on pages 42 to 56 form an integral part of the Financial Statements.

Statement of Cash Flows for the Year Ended 31 December 2022

(BGN'000)

	Notes	31 December 2022	31 December 2021
Cash flows from operating activities			
Cash receipts from banks as annual contributions		98	73
in the sub-fund under Article 134, paragraph 1, item 1 of the LRRCIIF		*98*	*73*
in the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF		-	-
Transfer from the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF to the account of the Single Resolution Fund		(34,082)	(29,560)
Net cash flows from operating activities		*(33,984)*	*(29,487)*
Cash flows from investing activities			
Payments related to cash		(2,026)	(4,045)
in the sub-fund under Article 134, paragraph 1, item 1 of the LRRCIIF		*(3)*	*(5)*
in the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF		*(2,023)*	*(4,040)*
Proceeds related to cash		1,377	-
in the sub-fund under Article 134, paragraph 1, item 1 of the LRRCIIF		*2*	-
in the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF		*1,375*	-
Net cash flows from investing activities		*(649)*	*(4,045)*
(Decrease) in cash flows during the year		**(34,633)**	**(33,532)**
Cash and cash equivalents at beginning of period		**507,622**	**541,154**
in the sub-fund under Article 134, paragraph 1, item 1 of the LRRCIIF		*683*	*615*
in the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF		*506,939*	*540,539*
Cash and cash equivalents at the end of period	9	**472,989**	**507,622**
in the sub-fund under Article 134, paragraph 1, item 1 of the LRRCIIF		*780*	*683*
in the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF		*472,209*	*506,939*

The accompanying notes on pages 42 to 56 form an integral part of the Financial Statements.

Statement of Changes in Net Assets for the Year Ended 31 December 2022

(BGN'000)

	Net assets
Balance as at 1 January 2021	**541,154**
Result for the year	(33,532)
Total comprehensive result	(33,532)
Balance as at 31 December 2021	**507,622**
Balance as at 1 January 2022	**507,622**
Result for the year	(34,633)
Total comprehensive result	(34,633)
Balance as at 31 December 2022	**472,989**

The accompanying notes on pages 42 to 56 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[1] (LRRCIIF).

The address of the BRF head office is: 1, Knyaz Alexander I Square, 1000 Sofia, Bulgaria.

The activities of the Banks Resolution Fund are governed by the LRRCIIF and the Law on the Bulgarian National Bank (LBNB).

With effect from 27 July 2020, the management of the BRF is performed by the BNB and the decisions related to the BRF management are taken by the BNB Governing Council. The BRF is not an autonomous legal entity.

The composition of the BNB Governing Council as of 31 December 2022 is as follows:

- Dimitar Radev – Governor of the BNB;
- Kalin Hristov – Deputy Governor, head of the Issue Department and member of the Governing Council of the BNB;
- Nina Stoyanova – Deputy Governor, head of the Banking Department and member of the Governing Council of the BNB;
- Radoslav Milenkov – Deputy Governor, head of the Banking Supervision Department and member of the Governing Council of the BNB;
- Lyudmila Elkova – member of the Governing Council of the BNB;
- Prof. Nikolay Nenovsky, D.Sc. – member of the Governing Council of the BNB;
- Iliya Lingorski – member of the Governing Council of the BNB.

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- Nina Stoyanova – Deputy Governor, head of the Banking Department and member of the Governing Council of the BNB;
- Radoslav Milenkov – Deputy Governor, head of the Banking Supervision Department and member of the Governing Council of the BNB;
- Elitsa Nikolova – member of the Governing Council of the BNB;
- Lyudmila Elkova – member of the Governing Council of the BNB;
- Prof. Nikolay Nenovsky, D.Sc. – member of the Governing Council of the BNB.

The Fund is designed as a special-purpose fund. Its 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.

[1] Effective as of 14 August 2015; Darjaven Vestnik, issue 62 of 2015.

According to Article 134, paragraph 1 of the LRRCIIF the Fund consists of two sub-funds 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).

The financial means of the BRF are reported on accounts with the BNB and are invested in accordance with the LBNB. 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.

2. Applicable Standards

The financial statements of the Fund have been prepared in accordance with the International Financial Reporting Standards adopted in the European Union (IFRS adopted in the EU).

3. Basis of Preparation

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

The financial statements of the BRF are prepared:

- 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 as of 1 January 2022. The Fund has applied for the first time certain standards and amendments which are effective for annual periods beginning on or after 1 January 2022.

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: the amendment updated the reference to the Conceptual Framework;

   The Board also added an exception to the recognition principle of IFRS 3 to avoid the issue of potential 'day 2' gains or losses arising for liabilities and contingent liabilities that would be within the scope of IAS 37 or IFRIC 21 *Levies*, if incurred separately. At the same time, the Board decided to clarify existing guidance in IFRS 3 for contingent assets that would not be affected by replacing the reference to the Framework for the Preparation and Presentation of Financial Statements;

2. IAS 16 Property, Plant and Equipment: the amendment relates to actions before the intended use regarding proceeds from selling items produced while bringing an asset into the location and condition necessary for it to be capable of operating in the manner intended by management;
3. IAS 37 Provisions, Contingent Liabilities and Contingent Assets: the amendment regarding costs a company should include as the cost of fulfilling a contract when assessing whether a contract is onerous;
4. Annual improvements 2018–2020: the pronouncement contains amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* – Subsidiary as a first-time adopter; IFRS 9 *Financial Instruments* – Fees in the '10 per cent' Test for Derecognition of Financial Liabilities, and IAS 41 *Agriculture* – Taxation in Fair Value Measurements, as a result of the annual improvements project.

The amendments, which are effective for annual periods beginning on or after 1 January 2022, were adopted by the EU on 28 June 2021 and published in the Official Journal of the EU on 2 July 2021.

These amendments have no material effect on the financial position or performance of the BRF.

IFRS 16 Leases – COVID-19-Related Rent Concessions beyond 30 June 2021 (Amendment)

In March 2021, the Council amended the terms of the practical expedient measure in IFRS 16 providing relief to lessees in applying the guidance in IFRS 16 for lease modifications on COVID-19-related rent concessions. The amendment is effective for annual reporting periods beginning on or after 1 April 2021, with earlier application is permitted. The amendment is not applicable to the BRF.

5. New standards and clarifications issued but not yet effective and not early adopted

Standards issued but not yet effective and not early adopted up to the date of issuance of BRF financial statements are briefly listed 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 (issued on 18 May 2017), including Amendments to IFRS 17 (issued on 25 June 2020)

On 25 June 2020 the International Accounting Standards Board (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 which was adopted by the EU on 19 November 2021 and published in the Official Journal of the EU on 23 November 2021 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 (issued on 23 January 2020 and 15 July 2020 respectively)

On 23 January 2020 the IASB issued Amendments to IAS 1 Presentation of Financial Statements to clarify requirements for classifying liabilities as current or non-current and 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). With this draft the IASB proposed to defer the effective date of the amendments to IAS 1 by one year and to apply to 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.

Disclosure of Accounting Policies: Amendments to IAS 1 Presentation of Financial Statements and IFRS Practice Statement 2: Making Materiality Judgements

On 12 February 2021 the IASB issued Disclosure of Accounting Policies: Amendments to IAS 1 *Presentation of Financial Statements* and IFRS *Practice Statement 2* to help companies improve accounting policy disclosures so that, on one hand, they provide more useful information to investors and other primary users of the financial statements by disclosing their significant policies, and, on the other hand, distinguish changes in accounting estimates from changes in accounting policies. The amendments are effective for annual periods beginning on or after 1 January 2023, with earlier application permitted. Amendments to IAS 1 and IFRS *Practice Statement 2* were adopted by the EU on 2 March 2022 and published in the Official Journal on 3 March 2022. The amendments are applied prospectively and are effective for annual reporting periods beginning on or after 1 January 2023. Earlier application is permitted. The BNB Governing Council will analyse and assess the impact of these amendments on the financial position or performance of the BRF.

Amendments to IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors: Definition of Accounting Estimates

On 12 February 2021, the IASB published definition of accounting estimates (amendments to IAS 8), to help entities distinguish changes in accounting policies from changes in accounting estimates. This distinction is important because changes are applied prospectively *i.e.* to future transactions or other future events, while changes in accounting policies are usually applied retrospectively *i.e.* to past transactions and other past events. The amendments to IAS 8, which are effective for reporting periods beginning on or after 1 January 2023, were adopted by the EU on 2 March 2022 and published in the Official Journal of the EU on 3 March 2022. Earlier application permitted. The BNB Governing Council will analyse and assess the impact of these amendments on the financial position and performance of the BRF.

Amendments to IAS 12 Income Taxes: Deferred Tax Related to Assets and Liabilities Arising from a Single Transaction

On 7 May 2021 the IASB published Amendments to IAS 12 Income Taxes: Deferred Tax Related to Assets and Liabilities Arising from a Single Transaction to recognise deferred tax in the cases where a company reports transactions, such as renting/leasing or decommissioning obligations, in which it recognises an asset and liability. The Board expects that these amendments will reduce diversity in reporting of deferred tax on such transactions in compliance with the main principle of IAS 12: to recognise deferred tax in respect of temporary differences. The amendments which have not yet been endorsed by the EU are effective for reporting periods beginning on or after 1 January 2023. The amendments are not applicable to the BRF.

Amendments to IFRS 17 Insurance Contracts: Initial Application of IFRS 17 and IFRS 9 – Comparative Information

On 9 December 2021 the IASB issued *Initial Application of IFRS 17 and IFRS 9 – Comparative Information* (Amendments to IFRS 17) enabling companies to improve the usefulness of comparative information presented upon initial application of IFRS 17 and IFRS 9. These amendments are not applicable to the BRF.

Amendments to IAS 1: Classification of Liabilities as Current or Non-current

In January 2020, the IASB published amendments in paragraphs 69 to 76 of IAS 1 specifically referring to the requirements on the classification of liabilities as current or non-current. The amendments clarify:

- what is meant by a right to defer settlement;
- that a right to defer must exist at the end of the reporting period;
- that classification is unaffected by the likelihood that an entity will exercise its deferral right;
- that if a derivative, embedded in a convertible liability, is itself an equity instrument the terms of the liability would not impact its classification.

In July 2021, the Council adopted a preliminary decision to propose several amendments to the clarifications provided in January 2020 and to postpone the date of entry into force to not earlier than 1 January 2024 (from 1 January 2023).

The Fund will analyse and assess the impact of these amendments on the financial position or performance.

Amendments to IFRS 16 Leases: Lease liability in a sale and leaseback transaction

In September 2022, the IASB issued amendments to IFRS 16 Leases: *Lease liability in a sale and leaseback transaction.* The amendments are intended to improve the requirements that the seller-lessee uses in measuring the lease liability arising in a sale and leaseback transaction under IFRS 16 by not changing the accounting for leases unrelated to this transaction. The amendments have not yet been endorsed by the EU and are not applicable to the BRF.

Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The amendments address the conflict between IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* when accounting for a loss of control over a subsidiary which is sold or contributed to an associate or a joint venture. The amendments have not yet been endorsed by the EU and 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 received by the BRF used for resolution purposes under the terms provided in the application of appropriate resolution tools and related income and compensation;
4. proceeds from borrowings and other forms of support and 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 are 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. With effect from 1 October 2020 the BNB may determine extraordinary contributions only for the branches of third-country credit institutions. In 2022 and 2021 no extraordinary contributions were raised.

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 instruments in accordance with the Law on the BNB and 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 other 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 LBNB.

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 the BRF 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.

When classifying financial assets, the Fund uses the following categories:

1. *Financial assets measured at amortised costs*: 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 obligations assumed by BRF for contributions according to funding plans in resolution of credit institutions, under loan agreements and other agreements, whereby the Fund is obliged to pay amounts and transfer funds. Following the initial recognition, the Fund classifies its financial liabilities in the category '*financial liabilities measured at amortised costs*'.

As of 31 December 2022 and as of 31 December 2021, financial instruments of the BRF are cash on accounts with the BNB. Cash is qualified as financial assets measured at amortised cost, amounting to BGN 472,989 thousand as of 31 December 2022 (BGN 507,622 thousand as of 31 December 2021), including:

- BGN 780 thousand (BGN 683 thousand as of 31 December 2021) of the sub-fund for branches of third-country credit institutions;
- BGN 472,209 thousand (BGN 506,939 thousand as of 31 December 2021) of the sub-fund for contributions to the SRF.

As of 31 December 2022 and as of 31 December 2021, 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 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 other 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 debt investments, 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 which arise as a result of BRF's assumed obligations for contributions in accordance with the funding plans in resolution of credit institutions are measured at amortised cost under the effective interest rate method.

Impairment

Debt instruments which are not carried at fair value through profit or loss are reviewed as of the date of each financial statement to determine whether there is evidence of impairment. Impairment is recognised where a significant and/or permanent decrease in the fair value of a certain asset exists compared to its initially recognised value.

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 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 statement 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. As of 27 July 2020, the date on which the BRF management is performed by the BNB, taxation of BRF activities complies with the Law on the Bulgarian National Bank.

7. Annual Contributions

In line with Article 136, paragraph 1, item 1 of the LRRCIIF and Article 3 of Ordinance No 41 of the BNB,[2] on 7 April 2022 the BNB Governing Council set the individual annual contributions of branches of third-country credit institutions for 2022 at the total amount of BGN 98 thousand. Annual contributions were paid up to the sub-fund for branches of third-country credit institutions within the statutory term.

In 2022 no contributions were raised in the sub-fund for contributions to the SRF. In relation to a decision of the SRB of 11 April 2022 on determining the annual *ex-ante* contributions of credit institutions to the SRF for 2022[3], the BNB Governing Council, taking account of available financial means in the earmarked sub-fund for contributions to the SRF and on the basis of the possibility provided for in the LRRCIIF,[4] made a decision the contributions due for 2022 to the SRF by the credit institutions licensed in the Republic of Bulgaria to be deducted from the financial means available in the earmarked sub-fund.

In 2022, as in 2021, no extraordinary contributions from the respective contribution debtors were determined and raised.

8. Expenses/Income

In 2022, funds from the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF in the amount of BGN 34,082 thousand were transferred to the SRF. This amount represents the part of the annual *ex-ante* contributions for 2022 due by the credit institutions licensed in the Republic of Bulgaria to the SRF, which was executed in cash. In 2021 the funds transferred from the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF to the SRF amounted to BGN 29,560 thousand.

Between 1 January and 26 July 2022, following a decision by the ECB Governing Council, the deposit facility rate remained unchanged at -0.50 per cent.

[2] BNB Ordinance No 41 of 25 February 2021 on Determining the Amount of the Individual Annual Contributions of Branches of Third-country Credit Institutions to the Banks Resolution Fund.

[3] SRB Decision (SRB/ES/2022/18) of 11 April 2022 on the calculation of the 2022 *ex-ante* contributions to the Single Resolution Fund.

[4] The second sentence of § 56, paragraph 2 of the Transitional and Final Provisions of the Law on Amendment of the LRRCIIF stipulates that after the transfer of the funds, the remaining funds generated in the sub-fund under Article 134, paragraph 1, item 2, if any, shall be deducted from the obligations of the entities for future contributions to the Single Resolution Fund following a decision of the resolution authority until they are exhausted.

As of 31 December 2022 the Fund's interest expenses on current accounts with the BNB, as defined in the General Terms and Conditions of the Bulgarian National Bank on Servicing Accounts of Banks, Budget Organisations and Other Customers, amounted to BGN 2026 thousand, of which BGN 3 thousand on the sub-fund for branches of third-country credit institutions and BGN 2023 thousand on the sub-fund for contributions to the SRF (31 December 2021: a total of BGN 4045 thousand, of which BGN 5 thousand on the sub-fund for branches of third-country credit institutions and BGN 4040 thousand on the sub-fund for contributions to the SRF).

In the second half of 2022, the ECB took action to normalise its monetary policy, as a result of which the deposit facility rate was raised successively as follows:

- 0.00 per cent for the 27 July – 13 September period;
- 0.75 per cent for the 14 September – 1 November period;
- 1.50 per cent for the 2 November – 20 December period; and
- 2.00 per cent, as of 21 December.

Following the adjustment of the ECB monetary policy, the Bulgarian National Bank changed the interest rates on accounts with the BNB in line with the Methodology for determining interest rates on accounts with the Bulgarian National Bank, adopted by Resolution No 380/14.11.2019 of the BNB Governing Council, as last amended by Resolution No 276/28.07.2022 of the Governing Council of the BNB. As a result of these changes, in 2022 the BRF earns interest income amounting to BGN 1377 thousand, of which BGN 2 thousand on the sub-fund for branches of third-country credit institutions and BGN 1375 thousand on the sub-fund for contributions to the SRF (as of 31 December 2021 the BRF did not report interest income).

Costs related to the BRF management are part of the BNB administrative costs arising from the resolution function, that 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 the BNB Ordinance No 40[5]. The total amount of administrative costs arising from the resolution function should be disclosed in the annual financial statements of the BNB for the relevant financial year.

At the reporting date the BRF has no outstanding obligations related to interest or other payments.

[5] 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.

9. Cash and Cash Equivalents

(BGN'000)

	31 December 2022	31 December 2021
Cash in levs, including	472,989	507,622
in the sub-fund under Article 134, paragraph 1, item 1 of the LRRCIIF	*780*	*683*
in the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF	*472,209*	*506,939*
	472,989	**507,622**

As of 31 December 2022 and as of 31 December 2021, the financial means of both sub-funds are held in separate earmarked current lev accounts with the BNB under the General Terms and Conditions of the Bulgarian National Bank on Servicing Accounts of Banks, Budget Organisations and Other Customers.

As of 31 December 2022, the Fund has no outstanding obligations.

10. Financial Risk Management

After 27 July 2020 the Fund's financial means are invested in compliance with the LBNB and the Internal Rules for Management of the Financial Means of the Banks Resolution Fund adopted by the BNB Governing Council.

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

The financial means in the individual sub-funds of the BRF are invested separately, with no mixture being allowed.

The structure of BRF financial assets and liabilities as of 31 December 2022 and 31 December 2021 by category is as follows:

(BGN'000)

	31 December 2022	31 December 2021
Financial assets		
The Financial assets measured at amortised costs category		
Cash and cash equivalents, including	472,989	507,622
in the sub-fund under Article 134, paragraph 1, item 1 of the LRRCIIF	*780*	*683*
in the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF	*472,209*	*506,939*
	472,989	**507,622**

As of 31 December 2022 and as of 31 December 2021, the Fund has no financial liabilities.

In February 2022, following the military conflict between Russia and Ukraine, some countries announced new packages of sanctions against the sovereign debt of the Russian Federation and a number of Russian banks, as well as personal sanctions against a number of individuals.

As a result of the rising geopolitical tensions, a significant increase in the volatility of securities and currency markets has been observed since February 2022, as well as a sizeable depreciation of the rouble against the US dollar and the euro. These developments are expected to affect the activities of Russian and Ukrainian corporations in various sectors of the economy.

The Fund has no direct exposures to persons or institutions from those countries.

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 Fund's financial means are not exposed to currency risks as of 31 December 2022 and as of 31 December 2021, as the financial instruments possessed by it are in Bulgarian levs.

2. Price risk

As of 31 December 2022 and as of 31 December 2021, the Fund has no financial instruments exposed to 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
31 December 2022				
Financial assets				
Cash and cash equivalents, including	472,989	-	-	472,989
in the sub-fund under Article 134, paragraph 1, item 1 of the LRRCIIF	*780*	-	-	*780*
in the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF	*472,209*	-	-	*472,209*
	472,989	-	-	**472,989**
31 December 2021				
Financial assets				
Cash and cash equivalents including	507,622	-	-	507,622
in the sub-fund under Article 134, paragraph 1, item 1 of the LRRCIIF	*683*	-	-	*683*
in the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF	*506,939*	-	-	*506,939*
	507,622	-	-	**507,622**

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 given default 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 is expected to receive.

The Fund's maximum exposure to credit risk is equivalent to the book value of cash on the accounts of both sub-funds.

Liquidity risk primarily manifested in two aspects: the first risk is 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.

As of 31 December 2022 and as of 31 December 2021, the Fund's cash is available on its accounts with 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
31 December 2022						
Financial assets						
Cash and cash equivalents, including	472,989	-	-	-	-	472,989
in the sub-fund under Article 134, paragraph 1, item 1 of the LRRCIIF	*780*	-	-	-	-	*780*
in the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF	*472,209*	-	-	-	-	*472,209*
	472,989	**-**	**-**	**-**	**-**	**472,989**
31 December 2021						
Financial assets						
Cash and cash equivalents, including	507,622	-	-	-	-	507,622
in the sub-fund under Article 134, paragraph 1, item 1 of the LRRCIIF	*683*	-	-	-	-	*683*
in the sub-fund under Article 134, paragraph 1, item 2 of the LRRCIIF	*506,939*	-	-	-	-	*506,939*
	507,622	**-**	**-**	**-**	**-**	**507,622**

11. Events Occurred after the Reporting Date

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

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The sculptural composition by Kiril Shivarov depicting Hermes and Demeter on the southern façade of the Bulgarian National Bank building is used in cover design.