BULGARIAN DEVELOPMENT BANK AD

ANNUAL MANAGEMENT REPORT
INDEPENDENT AUDITORS' REPORT AND
ANNUAL SEPARATE FINANCIAL STATEMENTS

31 December 2016

BULGARIAN DEVELOPMENT BANK

ANNUAL ACTIVITY REPORT

OF BULGARIAN DEVELOPMENT BANK AD

FOR 2016

Table of Contents

GENERAL DESCRIPTION OF THE BANK

Bulgarian Development Bank AD (BDB, the "Bank") was established on 11 March 1999 as a joint-stock company under the name of Encouragement Bank AD.

On 23 April 2008 the Bulgarian Parliament accepted Bulgarian Development Bank Act (*ZBBR*, Bul.). This law regulates the scope of the Bank's activities, including those of its subsidiaries envisaged for incorporation.

BDB is a key instrument and a channel for conducting government economic policies, including in specific areas, regions, industries and social groups. The Bank actively collaborates with all government state structures in order to ensure maximum impact of the public funds targeted on support of the economic development. Priority focus is set on pre-export, export and bridge financing. Traditionally, the Bank will continue to provide investment financing for SMEs with extended initial maturity and relaxed collateral requirements. As of 31 December 2016 the paid-in share capital amounted to BGN 601,774 thousand (31 December 2015: BGN 601,774 thousand), consisting of 6,017,735 ordinary registered voting shares with nominal value of BGN 100 each. The Bank has complied with the requirements of BNB for minimum share capital for banking activity, as well as with the capital requirements of BDBA. The ownership of the capital is as follows: 99.9999 per cent is owned by the Republic of Bulgaria represented by the Ministry of Finance; 0.0001 per cent is owned by DSK Bank.

The Bulgarian Development Bank Act has determined that a package of not less than 51 per cent of the shares in the capital of the Bank shall be state-owned and that the shares of the state, amounting to not less than 51 per cent of the registered share capital, are not transferable. In addition, a specific limit is established on the composition of the other shareholders, registered outside the Bulgarian state - through the Ministry of Finance. These may include: the Council of Europe Development Bank, the European Investment Bank, the European Investment Fund and other development banks of the Member States of the European Union. The Bank's shares cannot be pledged and the rights attached thereto may not be subject to transfer.

Regarding the acquisition of its own shares, pursuant to Article 187e and Article 247 of the Commercial Act, BDB declares that such an acquisition has not taken place and that no acquisition, possession or transfer of shares and bonds of the company has been performed by the board members during the reported year and that according to Article 6, paragraph 4 of the Bulgarian Development Bank Act the shares in the capital of the bank, apart from the Bulgarian state, may be acquired and held by the Council of Europe Development Bank, the European Investment Bank and the European Investment Fund as well as by development banks of Member States of the European Union. In these cases, Article 31 of the Law on Credit Institutions is not applied.

According to Article 6, paragraph 4 of the Bulgarian Development Bank Act, the members of the management and supervisory bodies, the procurators and the senior management cannot own shares and cannot be provided with options on BDB securities as well as that during the subsequent accounting periods no agreements may be concluded as a result of which in any future period changes may occur in the possession of the relative volume of shares held by the current shareholders.

Management of BDB is carried out in accordance with Article 5 of the Bulgarian Development Bank Act based on which the Bank has a two-tier system of governance and the rights of the State in the general assemblies of the shareholders shall be exercised by the Minister of Finance. Outside the powers of the Minister of Finance, changes in the Bulgarian Development Bank Act - as changes of the articles of association, and the right to issue or to share redemption - is possible only after the passing of a new law or amending the current legislation by the National Assembly. According to this article, and in the capacity of a representative of the majority shareholder in BDB, the decision to reduce the capital through the redemption of shares may be made only by the Minister of Finance.

The members of the management bodies of BDB are appointed in accordance with the generally applicable rules laid out in the requirements of the National law (Commercial Act) and the specific provisions of the national regulatory authority (the Bulgarian National Bank).

In 2016 BDB had no obligations on existing or new issues of securities.

At 31 December 2016 there were no pending legal, administrative or arbitration proceedings relating to liabilities or receivables of the BDB in the amount of 10 percent or more of its equity.

To fulfil its objectives BDB has formed a financial group with two of its subsidiaries - National Guarantee Fund EAD (NGF) and Micro Financing Institution Jobs EAD (MFI Jobs).

On 05 May 2015 amendments and supplementations to the Statute of BDB were registered with the Commercial Register at the Registry Agency.

Pursuant to the Articles of Association, the Bank's lending activity is directed towards:

Pre-export and export financing of SME; financing SME operations and projects either through intermediary banks or directly; refinancing banks granting loans to SME; financing SME investments abroad.

The Bank extends also other types of loans according to a procedure set by the Management Board, whereas the exposure to one customer or a group of related customers, other than credit institutions, central governments and central banks within the meaning of Regulation 575/2013/EU, cannot exceed 10 (ten) percent of the eligible capital (the equity) of the Bank after taking into account the effect of credit risk reduction. In case of exposure in violation of the above limit and as a result of a business combination and/or another transaction, the Management Board shall notify the Supervisory Board and shall make a proposal regarding the method, term and need of their regulation, asking for the approval of the Supervisory Board.

The Bank does not provide loans to the following activities/borrowers:

1. Activities not compliant with the National law, including for environment protection;
2. Companies with unknown ultimate controlling owner;
3. Political parties and their related parties;
4. Non-profit companies and organisations;
5. Media;
6. Activities relating to sports and sport initiatives;
7. Other activities prohibited by law.

With the aim to support the economic development and with the objective of granting financial support for every type of business, the Bank may finance/refinance companies with liabilities at the time of filing a credit application to BDB and after obtaining the approval of the Supervisory Board.

The Management Board shall pass a unanimous decision to form an exposure to one customer or a group of related customers if its amount exceeds 5 per cent of the Bank's equity, in compliance with the requirements of the Law on Credit Institutions and the internal rules of the Bank.

Bulgarian Development Bank provides services as an investment intermediary according to the provisions of the Public Offering of Securities Act (POSA). As an investment intermediary, the bank must meet certain requirements to protect the interests of its customers according to the Financial Instruments Directive Act (FIMA) and Decree 38 issued by the Financial Supervision Commission (FSC). The Bank should also comply with the requirements of Directive 2014/65/EC on the financial instruments markets (MiFID II) and Regulation 600/2014 of the EU relating to the Financial Instruments Markets (MiFIR). The Bank has established, and applies, an organisation associated with the conclusion and execution of contracts with customers, with requesting and obtaining information from the customers, with record keeping and preservation of the customer's assets in accordance with the aforementioned national and European regulations. The Bank has established a system of internal rules and internal control procedures to ensure full compliance with the regulations referred to above.

The headquarters of the "Bulgarian Development Bank" AD are located in the city of Sofia 1000, Sredets district, 1 Dyakon Ignatii Street. At 31 December 2016 the Bank had a staff of 153 employees.

At 31 December 2016 Bulgarian Development Bank had no branches.

MAIN FOCUS, ACTIVITIES AND PROJECTS FOR 2016

At the beginning of the year, the General Meeting of Shareholders took a decision not to distribute dividends to shareholders and to set the funds aside as reserves of the Bank. The shareholders have reinforced their practice to invest actively in strengthening the potential of the Bank.

During the reporting period the bank drafted and approved a new program called "Leasing Line" focused on partners which are non-banking financial institutions - lessors. To participate in the program a number of financial institutions, registered with the BNB and performing financial leasing, were invited. With an established starter program budget of EUR 25 million, 10 financial institutions applied for participation with a declared common interest amounting to EUR 34.75 million. As of 31 December 2016 contracts were signed with four leasing companies at a total of EUR 12.5 million and the utilized funds amounted to EUR 2.8 million.

At the beginning of 2016 Bulgarian Development Bank (BDB) signed a financial agreement for EUR 20 million with Industrial and Commercial Bank of China (ICBC). The funds are intended for general business activities, direct financing of the business or for creating on-lending programs through commercial banks to support investment projects and provide working capital, including the promotion of the trade relations between the two countries. The contract is signed for a term of two years. The aim of the agreement is to formalize a commitment to long-term partnership between the two banks and to encourage future cooperation in the field of cross-border funding, bilateral loans, investments and trade. On 8 August 2016, BDB utilized the entire amount of the loan in one tranche – EUR 20 million.

In 2016 BDB signed two agreements to finance the implementation of the National Programme for Energy Efficiency of Multi-Family Residential Buildings (NPEEMZHS) with CEB and KfW totalling EUR 250 million.

In February of 2016 BDB signed an agreement with the Council of Europe Development Bank (CEB) for the amount of EUR 150 million. The funds will be used to finance energy efficiency measures and the necessary structural measures within the NPEEMZHS. A collateral agreement with the Ministry of Finance was signed and ratified by the National Assembly. In December of 2016 BDB utilized the first tranche of EUR 45 million, under the contract with the CEB. The interest rate is floating and it is based on the three-month Euribor. The term set is seven years with a grace period of two years.

In August 2016 Bulgarian Development Bank signed a financing agreement with KFW for EUR 100 million. The financial means will be used specifically for funding energy efficiency measures and the necessary structural measures implemented by small and medium sized enterprises in Bulgaria within the NPEEMZHS framework. A collateral agreement was also signed between KfW and the Ministry of Finance, which was ratified by the National Assembly in December. The contract between KfW and BDB extends to seven years at the latest with a two years grace period. The term of repayment, set for this loan, is September 15, 2022 with a floating interest rate formed by 6M Euribor plus margin.

A part of the State guarantee for the year 2016 (EUR 511 million.), which is not used in the 2016 agreements – a balance in the amount of EUR 261 million - was transferred to the state's 2017 budget. In this regard, in 2017 BDB will continue negotiations with a third creditor (the European Investment Bank, the World Bank) to raise the remaining EUR 261 million for financing the NPEEMZHS. The conclusion of this agreement is expected to occur during the second half of 2017

In early January the National Assembly of Bulgaria voted to increase the program's funds by another BGN 1 billion. This increases the total amount of grants to the associations of owners under the Program to a total of 2 billion Levs.

On 18 November 2016 BDB signed a new contract with the European Investment Bank for SME financing in the amount of EUR 150 million. The funds are provided with EU support through EFSI collateral (European Fund for Strategic Investment), as a part of the European Investment Plan - Juncker Plan. The first tranche, disbursed in December, amounted to EUR 75 million, at a floating interest rate based on the six-month Euribor. The repayment term is 15 years with a grace period of five years and part of the funds will be used for crediting innovative projects. Another part of the loan is intended to support regions with high unemployment rates, as well as a part of the youth employment initiative or for start-up company projects. The greater part (more than 50 per cent) of the loan will be allocated through partner banks or via other financial intermediaries.

On 4 November 2016 BDB signed a new agreement for issuing a counter-guarantee with the European Investment Fund (EIF) under the COSME program in support of the small and medium sized business in the country. The aim is to facilitate the access to long-term, low-interest financing of the companies in the country and relax the requirements for setting up the collateral on the loans. The COSME program is supported by the EFSI (European Fund for Strategic Investment), also known as the Juncker Plan. BDB will be able to cover up to 60 per cent of the risk on the loans to the SMEs granted by commercial partner banks. This will reduce the requirements for granting collateral from the business side and will allow for more risk-taking by the financial institutions. With the resources, guaranteed under the COSME program, BBR's partner banks of will be able to grant investment and working capital loans, bank guarantees and revolving loans. The maximum credit amounts will reach EUR 150,000 with a repayment period between 1 and 10 years.

As a result of the 2016 review of the quality of banking assets in conformity with the provisions of §9 of TFP of the ZVPKIIP and Article 80 of LCI, Bulgarian Development Bank has demonstrated a high level of resilience to external shocks. Within the framework of the conducted stress test, in the conditions of adverse scenarios and after adjustments in the course of the review of the quality of the assets, by the end of the test horizon the total capital adequacy of the bank was estimated at 53.26 per cent - a figure, which significantly exceeds the performance of a number of financial institutions with a similar profile.

In the month of October 2016 the Bank was subjected to a supervisory inspection by the Bulgarian National Bank with a period of coverage ending on 30 June 2016 and with the performance of a review of the operational and market risks, the credit concentrations and with a verification of the manner of implementation of the given recommendations regarding the operation on these risks. By the date of preparation of these financial statements the Bank has not yet received a report on the findings from the inspection completed.

Throughout the entire year of 2016, the Bank had intensively refined and developed its internal regulations, including the Policy and the rules for determining the impairment for uncollectability of risk exposures.

Within the context of the project developed for preparing the Bank for the introduction of IFRS9 (starting on 01 January 2018), an organization was set up to prepare and implement the necessary changes in the bank's internal regulations and the establishment of the necessary technical arrangements for compliance with the requirements of the new standard. In December 2016 training was conducted, by qualified experts, for over 30 key employees from different departments in the Bank. This process will continue in the next year as well, and will be finalized by updating all in-house regulations, making investments in specialist software and upgrading the existing systems in compliance with the requirements of the Standard.

OVERVIEW OF THE EXTERNAL ENVIRONMENT - MACROECONOMIC ENVIRONMENT AND THE BANKING SYSTEM

The macroeconomic environment

The main features in the development of the Bulgarian economy in 2016 include the relatively high rate of economic growth, the continuing process of improving the situation on the labour market, the double surplus (in the current fiscal balance and in the balance of payments), the decreased external indebtedness of the economy as a whole, and the overcoming of the deflation observed during the last three years.

In 2016, the Bulgarian economy had been able sustain the momentum observed during the previous year. According to the estimates based on the official data the gross domestic product (GDP), generated during the first three quarters and the flash estimates of the GDP for the fourth quarter the real growth indicator for 2016 is expected to fall within the range of 3.3 per cent to 3.5 per cent (at the average 2015 prices). The drivers of growth appear to be both the domestic demand (entirely based on final consumption) and the external demand, which has registered high growth rates in the export of goods and services. Of the elements of domestic demand investments continued to be the only segment with a negative contribution to the growth of the Bulgarian economy. Gross fixed capital formation registered a drop in constant price rates throughout 2016 (with the exception of the first quarter).

Of the economic sectors the most dynamic has proven to be the services sector, which has been the key contributor to the growth of the Bulgarian economy throughout the year. The industry, with the exception of the second quarter of the year, has also recorded a relatively high growth both with the gross added value (GVA), produced by the sector, but also through the rise in sales and is one of the sectors which has been the major contributor to the national economy during the year. The agricultural sector continued to demonstrate erratic dynamics and after the registered decline during the first half of 2016 it went on to realize a growth during the last two quarters of the year, thus becoming a major contributor to the overall economic growth and taking a position nearly in par with the other branches of industry. The only sector which continued to develop negatively in 2016 was the construction sector: it recorded drops in its GVA in constant prices on an annual basis and still experiences difficulties in its development. In spite of this, some visible activation in lending of firms and households, at the end of the year, gives grounds to presume that the construction business has probably hit rock bottom in 2016 and that as early as next year there will be a reversal in the dynamics within the sector.

The maintaining of a relatively high economic growth for the second consecutive year has contributed to the further improvement of the state of the labour market. During the fourth quarter of 2016, unemployment rates fell to 6.7 percent. The economic activity of the population is kept within the range of 68 per cent - 69 per cent (the population between 15 and 64 years of age) and the employment rates have been over 63 per cent, which is comparable to the period of the greatest revival of the labour market in 2007-2008. Increasingly, one of the main obstacles to the future expansion of the activities of the Bulgarian companies appears to be the unavailability of adequately qualified labour power. This, in turn, exerts pressure on the wages in the country. The national average monthly salary for the fourth quarter of 2016 amounted to BGN 990, and during the year it had registered a nominal annual growth rate within the range of 7.5 to 8.0 per cent, a significant acceleration compared to 2010 - 2014. Along with the declining unemployment in the country, during the second half of 2016 employment remained relatively constant despite the increased demand for labour on the part of the entrepreneurs. This serves as an additional indicator that the workforce is close to its maximum capacity utilization and the problem of labour supply will become a still more pressing issue in the coming years.

The current balance of payments for 2016 was positive and by the end of November the realized surplus amounted to EUR 2.034 million (4.3 per cent of GDP). The current account surplus is about three times higher than that of the previous year and this improvement is mainly due, firstly, to the improvement of the trade balance in goods and services and secondly, to the improvement of the balance of the primary income. The real growth in the imports of goods and services (according to the System of National Accounts of NSI) for the year 2016 has exceeded 5 per cent, while that for exports is lower by about 2 per cent.

The process of reducing the external debt has continued and by November 2016 it was 72.7 per cent of GDP while by the end of 2015 that digit was 75.3 per cent. This decrease is entirely due to the dynamics in the private external debt, which has dropped from 62.0 per cent of GDP at the end of 2015 to 58.5 per cent in November of 2016. At the same time, the external State and State guaranteed debt has increased (mainly due to the issuing of Eurobonds during the first quarter of 2016) and by November 2016 it represented 14.2 per cent of GDP (compared to 13.3 per cent of GDP at the end of 2015).

The direct foreign investments (FDI) in Bulgaria remain low. According to BNB preliminary data covering the period ending in November 2016, their amount, for the last twelve months, was EUR 865.7 million (1.8 per cent of GDP).

During 2016 Bulgaria had registered a positive, albeit minimal inflation calculated on the basis of the national consumer price index (CPI). The value of CPI (December versus December) was 0.1 per cent and was positive for the first time since 2012. The groups contributing most to the positive inflation (by the end of the period) are foodstuffs and public catering. The deflation of non-food product prices fell during the year with fuels gradually exhausting their deflation potential. Only gaseous fuels have remain a serious factor for the negative inflation within the whole group (due to the mechanism adopted for setting their prices), but in the coming months they will also discontinue this price reduction due to the dynamics in the prices of liquid fuels. The other commodities, which contribute most to the negative price index of non-food goods, are clothing and footwear, furniture and related products, telephone and fax equipment, equipment for the reception and reproduction of sound as well as image and information processing machines.

The group with the most significant contribution to the deflationary dynamics in the CPI during 2016 is the group of services. Along with thermal energy production (influenced by the dynamics in the prices of liquid and gaseous fuels), the other services showing the greatest annual price drops are air passenger transport, communications services (associated with the reduction of prices of roaming in the middle of the year), package tourist and travel services, short-term accommodation services (probably influenced by the increased price competition from the country's neighbouring tourist destinations).

The banking sector

In 2016, the banking system remained highly liquid, capitalized and continued to increase its profitability compared to previous years. There had been some consolidation within the sector: during the year the Bulgarian branch of Alpha Bank Greece was acquired by CB Post Bank AD and the end of the year saw the announcement of the contract for the takeover of the UBB Bank AD by the KBC Group, which should be finalized by the end of the second quarter of 2017 with the merger of CB UBB and CB CIBank.

The assets of the banking system have increased by 5.2 per cent and by the end of 2016 they reached a value of BGN 92.1 billion. The most significant increase was observed in the financial assets of banks (by BGN 2.4 billion, or 21.2 per cent). In spite of the introduced negative interest rates on excess reserves, the commercial banks continue to hold large amounts in accounts registered in the central banks, which by the end of December 2016 amounted to BGN 18.2 billion (19.7 per cent of the total assets of the banking system) and which show a decrease of only BGN 98 million relative to the previous year. In 2016 the volume of loans and receivables showed an increase by BGN 1.8 billion (3.4 per cent) to reach BGN 56.1 billion by the end of the year. During the first half of 2016 loans to companies and households dropped in value compared to the end of 2015 which is mainly due to the caution demonstrated by the banks when granting new loans to the non-financial sector. In the second half of the year, however, and after the announcement of the results from the asset quality review, the commercial banks gradually increased their exposures to companies and households. As a result, loans to companies had shown a minimum annual decline of 0.3 per cent (according to data from the Banking Supervision service of the BNB), while loans to households had increased by 1.4 per cent in 2016 (one of the related factors is the implementation of the national energy efficiency program).

At the end of 2016 the share of loans with a probability of default for over 90 days within the total portfolio of loans to the non-banking sector fell to 12.83 per cent (compared to 15.35 per cent at the end of 2015).

The profit collected by the banking system (unaudited) after taxes is BGN 1.262 billion and is by 40 per cent greater when compared to the profit from the previous year. This is the highest profit level registered by the banking system for the past eight years. Its increase compared to 2015 is, in most part, due to the lower costs: the administrative expenses were down by BGN 259 million compared to 2016 and expenses on impairment have decreased by BGN 286 million. The net interest income, as well as fee and commission income, has also contributed to the increase of the system's profitability: the net interest income has increased by BGN 34 million compared to 2016, while the fee and commission income has increased by BGN 31 million.

At the end of December 2016 the capital of the banking system amounted to BGN 12.1 billion showing an increase by BGN 610 million (5.3 per cent) during the last twelve months.

The trend towards lowering interest rates on loans and deposits, observed in the past two years, remained persistent in 2016. The main factors behind these dynamics are the low values of the main referential interest levels in the European zone and the US; the retention of deflation in Bulgaria and the low inflation levels in the EU 28 as a whole; the high liquidity of the banking system, as well as the negative interest rates on the "excess reserves" of the commercial banks held in accounts with the Bulgarian National Bank. The average interest rates on loans to companies fell faster than those on corporate deposits, which had led to a reduction in the interest rate spread over the second half of 2016. Its value dropped from about 4.4 per cent in early 2016 to around 4.0 per cent at the year's end.

During the fourth quarter of 2016 the average interest rate on BGN loans to companies and new businesses registered a drop in the original maturity to below 4 per cent which was observed and which dropped for the first time as the fierce competition among commercial banks to attract the punctual customers continued to push the interest rates on credits down. At the same time, the average interest rates on loans to companies and new businesses fell to a level of around 4.5 per cent.

A considerable part of the commercial banks set their interest rates on short-term deposits of the companies within the range of 0.01 to 0.1 per cent, which is a clear indicator that in general, the banks are trying to minimize the inflow of new deposits from companies and individuals. Low interest rates on borrowings significantly reduce the incentive for firms and households to keep their savings in bank deposits and redirect them to other areas for investing their cash resources. The average interest rates on BGN deposits of companies and new businesses decreased to the 0.15 percent level during the last quarter of 2016, while the euro-denominated company deposits remained within the range from 0.20 per cent to 0.25 per cent.

ACTIVITY OVERVIEW

Bulgarian Development Bank AD continues to work actively on the achievement of the objectives set, while maintaining high levels of liquidity and capitalization. In 2016 the process of modernizing and upgrading the activities of BDB continued in parallel to the Bank's continued increase in activity volumes.

As of 31 December 2016, the financial result of Bulgarian Development Bank - after taxation - is a profit amounting to BGN 44,920 thousand, compared to that of the previous reporting year, which was BGN 37,765 thousand, thus representing an increase of 18.95 per cent.

The net interest income for 2016 is by 7.63 per cent higher compared to 2015, with a value amounting to BGN 56,572 thousand (at 31 December 2015 this sum was BGN 52,561 thousand). The major reasons for this decrease is the drop in interest expenses by 54.06 per cent, which is due to the maturity of the bond issue, a reduction in the volume of unused funds under the RDP program, the renegotiation of the interest rate on the deposits of large customers and the optimization of the sources of financing the Bank at lower cost of the resources following the trends of the market.

The net fee and commission income, realized at 31 December 2016, amounted to BGN 2,279 thousand, compared to the BGN 1,959 thousand for 2015, representing an increase of 16.33 per cent due to the increase in the amount of loans granted during 2016.

At 31 December 2016, the general and administrative expenses (excluding labour costs) made by the Bank amounted to BGN 6,946 thousand, compared to the costs incurred in 2015, which were BGN 8,442 thousand. The effect of the reduction of the general and administrative expenses during the reporting year is due, to a great extent, to the significant reduction of the sum of the contribution to the Deposit Insurance Fund, paid in 2016.

Labour costs for 2016 amounted to BGN 8,382 thousand and have shown a minimal drop when compared to the previous year (at 31 December 2015 – BGN 8,542 thousand).

The operational expenses coefficient (incl., personnel costs) related to the operational income decreased from 29.61 per cent at the end of 2015 to 25.42 per cent by the end of 2016, as a result of both the generated higher income levels and the drop in administrative costs.

In 2016, the net impairment charges and provisions for loans, receivables and contingent liabilities represent an income amounting to BGN 3,147 thousand (reintegration), compared to the income from the reversal of impairments and provisions amounting to BGN 1,976 thousand for the previous year. Information in greater detail about the impairments and provisions is presented in Notes 12, 18B and 33 to the annual financial statements.

At 31 December 2016, the Bank's assets amounted to BGN 1,911,985 thousand, thus representing an increase of 18 per cent over the previous year, which amounted to BGN 1,614,554 thousand at the end of 2015.

BDB's lending activity is expressed both in the direct provision of loan funds and in financing through programs (products) for crediting the commercial banks, which use the funds received to grant credits to SMEs and farmers, or the so-called "on-lending".

As of 31 December 2016 the gross amount of the Bank's portfolio of direct loans (excluding the volumes for the energy efficiency program) had increased by BGN 84 297 thousand, compared to the end of 2015, thus reaching BGN 863 888 thousand - a growth of 10.81 per cent.

In 2016 the Bank continued to develop its activities by supporting the Bulgarian businesses in a difficult economic environment. The Bank's loan portfolio (excluding the loans to banks) grew by 10.81 percent to BGN 863,888 thousand (2015: BGN 779 591 thousand), and BDB has continued to maintain a diversified section structure of its loan portfolio. Somewhat greater dynamics are observed in the relative shares of the industrial sector (a decrease of 6.3 per cent), real estate operations (down 3 per cent), transport (up 1.8 per cent) and other sectors of the economy (an increase of 8.1 per cent) (Note 18B to the AFS).

At 31 December 2016 the amount of funds provided for the indirect crediting of businesses through commercial banks (on-lending) amounted to BGN 170,102 thousand, showing a 5 per cent drop compared to 2015 volumes, which is due to the maturity of some of the loans.

At the end of December 2016, under the National Energy Efficiency Program (the Program) launched in 2015, which is aimed at the renovation of residential multifamily buildings, 4,022 requests were received for targeted funding for 2016 and 1,690 contracts were signed for the provision of such funds. The total cost of the first phase of the program is BGN 1 billion. BDB participates in the negotiation of financial resources for the implementation of the program for which it receives a State guarantee. The Bank enters into targeted funding, maintains a public register of requests and contracts according to the Program. As of 31 December 2016 the total amount of funding, agreed according to the contracts, was BGN 850,601 thousand (compared with the end of 2015 – BGN 11,923 thousand), of which the amount of BGN 395,169 thousand had been utilized (at 31.12. 2015 this sum was BGN 9,810 thousand).

BDB continues to implement its targeted export financing program, including through joint initiatives with Bulgarian Export Insurance Agency (BAEZ). Thereby, the Bank promotes the competitiveness of the Bulgarian exporters.

The Bank's management maintains a consistent, conservative risk assessment policy, in line with the economic environment and the specific characteristics of the loan portfolio of BDB. At the end of 2016 impairment coverage of exposures in the loan portfolio amounted to 16.34 per cent (2015: 18.72 per cent).

The ratio of gross loans to customers in arrears over 90 days to the total corporate loan portfolio (direct crediting, excluding claims from national and municipal budgets, staff and non-banking financial institutions) improved and at 31 December 2016 their share was 13.36 per cent compared to 19.34 per cent at the end of 2015. The change was due to the decrease in the volume of overdue loans and the increase in the volume of the portfolio.

At the end of 2016, the portfolio of securities, available for sale, has increased nominally by BGN 44,188 thousand (20.07 per cent) compared to the end of 2015. In 2016 the Bank increased its investments in debt securities in order to improve the liquidity management. The volume of BDB owned portfolio securities is at the value of BGN 264,268 thousand (2015 - BGN 220,180 thousand), the majority of which is composed of government securities.

The item "cash on hand" and balances in current account with the Central Bank fell by 77 per cent compared to the end of the year and the balance amounts to BGN 78,521 thousand (at 31 December 2015 – BGN 343,853 thousand). This is due to the growth in lending activity and the targeting of available resources in profitable instruments (GS), as well as the interbank market. At the end of 2016, the Bank reported an increase in receivables from banks by about BGN 24,151 thousand against the end of 2015, or an increase of 9.67 per cent.

As of 31 December 2016 the largest share of the liabilities of the Bank continue to be the deposits from customers other than credit institutions - 61 per cent (77 per cent at the end of 2015), and their value amounted to BGN 709,549 thousand (at 31 December 2015 this was BGN 695,080 thousand). Most of them (BGN 467 million, or about 66 per cent) are formed by funds provided for two projects of national importance.

The collected ratio of borrowings from international institutions increased significantly and by the end of 2016 they amounted to BGN 379,998 thousand, compared to BGN 178,723 thousand registered at the end of 2015; their share in the liabilities of the Bank was 32.84 per cent. The significant growth in volume is mainly due to two new disbursements from international credit institutions at the end of the calendar year: EUR 45 million for the CEB Program for energy efficiency and EUR 75 million, from the EIB.

BDB continues to maintain a good level of liquidity. As of 31 December 2016, the ratio of liquid assets of the bank decreased to 31.5 per cent (65.3 per cent at the end of 2015) due to the increased intensity of utilization by the national program for energy efficiency and redirecting part of the funds held by the BNB in interbank deposits.

The maintained bank capital adequacy ratio exceeds the regulatory requirements and has repeatedly been confirmed by stress tests conducted in 2016 and by the asset quality review. At 31 December 2016 the capital base (the bank's equity) amounted to BGN 622,578 thousand and the total capital adequacy of the bank, according to preliminary data, amounted to 49.13 per cent compared to 53.24 per cent at the end of 2015.

The group focuses on continued support for the development and training of its employees, creating conditions for the professional development of financial specialists within the framework of the only financial group in Bulgaria, which does not prioritize the creation of profit, but is focused more on achieving social goals. The BDB Group is not active in the field of research and development, other than personnel training. The main priorities of the companies within the Group are presented further below.

RISK MANAGEMENT

In the course of its ordinary activity the Bank may be exposed to various financial risks that, if occur, may result in losses and deterioration of the institution's financial stability. Financial risks are identified, measured and monitored using different control mechanisms for their management and for avoidance of any unjustified concentration of a particular risk. The risk management process is essential for the Bank's profitability and existence. The most significant risks are the following: credit risk, market risk and operational risk.

Credit risk

Credit risk is the main risk for the Bank and therefore, its management is fundamental for its activity. Credit risk management is performed in accordance with the Bulgarian Development Bank Act and the effective laws and regulations of the Republic of Bulgaria regulating credit activity, as well as the international regulations and best banking practices.

In assessing and managing the credit (including the counterparty risk) risk of its exposures, the Bank applies models for internal rating generation. Loan portfolio quality monitoring, control and assessment units are established and function within the BDB. Loan portfolio current monitoring, reporting and management procedures and mechanisms are implemented, which require periodical, and if necessary, extraordinary, reports on the financial and credit status of each borrower and liable persons. If new circumstances are established, which could result in changes in the borrowers' risk profile, including in higher risks of default of the credit exposure, adequate and conforming to the debtor's risk profile measures are taken. In managing its credit risk, the Bank applies an intra-bank system of limits by economic sectors, instruments, and other credit restrictions and limits on concentration, and the results from their monitoring are reported to the competent authorities. The system of limits is reviewed and updated periodically.

Market risks

In managing the foreign currency risk BDB follows the principle of maintaining minimum open currency positions within the specified limits. The Bank's positions in various currencies, as well as the overall foreign currency exposure are monitored daily. Foreign currency positions are not formed with speculative purposes, but are due to foreign currency transactions arising in the ordinary course of activity of the Bank. The Bank does not carry out significant transactions and does not hold significant open positions in currencies other than EUR and BGN. Until the exchange rate of the Bulgarian Lev is pegged to the Euro, the Euro is not considered as a currency bearing FX risk for the cash flows and the financial position of the Bank.

As part of the interest rate risk management, regular reports on financial assets and liabilities are prepared, divided in time buckets depending on their sensitivity to changes in interest rates. In case of misbalances in periods, an assessment of expected changes in interest rate curve is applied and potential risk for the interest income and capital of the Bank is measured.

The risks from transactions on the money and capital markets are controlled by a system of limits, reflecting the risk profile of the investments and certain parameters of the portfolio: such as counterparty, financial instrument, maturity, etc. The system of limits is reviewed periodically, and the implementation of these limits is subject to daily monitoring. The portfolio of securities, formed by BDB for the purposes of investing free cash, is characterized by a short duration, low interest rate risk and relatively liquid securities, issued by reliable institutions, i.e. they bear a low price risk. As there is no trading portfolio in accordance to the regulatory provisions, there is no regulatory requirement to BDB for capital allocation to cover the market risk.

BDB's liquidity is managed by closely monitored ratios indicating the liquidity position by periods. Liquidity risk is measured by applying additional scenarios for cash flows from operations. Measured and monitored are also the liquidity buffers of BDB and the additional sources of funding in cases of market-wide or idiosyncratic shocks. The compliance with the ratios indicating the liquidity position is monitored and reported regularly to the competent authorities.

Operational risk

Operational risk management is implemented through close observation and recording of all operational events, which occur in the activity of various units and processes of the Bank. Events of higher frequency as well as higher severity serve as bases for the operational risk analyses in different scenarios. The operational risk is measurable and controllable as in the process of work an operational event registry is kept, which is used as a basis for analysing and improving the work processes and minimising the conditions that would potentially result in operational events and loss for the Bank. The required capital to cover the operational risk is calculated by applying the "Basic indicator approach" in compliance with the applicable regulatory framework.

Control environment

BDB follows management philosophy and operating style, subject to the principles of conservatism in the performance of contracts according to the strategic objectives of the Bank set in the Bulgarian Development Bank Act. In connection with the special role of BDB as an instrument of state policy, the Bank has adopted a specialized approach to the control of the environment, where within the structure of the Bank a number of departments with specific control functions are set up – Risk Management Department, Liquidity Management Department, Planning, Analysis and Regulations Department, Legal Department, Classified Information Department, Compliance Department. Along with the periodic update of the internal regulatory framework, this approach allows management to take timely measures to control the risks, along with the traditional components of the controlled environment, ensured by the direct involvement of the bank's management in the preparation and verification of the financial statements and the activities of Accounting and Internal Audit Departments, acting in full compliance with the principles of the system of three pillar controls, introduced by the European regulations.

Management assigns powers and responsibilities for the operational activities in conformity with the developed internal regulatory framework, which is consistent with the national and European legislation. In order to ensure the relations, regarding the accountability and reporting process and the hierarchy of powers, a number of specialized committees have been set up to the Management Board and the Supervisory Board of BDB, as stated in the Declaration of Corporate Governance which is an integral part of the present financial report.

The Bank has developed an internal regulatory framework, which includes policies and communications, directed at ensuring that the personnel is familiar with the targets of the company, that it knows how the individual actions of each one of them are intrinsically linked and how they contribute to the achievements of these goals as well as who will bear the responsibility for the activities and what will the methods of reporting the final results from these activities be.

The Bank has built an information system, including related business processes, ensuring the quality and control of the financial reporting and communication process.

The Internal Audit Department and the Audit Committee to the Supervisory Board of the Bank conduct the current monitoring of the system of controls.

BANKING REGULATIONS ACCORDING TO THE BULGARIAN LEGISLATION

In accordance with the requirements of the laws and regulations governing the banking activity in the country, BDB should comply with the limits related to certain ratios in its financial statements. As at 31 December 2016, BDB has complied with all regulatory requirements of the BNB and the Bulgarian legislation.

The capital adequacy ratio on an individual basis as of 31 December 2016 was 49.13 per cent (31 December 2015 – 53.24 per cent). The coverage of assets with capital buffers substantially exceeds the required minimum regulatory level.

CREDIT RATING AND INTERNATIONAL ACTIVITIES

In the beginning of 2016 the international rating agency "Fitch Ratings" performed its regular annual review and reaffirmed all ratings of Bulgarian Development Bank AD. The long-term investment rating of the bank remains "BBB". The rating's perspective is stable, which maintains the position of BDB among the banks with the highest credit rating in the country. The short-term rating, and the support rating, are confirmed respectively at levels F3 and F2. The "Fitch Ratings" of BDB were reaffirmed at the beginning of 2017.

BDB continues to develop successful partnership with leading European and international financial institutions by participating in international specialised associations. These relations enable the Bank to be preferred business partner, to benefit from the best banking practices, know-how, information for financial products, and to participate in their development and implementation.

BDB has direct access to up-to-date general and specific information about the newest changes in the legislative base at EU level and its implementation in the area of the development banks, and has an opportunity to participate in the process of negotiating these changes. Membership in international specialized associations allows the Bank to participate in seminars and summits with the European Commission representatives and its divisions.

BDB has been an active member of the European Association of Public Banks (EAPB) since 2005. The membership in EAPB contributes for the exchange of experience and best practices between BDB and the European public banks.

BDB has been a full member at the Network of European Financial Institutions (NEFI), an organisation in which 17 institutions from different European countries participate, since 2007. The mission of the NEFI is to improve the exchange of information and ideas in order to facilitate the access to SME financing.

In 2016 BDB continued its participation in the European Association of Long-Term Investors (ELTI). BDB is a co-founder of this organisation.

BDB is a shareholder of the European Investment Fund (EIF), holding 3 shares of its equity, and participates regularly in the discussions of the Group of the financial institutions – shareholders, where the guidelines for development of the activities and policy of the EIF are discussed. BDB participates also in the on-line voting on various topics, such as the enrolment of new shareholders and other organisational issues.

BANK GOVERNANCE

Bulgarian Development Bank AD has a two-tier management structure consisting of Supervisory Board and Management Board. There were no changes in the management body's structure in 2016.

In 2016 the following individuals were members of the Supervisory Board (SB) of BDB: Atanas Slavchev Katzartchev – Chairman of SB, Kiril Milanov Ananiev – Vice Chairman and member of SB, Dimitar Kirilov Dimitrov – member of SB.

In 2016 the following individuals were members of the Management Board (MB) of BDB: Angel Kirilov Gekov - Chairman of MB and Executive Director; Bilian Lyubomirov Balev – Vice Chairman of MB and Executive Director; Iliya Vasilev Kirchev – member of MB and Executive Director. The Bank is represented jointly by any two of the three Executive Directors.

The persons managing the Bank in 2016 were paid a total of BGN 1,169,000. No contracts, which fall beyond the ordinary course of business or significantly deviate from market conditions, within the meaning of Article 240b of the Commercial Act, were concluded between members of the SB, MB or related persons on one side, and the Bank on the other side.

The participation of members of the SB and MB in commercial entities as general partners with unlimited liability, or possession of more than 25 percent of the capital of a legal entity, as well as participation in the management of other companies or associations as procurators, managers or Board members, within the meaning of Article 247, paragraph 2, item 4 of the Commercial Act, is as follows:

The members of the SB of BDB have the following participations in the management of other companies:

- Atanas Slavchev Katsartchev does not participate in the capital and the management of other companies.
- Kiril Milanov Ananiev does not participate in the capital and the management of other companies.
- Dimitar Kirilov Dimitrov is a partner at PGD OOD (UIC 175247211) and holds 50% of the company shares. The company does not carry out any activities. Mr Dimitrov participates in the management of "Eurohold Bulgaria" AD, UIC 175187337, as member of the MB.

The members of the MB of BDB have the following participations in the capital and management of other companies:

- Angel Kirilov Gekov participates in the management of National Guarantee Fund EAD, UIC 200321435 as Chairman of the Board of Directors.

Mr Gekov participates in the management of "PCA" OOD, UIC 201477526 and holds 25% of the company's capital. Mr Gekov holds 19% of the capital of BULGARPLOD CHERRY OOD, UIC 200204916.

- Bilian Lyubomirov Balev participates in the management of Micro Financing Institution JOBS EAD, UIC 201390740 as Chairman of the Board of Directors.

Mr Balev is a partner in Fininvest OOD and holds 99% of the capital of the company. The company is a foreign legal entity, established and existing under the laws of the United Kingdom of Great Britain and Northern Ireland. Mr Balev is a member of the administrative board of the European Association of Public Banks (EAPB) domiciled in Brussels, Belgium. He is also the sole proprietor of the capital and general manager of the company Fin Yachting, registered according to the laws of Malta.

- Iliya Vasilev Kirchev participates in the management of Microfinance Institution JOBS EAD, UIC 201390740 as Deputy Chairman of the Board of Directors.

Mr. Kirchev is a member of the management bodies of the following non-profit organisations:

1. Foundation "Academy 2007", town of Kardzhali, UIC 108688838;

2. Cultural Center "Dr. Hristo Adjarov"- Plovdiv, UIC 175962774.

TRANSACTIONS WITH RELATED PARTIES AND COMPANIES UNDER THE CONTROL OF THE STATE

The owner of BDB is the Bulgarian State, hence the Bank is a related party to the government authorities of the Republic of Bulgaria and the companies over which it exercises control. The transactions with related parties and companies under common control with the State are disclosed in note 38 to the separate financial statements of BDB for 2016.

DEVELOPMENT STRATEGY AND BUSINESS GOALS. FINANCIAL GOALS AND OBJECTIVES

BDB is a key instrument and a channel for conducting government economic policies, including in specific areas, regions, industries and social groups. The Bank actively collaborates with all government state structures in order to ensure maximum impact of the public funds targeted on support of the economic development.

The BDB Group operates in full transparency and applies the best banking and management practices. A core objective of the Bank is to identify and analyse the sectors of the economy experiencing difficulties in obtaining financing, and to undertake the necessary measures to facilitate their access to financing.

Facilitating SMEs access to bank financing is not the only priority of the Bank. The Bank supports government efforts for acceleration of economic growth in the country by means of providing expertise and performing activities in all area of economic policies, facilitating the absorption of the EU structural funds, enhancing the export potential of the country, etc.

In the light of the foregoing, the main principle underlying the BDB's activity is to supplement the market and not to allow displacement of the traditional commercial banks from the market. The objective of the Bank's activity is only to compensate any existing market shortages in financing certain segments and thus, to adjust their risk profile and to encourage the commercial banks to develop their exposures to these segments.

The BDB Group's strategic goals are:

- To facilitate the economic growth by increasing its exposure in support of regions and sectors of the economy with suppressed growth;
- To stimulate the economic activity of the investors for the modernization of the material and technological basis and for boosting the competitiveness of the economy;
- To facilitate the economic growth of the regions through financing, priority syndicated by nature, of sizable and infrastructural, by their nature, investments;
- To support the development of competitive production initiatives and sectors of the

economy of proven export potential;

- To facilitate, jointly with the other institutions, the access to financing of innovative and newly established companies;
- To facilitate and support the direction of capital flows to the Bulgarian economy.

The commercial policy of BDB foresees to preserve the two approaches, adopted so far, for the support of SME sector: direct lending and indirect programs. Additionally, the Bank will strictly adhere to its core principles:

- Supplementing the market and staying away from the competition with the commercial banks;
- Following a liberal pricing policy with adequate coverage of the risks.

Regarding the direct lending, the Bank will further develop product lines, focused on problem areas of SME's activities, which need special support. In this respect, priorities will be pre-export, export and bridge financing. Traditionally, the Bank will continue to provide funding to SMEs with extended initial maturity and relaxed collateral requirements.

Considering the specifics of both its product lines and the limited branch network, the Bank will realise its priorities using all available legal forms, including through the establishment of the Equity Investment Fund envisaged in Bulgarian Development Bank Act.

A key priority in the commercial efforts of the Bank will be the development of indirect SME financing programs. These programs will be significantly diversified with regard to the thematic focus and maturity. Product lines with greater flexibility in terms of maturity, interest rates, etc. will be developed, which will make them easily adaptable to the changing market conditions and thus to the requirements of the partner banks. The major accent will be placed on combining the provisions of resources with risk sharing adequate to the objectives of BDB.

The Bank considers that given the current highly liquid environment in the banking sector, underwriting of the incremental risk (the additional risk that restrains bank financing), together with partner banks, would be the key to the success of indirect lending programs.

BDB will collaborate with the management bodies of the EU operational programs in Bulgaria, by identifying existing financial gaps of specific measures and will propose solutions to resolve them, including specific forms of financing. BDB intends to maintain close consultations with authorities in order to become an integrated part of the overall model of managing public resources for the support of the real economy. The Bank considers its participation as an essential step in the improvement of the effectiveness of measures in support of the Bulgarian economy.

Key strategic objectives and policies of the Bank within horizon of Strategy 2015-2018 will be as follows:

- Reallocation of the assets in such a manner that indirect SMEs financing obtains a major contribution. Target ratio of indirect to direct financing should be 60:40;
- Realization of a sustainable process in the creation and development of targeted product lines under the two main approaches for SME financing;

- Conservative assessment of risks and maintenance of high level of impairment coverage of problem loans.

The Bank intends to significantly diversify its funding sources. Expectations are for an increase in bond instruments in the formation of liability where balancing, in terms of the international and the domestic market, will be made currently and depending on the specific market conditions.

BDB will continue to support Bulgarian State initiatives promoting the economic and social development in the country. More specifically, in 2017 BDB will continue to support the implementation of the National program for rehabilitation of multifamily buildings.

EVENTS AFTER THE DATE OF THE BALANCE SHEET

The financier Assoc. Prof. Krasimir Angarski was elected as a member of the Supervisory Board of the Bulgarian Development Bank (BDB) at an extraordinary general meeting of the shareholders. He replaced Kiril Ananiev, who was appointed Finance Minister in the caretaker government. The replacement was done in compliance with the legal provisions, as in his capacity as Minister of the Ministry of Finance, which is the principal of BDB, Kiril Ananiev is not allowed to be a member of the Supervisory Board of BDB.

Assoc. Prof. Krasimir Angarski was born in 1953 in Sofia. He graduated from the University of Economics "Karl Marx". Since 1980 he had worked in the Ministry of Finance, reaching the position of tax administration director for the Sofia district and of Sofia. In 1994-1995 Assoc. Prof. Angarski was the CEO of the Bank Consolidation Company and participated in the management of various state enterprises.

From 24 March to 21 May 1997 he was a minister without portfolio in the cabinet of Stefan Sofiyanski and was actively involved in the preparation for the introduction of the currency board. Then he became secretary for economic affairs of President Petar Stoyanov.

In 2001-2004, Assoc. Prof. Krasimir Angarski was the CEO of DSK Bank and in early 2005 he took the lead of DZI Bank. In early 2007 he became an adviser at Postbank. He teaches at the University of National and World Economy and is the leader of the group developing the currency board laws.

MANAGEMENT'S REPRESENTATIONS

Management of the Bank declares that the enclosed annual financial statements give a true and fair view of the property and financial position of the Bank at the end of 2016 and of the calculation of the financial result for the year in accordance with the effective law. Suitable accounting policies have been used and applied consistently. The necessary judgments are made in accordance with the principle of prudence in the preparation of the annual financial accounting statement at the year-end. Management applies consistently the applicable accounting standards and the annual financial statements have been prepared on a going concern basis.

Management of the Bank endeavours to maintain an adequate accounting system that complies with the applicable accounting standards. The annual financial statements disclose the standing of the Bank with a reasonable degree of accuracy.

All measures are taken to protect the assets of the Bank, to prevent fraud and violations of laws in the country and regulations of BNB on the banking activity.

This report was approved on 13 March 2017 by the Management Board of BDB and signed by:

EXECUTIVE DIRECTORS

ANGEL GEKOV **BILIAN BALEV** **ILIYA KIRCHEV**

БЪЛГАРСКА БАНКА ЗА РАЗВИТИЕ АД

CORPORATE GOVERNANCE STATEMENT

Principles of corporate governance

As a financial institution established according to a special law, while applying all the regulatory norms of the National Bank and European legislation and the implementation of its mission to be a sustainable instrument of state policy for promoting the development of small and medium sized businesses in Bulgaria, the BDB Group has targeted its activities to becoming the benchmark for good corporate governance and corporate responsibility; to consistently and strictly comply with the National Corporate Governance Code of 2007, the Code of Ethics of BDB by 2013, the Code of Ethics of the Internal Audit Group of BDB 2015, the laws and regulatory requirements in Bulgaria, the norms of European law and good corporate and banking practices.

Bulgarian Development Bank provides services as an investment intermediary according to the provisions of the Public Offering of Securities Act (POSA). As an investment intermediary, the bank must meet certain requirements to protect the interests of its customers according to the Financial Instruments Directive Act (FIMA) and Decree 38 issued by the Financial Supervision Commission (FSC). The Bank should also comply with the requirements of Directive 2014/65/EC on the financial instruments markets (MiFID II) and Regulation 600/2014 of the EU relating to the Financial Instruments Markets (MiFIR). The Bank has established and applies an organization associated with the conclusion and execution of contracts with customers, with information requests from the customers, with record keeping and preservation of the customer's assets in accordance with the aforementioned national and European regulations. The Bank has established a system of internal rules and internal control procedures to ensure full compliance with the regulations referred to above.

The Bulgarian Development Bank Group (the Group) includes Bulgarian Development Bank AD and its two subsidiaries - National Guarantee Fund EAD (NGF) and Micro Financing Institution Jobs EAD (MFI), in which BDB is the sole proprietor.

In addition to the group of BDB subsidiaries NGF and IFIs Jobs, BDB has no significant direct or indirect shareholdings (including indirect shareholdings through pyramid structures and cross-shareholdings) within the meaning of Article 85 of Directive 2001/34/EC.

Bulgarian Development Bank AD

Bulgarian Development Bank AD (BDB, the "Bank") was established on 11 March 1999 as a joint-stock company according to the name of Encouragement Bank AD.

On 23 April 2008 the Bulgarian parliament accepted Bulgarian Development Bank Act (*ZBBR*, Bul.). This law regulates the scope of the Bank's activities, including those of its subsidiaries envisaged for incorporation.

The headquarters of the "Bulgarian Development Bank" AD are located in the city of Sofia 1000, Sredets district, 1 Dyakon Ignatii Street.

At 31 December 2016 Bulgarian Development Bank had no branches.

BDB is a key instrument and a channel for conducting government economic policies, including in specific areas, regions, industries and social groups. The Bank actively collaborates with all government state structures in order to ensure maximum impact of the public funds targeted on support of the economic development. Priority focus is set on pre-export, export and bridge financing. Traditionally, the Bank will continue to provide investment financing for SMEs with extended initial maturity and relaxed collateral requirements.

The Bank has complied with the requirements of BNB for minimum share capital for banking activity, as well as with the capital requirements of BDBA. The ownership of the capital is as follows: 99.9999 per cent is owned by the Republic of Bulgaria, represented by the Ministry of Finance and 0.0001 per cent is owned by the DSK Bank. The conducted stress test and the analyses of the quality of the assets, owned by the banks in 2016, confirmed the exceptionally high capital adequacy of the Group and its resilience to shocks greatly exceeding the set regulatory requirements.

The equity of the parent company (the Bank) consists of 6,017,735 ordinary registered voting shares with a nominal value of BGN 100 each. BDB's shares are not traded on the stock market.

The Bulgarian Development Bank Act has determined that a package of not less than 51 per cent of the shares in the capital of the Bank shall be state-owned and that the shares of the state, amounting to not less than 51 per cent of the registered share capital, are not transferable. In addition, a specific limit is established on the composition of the other shareholders, registered outside the Bulgarian state - through the Ministry of Finance. These may include: the Council of Europe Development Bank, the European Investment Bank, the European Investment Fund and other development banks of the Member States of the European Union. The Bank's shares cannot be pledged and the rights attached thereto may not be subject to transfer.

Regarding the acquisition of its own shares, pursuant to Article 187e and Article 247 of the Commercial Act, BDB declares that such an acquisition has not taken place and that no acquisition, possession or transfer of shares and bonds of the Bank has been performed by the board members during the reported year and that according to Article 6, paragraph 4 of the Bulgarian Development Bank Act the shares in the capital of the Bank, apart from the Bulgarian state, may be acquired and held by the Council of Europe Development Bank, the European Investment Bank and the European Investment Fund as well as by development banks of Member States of the European Union. In these cases, Article 31 of the Law on Credit Institutions is not applied.

According to Article 6, paragraph 4 of BDB, the members of the management and supervisory bodies, the procurators and the senior management cannot own shares and cannot be provided with options on BDB securities as well as that during the subsequent accounting periods no agreements may be concluded as a result of which in any future period changes may occur in the possession of the relative volume of shares held by the current shareholders.

Management of BDB is carried out in accordance with Article 5 of the Bulgarian Development Bank Act based on which the Bank has a two-tier system of governance and the rights of the State in the general assemblies of the shareholders shall be exercised by the Minister of Finance. Outside the powers of the

Minister of Finance, changes in the Bulgarian Development Bank Act - as changes of the articles of association, and the right to issue or to share redemption - is possible only after the passing of a new law or amending the current legislation by the National Assembly. According to this article, and in the capacity of a representative of the majority shareholder in BDB, the decision to reduce the capital through the redemption of shares may be made only by the Minister of Finance.

In 2016 the BDB Group had no outstanding obligations related to any existing or newly issued securities.

At 31 December 2016 there were no pending legal, administrative or arbitration proceedings relating to liabilities or receivables of the BDB Group in the amount of 10 percent or more of its equity.

The BDB Group of does not prepare forecast financial statements.

Pursuant to the Articles of Association, the Bank's lending activity is directed towards:

- Pre-export and export financing of SME;
- Financing SME operations and projects either through intermediary banks or directly;
- Refinancing banks granting loans to SME;
- Financing SME investments abroad.

The Bank extends also other types of loans according to a procedure set by the Management Board, whereas the exposure to one customer or a group of related customers, other than credit institutions, central governments and central banks within the meaning of Regulation 575/2013/EU, cannot exceed 10 (ten) percent of the eligible capital (the equity) of the Bank after taking into account the effect of credit risk reduction. In case of exposure in violation of the above limit and as a result of a business combination and/or another transaction, the Management Board shall notify the Supervisory Board and shall make a proposal regarding the method, term and need of their regulation, asking for the approval of the Supervisory Board.

In support of the economic development, and to provide financial support for any business, the Bank may finance/refinance companies with liabilities classified in the credit register at the BNB in groups "Substandard" or "Loss" (or the equivalent of such a classification in case of legal changes) at the time of applying for a loan from the Development Bank and after confirmation by the Supervisory Board.

The Management Board passed a unanimous decision to form an exposure to one customer or a group of related customers if its amount exceeds 5 per cent of the Bank's equity, in compliance with the requirements of the Law on Credit Institutions and the internal rules of the Bank.

In view of its specific function related to carrying out the state policy on promoting the businesses, BDB prioritizes its activity programs and products to promote SMEs, on-lending programs, export financing and funding awarded mandates. The biggest credit exposure of the Bank provided to a group of connected persons /institutions outside the banking/ amounted to BGN 60,813 thousand at amortised cost (2015: BGN 50,510 thousand), representing 9.77 per cent of the equity of the Bank (2015: 8.66 per cent). Analysis of the structure of the loan portfolio arranged by segments is provided in the financial statements.

Considering the specific activity of the Bank by 31 December 2016, the funds, collected by the 20 largest non-bank depositors, represent 97.26 per cent of total liabilities to other customers (31 December 2015: 96.49 per cent).

In view of its specific activity, the BDB Group uses significant external funding from international financial institutions. Detailed information on the received external credit lines is disclosed in Note 30 to the Financial Statements.

National Guarantee Fund EAD (NGF)

National Guarantee Fund EAD (NGF) is a company established on 12 August 2008 on the grounds of the Bulgarian Development Bank Act and registered with the Commercial Registry on 22 August 2008. According to the Law on Credit Institutions (LCI), National Guarantee Fund EAD is a financial institution, registered in 2009 by BNB in the register under Article 3, paragraph 2 of the Law on Credit Institutions (LCI). In accordance with its Articles of Association, the scope of activity of the Fund includes:

- Issuing guarantees to supplement collateral for loans to small and medium enterprises;
- Offering other products for small and medium enterprises such as: guarantee for participation in tender; guarantee for good performance; guarantee for advance payment; guarantee for payment of loan to exporter, etc.;
- Issuing guarantees to supplement collateral for loans to small and medium enterprises involved in research and development activities, as well as for deployment of the results thereof in industry;
- Other activities that are not particularly prohibited by the Law.

The headquarters of National Guarantee Fund EAD (NGF) are located in the city of Sofia, 1 Dyakon Ignatii Street.

Micro Financing Institution JOBS EAD (MFI Jobs)

Micro Financing Institution JOBS EAD (MFI) is registered with the Commercial Register on 14 January 2011. The main scope of activity includes: micro financing, including granting of micro-loans, acquisition from third parties and leasing out of industrial equipment, cars and other vehicles, as well as other goods (financial leasing), purchase, sale and import of such goods, consultancy services, agency and brokerage for local and foreign individuals and legal entities, operating in the country, as well as any other activities not prohibited by Law.

The headquarters of Micro Financing Institution JOBS EAD (MFI Jobs) are located in the city of Sofia, 1 Dyakon Ignatii Street.

Risk Management within the BDB Group

In the course of its ordinary activity the BDB Group companies may be exposed to various financial risks that, if occur, may result in losses and deterioration of the Group's financial stability. Financial risks are identified, measured and monitored using different control mechanisms for their management and for avoidance of any unjustified concentration of a particular risk. The risk management process is essential for the Group's profitability and existence. The most significant risks are the following: credit risk, market risk and operational risk.

In the area of risk management, the Group is guided by the principles of conservatism, objectivity and full compliance with all relevant national, European legislation and regulatory recommendations. In support of this policy, the Group maintains substantially higher levels of liquidity buffers and capital adequacy than as required by the regulations.

Credit risk

Credit risk is the main risk for BDB and therefore, its management is fundamental for its activity. Credit risk management is performed in accordance with the BBD Act and the effective laws and regulations of the Republic of Bulgaria regulating credit activity, as well as the international regulations and best banking practices.

In assessing and managing the credit (including the counterparty risk) risk of its exposures, the Group applies models for internal rating generation. Loan portfolio quality monitoring, control and assessment units are established and function within the Group. Loan portfolio current monitoring, reporting and management procedures and mechanisms are implemented, which require periodical, and if necessary, extraordinary, reports on the financial and credit status of each borrower and liable persons. If new circumstances are established, which could result in changes in the borrowers' risk profile, including in higher risks of default of the credit exposure, adequate and conforming to the debtor's risk profile measures are taken.

In managing its credit risk, the Bank applies an intra-bank system of limits by economic sectors, instruments, and other credit restrictions and limits on concentration, and the results from their monitoring are reported to the competent authorities. The system of limits is reviewed and updated periodically.

The management of the credit risk in the off-balance sheet commitments (guarantee) obligations of NGF has two levels - at the level of individual transactions (guarantee) and on the portfolio level. The credit risk on an individual level is managed according to the internal rules and procedures to guarantee the activity, the proposal for the issuance of the guarantee (assuming guarantee commitment) dully reviewed and approved by the Risk Manager of the company before issuing confirmation of the guarantee by the representatives of the NGF. Under the guarantee scheme there is also a second level of approval, or the so-called Advisory Committee, which is composed of representatives of the MAF and BDB, who approve the assumption of guarantee commitments for amounts exceeding BGN 500 000. On the portfolio level the credit risk is managed through limits on the payment (caps) limiting the commitment of the NGF to pay a certain proportion of the value of the portfolio of guarantees issued under a given program to a given bank. The subsequent management of the credit risk commitment of the NGF is through monitoring procedures, according to which the fund may exclude from coverage certain portfolio loans which do not meet the specific requirements of the concluded guarantee agreements.

The policy which MFI JOBS has adopted to minimize the credit risk is to make a preliminary assessment of the creditworthiness of customers and to require additional collateral for the lease and loan contracts and the transferred entitlements: insurance of leased assets, registration of leases with the Central Register of Special Pledges (CRSR), surety, promissory notes and special pledges of receivables, as also mortgages of real-estate property and/or pledge of movables when granting the loans.

Market risks to which the BDB Group is exposed

In managing the foreign currency risk the BDB Group follows the principle of maintaining minimum open currency positions within the specified limits. Foreign currency positions are not formed with speculative purposes, but are due to foreign currency transactions arising in the ordinary course of activity of the Group. The Group does not carry out significant transactions and does not hold significant open positions in currencies other than EUR and BGN. Until the exchange rate of the Bulgarian Lev is pegged to the Euro, the Euro is not considered as a currency bearing FX risk for the cash flows and the financial position of the Group.

As part of the interest rate risk management, regular reports on financial assets and liabilities are prepared, divided in time buckets depending on their sensitivity to changes in interest rates. In case of misbalances in periods, an assessment of expected changes in interest rate curve is applied and potential risk for the interest income and capital of the Group is measured.

The risks from transactions on the money and capital markets are controlled by a system of limits, reflecting the risk profile of the investments and certain parameters of the portfolio: such as counterparty, financial instrument, maturity, etc. The system of limits is reviewed periodically, and the implementation of these limits is subject to daily monitoring. The portfolio of securities, formed by the BDB Group in the group for the purposes of investing free cash, is characterized by a short duration, low interest rate risk and relatively liquid securities, issued by reliable institutions, i.e. they bear a low price risk. As there is no trading portfolio in accordance to the regulatory provisions, there is no regulatory requirement for capital allocation to cover the market risk.

The BDB Group's liquidity is managed by closely monitored ratios indicating the liquidity position by periods. Liquidity risk is measured by applying additional scenarios for cash flows from operations.

Measured and monitored are also the liquidity buffers of the BDB Group and the additional sources of funding in cases of market-wide or idiosyncratic shocks. The compliance with the ratios indicating the liquidity position is monitored and reported regularly to the competent authorities.

Operational risk

Operational risk management is implemented through close observation and recording of all operational events, which occur in the activity of various units and processes of the Group. Events of higher frequency as well as higher severity serve as bases for the operational risk analyses in different scenarios. The operational risk is measurable and controllable as in the process of work an operational event registry is kept, which is used as a basis for analysing and improving the work processes and minimising the conditions that would potentially result in operational events and loss for the Group. The required capital to cover the operational risk is calculated by applying the "Basic indicator approach" in compliance with the applicable regulatory framework.

Risk management structure

The main units, which are directly responsible for managing the risks, are as follows:

For the parent company (the Bank):

- *Supervisory Board* – performs overall supervision of risk management;
- *Audit Committee of the Supervisory Board* – implements the best practices for independent audit control and builds a system of three pillars of control in the financial sector as recommended by the Basel III;
- *Management Board* – responsible for the overall risk management approach and for approving risk management strategies, principles and specific methods, techniques and procedures;
- *Risk Committee* – responsible for exercising control over the implementation of the risk management policies by various types of risk, as well as the adequacy of the Bank's risk profile to the tasks assigned to it.
- *Committee on Assets and Liability Management (ALCO)* – responsible for the strategic management of assets and liabilities and for market risk management, including liquidity risk management, related to the assets and liabilities.
- *Provisions Committee* – analyses credit transactions from the perspective of credit risk management for the loan portfolio in general, as well as of the level of credit deals and borrowers;
- *Executive Directors and members of the Management Board* – exercise current operating control of the maintenance and monitoring of the limits set for a particular types of risk and the application of the established procedures.
- The Central Bank exercises supplementary supervision of risk management at the Bank by requiring periodically regulatory reports and exercising subsequent control on the compliance with the statutory maximum levels of exposure to certain risks.

For the subsidiary National Guarantee Fund (the Fund)

The main units responsible for the management of risks are:

- *Supervisory Board* - Management Board of BDB AD (the parent company) – performs overall supervision of risk management;
- *Board of Directors* – responsible for the overall approach towards risk and approves risk management strategies, principles and specific methods, risk management techniques and procedures;

- *Provisions Committee* – analyses the guaranteed portfolio in terms of overall credit risk management of the whole portfolio, as well as of each guarantee deal and each beneficiary of the guarantee itself.
- *Risk and Monitoring Department* — performs monitoring of the guaranteed portfolios and the collateral provided. At least annually an inspection over the fulfilment of the economic and social requirements for the SME using a guarantee from National Guarantee Fund EAD is carried out.

For the subsidiary Microfinance Institution JOBS EAD (MFI):

The main units responsible for the risk management are:

- *Board of Directors* – adopts rules and procedures for risk management. Controls the risk factors of the Company and makes decisions within its powers. Analyses credit transactions for over BGN 100 thousand in terms of credit risk management;
- *Credit committee* – monitors and analyses on an ongoing basis the loan and lease portfolio of the Company in terms of credit risk, including by individual transactions;
- *Credit Council* – analyses credit and leasing transactions in terms of credit risk management upon their approval and / or renegotiation;
- *Operational Management (Executive director and Member of the BD)* – organises the activities for the implementation of the Rules for Risk Management adopted by the Board of Directors; creates a work organisation that ensures compliance with the limits and risk levels set; exercises control over the compliance of the risk analysis, measurement and evaluation procedures used by the officials as per the set internal regulations;
- *Risk Management Department* – develops and implements a risk management system; prepares and submits to the Board of Directors periodic reports for assessing the operational risks, including the observance of the limits, and reports on an ongoing basis to the Operational Management of the Company; performs initial and ongoing validation of the risk assessment methods; examines the inputs needed for the risk assessment in accordance with applicable principles of reliability and sufficiency.

Banking regulators according to the Bulgarian law

In accordance with the requirements of the laws and regulations governing the banking activities in the country, BDB should respect the limitations associated with certain ratios in the consolidated accounts. At 31 December 2016 BDB complied with all regulatory requirements of BNB and the Bulgarian legislation.

In its activities, the Group should comply with the regulatory requirements for capital adequacy and should also fulfil the initially set objectives - support for the economic policy of the country and the development of small and medium sized business. The values of the asset coverage with capital buffers exceed considerably the legally required levels.

Corporate governance of the BDB Group

Bulgarian Development Bank AD has a two-tier management structure consisting of Supervisory Board and Management Board. In 2016 there were no changes in the structure of the management.

Supervisory Board:

Atanas Katsarchev - Chairman

Atanas Katsarchev is a tax and financial advisor with years of managerial experience. He was Deputy Minister of Finance, Chairman and Board member of companies and is currently an adviser to the Minister of Finance. In the period 2001-2006 he was a member and from 2006-2009 - Chairman of the Supervisory Board of BDB.

Kiril Ananiev - Deputy Chairman

Kiril Ananiev, Deputy Minister of Finance in the caretaker government. Between 1998-2009, he was Deputy Minister of Finance according in three successive governments, as well as a Secretary for Financial Policies in the administration of the President of the Republic of Bulgaria and the political advisor in the Cabinet of Prime Minister. In the period 2006-2009 he was a member of the Supervisory Board of the Encouragement Bank (today Bulgarian Development Bank). In 2017 he was appointed provisional Minister of Finance.

Dimitar Dimitrov - Board Member

Dimitar Dimitrov has a proven professional and managerial experience in the banking sector. He was CEO of UBB, Deputy Minister of Economic Development, BNB Deputy Governor, Executive Director of BCC and others. From 2001 to 2011 he was a member of the Management Board of BDB.

In following the best control practices and the three pillar system, recommended according to Basel III, a specialized body, made up of an Audit committee, a Risk committee and a Remuneration committee, has been set up.

	Risk committee	**Remuneration committee**
Atanas Katsarchev	Chairman	Chairman
Kiril Ananiev	Member	Member
Dimitar Dimitrov	Member	Member

Audit Committee:

Mrs Valya Yordanova - President of the Committee

Mrs Ruslanna Radomirova - Member of the Committee;

Mr Ognyan Todorov - Member of the Committee.

Management Board:

Angel Gekov - Chairman of the Management Board and CEO

Angel Gekov has over 20 years of experience in the management of financial institutions. He graduated from the Law Faculty of the Sofia University "St. Kliment Ohridski" and later specialized CEE finance and banking in t Tokyo, Japan, and credit analysis in Vienna, Austria. His professional development began at the Commercial Bank in 1991. In 1997 he headed the Lending Department at Bulbank. From 2001 to 2005 his career continued through the positions of CEO at Roseximbank, the Municipal Bank and the Encouragement Bank (now Bulgarian Development Bank). Over the last three years before returning to BDB Gekov was a member of the Management Board and CEO of Commercial Bank D.

Bilian Balev - Deputy Chairman of the Management Board and CEO

Bilian Balev has graduated "Finance and Credit" at the UNWE. In the period 1992-1995 he attended additional courses and obtained qualifications successively in the US, UK and the Czech Republic. Balev specializes at the American Express Bank in New York, and in 1995 received training in portfolio management at Central European University, Prague. His career in banking began in 1991 at the Bulgarian Post Bank. Between 1992-1995, he held positions in the Private Agricultural and Investment Bank, Financial Brokerage House Sofia and Unionbank. From 1996 to 2001 he was CEO of Capman AD. In 2001, he became general manager of the company Nobel Advisors and in 2004 - of Forem Consulting Bulgaria. Since the end of 2013 he has been the CEO of BDB.

Iliya Kirchev - Member of the Management Board and CEO

Iliya Kirchev has master's degree in "Finance" from the University of National and World Economy. His career began in 1995 in Agrobusinessbank in Plovdiv. From 1999 to 2003 he was Governor of the Plovdiv branch of Allianz Bank Bulgaria. From 2003 to 2005, he held senior positions at the HVB Bank Biochim. From 2005 to 2010 he consecutively headed two of the Plovdiv branches of Eurobank Bulgaria, and in 2011 became regional manager for corporate customers in the bank. From 2012 to 2013, he was governor of the Plovdiv branch of the First Investment Bank. He is currently Assistant Professor at the Higher School of Agribusiness and Regional Development in Plovdiv.

Committees of the Management Board

In the course of implementing the legislation of Bulgaria and that of the EU and in following the best banking practices the Management Board of BDB has delegated some of its powers to specialized committees – Credit Committee, Committee on Impairment and Provisions, Committee on Asset and Liability Management and Commission on Complaints and Signals.

In December 2016 the Committee on Impairment and Provisions was closed and pending is a decision by the Board to transfer the rights and obligations of this committee to the Committee on the management of assets and liabilities. Monthly meetings are held by the Committee on assets and liabilities (ALCO), which reviews the main indicators relating to the strategic management of the bank's assets and liabilities. The main functions of ALCO are to identify, manage and monitor the liquidity risks for the Bank, to determine the strategy to attract resources, to determine the pricing policy of loans so as to ensure an adequate margin above the cost of funds, to decide on the strategic liquidity of the Bank, in order to ensure regular and timely meeting of the current and future obligations, both under normal conditions and in the event of a liquidity crisis as well as to determine the structure of the liquidity buffers and the sources of additional funding. The materials, reviewed at the meetings of the Committee, together with the minutes from the agenda, are submitted to the Management Board of BDB soon after each session. In addition to the board's members, participants in these meetings are also the heads of key departments in the bank:

	Credit Committee	Committee on Impairment and Provisions	Committee on Asset and Liability Management	Commission on Complaints and Signals
Angel Gekov	Member		Member	
Bilian Balev	Member			
Iliya Kirchev	Chairman			Member
Head of Risk Department	Alternative member			
Head of Legal Department				Member
Head of Bank Security				Member
Head of Planning, Analysis and Regulations Division		Chairman	Member	Member
Head of Internal Audit Group				Member
Head of Liquidity Division			Member	
Head of Corporate Banking Division	Alternative member			
Head of International Financial Institutions Division			Member	
Chief Expert Management at the Division of Planning, Analysis and Planning responsible for credit control		Member		
Deputy Head of Risk Division			Member	
Senior Expert Risk Management		Member		

** The Chairman of the Commission is elected by the members for a period of one year.*

The Bank is represented jointly by any two of the three Executive Directors.

In 2016 there were no changes in the basic principles of management of the BDB Group.

Contracts with related parties involved in the management and participation of the members of the Management and Supervisory Boards in other companies

No contracts, which fall beyond the ordinary course of business or significantly deviate from market conditions, within the meaning of Article 240b of the Commercial Act, were concluded between members of the SB, MB or related persons on one side, and the Bank on the other side.

In 2016 between BDB and its affiliates, no deals or offers to enter into transactions, falling outside the ordinary activity or significantly deviating from the market conditions to which BDB or its subsidiary is a party, were concluded.

There are no significant contracts signed by the Company which may generate effects, may be changed or terminated due to a change in the management and control of the company in the course of the mandatory tender offering and to the extent that there is a legal limit on the acceptable range of shareholders in BDB in conformity with the Bulgarian Development Bank Act no such contracts are expected to be concluded.

The BDB Group does not have the practice and has not concluded any agreements between the companies and their management bodies or employees for the payment of compensations upon resignation or dismissal without legal grounds or upon termination of the employment contracts for reasons related to tender offers.

The participation of members of the SB and MB in commercial entities as general partners with unlimited liability, or possession of more than 25 percent of the capital of a legal entity, as well as participation in the management of other companies or associations as procurators, managers or Board members, within the meaning of Article 247, paragraph 2, item 4 of the Commercial Act, is as follows:

The members of the Supervisory Board of BDB have the following interests in the capital or management of other companies:

Atanas Slavchev Katsarchev - does not participate in the capital and management of other companies.

Kiril Milanov Ananiev - does not participate in the capital and management of other companies.

Dimitar Kirilov Dimitrov is a partner in PGD OOD (UIC 175247211) and holds 50 per cent of the company shares. The company does not carry out any activities. Mr Dimitrov participates in the management of Eurohold Bulgaria AD, UIC 175187337, as a member of the MB.

The members of the MB of BDB have the following participations in the capital and management of other companies:

Angel Kirilov Gekov participates in the management of National Guarantee Fund EAD, UIC 200321435 as Chairman of the Board of Directors. Mr Gekov participates in the management of PCA

OOD, UIC 201477526 and holds 25 per cent of the company's capital. Mr Gekov holds 19 per cent of the capital of BULGARPLOD CHERRY OOD, UIC 200204916.

Bilian Lyubomirov Balev participates in the management of Micro Financing Institution JOBS EAD, UIC 201390740 as Chairman of the Board of Directors. Mr. Balev is a partner in Fininvest OOD and holds 99 per cent of the capital of the company. The company is a foreign legal entity, established and existing according to the laws of the United Kingdom of Great Britain and Northern Ireland. Mr Balev is the sole proprietor of the capital and general manager of the company Fin Yachting, registered as per the laws of Malta. He is a member of the administrative board of the European Association of Public Banks (EAPB) domiciled in Brussels, Belgium.

Iliya Vasilev Kirchev participates in the management of the Microfinance Institution JOBS EAD, UIC 201390740 as Deputy Chairman of the Board of Directors. Mr. Kirchev is a member of the management bodies of the following non-profit organizations: The Foundation "Academy 2007", town of Kardzhali, UIC 108688838 and the Cultural Center "Dr. Hristo Adjarov 2010" - Plovdiv, UIC 175962774.

Note 13A to the financial statements discloses comprehensive information on the full amount of the remuneration, rewards and/or benefits paid by the issuer and its subsidiaries to each of the members of the management and control bodies during the financial year,.

Management of the subsidiaries

BDB is the sole shareholder of the capital of its subsidiaries NGF EAD and MFI JOBS EAD.

National Guarantee Fund EAD

NGF EAD has a one-tier management system - Board of Directors (BD), which in 2016 was composed of three members.

Board of Directors

Angel Gekov - Chairman of the Board of Directors

Samuil Shiderov - Deputy Chairman of the Board of Directors

Samuil Shiderov is the Executive Director of the National Guarantee Fund. He holds a bachelor's degree in "Banking" and a master's degree in "Finance" from the University of Economics in Varna. He began his career at the end of 2001 at the SG Expressbank in Sofia. From 2003 to 2011 he worked in the Risk Management Department of Raiffeisenbank Bulgaria, where he took office successively as a credit manager, problematic loans specialist, head of sector and deputy head of department. From October 2011 to December 2012 he was head of a department at DSK Bank. Shiderov has been the Executive Director of the National Guarantee Fund since the beginning of 2013. On 18 June 2015 Samuel Shiderov was elected to the Board of Directors of the European Association of Guarantee Institutions (AESM).

Alexander Georgiev is a member of the Board of Directors.

Alexander Georgiev is a member of the Board of Directors of the National Guarantee Fund from March 2015. He has a master's degree in "Economics and Industrial Management" from the Academy of Economics "Dimitar Apostolov Tzenov" – town of Svishtov. Georgiev has extensive experience at expert and management positions in the insurance and financial services sphere.

The Fund is represented jointly by any two members of the Board of Directors.

The members of the Board of Directors of NGF EAD do not own shares in the Fund and have no special rights to acquire such shares.

No contracts, which fall beyond the ordinary course of business or significantly deviate from market conditions, within the meaning of Article 240b of the Commercial Act, were concluded between members of the BD of NGF EAD or related persons on one side, and the company on the other side.

The participation of members of the Board of Directors of NGF EAD in commercial entities as general partners with unlimited liability, or possession of more than 25 percent of the capital of a legal entity, as well as participation in the management of other companies or associations as procurators, managers or Board members, within the meaning of Article 247, paragraph 2, item 4 of the Commercial Act, is as follows:

Angel Kirilov Gekov is Executive Director and Chairman of the Management Board of Bulgarian Development Bank AD. Mr Gekov participates in the management of "PCA" OOD, UIC 201477526 and holds 25% of the company's capital. Mr Gekov holds 19% of the capital of BULGARPLOD CHERRY OOD, UIC 200204916.

Alexander Georgiev is a sole owner of KA SERVICE EOOD, UIC 114672190, Brandi BG EOOD, UIC 202605174, SP „Alexander Georgiev – AG", UIC 824083350.

Samuil Pavlov Shiderov does not have participations in other companies within the meaning of Article 247, paragraph 2, item 4 of the Commercial Act. Mr Shiderov is a member of the Board of Directors of European Association of Guarantee Institutions – AECM – an international non-profit organisation domiciled in Brussels, Belgium.

Micro Financing Institution Jobs EAD

IFI Jobs PLC also has a one-tier management system - Board of Directors (BD), which consists of three members.

Board of Directors

Bilian Balev - Chairman of the Board of Directors

Elijah Kirchev - Deputy Chairman of the Board of Directors

Kostadin Munev - Member of the Board of Directors and CEO

Kostadin Munev holds a master's degree in "Finance" from the University of National and World Economy in Sofia in 1996. In 2011 he was elected procurator of Micro Financing Institution JOBS PLC and Head of Lending and Leasing Department of the company and from April 2013 he is elected a Board member. In April 2014 he was elected Executive Director of Micro Financing Institution JOBS EAD. Munev has worked as chief accountant for Bulgarian enterprises and non-profit associations. He has extensive experience in micro-financing obtained in his capacity of manager of financial leasing in the JOBS project for the UN Development program during the period 2003 – 2010. Munev has participated in numerous international conferences on topics related to micro-financing and is the co-author of the publications "Guide to micro crediting in Europe", "From Exclusion to inclusion through micro financing", "Market research of micro crediting for the purposes of the European Investment Fund - International research in Western and Eastern Europe: a Report on Bulgaria". Munev is fluent in English and Russian.

The Company is represented jointly by any two of the members of the Board of Directors.

No contracts, which fall beyond the ordinary course of business or significantly deviate from market conditions, within the meaning of Article 240b of the Commercial Act, were concluded between members of the BD of MFI Jobs EAD or related persons on one side, and the Company on the other side.

The participation within the meaning of Article 247, paragraph 2, item 4 of the Commercial Act, of members of the BD of MFI Jobs EAD in commercial companies as general partners, holding of more than 25 percent of the capital of another company, as well as their participation in the management of other companies or associations as procurators, managers or Board members, is as follows:

Bilian Lyubomirov Balev participates in the management of Micro Financing Institution JOBS EAD, UIC 201390740 as Chairman of the Board of Directors. Mr. Balev is a partner in Fininvest OOD and holds 99 per cent of the capital of the company. The company is a foreign legal entity, established and existing according to the laws of the United Kingdom of Great Britain and Northern Ireland. Mr Balev is the sole proprietor of the capital and general manager of the company Fin Yachting, registered as per the laws of Malta. He is a member of the administrative board of the European Association of Public Banks (EAPB) domiciled in Brussels, Belgium.

Iliya Vasilev Kirchev participates in the management of the Microfinance Institution JOBS EAD, UIC 201390740 as Deputy Chairman of the Board of Directors. Mr. Kirchev is a member of the management bodies of the following non-profit organizations: The Foundation "Academy 2007", town of Kardzhali, UIC 108688838 and the Cultural Center "Dr. Hristo Adjarov 2010" - Plovdiv, UIC 175962774.

Kostadin Bozhikov Munev does not participate in other companies or cooperatives pursuant to Article 247 par. 2, item 4 of the Law of commerce.

Transactions with related parties and companies under the control of the state

The owner of BDB is the Bulgarian State, hence the BDB Group companies are related parties to the government authorities of the Republic of Bulgaria and the companies over which it exercises control.

The transactions with related parties and companies under common control with the State are disclosed in detail in the consolidated and separate financial statements.

Development strategy and business objectives

The BDB Group is a key instrument and a channel for conducting government economic policies, including in specific areas, regions, industries and social groups. The Bank actively collaborates with all government state structures in order to ensure maximum impact of the public funds targeted on support of the economic development.

The BDB Group operates in full transparency and applies the best banking and management practices. A core objective of the Group is to identify and analyse the sectors of the economy experiencing difficulties in obtaining financing, and to undertake the necessary measures to facilitate their access to financing.

Facilitating SMEs access to bank financing is not the only priority of the Bank. The Group supports government efforts for acceleration of economic growth in the country by means of providing expertise and performing activities in all area of economic policies, facilitating the absorption of the EU structural funds, enhancing the export potential of the country, etc.

In the light of the foregoing, the main principle underlying the Group's activity is to supplement the market and not to allow displacement of the traditional commercial banks from the market. The objective of the Group's activity is only to compensate any existing market shortages in financing certain segments and thus, to adjust their risk profile and to encourage the commercial banks to develop their exposures to these segments.

The strategic goals of BDB are:

- To facilitate the economic growth by increasing its exposure in support of regions and sectors of the economy with suppressed growth;
- To stimulate the economic activity of the investors for the modernization of the material and technological basis and for boosting the competitiveness of the economy;
- To facilitate the economic growth of the regions through financing, priority syndicated by nature, of sizable and infrastructural, by their nature, investments;
- To support the development of competitive production initiatives and sectors of the economy of proven export potential;
- To facilitate, jointly with the other institutions, the access to financing of innovative and newly established companies;
- To facilitate and support the direction of capital flows to the Bulgarian economy.

Social responsibility and the policy of diversity

Bulgarian Development Bank believes that investing in education and science is an investment in the future. That is why, we have recognized as our mission to support all who seek knowledge - the intelligent, talented, ambitious and promising young people of Bulgaria.

The Bulgaria's Scientific Wonders campaign is a joint initiative of the newspaper "Standard" and the Bulgarian Academy of Science, which was held for the first time in 2015. In 2016 Bulgarian Development Bank awarded the student from the New Bulgarian University, Atanas Atanasov, with the special award in the category "Young explorers" within the Bulgaria's Scientific Wonders campaign.

The Study and Work national campaign aims to help bridge the gap between supply and demand on the Bulgarian labour market. This gap deepens with each passing year as the business experiences an ever growing need of professionally qualified staff; a demand will continue to grow in the 10 -15 years due to the retirement of the older workers and the lack of qualified substitutes. At the same, the secondary school system produces a large number of cadres with vague possibilities for a professional career.

The campaign is being organized by the "24 hours" newspaper and it foresees the holding of a broad debate and the drawing of a map of the current vocational schools by region and types of professions and a map of the cadres which the country will need by the year 2030. The second card will be a large-scale national study, which will be organized in partnership with the nationally represented employer organizations and which will produce a clearer vision to trends on the labour market by 2030. The benefits from this initiative will be both for the business and for the workers themselves (incl. the students and their parents).

Bulgarian Development Bank traditionally supports the teams from the Sofia High School of Mathematics in their participation in international competitions and the Olympiads in mathematics, computer science and physics.

In order to meet the very specific functions assigned by the Bulgarian Development Bank Act, the Bank is pursuing a policy of diversity in terms of its administrative, management and supervisory bodies within the powers delegated by the State. The Bank strictly adheres to the best practices of non-discrimination in terms of age, sex or education and professional experience, part of is the continuing successful internship program of the Bank. In the period between July and September, the ongoing internship program resulted in the recruitment of 13 trainees who were given the opportunity to gain practical experience in strategic units of the bank.

The philosophy of BDB includes the understanding that art and culture are able to unite and cultivate people; that they boost national pride and the sense of belonging. Part of the Bank's efforts is aimed at supporting cultural and artistic historical projects and a priority is placed on initiatives aimed at the preservation and promotion of the Bulgarian spiritual and cultural heritage.

The Bank supported the publication of an album dedicated to the life and work of Vasil Levski, the authors of which are the Bulgarian Committee and the Vasil Levski Foundation. Together with the Bulgarian Glory Association the initiative called "Kolyo Ficheto – the bridge builder" served to popularize the man and his work as the greatest Bulgarian builder, architect and sculptor.

The BDB Group organized an exhibition with the archival photos footage of the building of the financial institution. The exhibition is located at 1 Dyakon Ignatii Street and it was opened in connection with the opening of the new headquarters of the bank in the capital city. The headquarters preserve to the last detail the authentic facade of the building, as it was erected at the end of the 19th century. It is now declared as a cultural monument of regional importance.

Bulgarian Development Bank has adopted the cause of preserving and promoting the Bulgarian spiritual and cultural heritage. The Bank supports initiatives in this sphere of the national cultural life, such as the national folk festival "Ludogorie", which was held in 2015 in the location called "Pchelina".

BDB supports the campaign called *Wonders of Bulgaria.* It is an annual held under the initiative of newspaper "Standard" and is aims at the popularization of the Bulgarian cultural heritage and the promotion of home tourism.

A major cause of the BDB Group is supporting the vulnerable groups of people, such as the children deprived of parental care and the disadvantaged. We understand charity as a mandatory element not only as a matter of corporate social responsibility, but also as an element of our daily personal lives and our lives as employees of BDB.

The Group has successfully partnered with the National Fund "St. Nicholas" in the implementation of a number of charity programs. The Bank supports the Fund in organizing summer rehabilitation camps for disabled children, for children deprived of parental care, as well as in organizing thematic tours.

The orphanage "St. Nicholas" in the "Holy Trinity" monastery is one of the institutions traditionally supported by Bulgarian Development Bank. The bank conducts regular internal campaigns to raise funds to cover the urgent needs of the children and youngsters living in the orphanage and in the protected houses in the village of Yakimovo.

BDB has accepted the "Bulgarian Christmas" as a part of its corporate social responsibility and has repeatedly supported this initiative.

Part of the philosophy of BDB is to support the disadvantaged people and to contribute to their successful integration in society. This is why, Bulgarian Development Bank sponsors the establishment of a special centre for children with special educational needs in the daily kindergarten "Winnie the Pooh" in the city of Stara Zagora.

Bulgarian Development Bank supports the application of modern technology in today's educational process and the creation of opportunities for an equal start for all children. Following this concept the bank has decided to help equip a computer lab in a home for children deprived of parental care "Asen Zlatarov" in the town of Vratsa, donating six complete computers sets.

In 2015 the "Manual for management and development of human resources in the BBR group" was approved and brought in line with best practices in the field of human resource management. The year 2016 saw the start of the implementation of the "Social measures and incentives package as a part of the manual's chapter "Motivation and retention".

The social program of BDB includes: life insurance, official clothing, sporting activities, and a one-off financial support for weddings, childbirth, and medical care support. "Rules for evaluation and modification of the remuneration of the employees in the BDB Group after the probation period" and a "Map of the employee's performance during the probation period".

The Group focuses on granting continued support for the development and training of employees, creating conditions for the professional development of the financial specialists working for the only financial group in Bulgaria, which does not prioritize the creation of profit but is focused more on social goals. The BDB Group is not engaged in the field of scientific research and development outside the training of its personnel.

The present Corporate Governance Statement is an integral part of the Activity report approved by the Management Board of Bulgarian Development Bank on 14 March 2017.

EXECUTIVE DIRECTORS:

ANGEL GEKOV **BILIAN BALEV** **ILIYA KIRCHEV**

БЪЛГАРСКА БАНКА ЗА РАЗВИТИЕ АД

Building a better working world

Ernst & Young Audit OOD
Polygraphia Office Center
47A Tsarigradsko Shose Blvd., floor 4
1124 Sofia, Bulgaria

Tel: +359 2 81 77 100
Fax: +359 2 81 77 111
ey.com

Independent auditor's report

To the shareholders of

Bulgarian Development Bank AD

Report on the Audit of the Separate Financial Statements

Opinion

We have audited the accompanying separate financial statements of Bulgarian Development Bank AD (the Bank), which comprise the separate statement of financial position as at 31 December 2016, and the separate statement of comprehensive income, separate statement of changes in equity and separate statement of cash flows for the year then ended, and notes to the separate financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying separate financial statements give a true and fair view of the financial position of the Bank as at 31 December 2016, 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 Separate Financial Statements* section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants (IESBA Code)* together with the ethical requirements of the Independent Financial Audit Act (IFAA) that are relevant to our audit of the separate 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.

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

Management is responsible for the other information. The other information comprises the management report, including information on the activity of the Bank as an investment intermediary and corporate governance statement prepared by management in accordance with Chapter Seven of the Accountancy Act, but does not include the separate financial statements and our auditor's report thereon, which corporate governance statement has been made available to us in advance.

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

Building a better working world

Our opinion on the separate 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 separate financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the separate 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 and Those Charged with Governance for the Separate Financial Statements

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

In preparing the separate financial statements, management is responsible for assessing the Bank'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 Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

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

Our objectives are to obtain reasonable assurance about whether the separate 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 Independent Financial Audit act and 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 separate financial statements.

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 separate 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 Bank'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 Bank'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 separate 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 Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the separate financial statements, including the disclosures, and whether the separate financial statements represent the underlying transactions and events in a manner that achieves true and fair presentation.

We communicate with those charged with governance 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.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

Building a better working world

Report on Other Legal and Regulatory Requirements

Additional Matters to be Reported under the Accountancy Act and the Public Offering of Securities Act

In addition to our responsibilities and reporting in accordance with ISAs, described above in the *Information Other than the Separate Financial Statements and Auditor's Report Thereon* section, in relation to the management report, including information on the activity of the Bank as investment intermediary and the corporate governance statement of the Bank, we have also performed the procedures added to those required under ISAs in accordance with the Guidelines of the professional organisation of certified public accountants and registered auditors in Bulgaria, i.e. the Institute of Certified Public Accountants (ICPA), issued and approved by its Management Board on 29 November 2016. These procedures refer to testing the existence, form and content of this other information to assist us in forming opinions about whether the other information includes the disclosures and reporting provided for in Chapter Seven of the Accountancy Act and in the Public Offering of Securities Act (Art. 100m, paragraph 10 of the POSA in conjunction with Art. 100m, paragraph 8(3) and (4) of the POSA) applicable in Bulgaria.

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 separate financial statements have been prepared is consistent with those separate financial statements.

b) Excluding the mentioned below, the separate management report has been prepared in accordance with the requirements of Chapter Seven of the Accountancy Act and of Art. 100(m), paragraph 7 of the Public Offering of Securities Act.
In the management report of the Bank is not included the required information under p.17 of the Appendix 10 from Ordinance 2 from 17 September 2003 in relation to Art. 100m, paragraph 7, p. 2 from POSA.

c) The corporate governance statement of the Bank referring to the financial year for which the separate financial statements have been prepared presents the information required under Chapter Seven of the Accountancy Act and Art. 100 (m), paragraph 8 of the Public Offering of Securities Act.

Building a better working world

Opinion in connection with Art. 100(m), paragraph 10 in conjunction with Art. 100 m, paragraph 8(3) and (4) of the Public Offering of Securities Act

Based on the procedures performed and the knowledge and understanding obtained about Bank's activities and the environment in which it operates, in our opinion, the description of the main characteristics of Bank's internal control and risk management systems relevant to the financial reporting process, which is part of the separate management report (as a component of the corporate governance statement) and the information under Art. 10 paragraph 1(c), (d), (f), (h) and (i) of Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids, do not contain any material misrepresentations.

Audit Firm Ernst & Young Audit OOD:

Milka Natcheva-Ivanova
Legal Representative

Nikolay Garnev
Registered Auditor in charge of the audit

Sofia, Bulgaria

15 March 2017

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

BULGARIAN DEVELOPMENT BANK GROUP

SEPARATE STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2016
All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

	Notes	As at 31.12.2016	As at 31.12.2015
Assets			
Cash in hand and balances in current account with the Central Bank	16	78,521	343,853
Receivables from banks	17	274,011	249,860
Financial assets held-for-trading	22	-	305
Available-for-sale securities	21	264,368	220,180
Loans and advances to customers	18	722,744	633,677
Receivables from the State budget	19	424,470	29,885
Assets, held for sale	26	4,657	8,712
Securities, held to maturity	20	1,384	1,979
Other assets	27	150	722
Assets, acquired from collateral foreclosure	27	11,372	4,714
Investment property	25	7,702	7,744
Investments in subsidiaries	23	87,643	87,643
Property, plant and equipment, intangible assets	24	33,698	24,555
Deferred tax assets	14	1,265	725
Total assets		**1,911,985**	**1,614,554**
Liabilities			
Deposits from credit institutions	28	43,737	842
Financial liabilities, held for trading	22	-	362
Current tax liabilities		1,813	140
Deposits from customers other than credit institutions	29	709,549	695,080
Provisions	32	3,319	1,642
Other liabilities	33	1,123	1,181
Borrowings from international institutions	30	379,998	178,723
Other borrowings	31	17,679	27,663
Other liabilities		**1,157,218**	**905,633**
Equity			
Share capital	34	601,774	601,774
Retained earnings		42,920	37,765
Revaluation reserve on available-for-sale securities	35	3,481	578
Reserves	35	106,592	68,804
Total equity		**754,767**	**708,921**
Total liabilities and equity		**1,911,985**	**1,614,554**

The notes on pages 7 to 82 are an integral part of these consolidated financial statements. The separate financial statements were approved by the Management Board of Bulgarian Development Bank AD on 14 March 2017.

Angel Gekov	Bilian Balev	Iliya Kirchev	Ivan Lichev
Executive Director	*Executive Director*	*Executive Director*	*Chief accountant*

БЪЛГАРСКА БАНКА ЗА РАЗВИТИЕ АД

Financial statements
on which our auditors' report was
issued dated:

EY 15-03-2017

Ernst & Young Audit OOD

EY Representative:............ Registred auditor:............

SEPARATE STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2016
All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

	Notes	2016	2015
Interest income	6	60,237	60,546
Interest expense	6	(3,665)	(7,985)
Net interest income	6	**56,572**	**52,561**
Fee and commission income	7	2,314	1,991
Fee and commission expense	7	(35)	(32)
Net fee and commission income	7	**2,279**	**1,959**
Net income on foreign exchange deals	8	760	429
Net gain/(loss) on available-for-sale securities	9	20	(40)
Net gain on financial instruments held-for-trading	10	45	309
Other operating income	11A	2,469	3,149
Other operating expenses	11B	(1,835)	(1,014)
Operating income before impairment		**60,310**	**57,353**
Costs of personnel	13A	(8,382)	(8,542)
General and administrative expenses	13B	(6,946)	(8,442)
Depreciation / amortisation expenses	24	(545)	(510)
Income from reversed impairment and provisions	12	3,147	1,976
Profit before income tax		**47,584**	**41,835**
Income tax expense	14	(4,664)	(4,070)
Net profit for the year		**42,920**	**37,765**
Other comprehensive income			
Items not to be reclassified to profit or loss in subsequent periods			
Actuarial gains /(losses) on defined benefit plans, net of taxes	34	23	(8)
Items to be reclassified to profit or loss in subsequent periods			
Net change in fair value of available-for-sale financial assets, net of tax	15	2,903	595
Total other comprehensive income for the year, net of tax		**2,926**	**587**
Total comprehensive income for the year		**45,846**	**38,352**

The notes on pages 7 to 82 are an integral part of these consolidated financial statements. The separate financial statements were approved by the Management Board of Bulgarian Development Bank AD on 14 March 2017.

Angel Gekov *Executive Director*	Bilian Balev *Executive Director*	Iliya Kirchev *Executive Director*	Ivan Lichev *Chief accountant*

БЪЛГАРСКА БАНКА ЗА РАЗВИТИЕ АД

Financial statements on which our auditors' report was issued dated:

EY 15-03-2017

Ernst & Young Audit OOD

EY Representative:...... Registred auditor:......

SEPARATE STATEMENT OF CHANGES IN EQUITY
AS AT 31 DECEMBER 2016
All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

	Share capital	Statutory reserves	Additional reserves	Revaluation reserve on available-for-sale securities	Retained earnings	Total
At 01 January 2015	**601,774**	**54,327**	**11,717**	**(17)**	**6,016**	**673,817**
Total comprehensive income for the period						
Profit	-	-	-	-	37,765	37,765
Other comprehensive income	-	-	(8)	595	-	587
Total comprehensive income for the period	-	-	(8)	595	37,765	38,352
Transactions with owners, recognised in equity						
Dividends to equity holders	-	-	-	-	(3,248)	(3,248)
Transfer to Reserves based on shareholders' decision	-	602	2,166	-	(2,768)	-
Total transactions with owners	-	602	2,166	-	(6,016)	(3,248)
At 31 December 2015	**601,774**	**54,929**	**13,875**	**578**	**37,765**	**708,921**
Total comprehensive income for the period						
Profit	-	-	-	-	42,920	42,920
Other comprehensive income	-	-	23	2,903	-	2,926
Total comprehensive income for the period	-	-	23	2,903	42,920	45,846
Transactions with owners, recognised in equity						
Transfer to Reserves based on shareholders' decision	-	3,776	33,989	-	(37,765)	-
Total transactions with owners	-	3,776	33,989	-	(37,765)	-
At 31 December 2016	**601,774**	**58,705**	**47,887**	**3,481**	**42,920**	**754,767**

The notes on pages 7 to 82 are an integral part of these consolidated financial statements. The separate financial statements were approved by the Management Board of Bulgarian Development Bank AD on 14 March 2017.

Angel Gekov *Executive Director*	Bilian Balev *Executive Director*	Iliya Kirchev *Executive Director*	Ivan Lichev *Chief accountant*

БЪЛГАРСКА БАНКА ЗА РАЗВИТИЕ АД

Financial statements on which our auditors' report was issued dated:
EY 15-03-2017
Ernst & Young Audit OOD
EY Representative: .... Registred auditor: ....

SEPARATE STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2016
All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

	Notes	2016	2015
Cash flows from operating activities			
Profit for the year		42,920	37,765
Adjustments for:			
Dividend income	11	(983)	(1,202)
Income from reversed loan impairment	12	(5,108)	(1,565)
Expenses / Income on/from guarantee provisions	12	1,542	(458)
Impairment loss on available-for-sale securities	9	0	43
Loss on revaluation of investment property	11	240	335
Impairment loss and sale of other assets	12	419	306
Gain on revaluation of financial instruments held-for-trading		(312)	(155)
Net gain on revaluation of foreign currency assets and liabilities	8	(58)	(195)
Depreciation / amortisation expenses	24	545	510
Carrying amount of written-off assets	24	33	59
Income tax expense	14	4,664	4,070
		43,902	**39,513**
Changes in:			
Reserve Guarantee Fund with BNB	16	47	3
Receivables from banks		24,151	64,938
Loans and receivables		(84,295)	16,489
Loans to the State budget		(394,585)	(29,885)
Available-for-sale securities		(41,285)	57,311
Held-for-trading financial instruments		(305)	760
Assets, held for sale	26	(2,755)	(11,722)
Other assets		(1,598)	109
Deposits from credit institutions		41,664	(79,939)
Deposits from customers other than credit institutions		12,704	(131,767)
Other liabilities		420	85
Cash flows used in operating activities		**(401,935)**	**(74,105)**
Dividends received		52	46
Income taxes paid		(3,400)	(4,000)
Net cash flows used in operating activities		**(405,283)**	**(78,059)**
Cash flows from investing activities			
Cash payments for acquisition of property, plant and equipment, and intangible assets		(9,749)	(4,564)
Cash proceeds from sale of property, plant and equipment, and intangible assets		28	67
Cash proceeds from matured securities, held to maturity		610	-
Dividends received from investments in subsidiaries		930	1,156
Net cash flows used in investing activities		**(8,181)**	**(3,341)**
Cash flows from financing activities			
Dividends paid to the equity owners		-	(3,248)
Cash paid on issued debenture loans		-	(78,499)
Cash paid on other borrowings		(10,302)	(10,102)
Cash received from other borrowings		-	173
Cash received from borrowings from international institutions		285,435	7,762
Cash paid on borrowings from international institutions		(89,704)	(50,935)
Net cash flows from/used in financing activities		**185,429**	**(134,849)**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

Net decrease in cash and cash equivalents		(228,035)	(216,249)
Cash and cash equivalents at the beginning of period	37	421,137	637,386
Cash and cash equivalents at end of period	37	193,102	**421,137**

The notes on pages 7 to 82 are an integral part of these consolidated financial statements. The separate financial statements were approved by the Management Board of Bulgarian Development Bank AD on 14 March 2017.

Angel Gekov
Executive Director

Bilian Balev
Executive Director

Iliya Kirchev
Executive Director

Ivan Lichev
Chief accountant

БЪЛГАРСКА БАНКА ЗА РАЗВИТИЕ АД

Financial statements on which our auditors' report was issued dated:

EY 15-03-2017

Ernst & Young Audit OOD

EY Representative:.......... Registred auditor:..........

1. ORGANISATION AND OPERATING POLICIES

The financial statements of Bulgarian Development Bank AD (the „Company") for the year ended 31 December 2016 were approved for issue by decision of the Management Board dated 14 March 2017.

Bulgarian Development Bank AD is a joint-stock company (AD) registered with the Commercial Register under UIC 121856059, with seat in the city of Sofia, Sofia City Region, Bulgaria, and management address: 1 Dyakon Ignatii Street. The financial year of the Bank ends on 31 December.

Bulgarian Development Bank AD (BDB AD/ the"Bank") was established on 11 March 1999 as a joint-stock company in Bulgaria under the name "Encouragement Bank" AD.

The Bulgarian Development Bank Act was adopted on 23 April 2008 (SG 43/29.04.2008) to regulate the structure and the scope of Bank's activities, including those for its subsidiaries, envisaged for incorporation. By virtue of that law the functions and all rights and obligations were applied to Encouragement Bank AD. Pursuanrt to a requirement of the law, a General Meeting of the Shareholders was held (26 June 2008) at which the name of the Bank was changed to Bulgarian Development Bank and its Articles of Incorporation were amended in line with the new legal requirements thereto.

The Bank holds a general banking licence, issued by Bulgarian National Bank (BNB) on 25 February 1999 with latest update of 16 November 2009 (due to the new Credit Institutions Act), and is allowed to conduct all banking transactions permitted by the Bulgarian legislation. The Bank is also a licensed investment intermediary.

From the very beginning, the Bank was established with a special purpose – to support the implementation of the economic policies of the State by financing the business development of small and medium-sized enterprises (SME), including by supporting their investment and export abilities and initiatives. With the adoption of the Bulgarian Development Bank Act in 2008 this objective was further elaborated in the objectives, principles and scope of the Bank's activities set by the law.

The Bank's activity includes: pre-export and export financing of SME; financing SME operations and projects either through intermediary banks or directly; refinancing banks that grant loans to SME; financing SME investments abroad.

The main objectives of the Bank are to promote, encourage and develop the general economic, export and technological potential of SMEs by facilitating their access to finance; drawing in and management of medium and long-term local and foreign resources needed for the implementation of economic development in the country; implementation of schemes and instruments to finance public investment projects that are priorities for the country's economy; fundraising and project management of international financial and other institutions; fundraising and grant funding in order to reduce regional misbalances in the country; financing of projects of local companies that create export, innovation, high employment and / or value added; financing of priority sectors of the economy, in line with the government policy for economic development.

Bulgarian Development Bank AD has a two-tier system of governance, which comprises Supervisory Board (SB) and Management Board (MB). No changes in the structure of the management bodies were made in 2016. The Supervisory Board and the Audit Committee represent those charged with governance.

In 2016 the members of the Supervisory Board of BDB (SB) were: Atanas Slavchev Katsarchev – Chairman of SB, Kiril Milanov Ananiev – Vice Chairman and member of SB, and Dimitar Kirilov Dimitrov – member of SB.

The composition of the Management Board of BDB in 2016 was as follows: Angel Kirilov Gekov, Chairman of MB and Executive Director; Bilian Lyubomirov Balev - Vice Chairman and Executive Director, and Iliya Vasilev Kirchev - member of MB and Executive Director.

The Bank is represented jointly by either two of the three Executive Directors.

As of 31 December 2016 the Bank's employees were 153 (31 December 2015: 151).

The Bulgarian Development Bank Act (2008) envisages the establishment of two Bank subsidiaries - the Equity Investment Fund and the National Guarantee Fund (Note 23).

The Equity Investment Fund is at project level and had not yet been established as of 31 December 2016.

Bulgarian Development Bank AD had no branches as at 31 December 2016.

2. BASIS OF PREPARATION OF THE SEPARATE FINANCIAL STATEMENTS

Applicable standards

The separate financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union.

These financial statements have been prepared on a separate basis. The Bank prepares consolidated financial statements in accordance with the Accounting Act. These separate financial statements shall be read together with the consolidated financial statements.

Basis of preparation

Statement of compliance

The financial statements of the Company have been prepared in accordance with International Financial Reporting Standards, as adopted by the European Union (IFRS as adopted by the EU). Reporting framework "IFRS as adopted by the EU" is essentially the defined national basis of accounting "IAS, as adopted by the EU", specified in the Bulgarian Accountancy Act and defined in paragraph 8 of its Additional provisions.

These separate financial statements have been prepared on the historical cost basis except for the following items:

- Derivative financial instruments, measured at fair value;
- Instruments held for trading and other instruments, designated at fair value through profit and loss, as long as the fair value can be measured reliably;
- Available-for-sale instruments, designated at fair value through profit and loss, as long as the fair value can be measured reliably;
- Investment property, assets held for sale and assets acquired from collateral foreclosure carried at fair value, less costs of sale and net realizable value (which, in the case of assets acquired from collateral foreclosure is their fair value, less costs of sale), as long as the fair value can be measured reliably.

Going concern

The Bank's management assessed the ability of the Bank to continue its activity as a going concern and is confident about the availability of sufficient resources to continue its normal operations in the foreseeable future. Moreover, management is not aware of any significant uncertainty that could cast doubts as to the ability of the Bank to continue as a going concern. In view of the above, these financial statements have been prepared on a going concern basis.

Order of liquidity and maturity structure

In general, the Bank presents its separate statement of financial position in order of liquidity. An analysis regarding recovery of assets or settlement of liabilities within twelve months after the date of the statement of financial position (current) and more than twelve months after the date of the statement of financial position (non-current) is presented in the notes to the separate financial statements.

Comparability of data

The separate financial statements provide comparative information with respect to one previous period.

Presentation currency

These financial statements are presented in thousands of Bulgarian leva (BGN'000), which is the reporting unit's functional currency.

2. BASIS OF PREPARATION OF THE SEPARATE FINANCIAL STATEMENTS (continued)

Accounting estimates

The preparation of the financial statements in accordance with International Financial Reporting Standards requires management to make judgements, estimates and assumptions that affect the reported amounts of income, expenses, assets and liabilities, and the disclosure of contingent liabilities at the date of the financial statements. These estimates are made on the basis of information available as of the date of the financial statement and therefore, the actual results may differ from these estimates. The items presuming a higher level of subjective assessment or complexity, or where the assumptions and accounting estimates are material for the financial statements, are disclosed in the notes below.

Key estimates and assumptions of high uncertainty

a) Impairment losses on loans and advances

Monthly, the Bank reviews its loan portfolio in order to detect the existence and calculates impairment losses. When assessing whether to include the impairment loss in the separate statement of comprehensive income, the Bank's management considers whether there are and what are the visible indicators and data, which indicate that there is a measurable reduction in the expected cash flows from the loan portfolio as a whole, or respectively – a decrease associated with a particular loan/component from this portfolio. Such indicators and data are those that indicate the existence of an adverse change in the payment options by the borrowers from a particular group or by a particular borrower, or the presence of national, economic or other conditions that are associated with a particular risk for a given group/type of loans.

In 2016, aiming at making estimates and assumptions used more precise, the scope of the individual review and relating impairment testing was broadened, now including all loans, except for those granted to employees and to owners' associations under the National Programme for Energy Efficiency of Multi-Family Residential Buildings (NPEEMFRB).

When analysing the risks of impairment losses and uncollectability, the loans are grouped in four risk categories: "standard", "watch" (over 30 days past due) and "non-performing" (over 90 days past due). In 2015 the risk classification groups were four: "standard", "watch", "non-performing" and "loss". The change made is in pursuance with the amended and supplemented EU acts regulating banking activities and the respective update of in-house regulations of the Bank, and with the aim to ensure a smoother transition to IFRS 9. The main indicators for determining the risk groups are the debtor's financial condition and project implementation, funded by the loan, problems with servicing, including interest in arrears and maturing principal, sources of repayment and granted collateral, as a type and opportunity for realisation. Additionally, for loans, guaranteed by the EIF, the impairment loss is recognised after deduction of the portion borne by the Fund (Note № 4.1).

In determining the future cash flows pattern, the Bank's management uses estimates, judgments and assumptions based on its historical loss experience for assets with similar credit risk characteristics, as well as an objective evidence for impairment of the portfolio from non-crystallized loss in a particular component thereof. Analogous approach is used also for assessments at individual credit exposure, with respect to individually significant loans, taking into account the quality of collateral as well. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly so as to minimize the discrepancies between loss estimates and actual loss experienced (Notes № 12, 18).

In 2016, management conducted a retrospective analysis of actual losses experienced on loans in order to update the applicable rates for loan impairment on a portfolio basis. As a result of this analysis and the enlarged scope of the individual impairment testing, the applied rate of impairment on a portfolio basis was set at 0 per cent (2015: 2.04 per cent).

b) Measurement of available-for-sale financial instruments non-quoted on the active stock market

The Bank classifies its investments as share participation in other non-public companies/entities (below 20 per cent of their capital) as available-for-sale financial assets that have been acquired for the purpose of establishing and development of business relations of importance for the Group. Management has judged and accepted that they should be measured at acquisition price (cost) because sufficiently reliable sources and methods to determine their fair value are not available at present and due to the specific closed manner of their trading until the time when new circumstances occur that allow the formation of reasonable assumptions and reliable valuation of their fair value.

2. BASIS OF PREPARATION OF THE SEPARATE FINANCIAL STATEMENTS (continued)

Key estimates and assumptions of high uncertainty (continued)

b) Measurement of available-for-sale financial instruments non-quoted on the active stock market (continued)

Analysis and assessment are performed by the Bank at each end of reporting period as to whether indications of impairment of its investments exist. The significant and continuous decrease in equity, including below the level of the registered share capital of the company/entity, subject to investment, is regarded as a main indicator. In such cases, impairment is determined with the assistance of a certified appraiser, but the smallest amount that is reported is that of the difference between the acquisition price (cost) and the assessment of participation under the equity method, including with additional adjustments of net assets, if necessary. In the cases of partial sales of similar shares in the reporting period, those from the same issuer, but remaining in the Bank's separate statement of financial position, are revalued at the selling price (Notes № 9, 21).

c) Impairment of available–for-sale financial instruments quoted on stock markets

As of 31 December 2016 the Bank conducted a detailed comparative analysis of the movements in the stock market prices of public companies shares held by it on the national stock market.
For investments in companies, whose shares are listed for dealing at the Bulgarian Stock Exchange, management has carried out research and analyses and deems that they may be subsequently carried at fair value determined directly on the basis of completed transactions in the stock market in the last month of the financial year (Level 1). In addition, the applied prices are analysed for trends in the behaviour of stock exchange prices of the respective securities at least for the last three months of the year and respectively, to the date of issuing of the separate financial statements. (Notes 9, 15, 21).

For investments in securities available for sale, held by the Bank for more than one year after the date of acquisition, a special analysis was conducted of monitored graphics of movement/volatility of their stock exchange prices and fair values, determined by alternative valuation techniques for a period of 18 months to 31 December, in order to determine whether there are conditions of permanent and material impairment.

d) Provisions for issued bank guarantees

The Bank reviews its contingent liabilities for the purpose of establishing whether any events have occurred, that would confirm with a high probability outflow of Bank's resources might take place for the settlement of an obligation. If such events occur, the Bank provides its liability up to the amount of its future costs related to the outflows of economic benefits/payments. These costs/losses are determined on the basis of the present value of the future net cash flows, representing the difference between the payment obligation and the possible inflows of subsequent recourse to third parties (Notes № 12, 36).

e) Actuarial calculations

In assessing the present value of the long-term liabilities to employees upon retirement, actuarial methods and calculations are used based on assumptions for mortality rate, staff turnover rate, future salary levels and a discount factor considered by management as reasonable and relevant to the Bank (Note № 33).

f) Valuation of investment property

The fair value of investment property, which management considers reasonable and adequate for the Bank, is determined by certified independent appraisers. The valuations are conducted by using various valuation techniques, such as the recoverable amount method, the method of income capitalisation, the method of market analogues, where for each method a weight is set for the purposes of achieving the final fair value of investment property at the end of the reporting period (Note № 25).

2. BASIS OF PREPARATION OF THE SEPARATE FINANCIAL STATEMENTS (continued)

Key estimates and assumptions of high uncertainty (continued)

g) Assets acquired from collateral foreclosure

Assets acquired from collateral foreclosure include assets held for sale (as a result of acquired loan collateral), but not sold within the envisaged 12-month period and reclassified as Assets acquired from collateral foreclosure. These assets are measured at the lower of cost and net realisable value. The net realisable value, which management considers reasonable and adequate for the Bank, is determined by certified independent appraisers.

h) Fair value of financial instruments

Where the fair values of financial assets and liabilities on the separate statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable financial market indicators, where possible, but where this is not feasible, a degree of judgement is required in establishing fair values. The assumptions include liquidity factors, volatility for longer derivatives and discount rates, early payments and assumptions for non-performance in connection with securities for which assets have been provided as collateral.

2.1 Changes in accounting policies and disclosures

New and amended standards and interpretations

The accounting policies adopted are consistent with those of the previous financial year. The following amendments to standards have been adopted by the Bank as of 1 January 2016:

IAS 16 *Property, Plant and Equipment and* IAS *38 Intangible assets (Amendments): Clarification of Acceptable Methods of Depreciation and Amortization*
The amendments clarify the principle in IAS 16 and IAS 38 that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is part) rather than the economic benefits that are consumed through use of the asset. As a result, the ratio of revenue generated to total revenue expected to be generated cannot be used to depreciate property, plant and equipment or amortise intangible assets. The amendments have no effect on the financial position or performance of the Bank.

IAS 16 *Property, Plant and Equipment and* IAS 41 *Agriculture (Amendments): Bearer Plants*
According to the amendments bearer plants are within the scope of IAS 16 and are subject to all of the requirements therein. This includes the ability to choose between the cost model and revaluation model for subsequent measurement. Agricultural produce growing on bearer plants (e.g., fruit growing on a tree) remains within the scope of IAS 41. Government grants relating to bearer plants are accounted for in accordance with IAS 20 Accounting for Government Grants and Disclosure of Government Assistance, instead of in accordance with IAS 41. The amendments have no effect on the financial position or performance of the Bank.

IAS 19 *Employee benefits (Amended): Employee Contributions*
The amendment applies to contributions from employees or third parties to defined benefit plans. The objective of the amendment is to simplify the accounting for contributions that are independent of the number of years of employee service, for example, employee contributions that are calculated according to a fixed percentage of salary. The amendment has no effect on the financial position or performance of the Bank.

IFRS 11 *Joint Arrangements (Amendment): Accounting for Acquisitions of Interests in Joint Operations*
The amendment adds new guidance on how to account for the acquisition of an interest in a joint operation that constitutes a business in accordance with IFRS. The Bank had no transactions in scope of this amendment.

2. BASIS OF PREPARATION OF THE SEPARATE FINANCIAL STATEMENTS (continued)

2.1 Changes in accounting policies and disclosures(continued)

IFRS 10, IFRS 12 *and* IAS 28: *Investment Entities: Applying the Consolidation Exception (Amendments)*
The amendments clarify that the exemption from presenting consolidated financial statements applies to a parent entity that is a subsidiary of an investment entity, when the investment entity measures all of its subsidiaries at fair value. Also, the amendments clarify that only a subsidiary that is not an investment entity itself and provides support services to the investment entity is consolidated. All other subsidiaries of an investment entity are measured at fair value. The amendments to IAS 28 Investments in Associates and Joint Ventures allow the investor, when applying the equity method, to retain the fair value measurement applied by the investment entity associate or joint venture to its interests in subsidiaries. The amendments have no effect on the financial position or performance of the Bank.

IAS 1 *Presentation of Financial Statements: Disclosure Initiative (Amendment)*
The amendments to IAS 1 Presentation of Financial Statements further encourage companies to apply professional judgment in determining what information to disclose and how to structure it in their financial statements. They clarify, rather than significantly change, existing IAS 1 requirements. The amendments relate to materiality, order of the notes, subtotals and disaggregation, accounting policies and presentation of items of other comprehensive income (OCI) arising from equity accounted Investments. The amendments to IAS 1 affect presentation only and have no impact on the Bank's financial position or performance.

IAS 27 *Separate Financial Statements (Amended)*
The amendment allows entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements. As the Bank does not report investments in subsidiaries under the equity method in its separate financial statements and has no joint ventures and associates, the amendment has no effect on the financial position or performance of the Bank.

Annual improvements to IFRSs 2010-2012 Cycle
Summary of amendments and related standards are provided below:

- IFRS 2 Share-based Payments – amended definitions of 'vesting conditions' and 'market condition' and adding the definitions of 'performance condition' and 'service condition';
- IFRS 3 Business Combinations – clarification on the accounting for contingent consideration arising from business combination;
- IFRS 8 Operating Segments – additional disclosures of management judgement on aggregating operating segments and clarification on reconciliation of total segments' assets to the entity's assets;
- IFRS 13 Fair Value Measurement – clarification on interaction with IFRS 9 as regards short-term receivables and payables;
- IAS 16 Property, Plant and Equipment – amended to state that when an item of property, plant and equipment is revalued, the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount while the accumulated depreciation is calculated as a difference between the gross carrying amount and the carrying amount after taking into account accumulated impairment losses;
- IAS 24 Related Party Disclosures – clarified that a management entity that provides key management services to a reporting entity is deemed to be a related party; disclosure of the service fee paid or payable is required;
- IAS 38 Intangible Assets – same amendment as IAS 16 above.

The adoption of the above amendments to standards has no effect on the financial statements of the Bank.

2. BASIS OF PREPARATION OF THE SEPARATE FINANCIAL STATEMENTS (continued)

2.1 Changes in accounting policies and disclosures(continued)

Annual improvements to IFRSs 2012-2014 Cycle
Summary of amendments and related standards are provided below:

- IFRS 5 Non-current Assets Held for Sale and Discontinued Operations – clarification that changing from one of the disposal methods to the other (through sale or through distribution to the owners) should not be considered to be a new plan of disposal, rather it is a continuation of the original plan;
- IFRS 7 Financial Instruments: Disclosures – provides examples of continuing involvement in a financial asset and clarifies required disclosures in the condensed interim financial report;
- IAS 19 Employee Benefits – clarification on long-term liability discount rate determination;
- IAS 34 Interim Financial Reporting – clarification on required interim disclosures: they must either be in the interim financial statements or incorporated by cross-reference to other interim financial information (e.g., in the management report) that is available to users on the same terms as the interim financial statements and at the same time.

The adoption of the above amendments to standards has no effect on the financial statements of the Bank.

2.2 Standards issued but not yet effective and not early adopted

Standards issued but not yet effective or not early adopted up to the date of issuance of the Bank's financial statements are listed below. This listing is of standards and interpretations issued, which the Bank reasonably expects to have an impact on disclosures, financial position or performance when applied at a future date. The Bank intends to adopt those standards when they become effective.

IFRS 9 *Financial Instruments*: *Classification and Measurement*
The standard is effective for annual periods beginning on or after 1 January 2018 with early adoption permitted. The final version of IFRS 9 reflects all phases of the financial instruments project and replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting.

In 2016, the process of preparation for the adoption of IFRS 9 is currently in the pipeline at the Bank; in 2017, the organisation of the preparation, as also the necessary changes in the internal by-laws and required technical assurance to guarantee compliance with the requirements of the new standard, are to be made. In December 2016 qualified experts and more than 30 key employees of different Bank divisions were trained. This process will continue in the next year as well, and will be finalized by updating all in-house regulations, making investments in specialist software and upgrading the existing systems in compliance with the requirements of the Standard. The Bank will carry out consultations on hiring an external advisor and selecting an information and technical solution for ensuring compliance with the requirements of IFRS 9. The first step will involve an analysis and assessment of the impact of this Standard on its future financial position or performance.

IFRS 15 *Revenue from Contracts with Customers*
The standard is effective for annual periods beginning on or after 1 January 2018 with earlier application permitted. IFRS 15 establishes a five-step model that will apply to revenue earned from a contract with a customer (with limited exceptions), regardless of the type of revenue transaction or the industry. The standard's requirements will also apply to the recognition and measurement of gains and losses on the sale of some non-financial assets that are not an output of the entity's ordinary activities (e.g., sales of property, plant and equipment or intangibles). Extensive disclosures will be required, including disaggregation of total revenue; information about performance obligations; changes in contract asset and liability account balances between periods and key judgments and estimates. The Bank will analyse and assess the impact of the new standard on its financial position or performance.

2. BASIS OF PREPARATION OF THE SEPARATE FINANCIAL STATEMENTS (continued)

2.2 Standards issued but not yet effective and not early adopted (continued)

IFRS 15 *Revenue from Contracts with Customers (Clarifications)*
The clarifications apply for annual periods beginning on or after 1 January 2018 with earlier application permitted. The objective of the clarifications is to clarify the IASB's intentions when developing the requirements in IFRS 15 *Revenue from Contracts with Customers*, particularly the accounting of identifying performance obligations amending the wording of the "separately identifiable" principle, of principal versus agent considerations including the assessment of whether an entity is a principal or an agent as well as applications of control principle and of licensing providing additional guidance for accounting of intellectual property and royalties. The clarifications also provide additional practical expedients for entities that either apply IFRS 15 fully retrospectively or that elect to apply the modified retrospective approach. These clarifications have not yet been endorsed by the EU. The Bank will analyse and assess the impact of these clarifications on its financial position or performance.

IFRS 16 *Leases*
The standard is effective for annual periods beginning on or after 1 January 2019. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor'). The new standard requires lessees to recognize most leases on their balance sheet and to have a single accounting model for all leases, with certain exemptions. Lessor accounting is substantially unchanged. The standard has not been yet endorsed by the EU. The Bank will analyse and assess the impact of the new standard on its financial position or performance.

Amendments in* IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture
The amendments address an acknowledged inconsistency between the requirements in IFRS 10 and those in IAS 28, in dealing with the sale or contribution of assets between an investor and its associate or joint venture. A full gain or loss is recognized when a transaction involves a business or a partial gain or loss is recognized when a transaction involves assets that do not constitute a business. The IASB postponed the effective date of this amendment indefinitely pending the outcome of its research project on the equity method of accounting. The amendments have not yet been endorsed by the EU. It is not expected that these amendments would impact the financial position or performance of the Bank.

IAS 12 *Income taxes (Amendments): Recognition of Deferred Tax Assets for Unrealised Losses*
The amendments are effective for annual periods beginning on or after 1 January 2017, with early application permitted. The objective of these amendments is to clarify the accounting for deferred tax assets for unrealised losses in order to address diversity in practice in the application of IAS 12 Income Taxes. The specific issues where diversity in practice existed relate to the existence of a deductible temporary difference upon a decrease in fair value, to recovering an asset for more than its carrying amount, to probable future taxable profit and to combined versus separate assessment. The amendments have not yet been endorsed by the EU. It is not expected that these amendments would impact the financial position or performance of the Bank.

IAS 7 *Statement of Cash Flows (Amendments): Disclosure Initiative*
The amendments are effective for annual periods beginning on or after 1 January 2017, with earlier application permitted. The objective of these amendments is to enable users of financial statements to evaluate changes in liabilities arising from financing activities. The amendments will require entities to provide disclosures that enable investors to evaluate changes in liabilities arising from financing activities, including changes arising from cash flows and non-cash changes. The amendments have not yet been endorsed by the EU. It is not expected that these amendments would impact the financial position or performance of the Bank.

2. BASIS OF PREPARATION OF THE SEPARATE FINANCIAL STATEMENTS (continued)

2.2 Standards issued but not yet effective and not early adopted (continued)

IFRS 2 *Share-based Payment (Amendments): Classification and Measurement of Share based Payment Transactions*
The amendments are effective for annual periods beginning on or after 1 January 2018 with earlier application permitted. The amendments provide requirements on the accounting for the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments, for share-based payment transactions with a net settlement feature for withholding tax obligations and for modifications to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. These amendments have not yet been endorsed by the EU. It is not expected that these amendments would impact the financial position or performance of the Bank.

IFRS 4 *Insurance Contracts (Amendments): Applying* IFRS 9 *Financial Instruments with* IFRS 4 *Insurance Contracts*
The amendments are effective for annual periods beginning on or after 1 January 2018. The objective of these amendments is to address issues arising from the different effective dates of IFRS 9 Financial Instruments and the upcoming new insurance contracts standard IFRS 17 Insurance Contract. Entities issuing insurance contracts will still be able to adopt IFRS 9 on 1 January 2018. The amendments introduce two alternative options for entities issuing contracts within the scope of IFRS 4, notably a temporary exemption and an overlay approach. The temporary exemption enables eligible entities to defer the implementation date of IFRS 9. The overlay approach allows an entity applying IFRS 9 from 2018 onwards to remove from profit or loss the effects of some of the accounting mismatches that may occur from applying IFRS 9 before IFRS 17 is applied. These amendments have not yet been endorsed by the EU. It is not expected that these amendments would impact the financial position or performance of the Bank.

IFRIC 22 *Foreign Currency Transactions and Advance Consideration*
The interpretation is effective for annual periods beginning on or after 1 January 2018 with earlier application permitted. This interpretation addresses how to determine the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration in a foreign currency. The interpretation has not yet been endorsed by the EU. The Bank is in the process of assessing the impact of the new interpretation on its financial position or performance.

IAS 40 *Investment Property (Amendments): Transfers of Investment Property*
The amendments are effective for annual periods beginning on or after 1 January 2018 with earlier application permitted. The amendments clarify transfers of property to, or from, investment property when there is a change in the use of such property which is supported by evidence. These amendments have not yet been endorsed by the EU. It is not expected that these amendments would impact the financial position or performance of the Bank.

Annual Improvements to IFRSs 2014-2016 Cycle
In the 2014-2016 annual improvements cycle, the IASB issued amendments to three standards which are effective for annual periods beginning on or after 1 January 2017 / 1 January 2018. Summary of amendments and related standards are provided below:

- IFRS 1 First-time Adoption of International Financial Reporting Standards - deletion of short-term exemptions for first-time adopters (effective for annual periods beginning on or after 1 January 2018);
- IFRS 12 Disclosure of Interests in Other Entities - clarification of the scope of the Standard (effective for annual periods beginning on or after 1 January 2017), and
- IAS 28 Investments in Associates and Joint Ventures - measuring an associate or joint venture at fair value (effective for annual periods beginning on or after 1 January 2018).

The improvements to IFRSs 2014 – 2016 Cycle have not yet been endorsed by EU. The Bank is in the process of assessing the impact of the amendments on its financial statements.

3. SIGNIFICANT ACCOUNTING POLICIES

Financial instruments

Financial assets

The Bank initially recognises loans, receivables and deposits on the date they were incurred. All other financial instruments (including assets and liabilities designated at fair value through profit or loss) are recognised initially on the trade date, which is the date that the Bank becomes a party to the contractual provisions of the instrument.

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or the Bank transfers the rights to receive the contractual cash flows in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in such transferred financial asset that qualify for derecognition, which is created or retained by the Bank, is recognised as a separate asset or liability.

Financial assets and liabilities are offset and the net amount presented in the separate statement of financial position when, and only when, the Bank has a legal right to set off the amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

The Bank has the following non-derivative financial assets: loans and receivables, financial assets available-for-sale and financial assets held-to-maturity.

Financial assets carried at fair value through profit or loss

A financial asset is carried at fair value through profit or loss if it is a derivative held for trading or if it is designated as such upon initial recognition. Financial assets are designated at fair value through profit or loss when the Bank manages them and makes decisions for purchases and sales on a fair value basis, in accordance with a documented risk or investment management strategy of the Bank. Attributable transaction costs are recognised in profit or loss as incurred. Financial assets at fair value through profit or loss are measured at fair value and any related changes, including dividend income, are recognised in profit or loss. Upon initial acquisition, the Bank's management determines whether a financial assets will be held for trading. Usually, management designates derivatives as such instruments.

A derivative is a financial instrument:

- Whose value changes in response to changes in interest rates, security prices, commodity prices, foreign exchange rates, price indices or interest rates, credit ratings or credit indices, or other variables;
- That requires no initial net investment, or one that is smaller than would be required for a contract with similar response to changes in market conditions;
- That is settled at a future date.

When upon entering a specific derivative transaction the Bank defines a position to be hedged and all the requirements of IAS 39 have been met, the corresponding derivative is recognised as such hedging. Derivatives that do not meet the criteria for hedge accounting are classified as held for trading.

Initially, derivative financial instruments are measured at cost (including transaction costs) and subsequently, they are measured at fair value. Derivatives are accounted for as assets when their fair value is positive and as liabilities when it is negative.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial instruments (continued)

Loans and receivables

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are initially measured at fair value plus incremental direct transaction costs. Subsequently, loans and receivables are measured at their amortised cost using the effective interest rate, less any impairment losses. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument, or, where appropriate, a shorter period, to the present carrying amount of the financial asset or liability. When calculating the effective interest rate, the Bank estimates the cash flows by considering all contractual terms of the financial instrument, but not considering any future credit losses. The calculation includes all charges and other fees paid to or received by the contractors that are an integral part of the effective interest rate.

The Bank assesses whether evidence of impairment of loans and receivables exists for each specific asset, except for receivables from employees and those, which have occurred in relation to NPEEMFRB (Note 3: Impairment of financial assets). After a thorough review of the quality and impairment testing of standard exposures, the Bank established that there were no indications of collective impairment of the credit portfolio as at 31 December 2016.

The amount of the impairment loss is measured as the difference between the financial asset's carrying amount and the present value of estimated future cash flows discounted at the original effective interest rate. The impairment loss is recognised in profit or loss and reported in an allowance account reducing the amount of loans and receivables. When an event, which has occurred after an impairment has been recognised, reduces the impairment loss, this reduction is reversed through profit or loss.

Loans and receivables include cash and cash equivalents, receivables from banks, loans and advances to customers, receivables from the State budget, and trade and other receivables.

Sales and repo deals

Securities subject to repurchase ("repo") agreements are not derecognised from the separate statement of financial position. Securities acquired under reverse repo deals ("reverse repo") are stated as receivables from banks. The difference between the selling price and the repo price is reported as interest over the term of the repo agreement using the effective interest rate method.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or are not classified as other category financial assets. Available-for-sale financial assets are initially recognised at fair value, including direct transaction costs. Subsequent to initial recognition, they are measured at fair value and any fair value changes, other than impairment losses (Note 3: Impairment of financial assets), and foreign exchange gains or losses on available-for-sale derivative instruments, are recognised in other comprehensive income and presented in the fair value reserve as part of equity. When an investment is derecognised, the accumulated gains or losses in other comprehensive income are reclassified to profit or loss.

The available-for-sale financial assets include debt and equity securities.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial instruments (continued)

Held-to-maturity financial assets

When the Bank has a positive intent and ability to hold debt securities to maturity, then these securities are classified as held-to-maturity financial assets. Held-to-maturity financial assets are initially recognised at fair value plus all direct transaction costs. After the initial recognition, held-to-maturity financial assets are carried at amortised cost using the effective interest method, less any impairment losses.

The held-to-maturity financial assets include debt securities.

Assets under trust management

The Bank provides trust management services that includes holding of or investing in assets on behalf of customers. Assets held under trust management, unless certain recognition criteria have been met, are not included in the Bank's financial statements since they are not assets of the Bank.

Bulgarian Development Bank performs services in its capacity as an investment intermediary in accordance with the provisions of the Public Offering of Securities Act (POSA). Being an investment intermediary, the Bank is obliged to comply with certain requirements in order to protect its customers' interests in accordance with the Markets in Financial Instruments Act (MFIA) and Ordinance 38, issued by the Financial Supervision Commission (FSC). Moreover, the Bank should also observe the requirements of Directive 2014/65/EC on the Markets in Financial Instruments (MiFID II) and Regulation 600/2014 of the EU on the Markets in Financial Instruments (MiFIR). The Bank has developed and implements organization relating to the conclusion and performance of contracts with customers, the requirement of information from customers, keeping records and storage of client's assets, in compliance with the provisions of the above-mentioned National and European legal acts. The Bank has implemented a system of in-house internal control rules and procedures aiming at ensuring its full compliance with the bodies of legislation mentioned above.

Reclassification of financial assets

Applicable as from 1 July 2008, the Bank has the right to reclassify, under certain conditions, non-derivative financial assets outside the category of held-for-trading into the categories of held-for-trading, loans and advances, or held-to-maturity. From the same date, it is also possible to reclassify, under certain conditions, financial instruments from the category of held-for-trading into the category of loans and advances. The reclassification is measured at fair value at the date of reclassification that becomes its new amortised cost.

For financial assets, classified outside the category of held-for-trading, all previous gains and losses recognized in the equity are amortised through profit or loss over the remaining life of the investment, using the effective interest rate. Any difference between the new amortised cost and estimated cash flows is also amortised over the remaining life of the asset, using the effective interest rate. If subsequently the asset is classified as impaired, its value reported in equity is transferred to the statement of comprehensive income.

In certain rare cases, the Bank may reclassify a non-derivative trading instrument from the category of held-for-trading into the category of loans and advances, if it meets the criteria to be recognized as loans and advances and the Bank has the intention and ability to hold the financial assets in the foreseeable future or until its maturity. If a financial asset has been reclassified and the Bank subsequently increases its expectations as to the cash flows to be obtained from the asset as a result of the improved ability to obtain such cash flows, the effect of this increase is recognized as a change in the effective interest rate from the date of recognition of the change.

The reclassification is done at management's discretion and is determined separately for each instrument. The Bank does not reclassify financial instruments at fair value through profit or loss (FVPL) subsequent to their initial recognition.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial instruments (continued)

Financial liabilities

Financial liabilities, which are not derivative instruments or which have not been designated on acquisition as liabilities to be measured at fair value through profit or loss, are measured at amortised cost. Initially, they are stated at "cost", i.e. the fair value of cash flows received on the origination of the liability, less any transaction costs. Subsequently, any difference between the net cash flows and the residual value is recognised in profit or loss for the period using the effective interest rate method over the term of the liability. The financial liabilities reported by the Bank as deposits, borrowings and securities issued are stated at amortised cost.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument, or, where appropriate, a shorter period, to the present carrying amount of the financial asset or liability. When calculating the effective interest rate the Bank estimates cash flows considering all contractual terms of the financial instrument, but does not consider future credit losses. The calculation includes all charges and other fees paid to or received by the contractors that are an integral part of the effective interest rate.

Financial assets and liabilities are offset and the net amount presented in the separate statement of financial position when, and only when, the Bank has a legal right to set off the amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

Derecognition of financial instruments

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is primarily derecognised when:

- the contractual rights to receive cash flows from the financial asset have expired;
- the contractual rights to receive cash flows from the financial assets have been transferred, or contractual rights to receive cash flows from the financial asset have been retained, but a contractual obligation has been assumed for their payment in full without material delay to a third party under a 'pass through' arrangement, and either:

(a) the Bank has transferred substantially all the risks and rewards of the financial asset, or

(b) the Bank has neither transferred nor retained substantially all the risks and rewards of the financial asset, but has transferred control of the asset.

When the Bank has transferred its contractual rights to receive cash flows from a financial asset and has neither transferred nor retained substantially all of the risks and rewards of the financial asset nor transferred control of the asset, the transferred financial asset is recognised to the extent of the Bank's continuing involvement in the asset. In this case, the Bank recognises the related obligation. The transferred asset and the concomitant obligation are evaluated to reflect the rights and obligations which the Bank has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

A financial liability is derecognised from the separate statement of financial position when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts of the original and new liability is recognised in the separate statement of comprehensive income.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of financial instruments

A financial asset, which is not recognised at fair value through profit and loss, is reviewed at each reporting date to assess whether there is objective evidence of its impairment. A financial asset is impaired when there is objective evidence that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows of the asset that can be estimated reliably.

Objective evidence a financial asset is impaired includes default or delinquency by a borrower, restructuring of a liability to the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, adverse changes in the payment status of a borrower or issuer, economic conditions that lead to failures or the disappearance of an active market for a security.

Financial assets measured at amortised cost

The Bank considers evidence for impairment of financial assets measured at amortised cost (loans and advances and held-to-maturity debt securities) at both individual and collective level. Assets with similar risk characteristics are collectively assessed for impairment.

In assessing collective impairment the Bank uses historical trends of the probability of default, the timing of recoveries and the amount of loss incurred.

Impairment losses on financial assets measured at amortised cost are calculated as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Impairment losses are recognised in profit or loss and reflected in an allowance account against loans and advances or held-to-maturity investment securities. When an event occurring after the impairment was recognised causes the amount of impairment losses to decrease, the decrease in impairment loss is reversed through profit or loss.

Available-for-sale financial assets

Impairment losses on available-for-sale financial assets are recognised by reclassification to profit or loss of the losses accumulated in the fair value reserve in the equity. The cumulative loss that is reclassified from equity to profit or loss is the difference between the acquisition cost, net of any principal repayments and amortisation, less any impairment loss previously recognised in profit or loss, and the present fair value. Any changes in impairment attributable to the application of the effective interest method are reflected as a component of interest income. If, in a subsequent period, the fair value of an impaired available-for sale debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, then the impairment loss is reversed, with the amount of the reversal being recognised in profit or loss. Any subsequent recovery of the fair value of an impaired available-for-sale equity security is recognised in other comprehensive income.

Fair value of financial assets and liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Bank discloses information about the fair value of those assets and liabilities for which there is market information available and the fair value of which significantly differs from their carrying amount.
The fair values of financial assets and liabilities that are quoted in active markets and for which there is market information available are based on announced market prices or closing prices. The use of real market prices and information reduces the need for management assessment and assumptions, as well as the uncertainty related to the determination of fair value. The availability of real market prices and information varies depending on products and markets, and changes according to the specific events and the general financial market conditions. For some of the other financial instruments the Bank determines the fair values by using of an evaluation method based on the net present value. The net present value calculation is provided by market yield curves and credit spreads, where necessary, for the respective instrument. The purpose of evaluation techniques is to determine fair value, which would be précised by direct market participants. For investments in subsidiaries and associated companies, as well as for equity investments for which there are no observable market prices, the Bank accepts that the fair value is the price of acquisition. The Bank has established control environment with respect to the assessment of fair values.

The fair values of financial instruments not traded in active markets (such as derivatives not traded on the market), which are an object of a transaction between the parties, are determined using valuation techniques. These valuation techniques adhere to the use of market data when available and as less as possible to the use of specific assessments of the company.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Fair value of financial assets and liabilities (continued)

Fair Value Hierarchy

The Bank applies the following hierarchy for measuring and disclosing the fair value of financial instruments using valuation techniques:

- Level 1 – quoted (unadjusted) market prices in active markets for identical instruments;
- Level 2 – inputs other than quoted prices included within Level 1 that are observable either directly or indirectly. This category includes instruments valued using quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data;
- Level 3 – unobservable inputs for an asset or a liability. This category includes all instruments, for which the valuation technique does not include observable inputs and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments;

The fair value hierarchy of financial assets and liabilities is disclosed in Note 5.

Cash and cash equivalents

For the purposes of the cash flow statement cash equivalents comprise cash in hand, cash in current accounts with other banks, deposits and placements with other banks – payable at sight and/or with original maturity of up to 3 months, including repo deals with original maturity of up to 3 months, as well as unrestricted (not blocked) balances with the Central Bank (BNB). The parent company (the Bank) maintains a minimum statutory reserve according to the requirements of BNB and for the purposes of cash flow statement it includes these funds included as a component of Cash and cash equivalents.
They are presented in the separate statement of financial position at amortised cost.
For the purposes of preparation of the separate cash flow statement, bank overdrafts payable on demand and forming an integral part of the Bank's cash management are included as a component of Cash and cash equivalents.

Assets held for sale

Assets are classified as held for sale, if their carrying amount will be recovered through a sale and not through a continuing use in the Bank's operations. Assets held for sale are stated initially at cost, with the transaction costs being taken into account in the initial measurement. Usually, these assets have been initially accepted by the Bank as collateral and subsequently acquired as a result of a "debt against property" exchange by borrowers that do not perform their obligations in accordance with the agreed contractual terms.
Assets classified in this group are available for immediate sale in their present condition.
Management is usually engaged actively and performs actions to realise a sale transaction within at least one year after the date of classification of the asset in this group.
Assets classified as held for sale are presented in the separate statement of financial position separately and measured at the lower of their carrying amount and their fair value less the estimated direct costs to sell.
The assets within this classification group are not depreciated.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Assets acquired from collateral foreclosure

Assets acquired from collateral foreclosure include assets held for sale (as a result of acquired loan collateral), but not sold within the envisaged 12-month period and reclassified as Assets acquired from collateral foreclosure. These assets are measured at the lower of cost and net realisable value.

Investments in subsidiaries

Lon-term investments, representing shares in subsidiaries, are presented in the separate financial statements at cost, which is the fair value of the consideration paid, including direct costs of acquisition of the investment. These investments are not traded on stock exchanges.

The investments in subsidiaries held by the Bank are subject to impairment testing. If indications of impairment are found, the latter is recognized in the separate statement of comprehensive income.

Purchases and sales of investments are recognised on trade date. Investments are derecognised when the rights originating from the investments have been transferred to third parties on the occurrence of the legal grounds to do so, and thus, the control on the business rewards of investments has been lost. Income from their sale is presented separately as part of other operating income / (expenses) in the separate statement of comprehensive income (in the profit or loss for the year).

Taxes

Current income taxes are determined by the Bank in accordance with the Bulgarian legislation. The income tax due is calculated on the basis of the taxable profit for the period determined in accordance with the rules established by the tax authorities on the grounds of which taxes are paid (reversed).

The tax effect relating to transactions and other events reported in the separate statement of comprehensive income is recognised also in the separate statement of comprehensive income and the tax effect relating to transactions and other events reported directly in equity is also recognised directly in equity.

Deferred income tax liabilities are recognised for all taxable temporary differences, except where the deferred income tax liability arises from the initial recognition of an asset or liability in a transaction that at the time of the transaction affects neither the accounting profit nor taxable profit or (loss).

Deferred income tax assets are recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised except where the deferred income tax asset arises from the initial recognition of an asset or liability in a transaction that at the time of the transaction affects neither the accounting profit nor taxable profit or (loss).

Deferred taxes are recognised as income or expense, and are included in the net profit for the period, except in cases, when these taxes arise from transactions or events, reported for the same or another period directly in equity. Deferred taxes are charged to or deducted directly from equity, when they relate to items, which have been charged to or deducted from equity in the same or in a different period.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, plant and equipment

Items of property, plant and equipment are presented on the separate financial statements at historical cost of acquisition, less any accumulated depreciation and impairment losses.

Initial recognition

Upon their initial acquisition, items of property, plant and equipment are valued at acquisition cost, which comprises the purchase price, including customs duties and any directly attributable costs of bringing the asset to working condition. Directly attributable costs include: costs for site preparation, initial delivery and handling costs, installation costs, professional fees for people involved in the project, non-refundable taxes etc.

Subsequent measurement

The approach chosen by the Bank for subsequent measurement of property, plant and equipment, is the cost model under IAS 16 - acquisition cost less any accumulated depreciation and any accumulated impairment losses.

Any gain or loss on disposal of an item of property, plant and equipment (calculated as the difference between the net proceeds from disposal and the carrying amount of the item) is recognised net in other operating income / expenses in profit or loss.

Depreciation method

The Bank applies the straight-line depreciation method for property, plant and equipment. The useful life per group of assets is as follows:

- buildings – 50 years
- bank equipment and computers – 5 years
- motor vehicles – 5 years
- fixtures and fittings – 6.7 years

The useful life by groups was not changed compared to 2015.

The useful life of the individual groups of assets is determined by the management considering: their physical wear and tear, features of the equipment, intentions for future use and expected obsolescence. The useful life of equipment is reviewed at each year-end and adjusted prospectively in case that any material deviations from future expectations concerning the terms of use are found.

Subsequent costs

Repair and maintenance expenses are recognised as current in the period in which they were incurred. Subsequent expenses relating to an item of property, plant and equipment that have the nature of replacement of certain components or improvements and restructuring are capitalised to the carrying amount of the relevant asset and its remaining useful life to the date of capitalisation is reassessed accordingly. At the same time, the unamortised portion of replaced components is derecognised from the assets' carrying amount and recognised as current expenses for the period of restructure.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Intangible assets

Intangible assets are presented on the separate financial statements at cost less accumulated amortisation and any accumulated impairment losses. They include software and software licences.

The Bank applies the straight-line depreciation method for the intangible assets with a determined useful life of 5 years.

The carrying amount of the intangible assets is subject to review for impairment when events or changes in circumstances indicate that their carrying amount might exceed their recoverable amount. Impairment losses are recognised in the statement of comprehensive income.

Intangible assets are derecognised from the separate financial statement when permanently withdrawn from use (upon retirement), when no future economic benefits are expected from their use or on disposal. Any gains or losses on disposal of individual assets from the group of intangible assets are determined by comparing the sales proceeds and the carrying amount of the asset at the date of the sale.

Investment property

The Bank's management uses this category upon lease of assets acquired from collateral foreclosure on loans. Investment property is measured initially at cost plus any transaction costs. Subsequent to initial recognition, investment property is recognised at fair value. Any gain or loss due to changes in the fair value of investment property is recognised in the profit or loss in the period in which it has occurred. The fair value of investment property is determined on the basis of a valuation made by an independent appraiser.

Investment property rental income is presented as other operating income, while operating expenses directly or indirectly relating to the generated rental income are presented as other operating expenses. Investment property is derecognised on disposal or upon withdrawal from use (retirement), when no future economic benefits are expected from its disposal. Any gains or losses on derecognition of investment property are recognised in the profit or loss in the period in which they have occurred.

Pensions and other payables to personnel under the social security and labour legislation

According to the Bulgarian legislation, the Bank is obliged to pay contributions to social security and health insurance funds. The employment relations of the employees with the Bank, in its capacity of an employer, are based on the provisions of the Labour Code.

Short-term employee benefits

Short-term employee benefits of the Bank in the form of salaries, bonuses and social payments and benefits are recognised as an expense in the separate statement of comprehensive income in the period in which the respective service has been rendered or the requirements for their receipt have been met, and as a current liability at their undiscounted amount. The Bank's obligations to make social security and health insurance contributions are recognised as a current expense and liability at their undiscounted amount together and in the period of accrual of the respective benefits they relate to.

At the end of each reporting period the Bank assesses and reports the expected costs of accumulating compensated absences as the amount that is expected to be paid as a result of the unused entitlement. The assessment includes the estimated costs of employee's remuneration and the statutory social security and health insurance contributions owed by the employer on these amounts.

Long-term retirement benefits

In accordance with the requirements of the Labour Code, the employer is obliged to pay to its personnel upon retirement an indemnity that depending on the length of service with the entity varies between two and six gross monthly salaries as of the date of employment termination. In their nature these are defined benefit plans.

The calculation of the amount of these liabilities requires the involvement of qualified actuaries in order to determine their present value at the date of the separate financial statements, at which they are included in the separate statement of financial position, adjusted with the amount of the actuarial gains and losses, and respectively, the change in their value, including the recognised actuarial gains and losses – in other comprehensive income.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Long-term retirement benefits (continued)

Past service costs are recognised immediately in the separate statement of comprehensive income in the period in which they were incurred. At the end of each reporting period, the Bank assigns certified actuaries who issue a report with calculations regarding the long-term retirement benefit obligations. For the purpose, they apply the Projected Unit Credit Method. The present value of the defined benefit obligation is determined by discounting the future cash flows, which are expected to be paid within the maturity of this obligation, and by applying the interest rates of long-term government bonds denominated in Bulgarian leva.

Actuarial gains and losses arise from changes in the actuarial assumptions and experience adjustments. Actuarial gains and losses from changes in demographic and financial assumptions upon retirement for assured length of service and age are recognised in the separate statement of comprehensive income.

Termination benefits

In accordance with the provisions of the Labour Code, the employer is obliged, upon termination of an employment contract prior to retirement, to pay indemnities as follows:

- for non-observed preliminary notice: one gross monthly salary;
- due to closing down the enterprise or part of it, outlays, reduction of the volume of work and work stoppage for more than 15 days, etc.: one gross monthly salary;
- upon termination of the employment contract due to illness: two gross monthly salaries;
- for unused annual paid leave: for the respective years of the time recognised as service period.

The Bank recognises employee benefit obligations in the event of employment termination before the normal retirement date when it is demonstrably committed, based on an announced plan, to either terminating the employment of current employees without possibility of withdrawal or providing termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits failing due more than 12 months are discounted to and presented in the separate statement of financial position at present value.

Impairment of non-financial assets

The carrying amounts of the Bank's non-financial assets, other than investment property, inventory and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indications exist, then the asset's recoverable amount is estimated. For intangible assets with indefinite useful life or not yet brought into use, the recoverable amount is estimated annually. An impairment loss is recognised always when the carrying amount of an asset or a cash-generating unit (CGU) exceeds its recoverable amount.

The recoverable amount of an asset or CGU is the greater of value in use and fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using the pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU. For impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or CGUs.

Impairment losses are recognised in profit or loss. Impairment losses recognised with respect to CGUs are allocated to reduce the carrying amount of the assets in the CGU on a pro rata basis.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised.

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Share capital

The share capital is stated at the nominal value of shares issued and paid. Any proceeds from shares issued over their nominal value are reported as share premium.

Expenses directly relating to the issuance of new shares, except of such relating to business combinations are deducted from the capital net of any associated taxes. Dividends on ordinary shares are recognised in the period in which they were approved by the shareholders. Dividends for the period, which have been announced after the date of preparation of the financial statements, are disclosed as events after the date of the financial statements.

Dividends

An obligation for cash payables to the owners is recognised when the distribution has been approved by them and no longer depends on the Bank. The corresponding amount is written off directly from equity.

Interest income and interest expenses

Interest income and interest expenses are recognised in the statement of comprehensive income on an accrual basis for all interest-bearing instruments using the effective yield method based on the actual price of acquisition or the applicable floating interest rate. Interest income and interest expenses include the amortisation of any discount or premium, or any other differences between the original carrying amount of an interest-bearing instrument and its amount at maturity calculated on an effective interest rate basis.

Interest income includes interest income on available-for-sale and held-for-trading debt securities, interest on deposits with other banks, interest on loans and advances to customers, and fees and commissions on loans and advances to customers, which are an integral part of the effective yield of the financial instrument.

Interest expense is recognised on an accrual basis and comprises the interest accrued on deposits of customers and banks, as well as on loans received and other borrowings, fees and commissions on loans received, which form an integral part of the effective interest expense.

The Bank also holds investments and assets in countries with negative interest rate levels. The Bank discloses the interest paid on such assets as interest expense with additional disclosure (Note 6).

Fees and commissions

Fees and commissions on bank guarantees are recognised on a systematic basis over the period of existence of the exposure to match the cost of providing the service. Fee and commission expenses relating to servicing Nostro accounts with other banks or to the provision of another bank service are recognised at the time of provision of the underlying service and attaining the result thereof.

Trust management fees are recognised on an accrual basis over the period of providing the service.

Foreign currency transactions

Foreign currency transactions are translated into BGN at the exchange rate of BNB prevailing at the date of the transaction. Receivables and liabilities denominated in foreign currency are revalued on a daily basis. At the end of the year, they are translated in BGN at the closing exchange rates of BNB, which for the main currencies as of the date of the separate financial statements are the following:

Foreign currency	31 December 2016	31 December 2015
USD	1.85545	1.79007
Euro	1.95583	1.95583

Since 1999 the Bulgarian Lev (BGN) has been fixed to the Euro (EUR), the official currency of the European Union, at ratio of BGN 1.95583/ EUR 1.0

Net gains or losses on changes in exchange rates, which have incurred from revaluation of receivables, liabilities, as well as from foreign currency transactions, are presented on the separate statement of comprehensive income in the period in which they have occurred.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Provisions and contingent liabilities

Provisions are recognised when the Bank has a present legal or constructive liability as a result of past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the liability. Provisions are measured on the basis of the best management's estimate at the end of reporting period of the expenses necessary to settle the particular obligation. The estimate is discounted if the obligation is long-term.

Contingent liabilities are obligations arising from past events, the existence of which can be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not entirely within the control of the Bank, or it is not probable that an outflow of resources will be required to settle the obligation. They are not recognised in the separate statement of financial position but are subject to special disclosure.

Segment reporting

The Bank does not report operating segments, because its major source of risk and return is the corporate business sector; there isn't a single external customer the revenue from who to form more than 10 per cent of the total revenue, and the Bank operates in the territory of the country. If these factors change in the future and the Bank starts to report operating segments, they will be determined and presented in accordance with the requirements of IFRS 8 Operating Segments.

4. FINANCIAL RISK MANAGEMENT

In the ordinary course of business, the Bank is exposed to a variety of risks that, if occur, could result in formation of losses and deterioration of the Bank's financial stability. These risks are identified, measured and monitored through various control mechanisms in order to be managed and to prevent undue risk concentration. The process of risk management is essential for the Bank's profitability and existence.

The risk management within Bulgarian Development Bank AD is a complex of methods and procedures used by the Bank for identifying, measuring and monitoring its risk exposures. The Bank manages the following main categories of risk:

- Credit risk;
- Liquidity risk;
- Market risk;
- Operational risk.

When managing the risks, Bulgarian Development Bank AD applies policies and procedures relevant to the nature and complexity of its activity, which are based on best practices in banking industry.

4.1. Credit risk

Credit risk is the risk of potential losses due to a failure of the Group's customers to discharge their contractual obligations in connection with receivables and financial instruments held by the Bank.

Credit risk is the main risk for the Bank and therefore, its management is fundamental for its activity. Credit risk management is performed in accordance with the law for BDB AD and the effective laws and regulations of the Republic of Bulgaria regulating credit activity, as well as the international regulations and best banking practices, and the requirements of IFRS.

In assessing and managing credit risks (including the counterparty risk) of its exposures, the Bank applies internal rating generation models. These rating models are based on an analysis of historical data and the counterparty's and its relating parties' current financial position; their history and behaviour in servicing their liabilities to other contractors; future cash flow analyses; sources of servicing the existing and any potential future liabilities to the Bank, and other parameters specific to a particular transaction. Credit portfolio quality monitoring, control and assessment units are established and function within BDB. Credit portfolio current monitoring, reporting and management procedures and mechanisms are implemented, which require periodical, and if necessary, extraordinary, reports on the financial and credit status of each borrower and other liable persons. In managing its credit risk, the Bank applies an intra-bank system of limits that is subject to periodic review and updating.

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

There is a specialized unit functioning within the Bank, which is in charge of the risk assessment both at the customer level and at the exposure level, where the solvency level is assessed and monitored throughout the entire loan term - from application to full repayment. The credit risk is partially reduced also by applying the secured credit line technique through accepting different types of collateral, where at any point in time the valuation of collateral shall not be older than 12 months.

The Bank forms impairment on exposures depending on the borrower's and / or group of related clients' risk profile based on conducted individual impairment tests.

The exposures in the Bank's credit portfolio are classified mainly in three categories depending on the existence of indications of impairment – changes in the objective indicators on the basis of which the initial measurement and subsequent monitoring of exposure / customer are carried out, which would result in changes in cash flows from financial assets, including default in payment due by the borrower: „standard" (with assigned internal credit ratings from 1 to 6, incl.; "watch" or "forborne" (with assigned internal credit ratings of 7 or 8) and „problematic/non-preforming" (with assigned internal credit ratings of 8, 9 or 10). In follow-up of the recommendations of the Basel Committee and their transposition into regulations within the European Union and in particular, Regulation 575/2013/EC and Directive 2013/36/EC, the commercial banks are required to implement in their internal regulations an in-house rating system that allows them to achieve comparability with the borrowers' official crediting rating assigned by recognized external credit rating institutions, which adopts the scale, used worldwide, of ten credit rating categories, including two categories for non-performing loans. The Bank has developed a detailed internal normative base, comprising Policy and rules for determining the impairment due to uncollectability of risk exposures, Methodology for credit risk analysis and assessment of Bulgarian Development Bank AD, and Credit activity manual of BDB, ensuring full compliance of the policy and procedures for determining internal credit ratings with the above EU regulations. The amount of the impairment is calculated as the difference between the current amount of the amortised cost of the customer's exposure to the Bank and its recoverable amount.

In order to minimise its credit risk, the Bank accepts collateral in the form of mortgages of land, industrial property, hotels, commercial and residential buildings. Collateral in the form of bank guarantees, pledge of commercial enterprises, pledge of plant, machinery, equipment and inventories, securities, cash deposits, company shares, promissory notes, third party's avals and guarantees is accepted as well. It is a common practice of the Bank to require collateral from the borrowers that is equal to at least 100 per cent of the agreed loan amount.

Based on a Guarantee letter from year 2003 and the subsequent annexes signed with the European Investment Fund (EIF), the Bank participates in the EU SME Guarantee Facility under conditions determined by the long-term EU Program on SMEs. EIF is committed to provide a direct guarantee covering 50 per cent of the remaining loss on the principal and interest of each loan, included in the sub-portfolio of the Bank, formed on the basis of the conditions of the agreement, but not exceeding EUR 2,520 thousand (BGN 4,929 thousand). The Bank has applied reduced requirements in accepting collaterals for the EIF-guaranteed portfolio of loans. As of 31 December 2016 the total exposure on EIF-guaranteed loans amounted to BGN 5,974 thousand (31 December 2015: BGN 6,679 thousand). This amount includes the utilised but not yet repaid portion of the loans, as well as the Bank's commitments on unutilised loans.

The payment engagement of EIF to date amounts to BGN 3,563 thousand (31 December 2015: BGN 4,929 thousand), whereas the losses covered by EIF amount to BGN 2,887 thousand (31 December 2015: BGN 3,044 thousand).

In November 2016, BDB signed a counter-guarantee agreement with the European Investment Fund (EIF) under the COSME programme for small and medium-sized enterprises. The COSME programme is implemented with the support of EFSI (the European Fund for Strategic Investment), known as the "Juncker Plan". BDB is able to cover up to 60 per cent of the risk on loans extended to SMEs by commercial banks it will partner with. Half of this risk will be counter-guaranteed by EIF and the total amount of the counter-guarantee is EUR 10 million. By using the resource guaranteed by the COSME programme, the banks-partners to BDB will be able to extend investment loans and loans for working capital, bank guarantees and revolving loans. The maximum amount of loans extended is EUR 150,000. The term of repayment vary from 1 to 10 years.

As at 31 December 2016 there was no commitment on the counter-guarantee agreement.

Letters of guarantee and letters of credit represent another source of credit risk for the Bank. They represent irrevocable commitment of the Bank to make payments in case a customer is not able to meet his obligations to a third party. These instruments bear the same credit risk as the loan exposures.

Another contingent/off-balance sheet commitment of the Bank is the unutilised portion of authorized loan agreements in the form of loans, letters of guarantee or letters of credit.

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

The Bank forms various sub-portfolios based on the type of contractors and credit risk carriers, as follows:

- Direct lending – loan portfolio, credit lines, investment loans and other forms of lending of legal entities, other than financial institutions and loans to individuals (loans to Bank's employees);
- Indirect lending or „on-lending" – portfolio of loans to financial (banking and non-banking) institutions, the purpose of which is to provide financing/to facilitate the access to financing for micro, small and medium-sized enterprises in the Republic of Bulgaria.

Beyond the credit portfolio, the Bank's activity is exposed to credit risk also with respect to exposures related to other activities of the Bank:

- portfolio of financial instruments, other than loans, formed in connection with the Bank's free cash management, which comprises mainly government securities issued by the Republic of Bulgaria, classified as „available-for-sale financial assets";
- to banks in connection with money market transactions, placed term deposits and available balances in Nostro accounts;
- in connection with receivables relating to the State budget.

The Bank applies a system of limits relating to credit risk and concentration risk with respect to the different sub-portfolios, and currently monitors the credit risk of concentration of financial assets on the basis of industry and geographical criteria, and also by individual counterparty. Maximum exposure limits are set and periodically monitored, analysed and updated. The Bank does not form exposures to customers and groups of related parties, other than credit institutions, central governments and central banks within the meaning of Regulation 575/2013/EC, exceeding by more than 10 per cent its equity.

Maximum exposure to credit risk

Exposure to credit risk attributable to financial assets recognised in the separate statement of financial position is as follows:

	2016		2015	
Financial asset	maximum	net	maximum	net
Receivables from banks	274,011	274,011	249,860	249,860
Loans and advances to customers	863,888	647,435	779,591	611,346
Receivables from the State budget	424,470	424,470	29,885	29,885
Available-for-sale securities	264,368	264,368	220,180	220,180
Securities held to maturity	1,384	1,384	1,979	1,979
Financial assets held for trading	-	-	305	305
Other financial assets	47	47	103	103
	1,828,168	**1,611,715**	**1,281,903**	**1,113,658**

The heading *Receivables from the State Budget* comprise loans on the National Programme for Energy Efficiency of Multi-Family Residential Buildings amounting to BGN 397,568 thousand (2015: BGN 9,848 thousand).

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

Exposure to credit risk attributable to off-balance sheet contingent commitments is as follows:

	2016		2015	
	maximum	net	maximum	net
Bank guarantees and letters of credit	80,366	76,513	77,771	75,487
Unutilised amount of authorized loans	557,152	557,152	100,408	100,408
Participation in the SIA investment program	1,724	1,724	1,804	1,804
	639,242	**635,389**	**179,983**	**177,699**
Maximum exposure to credit risk	**2,326,266**	**2,247,104**	**1,315,972**	**1,291,357**

In assessing the net exposure, highly-liquid collateral (government securities and cash), as also the net present value of liquid collateral – real estate, have been taken into account.

Credit risk - concentration

The financial assets of the Bank, classified by industry sectors (at amortised cost), are presented in the table below:

	2016	%	2015	%
Sectors				
Government	673,104	35.30	244,520	15.04
Financial services	415,598	21.80	666,537	41.00
Construction	136,626	7.17	110,938	6.82
Transport	107,192	5.62	87,148	5.36
Industry, total	326,829	17.15	331,201	20.37
Industry – energy generation and distribution	*103,520*	*5.43*	*132,365*	*8.14*
Industry – other industries	*65,545*	*3.44*	*80,607*	*4.96*
Industry – manufacture of foodstuffs	*60,962*	*3.20*	*56,110*	*3.45*
Industry – manufacture of tobacco products	*55,675*	*2.92*	*50,510*	*3.11*
Industry – manufacture of plant and equipment	*41,127*	*2.16*	*11,609*	*0.71*
Trade	53,994	2.83	48,241	2.97
Administrative and office activities	48,816	2.56	-	-
Other industries	46,052	2.42	22,390	1.38
Real estate transactions	41,829	2.19	60,969	3.75
Agriculture	26,474	1.39	14,569	0.90
Tourist services	17,573	0.92	21,772	1.34
Collection and disposal of garbage	12,602	0.65	17,471	1.07
	1,906,689	**100**	**1,625,756**	**100**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

Credit risk – concentration (continued)

The largest credit exposure of the Bank to a group of related parties /other than bank institutions/ amounts to BGN 62,202 thousand (2015: BGN 50,510 thousand) at amortised cost, which represents 9.99 per cent of Bank's capital base (2015: 8.66 per cent). The concentration of client's portfolio (net of receivables from financial institutions and receivables from the State budget) is presented in the following table:

	(BGN'000)	*% of Total**	*(BGN'000)*	*% of Total**
The biggest total exposure to a customer group	62 202	6.19%	52 150	6.05%
Total amount of the ten biggest exposures	488 547	48.65%	399 836	46.40%
Total amount of the twenty biggest exposures	708 750	70.58%	568 428	65.96%

There is no exposure to a customer of group of related customer as at 31 December 2016, exceeding 10 per cent of Bank's capital base.

The structure of the financial assets of the Bank by risk classification groups is as follows (at amortised cost):

At 31 December 2016	**Standard**	**Watch**	**Non-performing**	**Total**
Cash in hand and balances in current account with the Central Bank	78,521	-	-	78,521
Receivables from banks	274,011	-	-	274,011
Receivables from the State budget	424,470	-	-	424,470
Loans for commercial property and construction	297,868	94,091	50,771	442,730
Trade loans	212,357	72,902	18,803	304,062
Agricultural loans	-	-	2,059	2,059
Consumer loans	1,237	31	-	1,268
Residential mortgage loans to individuals	2,509	-	-	2,509
Loans to other financial institutions	12,111	-	43,815	55,926
Other loans and receivables	38,575	16,759	-	55,334
Available-for-sale securities	264,368	-	-	264,368
Securities, held to maturity	1,384	-	-	1,384
Other financial assets	47	-	-	47
Total financial assets	**1,607,458**	**183,783**	**115,448**	**1,906,689**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

At 31 December 2015	Standard	Watch	Non-performing	Total
Cash in hand and balances in current account with the Central Bank	343,853	-	-	343,853
Receivables from banks	249,860	-	-	249,860
Receivables from the State budget	29,885	-	-	29,885
Loans for commercial property and construction	298,397	70,104	63,112	431,613
Trade loans	199,635	15,691	20,461	235,787
Agricultural loans	-	-	2,010	2,010
Consumer loans	1,164	-	-	1,164
Residential mortgage loans to individuals	2,341	-	-	2,341
Loans to other financial institutions	-	-	65,139	65,139
Other loans and receivables	41,460	-	77	41,537
Available-for-sale securities	220,180	-	-	220,180
Financial assets held for trading	305	-	-	305
Securities, held to maturity	1,979	-	-	1,979
Other financial assets	103	-	-	103
Total financial assets	**1,389,162**	**85,795**	**150,799**	**1,625,756**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

The table below presents the types of collaterals, held by the Bank in relation to loans granted, at fair value mot limited to the maximum credit exposure of the respective borrower and determined with the assistance of an internal certified appraiser:

Type of collateral	2016 Fair value	%	2015 Fair value	%
Mortgages	255,007	42.00	372,511	51.18
Mortgages on ships	100,438	16.54	52,434	7.20
Pledge of plant, machinery, equipment, and inventories	188,990	31.12	178,952	24.59
Securities quoted on a stock market	35,426	5.83	89,327	12.27
Credit risk insurance	22,475	3.70	31,771	4.37
Bank guarantees	4,076	0.67	2,024	0.28
Restricted deposits	790	0.13	800	0.11
Total collateral	**607,202**	**100**	**727,819**	**100**

The following table shows the distribution by type of collateral for the respective exposure covered by the relevant type of collateral, where one exposure could have more than one collateral, i.e. it could be included in more than one position. The amount of the collateral could exceed 100 per cent, as more than one collateral could be provided to secure one loan, as follows:

Type of credit exposure	**Principal type of collateral**	**Percentage of exposure that is subject to an arrangement requiring collateral 2016**	**2015**
Loans and receivables	1. Mortgages	73	100
	2. Mortgages on ships	100	100
	3. Pledge of plant, machinery, equipment, and inventories	71	77
	4.Credit risk insurance	53	100
	5.Securities	100	97
	6. Restricted deposits	4	5
	7. Bank guarantees	100	34
Repo deals	1. Securities	100	100

At the request of the contractors, the Bank is able to re-negotiate the initial terms and conditions on the contract. Usually, these are the terms of loan utilization, loan amount, interest rates and/or repayment schedules from the point of view of the amount of a particular repayment instalment. Most of all, this are cases of changes in the initial parameters, purpose and scope, and respectively, the time schedule of projects. Regarding the loans extended under the Programme for Energy Efficiency, it should be noted that according to the programme's parameters the amount of the loan approved is subject to regular updating in order to ensure expenditure control. The signature of annexes to the loan contracts, by means of which the financial parameters are updated, is a result of those controls.

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

The table below presents data on the portfolio amount of the Bank's financial assets by type of instrument *at amortised costs* and the impairment made:

	Loans and receivables from non-financial institutions		Receivables from the State budget		Loans and receivables from financial institutions		Loans and receivables from individuals		Cash in hand and balances in current account with the Central Bank		Available-for-sale securities		Financial assets held for trading		Securities, held to maturity	
	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
Impaired on an individual basis																
-watch	131,881	85,794	-	-	-	-	31	-	-	-	-	-	-	-	-	-
-non-performing	105,277	150,797	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gross amount	**237,158**	**236,591**	-	-	-	-	**31**	-	-	-	-	-	-	-	-	-
Incl. renegotiated	171,904	152,723	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Past due but not impaired																
- standard	24,223	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-watch	9,797	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
- non-performing	6,905	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gross amount	**40,925**	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Incl. renegotiated	23,822	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Not past due and not impaired																
-standard	536,736	539,589	424,470	29,885	274,011	249,860	3,746	3,505	78,521	343,853	264,368	220,180	-	305	1,384	1,979
-watch	42,073															
- non-performing	3,266	9														
Gross amount	**582,075**	**539,598**	**424,470**	**29,885**	**274,011**	**249,860**	**3,746**	**3,505**	**78,521**	**343,853**	**264,368**	**220,180**	-	**305**	**1,384**	**1,979**
Incl. renegotiated	340,581	261,058	-		-	-	680	719	-	-	-	-	-	-	-	-
Gross amount	**860,158**	**776,189**	**424,470**	**29,885**	**274,011**	**249,860**	**3,777**	**3,505**	**78,521**	**343,853**	**264,368**	**220,180**	-	**305**	**1,384**	**1,979**
Incl. renegotiated	**536,307**	**413,781**	-	-	-	-	680	719	-	-	-	-	-	-	-	-

The Bank assesses the credit quality of provided contingent commitments by applying a methodology, which estimates whether events indicating with a high probability that outflow of Bank's resources might take place have occurred. If any such events occur, the Bank provides its liability up to the amount of its future costs (losses) related to outflows of economic benefits (payments). These costs (losses) are determined on the basis of the present value of the future net cash flows, calculated as the difference between the payment obligation and the possible inflows of subsequent resources to third parties. At the date of the financial statements, the Bank identified commitments amounting to BGN 8,013 thousand (2015 : BGN 3,262 thousand), which were provided by BGN 3,145 thousand (2015: BGN 1,468 thousand) (Note 32).

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

The watched loans and receivables, presented at amortised cost, are as follows:

	2016	2015
Loans for commercial property and construction	94,091	66,055
Trade loans	72,902	15,691
Consumer loans	31	-
Other loans and receivables	16,759	-
	183,783	**81,746**

A loan is classified as "restructured" when the initial terms of the agreement have been modified by the Bank by granting relief of certain credit terms to the debtor due to deterioration of its financial position having resulted in its inability to repay the loan within the original contractual maturity.

The restructured loans and receivables, presented at amortised cost, are as follows:

In BGN'000	**2016**	**2015**
Loans for commercial property and construction	**66,963**	**45,943**
incl. Standard	*17 965*	*19 590*
Watch	*25 443*	*9 638*
Non-performing	*23 555*	*16 715*
Other loans and receivables	**13,839**	**3,350**
incl. Standard	*90*	*97*
Watch	*10 670*	*2 383*
Non-performing	*3 079*	*870*
	80,802	**49,293**

4.1.1. Country (sovereign) risk

The Bank has formed a portfolio of securities classified as available-for-sale financial assets, comprising mostly government securities issued by the Republic of Bulgaria. The following table presents the Bank's exposure to sovereign debt as of 31 December 2016 and 31 December 2015:

At 31 December 2016	**Within 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Government securities						
Republic of Bulgaria	39,760	10,821	32,145	140,947	24,961	248,634
Total	**39,760**	**10,821**	**32,145**	**140,947**	**24,961**	**248,634**

At 31 December 2015	**Within 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Government securities						
Republic of Bulgaria	11,963	32,830	239	134,221	35,229	214,482
Total	**11,963**	**32,830**	**239**	**134,221**	**35,229**	**214,482**

Standard & Poor's credit rating for Republic of Bulgaria stands at BB+ with stable outlook (12 December 2014). Fitch's credit rating for Republic of Bulgaria is BBB- with stable outlook (10 January 2014). Moody's credit rating for Republic of Bulgaria was last set at Baa2 with stable outlook (05

August 2011).

4. FINANCIAL RISK MANAGEMENT (continued)

4.2. Market risk

Market risk is the risk of adverse movements in interest rates, exchange rates, liquidity position, and other factors affecting the price of securities and other financial assets. These movements affect the Bank's profitability and financial position.

Interest rate risk

Interest rate risk is the probability for potential change of the net interest income or the net interest margin and the market value of the equity due to changes in market interest rates.

The interest rate risk is considered in view of the overall activity of the Bank. Analyses of financial assets and liabilities grouped in time intervals depending on their sensitivity to changes in the interest rates are conducted on regular basis.

The approach for measuring interest rate risk with respect to the overall activity comprises primarily:

- Analysis of the interest rate sensitivity of income – measuring the interest rate sensitivity of the Bank's net income;
- Analysis of the interest rate sensitivity of economic capital (Duration GAP Analysis) – measuring the interest rate sensitivity of the Bank's economic value;
- Determination, application and reporting of limits for interest rate risk reflecting the volatility of the respective interest rate curve and the Bank's risk appetite;
- Stress tests for interest rate risk – presenting the potential movements in the annual interest income after applying a stress scenario involving changes in the interest rate curves by types of currencies.

Cash flow interest rate analysis is conducted by allocating the cash flows from assets and liabilities included in the interest rate imbalance analysis and forming the respective maturity gaps. In case of Bank's balance sheet items classified as such and measured at fair value, the fair value risk analysis is limited to placing the relevant item with the applicable maturity structure within the interest rate imbalance analysis.

Besides the interest rate sensitivity analyses, for the interest risk management main sources related to the change in the net interest spread of the Bank are also identified. This helps decision making on the interest rates policies of the Bank, in particular, the development of specific products and providing sources of financing having relevant characteristics.

Assets and Liabilities Committee (ALCO) currently monitors the interest rate risk to which the Bank is exposed and develops measures for its coverage and maintenance within the Bank's permitted levels and limits.

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.2. Market risk (continued)

The table on the next page summarises the interest exposure and risk of the Bank. It includes information on Bank's assets and liabilities at their carrying amount in accordance with interest-related clauses, set in the contracts, their maturity structure and sensitivity to movements in interest rates.

31 December 2016	*With floating interest rate %*	*With fixed interest rate %*	*Interest-free*	*Total*
Financial assets				
Receivables from banks	119,226	145,014	9,771	**274,011**
Loans and advances to customers	665,786	56,958	-	**722,744**
Receivables from the State budget	397,568	26,902	-	**424,470**
Securities, held to maturity	1,384	-	-	**1,384**
Available-for-sale securities	-	261,480	2,888	**264,368**
Other financial assets	-	-	47	**47**
Total financial assets	**1,183,964**	**490,354**	**12,706**	**1,687,024**
Financial liabilities				
Deposits from credit institutions	4,161	39,576	-	**43,737**
Deposits from customers other than credit institutions	88,239	592,689	28,621	**709,549**
Borrowings from international institutions	376,720	3,278	-	**379,998**
Other borrowings	11,236	6,443	-	**17,679**
Total financial liabilities	**480,356**	**641,986**	**28,621**	**1,150,963**
Total balance sheet interest exposure	**703,608**	**(151,632)**	**(15,915)**	**536,061**

31 December 2015	*With floating interest rate %*	*With fixed interest rate %*	*Interest-free*	*Total*
Financial assets				
Receivables from banks	114,909	127,483	7,468	**249,860**
Loans and advances to customers	544,338	89,339	-	**633,677**
Receivables from the State budget	9,848	20,037	-	**29,885**
Securities, held to maturity	1,979	-	-	**1,979**
Available-for-sale securities	-	217,536	2,644	**220,180**
Financial assets held for trading	-	-	305	**305**
Other financial assets	-	-	103	**103**
Total financial assets	**671,074**	**454,395**	**10,520**	**1,135,989**
Financial liabilities				
Deposits from credit institutions	842	-	-	**842**
Deposits from customers other than credit institutions	177,482	507,838	9,760	**695,080**
Financial liabilities, held for trading	362	-	-	**362**
Borrowings from international institutions	178,723	-	-	**178,723**
Other borrowings	11,226	16,437	-	**27,663**
Total financial liabilities	**368,635**	**524,275**	**9,760**	**902,670**
Total balance sheet interest exposure	**302,439**	**(69,880)**	**760**	**233,319**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.2. Market risk (continued)

Interest rate sensitivity analysis

The table below includes the financial instruments of the Group, presented at carrying value, classified by the earlier of the date of interest rate change under the contract and the maturity date.

31 December 2016	*within 1 month*	*1-3 months*	*3-6 months*	*6-12 months*	*1-5 years*	*over 5 years*	*With fixed interest rate*	*Interest-free*	*Total*
Financial assets									
Receivables from banks	90,479	28,747	-	-	-	-	145,014	9,771	274,011
Loans and advances to customers	110,973	554,813	-	-	-	-	56,958	-	722,744
Receivables from the State budget	397,568	-	-	-	26,902	-	-	-	424,470
Securities, held to maturity	1,384	-	-	-	-	-	-	-	1,384
Available-for-sale securities	38,363	10,223	3,019	32,145	142,561	35,169	-	2,888	264,368
Other financial assets	-	-	-	-	-	-	-	47	47
Total financial assets	**638,767**	**593,783**	**3,019**	**32,145**	**169,463**	**35,169**	**201,972**	**12,706**	**1,687,024**
Financial liabilities									
Deposits from credit institutions	43,737	-	-	-	-	-	-	-	43,737
Deposits from customers other than credit institutions	147,352	21,358	4,678	479,527	28,013	-	-	28,621	709,549
Borrowings from international institutions	8,259	179,259	184,887	4,315	-	-	3,278	-	379,998
Other borrowings	-	11,236	-	-	-	6,443	-	-	17,679
Total financial liabilities	**199,348**	**211,853**	**189,565**	**483,842**	**28,013**	**6,443**	**3,278**	**28,621**	**1,150,963**
Total exposure to interest rate sensitivity	**439,419**	**381,930**	**(186,546)**	**(451,697)**	**141,450**	**28,726**	**198,694**	**(15,915)**	**536,061**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.2. Market risk (continued)

31 December 2015	*within 1 month*	*1-3 months*	*3-6 months*	*6-12 months*	*1-5 years*	*over 5 years*	*With fixed interest rate*	*Interest-free*	*total*
Financial assets									
Receivables from banks	51,384	41,055	22,470	-	-	-	127,483	7,468	249,860
Loans and advances to customers	485,494	58,844	-	-	-	-	89,339	-	633,677
Receivables from the State budget	9,848	-	-	-	20,037	-	-	-	29,885
Securities, held to maturity	-	-	1,979	-	-	-	-	-	1,979
Available-for-sale securities	10,660	32,285	-	-	138,915	35,676	-	2,644	220,180
Financial assets held for trading	-	-	-	-	-	-	-	305	305
Other financial assets	-	-	-	-	-	-	-	103	103
Total financial assets	**557,386**	**132,184**	**24,449**	**-**	**158,952**	**35,676**	**216,822**	**10,520**	**1,135,989**
Financial liabilities									
Deposits from credit institutions	842	-	-	-	-	-	-	-	842
Deposits from customers other than credit institutions	179,143	581	2,581	30,150	472,865	-	-	9,760	695,080
Financial liabilities, held for trading	-	362	-	-	-	-	-	-	362
Borrowings from international institutions	12,174	106,152	33,609	26,788	-	-	-	-	178,723
Other borrowings	-	11,226	-	9,807	-	6,630	-	-	27,663
Total financial liabilities	**192,159**	**118,321**	**36,190**	**66,745**	**472,865**	**6,630**	**-**	**9,760**	**902,670**
Total exposure to interest rate sensitivity	**365,227**	**13,863**	**(11,741)**	**(66,745)**	**(313,913)**	**29,046**	**216,822**	**760**	**233,319**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.2. Market risk (continued)

Sensitivity of the floating rate interest assets and liabilities

The table below represents the sensitivity of the Bank to possible changes in interest rates based on the structure of floating rate assets and liabilities as of 31 December, under the assumption that the influence of the other variables is ignored. The actual effect of changes in market interest rates could be different, as a significant portion of the loans and receivables from customers bear floating interest rates that are based on a variable portion determined by the Bank, which in turn is influenced by numerous factors.

	2016			2015		
Currency	*Increase in percentage points*	*Sensitivity of the financial result*	*Sensitivity of the equity*	*Increase in percentage points*	*Sensitivity of the financial result*	*Sensitivity of the equity*
BGN	0.50%	2,467	(725)	0.50%	(1,734)	(1,091)
EUR	0.50%	288	(1,742)	0.50%	890	(1,565)
USD	0.50%	(82)	-	0.50%	63	-
BGN	-0.50%	(2,467)	725	-0.50%	1,734	1,091
EUR	-0.50%	(288)	1,742	-0.50%	(890)	1,565
USD	-0.50%	82	-	-0.50%	(63)	-

The average interest rates by financial assets and financial liabilities are presented in the following table:

	31.12.2016	31.12.2015
Financial assets	3,65%	3.59%
Financial liabilities	0,38%	0.44%

Currency risk

The currency risk is the risk that the financial position and cash flows of the Bank might be affected adversely by changes in exchange rates due to open currency positions. In managing the foreign currency risk, the Bank follows the principle of maintaining minimum open currency positions within the specified limits. Foreign currency positions are not formed with speculative purposes, but arise out of foreign currency transactions in the ordinary course of business of the Bank. The policy of the parent company (the "Bank") is that the main portion of the assets and liabilities, and respectively the bank transactions, shall be denominated in EUR or BGN. The Bank does not carry out significant transactions and does not hold significant open positions in currencies other than EUR and BGN. As the exchange rate of the Bulgarian lev is pegged to that of the Euro, there is no significant open currency risk for the Bank's cash flows and financial performance.

The currency risk is regarded with respect to the overall activity of the Bank. Analyses of the financial assets and liabilities by types of currency of denomination are conducted on a regular basis.

The approach of measuring the overall activity currency risk includes mainly:

- Foreign currency sensitivity analysis – measuring the Bank's income from foreign currency transactions;
- Determination, implementation and reporting of currency risk limits, reflecting the Bank's risk appetite;
- Stress tests for currency risk, which present the potential change of annual income after the implementation of stress scenarios for exchange rate changes.

The currency risk analysis is performed by allocating the Bank's assets and liabilities by types of currency of denomination, which facilitates the timely decision making regarding the Bank's foreign currency policy, and in particular, the formation of specific products and ensuring sources of financing with relevant characteristics.

The Asset and Liability Management Committee (ALCO) monitors currently the currency risk to which the Bank is exposed and develops measures for its management and maintenance within the limits acceptable to the Bank.

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.2. Market risk (continued)

The following table summarises the Bank's exposure to currency risk. The table includes the Bank's financial instruments and the contingent liabilities and commitments, presented at carrying amount, classified by type of currency.

At 31 December 2016	In USD	In EUR	In other foreign currency	In BGN	Total
Financial assets					
Cash in hand and balances in current account with the Central Bank	24	1,873	-	76,624	78,521
Receivables from banks	93,446	55,231	114	125,220	274,011
Loans and advances to customers	-	492,090	3,313	227,341	722,744
Receivables from the State budget	-	-	-	424,470	424,470
Securities, held to maturity	-	1,384	-	-	1,384
Available-for-sale securities	-	126,040	-	138,328	264,368
Other financial assets	-	-	-	47	47
Total financial assets	**93,470**	**676,618**	**3,427**	**992,030**	**1,765,545**
Financial liabilities					
Deposits from credit institutions	9,280	2,090	-	32,367	43,737
Deposits from customers other than credit institutions	84,156	41,335	4	584,054	709,549
Borrowings from international institutions	-	376,720	3,278	-	379,998
Other borrowings	-	17,679	-	-	17,679
Total financial liabilities	**93,436**	**437,824**	**3,282**	**616,421**	**1,150,963**
Net balance sheet currency position	**34**	**238,794**	**145**	**375,609**	**614,582**
Commitments and contingencies	**464**	**82,444**	**-**	**556,334**	**639,242**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.2. Market risk (continued)

At 31 December 2015	In USD	In EUR	In other foreign currency	In BGN	Total
Financial assets					
Cash in hand and balances in current account with the Central Bank	5	3,292	-	340,556	343,853
Receivables from banks	23,359	55,843	109	170,549	249,860
Loans and advances to customers	13,306	452,937	5,213	162,221	633,677
Receivables from the State budget	-	-	-	29,885	29,885
Securities, held to maturity	-	1,979	-	-	1,979
Available-for-sale securities	-	120,390	-	99,790	220,180
Financial assets held for trading	-	305	-	-	305
Other financial assets	-	-	-	103	103
Total financial assets	**36,670**	**634,746**	**5,322**	**803,104**	**1,479,842**
Financial liabilities					
Deposits from credit institutions	-	561	-	281	842
Deposits from customers other than credit institutions	25,325	74,781	8	549,966	695,080
Financial liabilities, held for trading	-	362	-	-	362
Borrowings from international institutions	-	173,583	5,140	-	178,723
Other borrowings	-	27,663	-	-	27,663
Total financial liabilities	**25,325**	**276,950**	**5,148**	**595,247**	**902,670**
Net balance sheet currency position	**11,345**	**357,796**	**174**	**207,857**	**577,172**
Commitments and contingencies	**9,398**	**27,961**	**-**	**142,624**	**179,983**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.2. Market risk (continued)

The following table presents the Bank's sensitivity to possible changes in exchange rates based on the structure of the assets and liabilities at 31 December:

	2016					
Currency	Change in exchange rates			Effect on the pre-tax profit in case of change in exchange rates*		Effect on equity
	Exchange rate	Decrease (BPS)	Increase (BPS)	Decrease	Increase	
EUR	1.9558	-	-	-	-	-
USD	1.8555	-1.071	+2.665	25	(62)	-
JPY	0.0158	-13	+20	(11)	16	-
GBP	2.2844	-2.631	+2.096	(2)	2	-
Total effect				**12**	**(44)**	**-**

	2015					
Currency	Change in exchange rates			Effect on the pre-tax profit in case of change in exchange rates*		Effect on equity
	Exchange rate	Decrease (BPS)	Increase (BPS)	Decrease	Increase	
EUR	1.9558	-	-	-	-	-
USD	1.7901	-1.051	+2.585	535	(1,316)	-
JPY	0.0149	-30	+19	(2)	1	-
GBP	2.6502	-1.957	+2.510	(2)	2	-
Total effect				**531**	**(1,313)**	**-**

There is no effect on the Bank's equity as the Bank does not hold financial instruments denominated in USD.

Price risk of shares quoted on the Stock Exchange

The Bank is exposed to price risk with respect to the shares it holds, classified as available-for-sale investments. Management of the Bank monitors and analyses all changes in the security market, and engages the advisory services of renowned local investment intermediaries. In addition, at this stage, the Bank has decided to greatly reduce the operations on the stock markets and the trade in the acquired shares, and currently monitors the financial and business indicators, reported by the respective issuer, as well as the development of its activities.

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.3. Liquidity risk

Liquidity risk is the risk that the Bank will not be able to meet its current and potential payment obligations as they fall due without suffering losses.

The Bank's business requires a stable cash flow both to replace existing deposits and loans received prior to their maturity, and to satisfy demands of customers for additional loans. Undrawn borrowing facility commitments and the level of all outstanding contingent obligations are taken into consideration in managing the Bank's liquidity risk.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, as well as the impact of the changes in interest rates and exchange rates on the pre-tax profit and equity, are important factors in assessing the Bank's liquidity. In order to manage this risk, the Bank maintains at all times highly liquid assets depending on the currency of its liabilities.

The overall liquidity control and monitoring are performed by ALCO and are based on maturity tables with scenarios for measuring the net cash flows by periods, including nominal, realistic and pessimistic scenario, reflecting to a different degree the negative assumptions relating to loss of confidence by the customers, deterioration of the credit portfolio quality, negative assumptions about the banking market and other assumptions that could have an impact on the Bank's liquid position and certain statutory coefficients and ratios. Additionally, varieties of correlations are monitored to indicate the liquid position by periods. Liquidity risk is also measured through application of three additional scenarios for the cash flows from operating activities and monitoring the liquidity buffers of the Bank and the additional sources of financing in case of market and idiosyncratic shocks, representing loss of confidence by the market in a particular bank or banking group, which is tantamount to downgrading of the institution with two degrees at least and combined shocks.

The table below presents the amounts in percentage of the ratio of liquid assets to liabilities of the Bank:

	2016	**2015**
At 31 December	31.45%	65.25%
Average for the period	38.36%	64.56%
Highest for the period	48.53%	70.03%
Lowest for the period	29.50%	59.10%

	2016	**2015**
Cash and cash balances with BNB	78,521	343,805
Balances in current accounts with other banks and international deposits of up to 7 days	90,477	39,760
Government securities	193,916	206,649
Liquid assets	**362,914**	**590,214**
Financial liabilities held for trading	-	362
Financial liabilities measured at amortised cost	1,150,963	902,308
Provisions	3,319	1,642
Employee retirement benefits	228	198
Liabilities	**1,154,510**	**904,510**
Liquidity assets ratio (LAR)	**31.45%**	**65.25%**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.3. Liquidity risk (continued)

The table below provides an analysis of the financial assets and liabilities of the Bank at carrying amount, grouped by remaining maturity:

At 31 December 2016	Within 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite maturity	Total
Financial assets							
Cash in hand and balances in current account with the Central Bank	78,521	-	-	-	-	-	78,521
Receivables from banks	90,657	28,400	1,904	38,050	115,000	-	274,011
Loans and advances to customers	8,172	19,487	149,440	302,886	242,759	-	722,744
Receivables from the State budget	-	-	-	424,470	-	-	424,470
Available-for-sale securities	39,760	13,761	32,274	140,947	34,738	2,888	264,368
Assets, held for sale	-	-	-	-	-	4,657	4,657
Securities, held to maturity	211	-	587	586	-	-	1,384
Other assets	-	-	-	-	-	150	150
Assets, acquired from collateral foreclosure	-	-	-	-	-	11,372	11,372
Investment property	-	-	-	-	-	7,702	7,702
Investments in subsidiaries	-	-	-	-	-	87,643	87,643
Property, plant and equipment, intangible assets	-	-	-	-	-	33,698	33,698
Deferred tax assets	-	-	-	-	-	1,265	1,265
Total financial assets	**217,321**	**61,648**	**184,205**	**906,939**	**392,497**	**149,375**	**1,911,985**
Financial liabilities							
Deposits from credit institutions	43,737	-	-	-	-	-	43,737
Current tax liabilities	-	1,813	-	-	-	-	1,813
Deposits from customers other than credit institutions	147,530	23,853	500,637	37,529	-	-	709,549
Provisions	-	-	-	-	-	3,319	3,319
Other liabilities	506	-	-	31	-	586	1,123
Borrowings from international institutions	2,298	3,155	44,976	148,042	181,527	-	379,998
Other borrowings	-	-	11,450	853	5,376	-	17,679
Total financial liabilities	**194,071**	**28,821**	**557,063**	**186,455**	**186,903**	**3,905**	**1,157,218**
Gap in maturity thresholds of assets and liabilities	**23,250**	**32,827**	**(372,858)**	**720,484**	**205,594**	**145,470**	**754,767**
Commitments and contingencies	**30,905**	**7,612**	**79,679**	**510,482**	**3,566**	**4,694**	**636,938**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.3. Liquidity risk (continued)

At 31 December 2015	Within 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite maturity	Total
Financial assets							
Cash in hand and balances in current account with the Central Bank	343,853	-	-	-	-	-	343,853
Receivables from banks	51,384	41,433	8,996	80,047	68,000	-	249,860
Financial assets held for trading	-	-	305	-	-	-	305
Loans and advances to customers	39,647	22,267	96,870	307,646	167,247	-	633,677
Receivables from the State budget	-	-	693	19,344	9,848	-	29,885
Available-for-sale securities	10,660	32,285	-	138,915	35,676	2,644	220,180
Assets, held for sale	-	-	-	-	-	8,712	8,712
Securities, held to maturity	24	-	588	1,367	-	-	1,979
Other assets	-	-	-	-	-	722	722
Assets, acquired from collateral foreclosure	-	-	-	-	-	4,714	4,714
Investment property	-	-	-	-	-	7,744	7,744
Investments in subsidiaries	-	-	-	-	-	87,643	87,643
Property, plant and equipment, intangible assets	-	-	-	-	-	24,555	24,555
Deferred tax assets	-	-	-	-	-	725	725
Total financial assets	**445,568**	**95,985**	**107,452**	**547,319**	**280,771**	**137,459**	**1,614,554**
Financial liabilities							
Deposits from credit institutions	842	-	-	-	-	-	842
Financial liabilities, held for trading	-	-	362	-	-	-	362
Current tax liabilities	-	140	-	-	-	-	140
Deposits from customers other than credit institutions	179,143	581	33,467	481,889	-	-	695,080
Provisions	-	-	-	-	-	1,642	1,642
Other liabilities	458	-	-	34	-	689	1,181
Borrowings from international institutions	2,884	8,609	41,581	103,293	22,356	-	178,723
Other borrowings	-	28	9,992	12,079	5,564	-	27,663
Total financial liabilities	**183,327**	**9,358**	**85,402**	**597,295**	**27,920**	**2,331**	**905,633**
Gap in maturity thresholds of assets and liabilities	**262,241**	**86,627**	**22,050**	**(49,976)**	**252,851**	**135,128**	**708,921**
Commitments and contingencies	**24,039**	**10,488**	**89,677**	**41,796**	**10,231**	**4,694**	**180,925**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.3. Liquidity risk (continued)

The table below presents the gross undiscounted cash flows related to the Bank's liabilities as of 31 December:

At 31 December 2016	Carrying amount	Gross flow	Less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years
Financial liabilities							
Deposits from credit institutions	43,737	43,741	43,741	-	-	-	-
Deposits from customers other than credit institutions	709,549	710,499	147,531	23,857	501,263	37,848	-
Financial liabilities, held for trading	-	-	-	-	-	-	-
Borrowings from international institutions	379,998	394,724	2,302	3,005	45,765	150,847	192,805
Other borrowings	17,679	19,503	-	32	11,543	1,322	6,606
	1,150,963	**1,168,467**	**193,574**	**26,894**	**558,571**	**190,017**	**199,411**
Bank guarantee provisions	3,145	3,145	1,644	936	565	-	-
Unutilised loan commitments	557,152	557,152	23,925	546	64,633	468,048	-

At 31 December 2015	Carrying amount	Gross flow	Less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years
Financial liabilities							
Deposits from credit institutions	842	843	843	-	-	-	-
Deposits from customers other than credit institutions	695,080	696,498	179,142	582	33,673	483,101	-
Financial liabilities, held for trading	362	362	-	-	362	-	-
Borrowings from international institutions	178,723	185,089	2,893	8,870	42,267	107,093	23,966
Other borrowings	27,663	29,777	-	60	10,231	12,593	6,893
	902,670	**912,569**	**182,878**	**9,512**	**86,533**	**602,787**	**30,859**
Bank guarantee provisions	1,468	1,468	300	600	568	-	-
Unutilised loan commitments	100,408	100,408	4,065	5,047	65,679	25,617	-
Amount of agreed receivables		11,046	-	-	11,046	-	-
Amount of agreed payables		(10,741)	-	-	(10,741)	-	-
		305	-	-	305	-	-

Considering the specific activity of the Bank, the funds attracted from the biggest 20 non-bank depositors at 31 December 2016 represent 97.26 per cent of the total amount of payables to other customers (31 December 2015: 96.49 per cent). The share of the biggest non-bank depositor of the total amount of payables to other customers is 53.92 per cent (31 December 2015: 55.25 per cent).

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.3. Liquidity risk (continued)

The financial assets of the Bank available for future financing and the financial assets pledged as collateral for financial liabilities are presented in the table below:

At 31 December 2016

Financial assets	Pledged as collateral*	Available for collateral	Other**	Total
Cash in hand and balances in current account with the Central Bank	-	1,970	76,551	78,521
Receivables from banks	9,771	240,139	24,101	274,011
Loans and advances to customers	-	591,558	131,186	722,744
Receivables from the State budget	-	424,470	-	424,470
Available-for-sale securities	54,718	207,007	2,643	264,368
Securities, held to maturity	-	1,384	-	1,384
Other financial assets	-	-	47	47
Total financial assets	**64,489**	**1,466,528**	**234,528**	**1,765,545**

At 31 December 2015

Financial assets	Pledged as collateral	Available for collateral	Other	Total
Cash in hand and balances in current account with the Central Bank	-	265,400	78,453	343,853
Receivables from banks	7,468	187,541	54,851	249,860
Loans and advances to customers	-	527,200	106,477	633,677
Receivables from the State budget	-	29,885	-	29,885
Available-for-sale securities	7,833	209,863	2,484	220,180
Securities, held to maturity	-	1,979	-	1,979
Financial assets held for trading	-	305	-	305
Other financial assets	-	-	103	103
Total financial assets	**15,301**	**1,222,173**	**242,368**	**1,479,842**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.3. Liquidity risk (continued)

* At 31 December 2016, funds amounting to BGN 9,771 thousand were blocked in letters of credit of two corporate customers, maturing as follows:

Maturity interval	Receivables from banks pledged as collateral
On demand	130
Within 30 days	47
From 31 to 90 days	2,457
From 91 to 180 days	225
From 181 to one year	1,364
Over one year	5,548

At 31 December 2016 securities on a legal requirement to provide for funds of the State budget amount to BGN 34,085 thousand and those on one repo deal with a commercial bank maturing within seven days amount to BGN 30,632 thousand.

**Other represent financial assets not encumbered or restricted to be used as collateral, but the Bank would not take it into consideration as available to support a future financing in the normal course of its activity.

Review of the size, development and the credit quality of the unencumbered assets is done once a year.

Risk Management, together with other Bank divisions, monthly monitors and reports to ALCO on the ratios between the encumbered assets and the total carrying amount of the Bank's assets. In a case of excess above the limits approved by the Management Board, ALCO reports back to the MB for undertaking corrective actions.

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.4. Operational risk

The main sources of operational risk within the Bank are its personnel, processes, systems and external events. The Bank designated the following as the major types of operational risk:

- Risk of loss due to inadequate or poorly working internal processes;
- Risk of loss due to inadequate, illegal and/or incorrect acts and omissions of personnel;
- Risk of loss due to inadequate or poorly working systems;
- Risk of loss due to external events, including legal risk.

Operational risk management is based on the principles of not taking unreasonable risks, strict compliance with the levels of competence and the applicable legislation. The Bank applies reliable methods for limiting the impact of operational risks, including by dividing the functions and responsibilities, introducing double-checking control, levels of competence, internal control, etc. Moreover, control procedures for reducing the operational risk are added to all internal rules and procedures of the Bank.

In operational risk management all operational events, which occur in the activity of various units and processes of the Bank, are strictly monitored and registered, while the events of higher frequency, as well as those of significant importance, serve as bases for the operational risk analyses in different scenarios. The operational risk is measurable and monitorable, and in the process of work an operational event register is kept, which is used as a basis for analysing and improving the work processes, and minimising the conditions that would potentially result in operational events and loss for the Bank.

For the purposes of measuring its operational risk, the Bank has decided to apply the "Basic indicator method".

4.5 Capital management

The main objectives of the Bank's capital management is to maintain its level at amounts sufficient for activity developing and achieving the general objectives set at its foundation – to support the economic policy of the country and the development of small and medium-sized businesses.

In its activities the Bank should observe the regulatory requirements for capital, as well as to continue operating as a going concern.

The table below presents the main equity components following the regulatory requirements and ratios achieved by the Bank:

	2016	2015
OWN FUNDS	622,579	583,034
TIER I CAPITAL	622,579	583,034
COMMON EQUITY TIER I CAPITAL	622,579	583,034
Share capital	601,774	601,774
Statutory reserves	58,705	54,929
Additional reserves	47,866	13,876
Accumulated other comprehensive income	3,502	577
Intangible assets	(226)	(80)
Investments in subsidiaries	(87,643)	(87,643)
Other transitional adjustments to CET1 Capital	(1,399)	(399)
ADDITIONAL TIER I CAPITAL	-	-
TIER II CAPITAL	-	-

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (continued)

4.5. Capital management (continued)

	2016	2015
TOTAL RISK EXPOSURES	1,267,103	1,095,045
Credit risk - Standardised approach	1,161,628	986,707
Central governments or central banks	-	5,464
Regional governments or local authorities	265	1,246
Public sector entities	26,902	20,037
Multilateral development banks	939	939
Institutions	187,362	214,923
Corporates	632,843	621,268
Retail	15,090	10,964
Secured by mortgages on immovable property	87,819	41,540
Exposures in default	146,809	19,066
Items associated with particular high risk	2,934	2,934
Equity exposures	150	146
Other items	60,515	48,180
Foreign exchange and commodity risk	-	-
Operational risk - Basic indicator approach	105,475	108,338
CET 1 Capital Ratio	**49.13%**	**53.24%**
Total Capital Ratio	**49.13%**	**53.24%**
Capital conservation buffer	*31,678*	*27,376*
Systemic risk buffer	*38,013*	*32,851*
Discretionary counter-cyclical buffer	-	-
Regulatory required levels		
CET 1 Capital Ratio	*4.50%*	*4.50%*
Tier 1 Capital ratio	*6.00%*	*6.00%*
Total Capital ratio	*8.00%*	*8.00%*
Capital conservation buffer	*2.50%*	*2.50%*
Systemic risk buffer	*3.00%*	*3.00%*
Discretionary counter-cyclical buffer	*0.00%*	*0.00%*

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

5. FAIR VALUE DISCLOSURE

The table below presents the carrying amount and fair values of financial assets and liabilities, including by their levels in the fair value hierarchy:

As at 31.12.2016		**Carrying amount**						**Fair value**			
	Note	**Held-to-maturity**	**Loans and receivables**	**Held-for-trading**	**Available-for-sale**	**Other**	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets measured at fair value											
Available-for-sale securities	21	-	-	-	264,368	-	264,368	251,653	12,345	-	263,998
Financial assets held for trading	22	-	-	-	-	-	-	-	-	-	-
Assets, acquired from collateral foreclosure	27	-	-	-	-	11,372	11,372	-	-	11,372	11,372
Investment property	25	-	-	-	-	7,702	7,702	-	-	7,702	7,702
			-	-	264,368	19,074	283,442	251,653	12,345	19,074	283,072
Financial assets not measured at fair value											
Cash in hand and balances in current account with the Central Bank	16	-	78,521	-	-	-	78,521	-	78,521	-	78,521
Loans to banks	17	-	149,660	-	-	-	149,660	-	150,886	-	150,886
Current accounts and term deposits of banks	17	-	124,351	-	-	-	124,351	-	124,351	-	124,351
Loans and advances to customers	18	-	722,744	-	-	-	722,744	-	739,757	-	739,757
Receivables from the State budget		-	424,470	-	-	-	424,470	-	469,168	-	469,168
Securities, held to maturity	20	1,384	-	-	-	-	1,384	-	1,403	-	1,403
		1,384	1,499,746	-	-	-	1,501,130	-	1,564,086	-	1,564,086
Liabilities measured at fair value											
Financial liabilities, held for trading	22	-	-	-	-	-	-	-	-	-	-
		-	-	-	-	-	-	-	-	-	-
Liabilities not measured at fair value											
Deposits from credit institutions - Current accounts and term deposits from banks	28	-	-	-	-	43,737	43,737	-	43,738	-	43,738
Deposits from customers other than credit institutions	29	-	-	-	-	709,549	.709,549	-	709,728	-	709,728
Borrowings from international institutions	30	-	-	-	-	379,998	379,998	-	380,991	-	380,991
Other borrowings	31	-	-	-	-	17,679	17,679	-	18,693	-	18,693
		-	-	-	-	1,150,963	1,150,963	-	1,153,150	-	1,153,150

The fair value of securities classified as available-for-sale investments with carrying amount of BGN 370 thousand at 31 December 2016 (2015: BGN 290 thousand) carried at cost is not disclosed as it cannot be measured reliably.

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

5. FAIR VALUE DISCLOSURE (continued)

At 31.12.2015		Carrying amount						Fair value			
	Note	Held-to-maturity	Loans and receivables	Held-for-trading	Available-for-sale	Other	Total	Level 1	Level 2	Level 3	Total
Assets measured at fair value											
Available-for-sale securities	21	-	-	-	220,180	-	220,180	217,536	2,354	-	219,890
Financial assets held for trading	22	-	-	305	-	-	305	-	305	-	305
Assets, acquired from collateral	27	-	-	-	-	4,714	4,714	-	-	4,714	4,714
Investment property	25	-	-	-	-	7,744	7,744	-	-	7,744	7,744
			-	**305**	**220,180**	**12,458**	**232,943**	**217,536**	**2,659**	**12,458**	**232,653**
Financial assets not measured at fair value											
Cash in hand and balances in current account with the Central Bank	16	-	343,853	-	-	-	343,853	-	343,853	-	343,853
Loans to banks	17		141,718	-	-	-	141,718	-	150,176	-	150,176
Current accounts and term deposits of banks	17	-	108,142	-	-	-	108,142	-	108,142	-	108,142
Loans and advances to customers	18	-	633,677	-	-	-	633,677	-	638,561	-	638,561
Receivables from the State budget		-	29,885	-	-	-	29,885	-	35,818	-	35,818
Securities, held to maturity	20	1,979	-	-	-	-	1,979	-	1,925	-	1,925
		1,979	**1,257,275**	**-**	**-**	**-**	**1,259,254**	**-**	**1,278,475**	**-**	**1,278,475**
Liabilities measured at fair value											
Financial liabilities, held for trading	22	-	-	362	-	-	362	-	362	-	362
		-	**-**	**362**	**-**	**-**	**362**	**-**	**362**	**-**	**362**
Liabilities not measured at fair value											
Deposits from credit institutions - Current accounts and term deposits from banks	28	-	-	-	-	842	842	-	842	-	842
Deposits from customers other than credit institutions	29	-	-	-	-	695,080	695,080	-	691,649	-	691,649
Borrowings from international institutions	30	-	-	-	-	178,723	178,723	-	181,103	-	181,103
Other borrowings	31	-	-	-	-	27,663	27,663	-	28,038	-	28,038
		-	**-**	**-**	**-**	**902,308**	**902,308**	**-**	**901,632**	**-**	**901,632**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

5. FAIR VALUE DISCLOSURE (continued)

Fair value of assets and liabilities measured at fair value is presented in the following table by types of assets at the reporting date:

Financial instrument	Fair value as of	Fair value as of	Fair value hierarchy	Valuation techniques	Significant unobservable inputs	Relationship of unobservable inputs to fair value
	31.12.2016	31.12.2015				
Investment property	7,702	7,744	Level 3	Market analogues method Under the market analogues method an assessment is made by directly comparing the property under review with sold similar properties; the price is determined on the basis of such previous transactions. When applying this approach, it is necessary to use actually similar data of the comparable properties, the properties should be in the same location and the timing of the transaction and the date of preparation of the evaluation should be close enough.	1. Market realisation coefficient (0.8-0.95) 2. Location coefficient (0.81-1.0) 3. Coefficient of specific features (status) (0.8-1.1)	The higher (lower) fair value if: • Higher (lower) market realisation coefficient • Higher (lower) location coefficient • Higher (lower) coefficient of specific features (status)
Assets, acquired from collateral foreclosure	11,372	4,714		Income capitalisation method (revenue method) The revenue method, used for assessing the real estate value, consists of an analysis of the value of the real estate based on its ability to generate income through capitalisation of the net income derived from the property over a given period. For the determination of the evaluated property's amount, the permanently generated net annual income is used and its amount is calculated on the basis of the actual or possible permanently achieved rental income, which it turn is calculated on the basis of the average offered rent in the area (observable inputs), by taking into account the condition of the building fund and the residual term of use.	Offer market adequacy adjustment coefficient (from -10% to +5%)	The higher (lower) fair value if: • Higher (lower) offer market adequacy adjustment coefficient

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

5. FAIR VALUE DISCLOSURE (continued)

Fair value of financial assets and financial liabilities not measured at fair value, but for which fair value disclosures are required.

Financial instrument	Fair value as of 31.12.2016	Fair value as of 31.12.2015	Fair value hierarchy	Valuation techniques	Significant unobservable inputs	Relationship of unobservable inputs to fair value
Loans to banks	150,886	150,176	Level 2	Discounted cash flows Future cash flows are discounted using the 12 month Sofibor, adjusted for yield curve of Bulgarian government securities on primary market according to Bloomberg publication	N/A	N/A
Loans and advances to customers	739,757	638,561	Level 2	Discounted cash flows Future cash flows are measured using the officially published by BNB interest rates (unadjusted) of new loans for December 2015.	N/A	N/A
Receivables from the State budget	469,168	35,818	Level 2	Discounted cash flows Future cash flows are measured using the officially published by BNB yield of Bulgarian government securities (unadjusted) for December 2015	N/A	N/A
Securities, held to maturity	1,403	1,925	Level 2	Discounted cash flows Future cash flows are measured using the officially published by BNB interest rates (unadjusted) of new loans to non-financial entities for December 2015	N/A	N/A
Other borrowings	18,693	28,038	Level 2	Discounted cash flows Future cash flows are measured using the officially published by BNB yield of Bulgarian government securities (unadjusted) for December 2015	N/A	N/A
Borrowings from international institutions	380,991	181,103	Level 2		N/A	N/A

For the balance sheet assets and liabilities not disclosed in the table the Bank's management is of the opinion that their fair value approximates their carrying amount.

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

6. NET INTEREST INCOME

	2016	2015
Interest income		
Loans and advances to customers	49,714	51,277
Receivables from the State budget	4,743	462
Loans to banks	3,409	6,220
Available-for-sale securities	1,840	1,870
Deposits placed with other banks	350	599
Securities, held to maturity	97	118
Other assets (effect of negative interest)	84	-
	60,237	**60,546**
Incl. Interest income on impaired loans and receivables	**8,067**	**7,898**
Interest expenses		
Borrowings from international institutions	(2,410)	(3,283)
Deposits from customers other than credit institutions	(924)	(1,509)
Other borrowings	(268)	(492)
Other liabilities (effect of negative interest)	(60)	(2)
Deposits from credit institutions	(3)	(44)
Debenture loans	-	(2,655)
	(3,665)	**(7,985)**
Net interest income	**56,572**	**52,561**

The yield on the assets, as a ratio of net profit to the balance sheet figure, is 2.24 per cent (2015: 2.34 per cent).

7. NET FEE AND COMMISSION INCOME

	2016	2015
Fee and commission income		
Guarantees and letters of credit	1,356	1,141
Customers' accounts, bank transfers, cash operations of customers, etc.	622	513
Servicing of debenture issues	270	270
Special-purpose funds of the Ministry of Finance (Note 31)	66	67
	2,314	**1,991**
Fee and commission expense		
Servicing of accounts in other banks	(26)	(25)
Bank transfers and cash operations with other banks	(9)	(7)
	(35)	**(32)**
Net fee and commission income	**2,279**	**1,959**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

8. NET GAIN ON FOREIGN EXCHANGE DEALS

	2016	2015
Net gain on dealing in foreign currencies	483	277
Net loss on foreign currency swap transactions and revaluation	219	(43)
Net gain on foreign currency translation of assets and liabilities	58	195
	760	**429**

9. NET GAIN/ (LOSS) ON AVAILABLE-FOR-SALE SECURITIES

	2016	2015
Net gain on dealing in available-for-sale securities, incl. revaluation reserve realised	20	3
Impairment of available-for-sale financial assets	-	(43)
	20	**(40)**

10. NET GAIN ON HELD-FOR-TRADING FINANCIAL INSTRUMENTS

	2016	2015
Interest income from financial instruments held for trading	-	737
Interest expense on financial instruments held for trading	(267)	(560)
Net gain on revaluation of held-for-trading financial instruments	312	132
	45	**309**

11A. OTHER OPERATING INCOME

	2016	2015
Dividends received	983	1,202
Income from rent of investment property	836	333
Refunded litigation expenses	309	1,356
Proceeds from disposal of assets held for sale	150	56
Proceeds from disposal of FTA	38	67
Other income	153	135
	2,469	**3,149**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

11B. OTHER OPERATING EXPENSES

	2016	2015
Expenses on assets held for sale	(301)	(315)
Litigation expenses	(579)	(267)
Loss on revaluation of investment property	(240)	(335)
Withholding tax	(28)	(12)
Direct operating expenses relating to investment property	(168)	(27)
Expenses on disposal of FTA	(33)	(58)
Other expenses	(486)	-
	(1,835)	**(1,014)**

12. INCOME FROM REVERSED IMPAIRMENT LOSSES AND PROVISIONS

	2016	2015
Expenses / Income on / from reversed impairment losses on individually impaired assets, net	(10,692)	1,797
(Income / (Expenses) from / on reversed impairment of loans relating to common credit risk on portfolio basis, net	15,800	(232)
Expenses / (Income on / from reversed) guarantee provisions, net	(1,542)	458
Expenses on impairment of assets acquired from collateral foreclosure	(419)	(47)
	3,147	**1,976**

The movement in the balance sheet accumulated expenses on impairment and provisions is disclosed in Notes 18B and 33A.

13A. COSTS OF PERSONNEL

	2016	2015
Staff remuneration and social security	(7,213)	(6,851)
Remuneration to members of the Management and Supervisory Boards	(1,169)	(1,691)
	(8,382)	**(8,542)**

	2016	2015
Personnel costs consist of:		
Salaries	(6,218)	(5,900)
Social security	(845)	(814)
Social benefits	(96)	(88)
Amounts accrued on retirement benefits	(54)	(49)
	(7,213)	**(6,851)**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

13Б. GENERAL AND ADMINISTRATIVE EXPENSES

	2016	2015
Contribution to the Fund for Orderly Bank Restructuring	(3,814)	(3,073)
Contribution to the Deposit Insurance Fund	(36)	(2,004)
Rents	(811)	(978)
Communications and IT services	(508)	(633)
Office and office equipment maintenance	(536)	(474)
Legal and consulting services	(479)	(405)
Advertising and entertainment expenses	(333)	(364)
Taxes and government charges	(139)	(152)
Hired services	(131)	(108)
Advisory services by the registered audit firm	(12)	(99)
Business trips	(68)	(77)
Audit services by the registered audit firm	(79)	(75)
	(6,946)	**(8,442)**

14. TAXATION

	2016	2015
Current tax expense	5,204	4,141
Deferred tax (benefit)/expense due to temporary differences	(540)	(71)
Total tax expense	**4,664**	**4,070**

	2016	2015
Accounting profit	47,584	41,835
Income tax calculated at the effective tax rate (10 per cent for 2016, 10 per cent for 2015)	4,758	4,184
Expense on non-deductible expenses	4	7
Non-deductible income	(98)	(121)
Total tax expense	**4,664**	**4,070**
Effective tax rate	**9.80%**	**9.73%**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

14. TAXATION (continued)

Outstanding balances of deferred taxes relate to the following items of the separate statement of financial position and changes in the separate statement of comprehensive income:

	Assets		Liabilities		
	2016	**2015**	**2016**	**2015**	**Changes in the statement of comprehensive income**
Property and equipment	(14)	(11)	-	-	(3)
Other assets	(479)	(437)	-	-	(42)
Investment property	(57)	(33)	-	-	(24)
Guarantee portfolio	26	(147)	-	-	173
Other liabilities	(48)	(48)	-	-	-
Available-for-sale securities	(693)	(49)	-	-	(644)
	(1,265)	**(725)**	**-**	**-**	**(540)**

The changes in the temporary differences during the year are recognised in the separate statement of comprehensive income.

The probability that the individual differences might reverse in the future and the Bank's ability to generate sufficient taxable profit have also been taken into account on recognising deferred tax assets.

15. NET CHANGE IN THE FAIR VALUE OF AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2016	**2015**
Change in the fair value of available-for-sale financial assets		
Gains on revaluation of available-for-sale assets, which have occurred during the year	2,903	615
Income recycling	-	(20)
Other comprehensive income for the year	**2,903**	**595**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

16. CASH IN HAND AND BALANCES IN CURRENT ACCOUNT WITH THE CENTRAL BANK

	2016	2015
Cash in hand	120	87
Current accounts	78,401	343,719
Incl. Minimum statutory reserves	*76,551*	*78,406*
Reserve Security Fund	-	47
Total cash with the Central Bank	**78,401**	**343,766**
Total cash in hand and in accounts with the Central Bank	**78,521**	**343,853**

Deposits with the Central Bank are interest-free (2015: similarly).

17. RECEIVABLES FROM BANKS

	2016	2015
Current accounts and demand deposits with local banks	189	200
Current accounts and demand deposits with foreign banks	13,570	10,682
Term deposits with local banks (incl. repo deals)	86,490	62,604
Term deposits with foreign banks (incl. repo deals)	24,102	34,656
Loans to local banks	135,574	135,607
Loans to foreign banks	14,086	6,111
	274,011	249,860

At 31 December 2016 special-purpose loans, denominated and BGN and EUR, with original maturity of up to 10 years and interest rate levels ranging from 1.49 per cent to 4.40 per cent, were extended to local banks with the aim to develop small and medium-sized enterprises. (2015:1.69% up to 5%).

Funds amounting to BGN 9,770 thousand were blocked to cover letters of credit (2015: BGN 7,468 thousand).

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

18. LOANS AND ADVANCES TO CUSTOMERS

	2016	2015
Loans (gross amount)	863,888	779,591
Allowance for impairment and uncollectability of loans	(141,144)	(145,914)
	722,744	**633,677**

	2016	2015
A. Analysis by customer type		
Corporate and sole traders	858,784	769,856
Municipalities	1,327	6,230
Individuals	3,777	3,505
	863,888	**779,591**

		2015
B. Analysis by industry sector depending on the purpose of the loan		
Industry, total	316,989	362,852
Industry – energy generation and distribution	*103,520*	*132,365*
Industry – manufacture of foodstuffs	*60,962*	*56,110*
Industry – other industries	*55,705*	*112,258*
Industry – manufacture of tobacco products	*55,675*	*50,510*
Industry – manufacture of plant and equipment	*41,127*	*11,609*
Construction	136,626	110,938
Transport	107,192	55,485
Financial services	55,926	65,139
Trade	53,994	48,241
Administrative and office activities	48,816	-
Real estate transactions	41,829	60,969
Government sector	31,144	6,230
Agriculture	26,474	14,569
Tourist services	17,573	21,772
Other industries	14,723	15,925
Collection and disposal of garbage	12,602	17,471
	863,888	**779,591**

The Bank finance mainly the activities of small and medium-sized enterprises, as well as investment projects to achieve return from 5 to 10 years.

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

18. LOANS AND ADVANCES TO CUSTOMERS (continued)

C. Movement in the allowance for loan impairment and uncollectability

	2016			2015		
	Individually impaired	Collectively impaired	Total	Individually impaired	Collectively impaired	Total
At 1 January	**130,114**	**15,800**	**145,914**	**99,677**	**15,568**	**115,245**
Sectorial reclassification of a customer (*)	-	-	-	42,533	-	42,533
Net change for the year	10,692	(15,800)	**(5,108)**	(1,797)	232	(1,565)
Written-off against impairment	338	-	**338**	(10,299)	-	(10,299)
At 31 December	**141,144**	**-**	**141,144**	**130,114**	**15,800**	**145,914**

19. RECEIVABLES FROM THE STATE BUDGET

	2016	2015
Acquired receivables	26,902	20,037
Energy Efficiency Program	397,568	9,848
	424,470	**29,885**

At 31 December 2016 (and at 31 December 2015 as well) the receivables classified as Receivables from the State budget – Acquired receivables represent receivables originating from assignment contracts with debtors - secondary budget spending units.

By Decree No. 18 of 2 February 2015, the Council of Ministers of the Republic of Bulgaria approved National Programme for Energy Efficiency of Multi-Family Residential Buildings (the Programme) on the terms and conditions for grants award under the Programme and for designating the bodies that will be in charge of its implementation.

The financing under the Programme goes through BDB. For the purpose, the Bank concludes trilateral agreements with regional governors (representatives of the State) and municipal mayors (authorized representatives of the owners' associations).

The Bank is of the opinion that the existing receivables bear a minimal credit risk in so far as the source of the payments is the budget of the Republic of Bulgaria. The resources attracted by international partners for the purpose of financing the Programme is covered by a State guarantee (see Note 30).

Funds utilised under the Program as of 31 December 2016 amounted to BGN 397,568 thousand (at 31 December 2015: BGN 9,848 thousand).

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

20. SECURITIES HELD TO MATURITY

	2016	2015
Corporate bonds of financial entities	1,384	1,979
	1,384	**1,979**

The corporate bonds of financial entities comprise bonds issued by a Bulgarian entity, denominated in EUR, with nominal amount of EUR 1,000 thousand.

21. AVAILABLE-FOR-SALE SECURITIES

	2016	2015
Government securities	248,634	214,482
Corporate bonds	12,846	3,054
Non-public companies' shares	2,643	2,484
Participation in the SIA investment program (note 36)	232	152
Public companies' shares	13	8
	264,368	**220,180**

Movement in available-for-sale securities

	2016	2015
At 1 January	220,180	274,698
Additions (purchases)	156,382	358,233
Disposals (sale and/or maturity)	(115,097)	(413,346)
Net increase due to revaluation of available-for-sale securities to fair value	2,903	595
At 31 December	**264,368**	**220,180**

The non-public companies' shares held by the Bank include shares of the European Investment Fund (EIF) amounting to BGN 2,505 thousand. The portion of the nominal value of the acquired shares of EIF, which has not been paid, is due after a decision is taken by the General Meeting of Shareholders of EIF (Note 36).

The remaining portion of the non-public companies' shares amounting to BGN 138 thousand represent shares of the company licensed as a payment system operator under the Bulgarian law – BORICA - Bankservice AD. Only banks can be shareholders of this company and they acquire shares following a specific procedure; the share price is determined using a formula specified in the company's Statute. These shares are presented at cost (acquisition price) due to fact that at the reporting date there is no sufficiently reliable public information to determine an actual fair value of these shares.

The revaluation reserve formed on available-for-sale financial assets as of 31 December 2016 amounts to BGN 3,481 thousand – positive value (31 December 2015: BGN 578 thousand - positive value) (Note 35).

In 2016 there was no allowance for impairment of available-for-sale securities transferred to and reported on the consolidated statement of comprehensive income (Note 9) (2015: BGN 43 thousand.)

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

22. HELD-FOR-TRADING FINANCIAL ASSETS/LIABILITIES

	Agreed/Contingent amount	Fair value at 31 December 2016		Agreed/Contingent amount	Fair value at 31 December 2015	
		Assets	Liabilities		Assets	Liabilities
Interest rate swaps	-	-	-	9,779	-	362
Currency swaps	-	-	-	21,786	305	-
	-	-	-	**31,565**	**305**	**362**

Financial assets and liabilities held for trading include out-of-counter derivative financial instruments – interest rate swaps and currency swaps. In 2016 and 2015 the Bank did not designate derivatives as hedging instruments in accordance with the requirements of IAS 39.

23. INVESTMENTS IN SUBSIDIARIES

The Bank is a sole owner of the capital of National Guarantee Fund EAD, registered with the Commercial Register on 22 August 2008. The total registered share capital at 31 December 2016 consists of 800,000 shares of BGN 100 each (31 December 2015: 800,000 shares of BGN 100 per share). The registered capital at 31 December 2016 amounts to BGN 80,000 thousand (31 December 2015: BGN 80,000 thousand). The investment in the subsidiary at 31 December 2016 amounts to BGN 80,000 thousand (31 December 2015: BGN 80,000 thousand), measured at historical cost of acquisition.

The Bank is a sole owner of the capital of Micro Financing Institution Jobs, registered on 14 January 2011. The total registered share capital at 31 December 2016 amounts to BGN 7,643 thousand, split into 76,430 shares of BGN 100 each. The investment in the subsidiary at 31 December 2016 amounts to BGN 7,643 thousand (31 December 2015: BGN 7,643 thousand), measured at historical cost of acquisition.

At 31 December 2016 management conducted a review for impairment of the investments in subsidiaries and found that there were no indications of impairment.

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

24. PROPERTY, PLANT AND EQUIPMENT, INTANGIBLE ASSETS

	Land and buildings	Bank equipment and computers	Fixtures and fittings	Motor vehicles	Licences and software	Total
Book value						
As of 1 January 2015	**20,043**	**1,084**	**292**	**343**	**854**	**22,616**
Additions	4,112	327	1	57	-	4,497
Disposals	-	(9)	-	(66)	-	(75)
As of 31 December 2015	**24,155**	**1,402**	**293**	**334**	**854**	**27,038**
Additions	8,398	789	317	-	217	9,721
Disposals	-	(77)	(7)	(43)	-	(127)
As of 31 December 2016	**32,553**	**2,114**	**603**	**291**	**1,071**	**36,632**
Accumulated depreciation						
As of 1 January 2015	**512**	**677**	**206**	**21**	**573**	**1,989**
Charge for the year	37	184	27	61	201	510
Disposals	-	(11)	-	(5)	-	(16)
As of 31 December 2015	**549**	**850**	**233**	**77**	**774**	**2,483**
Charge for the year	172	219	25	58	71	545
Disposals	-	(76)	(6)	(12)	-	(94)
As of 31 December 2016	**721**	**993**	**252**	**123**	**845**	**2,934**
Net book value						
As of 31 December 2016	**31,832**	**1,121**	**351**	**168**	**226**	**33,698**
As of 31 December 2015	**23,606**	**552**	**60**	**257**	**80**	**24,555**
At 1 January 2015	**19,531**	**407**	**86**	**322**	**281**	**20,627**

The land and buildings amounting to BGN 8.398 thousand acquired in 2016 (2015: BGN 4,112 thousand) comprise FTAs in progress relating to the construction and development of a building owned by the Bank located at 1 Dyakon Ignatii Street, Sofia.

The fully depreciated property, plant and equipment still in use at 31 December 2016 amounts to BGN 427 thousand at cost (2015: BGN 474 thousand) and intangible assets amount to BGN 640 thousand (2015: BGN 628 thousand) respectively.

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

25. INVESTMENT PROPERTY

	2016	2015
Carrying amount at the beginning of period	7,744	-
Reclassified from held for sale	251	3,095
Reclassified from other assets	-	4,984
Sold	(53)	-
Loss on change in the fair value included in profit and loss for the period	(240)	(335)
	7,702	7,744

The Bank holds investment properties as a result of collateral acquired on problem loans. They are leased to third parties. Rental income generated for 2016 amounts to BGN 836 thousand (2015: BGN 333 thousand) (Note 11). The fair value at 31 December 2016 has been determined by an independent certified appraiser.

The Bank classifies its investment property in Level 3 of the fair value hierarchy. The fair value has been determined on the basis of the valuation calculated by independent certified appraisers by employing valuation techniques and key inputs for the valuation of the investment property disclosed in Note 5.

26. ASSETS, HELD FOR SALE

Properties (land, buildings and fixtures and fittings) at 31 December 2016 amounting to BGN 4,657 thousand (2015: BGN 8,712 thousand – land, buildings and fixtures and fittings) were acquired by the Bank in 2016 against payment of liabilities under problem loans of borrowers.

The assets have not been used and it is not planned to be used in the Bank's activity. Management actively seeks buyers with the purpose to sell them by the end of 2017.

Movement in assets held for sale in 2016 and 2015:	2016	2015
Carrying amount at the beginning of period	8,712	1,122
Acquired from collateral foreclosure	4,699	11,773
Reclassified to assets acquired from collateral foreclosure	(7,113)	(1,088)
Reclassified to investment property	(251)	(3,095)
Sold	(1,390)	-
Impaired	-	-
	4,657	8,712

27. OTHER ASSETS И ASSETS, ACQUIRED FROM COLLATERAL FORECLOSURE

	2016	2015
Assets acquired from collateral foreclosure	11,372	4,714
Other receivables	47	103
VAT refundable	-	373
Prepayments and advances	103	246
	11,522	5,436

Assets acquired from collateral foreclosure include assets classified as held for sale (acquired from collateral foreclosure), but not realised within the stipulated 12-month period and reclassified to assets acquired from collateral foreclosure. These assets are valued at the lower of cost and net realisable value.

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

27. OTHER ASSETS (continued)

Movement in assets acquired from collateral foreclosure in 2016 and 2015:	2016	2015
Carrying amount at the beginning of period	4,714	8,708
Reclassified from held for sale	7,113	1,088
Reclassified to investment property	-	(4,984)
Sold	(36)	(51)
Impairment	(419)	(47)
Carrying amount at the end of period	**11,372**	**4,714**

28. DEPOSITS FROM CREDIT INSTITUTIONS

	2016	2015
Deposits from local banks	42,157	413
Deposits from foreign banks	1,580	429
	43,737	**842**

Interest payable on deposits from credit institutions at 31 December 2016 amounts to BGN 1 thousand (2015: BGN 1 thousand).

	2016	2015
Term deposits	39,576	-
Demand deposits	4,161	842
	43,737	**842**

29. DEPOSITS FROM CUSTOMERS OTHER THAN CREDIT INSTITUTIONS

	2016	2015
Individuals	4,641	5,147
Companies and sole traders	609,748	594,152
Special-purpose deposits	95,160	95,781
	709,549	**695,080**

Interest payable on deposits from other customers, other than credit institutions, at 31 December 2016 amounts to BGN 659 thousand (2015: BGN 261 thousand).

The amount of the special-purpose deposits comprises the deposits of National Guarantee Fund EAD, a subsidiary of BDB, in connection with projects for establishing a Guarantee Fund to support rural areas of the country under the Rural Development Programme of the Republic of Bulgaria (2007-2013) at the Ministry of Agriculture and Food, and of the Operational Programme for Development of Fisheries Sector (2007-2013) at the Executive Agency Fisheries and Aquacultures (EAFA).

	2016	2015
Term deposits	592,689	507,838
Demand deposits	116,860	187,242
	709,549	**695,080**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

30. BORROWINGS FROM INTERNATIONAL INSTITUTIONS

	2016	2015
Long-term frame loan agreement with the Council of Europe Development Bank	128,152	47,730
Long-term loans from European Investment Bank	146,723	38,544
Long-term loans from the Nordic investment bank	22,014	28,664
Long-term loans from the Kreditanstalt für Wiederaufbau	23,038	28,817
Long-term loan from Black Sea Trade and Development Bank	-	12,035
Sumitomo Mitsui Banking Corporation Europe	4,315	7,795
Long-term loan from Dexia Credit Local	1,951	5,851
Long-term loan from DEPFA Investment Bank - Fms Wertmanagement Aor	1,384	4,147
Long-term loans from JBIC Japan Bank for International Cooperation	3,278	5,140
European Investment Fund	9,823	-
Industrial and Commercial Bank of China	39,320	-
	379,998	**178,723**

Interest payable on borrowings from international institutions at 31 December 2016 amount to BGN 489 thousand (2015: BGN 338 thousand). Effective interest rates on borrowings from international institutions at 31 December 2016 vary from 0.099 per cent to 3.39 per cent (31 December 2015: from 0.27 per cent to 3.39 per cent).

Council of Europe Development Bank

On 2 January 2003 between the Council of Europe Development Bank (CEB), the Republic of Bulgaria represented by the Minister of Finance and Encouragement Bank AD (being at present Bulgarian Development Bank AD) were signed two Framework Loan Agreements for EUR 10,000 thousand and EUR 5,000 thousand for financing of micro, small and medium-sized enterprises in Bulgaria. The loan agreement amounting to EUR 10,000 thousand is secured by a State guarantee provided by the Republic of Bulgaria. As of 31 December 2015 the loans from the year 2003 were fully repaid.

On 18 November 2009 a third Loan agreement was signed between Bulgarian Development Bank AD and the Council of Europe Development Bank (CEB) for EUR 15,000 thousand. The purpose of the loan is to finance investment projects of micro-, small and medium-sized enterprises from the real sector with the aim to open new and to preserve already existing jobs. The loan is unsecured. As of 31 December 2016 the loan was fully utilised and the outstanding principal under the facility amounted to EUR 7,500 thousand equivalent to BGN 14,669 thousand (31 December 2015: EUR 9,375 thousand equivalent to BGN 18,336 thousand). The interest rate is floating, based on the 3-month EURIBOR plus margin.

On 30 March 2011 a fourth Loan Agreement was signed between Bulgarian Development Bank AD and the Council of Europe Development Bank for EUR 20,000 thousand. The purpose of the loan is to improve the access to financing of the Bulgarian small and medium-sized enterprises, to open new jobs, and to preserve already existing jobs. The loan is unsecured. As of 31 December 2016 the loan was fully utilised and the outstanding principal under the facility amounted to EUR 13,000 thousand equivalent to BGN 25,426 thousand (31 December 2015: EUR 15,000 thousand equivalent to BGN 29,337 thousand). The interest rate on the first tranche is floating, based on the 3-month EURIBOR plus margin, and on the second tranche it is fixed.

On 23 February 2016 Bulgarian Development Bank signed a Contract with the Council of Europe Development Bank (CEB) amounting to EUR 150,000 thousand. The funds will be used to finance energy efficiency measures and requires structural measures within the National Energy Efficiency Programme. The loan is a specific purpose loan and will be used for renovation of multi-family buildings. The term of repayment of the loan is up to 10 years. The loan is secured by a State guarantee, which is provided on the grounds of the Public Debt Act for 2016. A Guarantee Agreement was signed between CEB and the Ministry of Finance, which was ratified by the National Assembly. The Guarantee Agreement Ratification Act was promulgated in State Gazette on 3 May 2016.

30. BORROWINGS FROM INTERNATIONAL INSTITUTIONS (continued)

European Investment Bank

On 4/6 October 2000 the Bank signed a financial contract (Global Loan Bulgaria – Encouragement Bank) with the European Investment Bank for EUR 10,000 thousand for financing of small and medium sized enterprises. The loan is based on an Agreement between European Investment Bank and Republic of Bulgaria signed on 14 July 1997. The loan is secured by a State guarantee issued by the Republic of Bulgaria. At 31 December 2016 the loan was fully repaid.

On 30 December 2009 a second finance contract was signed between Bulgarian Development Bank and EIB for EUR 25,000 thousand for financing of SMEs and priority projects in the fields of infrastructure, energy, environmental protection, industry, health and education. The loan is unsecured and has been fully utilised. The loan was fully repaid at 31 December 2016 (at 31 December 2015: EUR 19,706 thousand equivalent to BGN 38,541 thousand).

On 18 November 2016 BDB signed a third contract with European Investment Bank for the amount of EUR 150,000 thousand for financing projects of small and medium-sized enterprises. The funds are provided with the support of EU through a guarantee issued by EFSI (European Fund for Strategic Investment), part of the Investment Plan for Europe – the Juncker Plan. This is the first contract signed under the Plan, which is provided by the EIB in Bulgaria. The loan term, including a grace period, is set for each individual tranche. The funds will be used to finance SMEs, including innovative projects, to support regions with high unemployment rates, as well as a part of the youth employment initiative or for start-up company projects. The loan will be allocated through partner banks, other financial intermediaries or directly. The loan is unsecured. At 31 December 2016, the principal due on the loan amounted to EUR 75,000 thousand, or BGN equivalent to BGN 146,687 thousand (funds were not utilized from the loan as at 31 December 2015). The interest rate is floating, based on the 6-month EURIBOR plus margin.

Kreditanstalt für Wiederaufbau

On 27 July 2010 Bulgarian Development Bank AD signed a direct loan agreement for EUR 25,000 thousand with the German Development Bank Kreditanstalt für Wiederaufbau. The financial resource is intended for direct lending to small and medium sized enterprises and/or for providing credit lines to commercial banks for special-purpose financing for the business. The loan is unsecured. At 31 December 2016 the loan was fully utilised, and the outstanding principal under the facility amounted to EUR 11,765 thousand equivalent to BGN 23,010 thousand (at 31 December 2015 the outstanding principal amounted to EUR 14,706 thousand equivalent to BGN 28,762 thousand). The interest rate is floating, based on the 6-month EURIBOR plus margin.

On 16 August 2016 Bulgarian Development Bank signed a Contract with KfW for EUR 100,000 thousand. The funds will be used to finance energy efficiency measures and requires structural measures within the National Energy Efficiency Programme. The loan is secured by a State guarantee, in accordance with the Public Debt Act and a Guarantee Agreement signed between KfW and the Ministry of Finance. The Guarantee Agreement between KfW and the Ministry of Finance was ratified by the National Assembly. The Guarantee Agreement Ratification Act was promulgated in State Gazette on 30 December 2016. The interest rate is floating, based on the 6M Euribor plus margin. The term of repayment of the loan is up to 7 years, with a grace period of 2 years. At 31 December 2016 the loan facility was not utilised.

Nordic Investment Bank

On 16 November 2004 a Loan Agreement was signed with the Nordic Investment Bank for a credit facility amounting to EUR 10,000 thousand for financing of projects of small and medium-sized enterprises, which are of mutual interest for Bulgaria and the Nordic Investment Bank member states. The Loan is secured by a Letter of Intent. At 31 December 2016 the loan was fully utilised, and the outstanding principal under the facility amounted to EUR 0,471 thousand equivalent to BGN 0,920 thousand (31 December 2015: EUR 1,529 thousand equivalent to BGN 2,991 thousand). The interest rate is floating, based on 6-month EURIBOR plus margin.

On 15 December 2010 a second credit line was signed between the Nordic Investment Bank and Bulgarian Development Bank AD for EUR 20,000 thousand. The funds are intended for financing of renewable energy projects or ecological projects; projects involving the Nordic Investment Bank member states, as well as indirect financing through commercial bank-partners. The loan is unsecured. At 31 December 2016 the loan was fully utilised, and the outstanding principal under the facility amounted to EUR 10,842 thousand equivalent to BGN 21,205 thousand (31 December 2015: EUR 13,195 thousand equivalent to BGN 25,807 thousand). The interest rate is floating, based on 6-month EURIBOR plus margin.

30. BORROWINGS FROM INTERNATIONAL INSTITUTIONS (continued)

Black Sea Trade and Development Bank (BSTDB)

On 9 October 2009 Bulgarian Development Bank AD and Black Sea Trade and Development Bank signed a Loan Agreement for EUR 8,000 thousand. The resources are intended for financing of Bulgarian small and medium-sized enterprises. The loan is unsecured. As of 31 December 2016 the loan was fully repaid.

On 9 September 2011 a second Loan Agreement was signed between Bulgarian Development Bank AD and Black Sea Trade And Development Bank for EUR 31,000 thousand. The loan is intended for financing of investment projects, working capital, export and pre-export financing of SMEs. The loan is unsecured. At 31 December 2016 the loan was fully repaid (31 December 2015: the outstanding principal under the facility amounted to EUR 6,200 thousand equivalent to BGN 12,126 thousand).

Sumitomo Mitsui Banking Corporation Europe

On 11 November 2014 BDB signed a new agreement with Sumitomo Mitsui Banking Corporation Europe for trade financing, which enables the financing of commercial transactions and letters of credit, including export deals, with a term of up to 12 months. The agreement is for EUR 10,000 thousand. At 31 December 2016 the loan liability amounted to EUR 2,200 thousand equivalent to BGN 4,303 thousand (at 31 December 2015: the loan liability amounted to EUR 3,969 equivalent to BGN 7,762 thousand). The interest rate is floating, based on EURIBOR plus margin.

Dexia Credit Local

On 23 May 2007 the Bank signed a Loan agreement with DEXIA Kommunalkredit Bank (as of 12 July 2013 - Dexia Credit Local) for EUR 10,000 thousand. The loan is intended for financing of investment projects of small and medium-sized enterprises in Bulgaria. As of 31 December 2016 the loan was fully utilised. The loan is secured by a Letter of Intent, signed by the Minister of Finance. As of 31 December 2016 the outstanding principal under the loan amounted to EUR 1,000 thousand equivalent to BGN 1,956 thousand (31 December 2015: EUR 3,000 thousand equivalent to BGN 5,867 thousand). The interest rate is floating, on the basis of 3-month EURIBOR plus margin.

DEPFA Investment Bank - Fms Wertmanagement Aor

On 18 May 2007 an Agreement was signed with DEPFA Investment Bank (as of 23 September 2011 - Fms Wertmanagement Aor) for EUR 15,000 thousand for general corporate purposes. The loan is unsecured. As of 31 December 2016 the loan was fully utilised and the outstanding principal under the loan amounted to EUR 0,714 thousand equivalent to BGN 1,397 thousand (31 December 2015: EUR 2,143 thousand equivalent to BGN 4,191 thousand). The interest rate is floating, on the basis of 6-month EURIBOR plus margin.

Japan Bank for International Cooperation (JBIC)

On 17 December 2009 a Loan agreement was signed between Bulgarian Development Bank AD and Japan Bank for International Cooperation for EUR 20,000 thousand. The loan is intended for financing of Japanese projects and can be utilised both in EUR and in JPY. For a loan in EUR the applicable interest rate will be formed as fixed (CIRR plus risk margin) for 60 per cent of the amount and floating (6-month EURIBOR + margin) for the rest 40 per cent of the amount. For a loan in JPY the applicable interest rate is fixed (CIRR plus risk margin). The loan is unsecured. The utilised amount under the loan is JPY 1,122,594 thousand equivalent to BGN 19,812 thousand. As of 31 December 2016 the outstanding principal under the loan amounted to JPY 210,475 thousand equivalent to BGN 3,336 thousand (31 December 2015: JPY 350,801 thousand equivalent to BGN 5,211 thousand).

Hungarian EXIM Bank

On 29 May 2013 a credit line agreement was signed between Bulgarian Development Bank AD and Hungarian EXIM Bank for EUR 10,000 thousand (BGN 19,558 thousand). Every commercial transaction under the agreement will be provided for a period of 2 to 5 years. The funds will be used for financing of imports of Hungarian goods in Bulgaria. The interest rate is fixed (CIRR + margin). As of 31 December 2016 the credit line facility was not utilised.

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

30. BORROWINGS FROM INTERNATIONAL INSTITUTIONS (continued)

Progress Program of the European Investment Fund

On 24 July 2015 a loan agreement was signed between Bulgarian Development Bank AD and the Progress Program of EIF for EUR 5,000 thousand (BGN 9,779 thousand). The loan is intended to finance micro-leases and micro-loans for micro and small enterprises, as well as for financing of micro-loans through financial institutions. This Program is directed to companies with up to 10 employees and assets amounting up to EUR 2 million (BGN 3,912 thousand). Eligible beneficiaries are also self-employed persons, start-ups, or persons experiencing difficulties in obtaining financing. At 31 December 2016 the loan principal due amounted to EUR 5,000 thousand equivalent to BGN 9,779 thousand (31 December 2015, the loan facility was not utilised). The loan bears a fixed interest rate.

Industrial and Commercial Bank of China (ICBC)

On 22 February 2016 BDB signed an inter-bank loan agreement with ICBC for the amount of EUR 20,000 thousand. The funds are intended to support the general lending activity of BDB, direct financing of business or for creating on-lending programmes through commercial banks to support investment projects and provide working capital. The term of the loan is two years. At 31 December 2016 the loan was fully utilized.

At 31 December 2016, the loan liability amounted to EUR 20,000 thousand equivalent to BGN 39,117 thousand (at 31 December 2015 the loan facility was not utilised). The interest rate is floating based on the 6-month EURIBOR plus margin. The loan is unsecured.

31. OTHER BORROWINGS

	2016	2015
Loan financing from the Ministry of Finance with funds from KfW	11,236	11,226
KfW funds provided by the Ministry of Finance for trust management	6,443	6,630
Loans from local banks	-	9,807
	17,679	27,663

Interest liabilities accrued on other borrowings at 31 December 2016: Nil (2015: BGN 28 thousand).

Loan financing from the Ministry of Finance with funds from KfW

On 18 April 2007 the Bank concluded a loan agreement with the Government of the Republic of Bulgaria, represented by the Minister of Finance. This agreement is based on the Treaty between Bulgaria and Germany for financial collaboration from year 2001 and an agreement between the Republic of Bulgaria and Kreditanstalt für Wiederaufbau (KfW). By virtue of this agreement, the amount of EUR 4,929 thousand (BGN 9,640 thousand) is granted to the Bank designated as Project Provider for the purpose of financing micro, small and medium-sized enterprises. The term of the agreement is 10 years as from the date of fund receipt, while the latter along with the due interest is repaid bullet at the end of the period. As of 31 December 2016 the outstanding principal and the capitalised interest amounted to EUR 5,745 thousand equivalent to BGN 11,236 thousand (as of 31 December 2015: EUR 5,739 thousand equivalent to BGN 11,225 thousand). The loan interest is capitalised quarterly and is based on 3-month EURIBOR plus margin.

KfW funds provided by the Ministry of Finance for trust management

The Bank concluded an agreement with the Ministry of Finance (MF) for management of funds granted by Kreditanstalt fur Wiederaufbau (KfW) pursuant to an agreement between the Governments of Bulgaria and Germany. These funds are provided for the purpose of financing small and medium-sized enterprises. The Ministry of Finance bears the risk for the advanced provided to the banks - intermediaries. The Bank selects the banks and transfers the funds to those approved; gathers information and performs periodic reviews regarding the funds utilisation, and monitors the timely payments of the interest and principal due and their repayment to the special account of the Ministry of Finance. As of 31 December 2016 the balance of the loan with the Bank amounts to EUR 3,294 thousand equivalent to BGN 6,443 thousand (31 December 2015: EUR 3,390 thousand equivalent to BGN 6,629 thousand).

The Bank receives a management fee and accrued interest on the special account of the Fund on quarterly basis.

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

31. OTHER BORROWINGS (continued)

Loans from local banks

On 16 September 2011 Bulgarian Development Bank AD signed a mid-term loan agreement with Citibank N.A. – Sofia Branch (from 1 January 2014 Citibank Europe AD, Bulgaria Branch) amounting to EUR 20,000 thousand. The purpose of these funds is to finance directly or indirectly new and existing loan portfolios of small and mid-sized enterprises. The loan is unsecured. At 31 December 2016 the loan was fully utilised. At 31 December 2016 the loan was fully repaid (31 December 2015: EUR 5,000 thousand equivalent to BGN 9,779 thousand).

32. PROVISIONS

	2016	2015
Bank guarantee provisions	3,145	1,468
Litigation provisions	174	174
	3,319	**1,642**

Bank guarantee provisions consist of the amounts the Bank estimates as highly probable to be required to be actually paid to third parties. Out of them, BGN 1, 045 thousand (2015: BGN 1,468 thousand) relates to bank guarantees on "Guarantee Fund for Micro Lending" project of MLSP is, and BGN 2,100 thousand relates to individual guarantees issued (2015: Nil).

Litigation provisions relate to future payments under lawsuits relating to labour disputes.

The table below presents the movements in the guarantee provisions:

	2016	2014
Balance at 1 January	1,468	1,941
Charged over the year (Note 12)	2,140	388
Utilised over the year	135	(15)
Reversed over the year (Note 12)	(598)	(846)
Balance at 31 December	**3,145**	**1,468**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

33. OTHER LIABILITIES

	2016	2015
Payables to personnel for salaries and social security	269	233
Retirement benefit liabilities	229	198
Charges on debenture loans and guarantees	357	491
Tax liabilities	121	116
Accruals for expenses	115	109
Other creditors	32	34
	1,123	**1,181**

Payables to personnel for salaries and social security contributions comprise accruals on compensated absences and social security contributions due thereon.

Employee retirement benefits are due by the Bank to employees reaching retirement age and are stated at their present value.

In accordance with the Labour Code each employee is entitled to indemnity on retirement amounting to two gross monthly salaries, and if he / she has worked for more than 10 years for the Bank – to six gross monthly salaries at the time of retirement. The Bank estimated the amount of these liabilities by using mathematical models and the services of a certified actuary. On the basis of the calculations made, the amount of BGN 229 thousand was included in the separate statement of financial position at 31 December 2016 (31 December 2015: BGN 198 thousand).

	2016	2015
Present value of the liability at 1 January	**198**	**178**
Current service cost	44	34
Interest expense	7	7
Amounts paid in the period	-	(36)
Actuarial (gains)/losses from changes in demographic and financial assumptions and actual experience	(20)	15
Present value of the liability at 31 December	**229**	**198**

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

33. OTHER LIABILITIES (continued)

	Amounts on retirement for old age and length of service		Amounts on retirements due to illness		Total	
	2016	**2015**	**2016**	**2015**	**2016**	**2015**
Actuarial gain/(loss) at 1 January	(1)	6	-	-	(1)	6
Actuarial gain / (loss) recognized in other comprehensive income for the period	23	(7)	-	-	23	(7)
Actuarial gain/(loss) at 31 December	22	(1)	-	-	22	(1)

The following actuarial assumptions are used in calculating the present value of the liabilities as of 31 December 2016:

- mortality rate – in accordance with the table prepared on the basis of statistics issued by the National Statistical Institute for the total mortality rate of the population in Bulgaria for the period 2013 – 2015;
- staff turnover rate – from 0 per cent to 10 per cent depending of five age groups formed;
- rate of early retirement due to illness – from 0.027 per cent to 0.3212 per cent depending of five age groups formed;
- effective annual interest rate for discounting – 2.5 per cent (2015 – 2.8 per cent);
- assumptions for the future level of working salaries in the Bank are based on the Bank's development plan for 2016 – 5 per cent compared to the 2016 level and for 2017 and subsequent years – 5 per cent compared to the previous year level.

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

33. OTHER LIABILITIES (continued)

The effect for 2016 of the increase and decrease by 1 per cent of the salary growth and the interest rate on the total amount of current service costs and interest, and on the present value of the liability for payment of defined benefits upon retirement, are as follows:

	Increase by 1% of salary growth	Decrease by 1% of salary growth
Change in the interest and current service costs ("+"- increase, "–"- decrease)	8	(7)
Change in the present value of the liability as of 31 December 2016 ("+"- increase, "–"- decrease)	34	(28)

	Increase by 1% of interest rate	Decrease by 1% of interest rate
Change in the interest and current service costs ("+"- increase, "–"- decrease)	(5)	6
Change in the present value of the liability as of 31 December 2016 ("+"- increase, "–"- decrease)	(29)	35

	Increase by 1% of staff turnover rate	Decrease by 1% of staff turnover rate
Change in the interest and current service costs ("+"- increase, "–"- decrease)	(8)	10
Change in the present value of the liability as of 31 December 2016 ("+"- increase, "–"- decrease)	(30)	37

The effect for 2015 of the increase and decrease by 1 per cent of the salary growth and the interest rate on the total amount of current service costs and interest, and on the present value of the liability for payment of defined benefits upon retirement, are as follows:

	Increase by 1% of salary growth	Decrease by 1% of salary growth
Change in the interest and current service costs ("+"- increase, "–"- decrease)	8	(6)
Change in the present value of the liability as of 31 December 2015 ("+"- increase, "–"- decrease)	29	(24)

	Increase by 1% of interest rate	Decrease by 1% of interest rate
Change in the interest and current service costs ("+"- increase, "–"- decrease)	(4)	5
Change in the present value of the liability as of 31 December 2015 ("+"- increase, "–"- decrease)	(24)	29

	Increase by 1% of staff turnover rate	Decrease by 1% of staff turnover rate
Change in the interest and current service costs ("+"- increase, "–"- decrease)	(7)	9

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

Change in the present value of the liability as of 31 December 2015 ("+"- increase, "–"- decrease)	(25)	31

34. SHARE CAPITAL

	2016	2015
Share capital		
Ordinary shares issued paid in cash	587,964	587,964
Ordinary shares issued – in-kind contribution (land for the building of the bank)	12,200	12,200
Ordinary shares issued - in-kind contribution (the building of the bank)	1,610	1,610
	601,774	601,774

The capital of the Bank is composed by 6,017,735 ordinary registered voting shares with par value of BGN 100 each.

The Bulgarian Development Bank Act provides that not less than 51 per cent of shares forming the Bank's capital should be owned by the State; the shares of the State amounting to not less than 51 per cent of the registered share capital are non-transferable. Also, a specific limit is established with regard to the remaining shareholders, other than the Bulgarian State through the Ministry of Finance. Shareholders may be: the Council of Europe Development Bank, the European Investment Bank, the European Investment Fund as well as other banks for development in EU member states. The Bank's shares may not be pledged and the rights thereon may not be subject to transfer deals.

At 31 December 2016, 99.99 per cent of the Bank's shares are held by the State through the Ministry of Finance (31 December 2015 – 99.99 per cent).

35. RESERVES

In accordance with the general provisions of the Commercial Act, the Bank shall allocate to Reserve Fund at least 1/10 of its profit for the year until the reserves reach 10 percent of the share capital as stipulated in the Articles of Association. Pursuant to the Articles of Association of the Bank, the Bank shall set aside to the Reserve Fund at least ½ of its after-tax annual profit until the reserves reach 50 percent of its share capital.

The Reserve Fund may be used by the Bank only to cover its current or prior period losses, and not for distribution of dividends, without the authorisation of Bulgarian National Bank.

Moreover, the Credit Institutions Act stipulates that the banks in Bulgaria cannot distribute dividends before accumulating the minimum reserves (mainly the Reserve Fund) required by law or by their Articles of Association, or if the distribution of dividends will result in violation of the regulatory capital adequacy ratios. The requirement under the Bulgarian Development Bank Act is similar.

As of 31 December 2016 the Reserve Fund of the Bank amounted to BGN 58,705 thousand. (31 December 2015: BGN 54,929 thousand).

As of 31 December 2016 the Additional Reserves of the Bank amounted to BGN 47,866 thousand (31 December 2015: BGN 13,875 thousand) and were formed as result of distribution of profits of the Bank from previous periods, according to decisions of the General Meeting of Shareholders.

In 2016, after a regular General Meeting of Shareholders of the Bank and in accordance with the provision of article 92, paragraph 2 of the State Budget Law of the Republic of Bulgaria for 2016, a decision was passed not to distribute dividends from profits after deduction of the contribution to the Reserve Fund. The dividend paid in 2015 amounted to BGN 3,248 thousand.

In accordance with the Bulgarian Development Bank Act, each shareholder of the Bank is allowed to waive the right to a dividend and then the dividend amount is transferred to Additional Reserves.

All unrealised gains and losses on fair value revaluation of the available-for-sale securities held at the end of each reporting period are recognised in equity, in a special components thereof formed by the Bank and titled Available-for-sale financial assets reserve. These gains and losses are transferred to current profits and losses upon sale/maturity of the respective securities and/or on permanent impairment. The available-for-sale financial assets reserve is presented net of taxes. As of 31 December 2016 the reserve is a positive value amounting to BGN 3,481 thousand (31 December 2015: BGN 578 thousand – positive value).

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

36. COMMITMENTS AND CONTINGENCIES

	2016	2015
Contingent liabilities		
Bank guarantees and letters of credit	80,366	77,771
incl. with cash collateral	(3,853)	(2,284)
Letters of credit with borrowed funds, accounted as loan commitment	-	-
Guarantee provisions	(3,145)	(1,468)
	73,368	**74,019**
Irrevocable commitments		
Unutilised amount of approved loans	557,152	100,408
incl. letters of credit with borrowed funds	-	-
Participation in the SIA investment program	1,724	1,804
Unclaimed portion of par value of EIF shares	4,694	4,694
	563,570	**106,906**
	636,938	**180,925**

Pursuant to the Bulgarian Development Bank Act, the transfers of activities under the Micro-credits Guarantee Fund Project from the Ministry of Labour and Social Policy (MLSP) to the National Guarantee Fund EAD – subsidiary of the Bank began in the last quarter of 2008. Based on the law and on Council of Ministers Decision No. 309/3 May 2007, re-negotiations were carried out within one year (until May 2009) with each of the partner banks to the Micro-credits Guarantee Fund Project of MLSP for replacing the security of MLSP deposits with bank guarantees of Bulgarian Development Bank AD. The capital of Bulgarian Development Bank AD and respectively, of National Guarantee Fund, was increased with the amount of the government funds released under the project.

As of 31 December 2016 agreements with seven partner banks were concluded by the Bank and bank guarantees amounting to BGN 2,321 thousand (31 December 2015: seven partner banks and bank guarantees issued amounting to BGN 3,262 thousand) were issued.

On 17 July 2015 Bulgarian Development Bank AD signed a funds management contract with EIF for accession to the SIA investment program (SIA - Social Impact Accelerator) of EIF for investing in social venture funds, with the participation amounting to EUR 1 million over an engagement period of up to 5 years. The goal of the SIA program is to invest in small and medium-sized enterprises having considerable social impact. EIF is the manager of the program. As of 31 December 2016 four equity contributions were made under the initiative amounting to EUR 119 thousand equivalent to BGN 232 thousand (Note 21).

In 2015 the Bank launched a new program for indirect financing of micro, small and medium-sized businesses subject to a maximum of BGN 150,000 thousand. Under the program BDB will be able to assume part of the risk – up to 30 per cent of the amount of the individual sub-loans - on loans granted by partner banks to businesses. At 31 December 2016 the Bank signed agreements with five partner banks and the so-formed portfolio of guarantees amounted to BGN 3,566 thousand (31 December 2015: five partner banks and portfolio of guarantees amounting to BGN 1,211 thousand).

Nature of instruments and credit risk

These commitments of contingent nature bear an off-balance sheet credit risk because only fees are recognised in the financial statements until the commitments are fulfilled or expire. The amounts reflected in the above table as guarantees represent the maximum accounting loss that would have been recognised at the end of the reporting period if counterparties failed to perform in full their contractual obligations. Many of the contingent liabilities and commitments will expire without being advanced fully or partially. Therefore, the amounts do not represent expected future cash flows. Collateral for issuance of common bank guarantees exceeds 100 per cent and represents primarily restricted deposits at the Bank, mortgages of real estate and insurance policies issued in favour of the Bank. When conditions for enforcement of an issued guarantee occur, the Bank judges the possibilities for recourse to the counterparty and eventual realisation of the provided securities.

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

36. COMMITMENTS AND CONTINGENCIES (continued)

Nature of instruments and credit risk (continued)

The guarantees of the Bank, issued under the Micro-credits Guarantee Fund Project of MLSP are not secured. In case of activation of a component of a guarantee issued by the Bank, the payment thereon is not assessed as ultimate loss because the partner-bank is obliged to undertake all necessary measures for realising the received collateral of the non-performing loan and to reimburse the respective amount to BDB.

The non-paid portion of the nominal value of EIF shares held by the Bank shall become due for payment after a special decision for this purpose taken by European Investment Fund's General Meeting of Shareholders. By the issue date of this financial statement no such a decision has been taken.

37. CASH AND CASH EQUIVALENTS

	2016	2015
Cash in hand (Note 16)	120	87
Current accounts with the Central Bank (Note 16)	78,401	343,719
Receivables from banks with original maturity up to 3 months	114,581	77,331
	193,102	**421,137**

38. TRANSACTIONS WITH RELATED PARTIES AND COMPANIES UNDER JOINT CONTROL WITH THE STATE

Entity/person	*Type of control*
Ministry of Finance	Majority shareholder of the capital of the Bank representing the State
National Guarantee Fund EAD	Subsidiary
Micro Financing Institution EAD	Subsidiary
Military Medical Academy	Company under common control with the State
Road Infrastructure Agency	Company under common control with the State
Bulgarian Export Insurance Agency EAD	Company under common control with the State
Holding Bulgarian State Railways EAD	Company under common control with the State
National Electricity Company EAD	Company under common control with the State
BULGARGAZ EAD	Company under common control with the State
Bulgarian Institute for Standardization	Company under common control with the State
South Stream Bulgaria AD	Company under common control with the State
State-owned Enterprise "Transport Construction and Rehabilitation"	Company under common control with the State
"I C J B" AD	Company under common control with the State
State Fund Agriculture	Company under common control with the State
Bulgarian Energy Holding EAD	Company under common control with the State
Bulgarian Independent Energy Exchange EAD	Company under common control with the State
Kinteks EAD	Company under common control with the State
Energy Investment Company EAD	Company under common control with the State
Urban Mobility Center	Company under common control with the State
Manager Fund of Financial Instruments in Bulgaria	Company under common control with the State
Water Supply and Sewerage EOOD Plovdiv	Company under common control with the State
Mini Maritsa East EAD	Company under common control with the State
TPP Maritsa East 2 EAD	Company under common control with the State

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

State Consolidation Company EAD	Company under common control with the State

38. TRANSACTIONS WITH RELATED PARTIES AND COMPANIES UNDER JOINT CONTROL WITH THE STATE (continued)

The table above shows the companies with which the Bank had transactions during the reporting period.
Related party balances in the statement of financial position :

Assets

Entity/person	***Type of balance***	**2016**	**2015**
Ministry of Finance	Available-for-sale securities	248,634	214,481
Micro Financing Institution EAD	Loans and advances to customers	3,671	-
National Guarantee Fund EAD	Other assets	-	-
Company under common control with the State	Loans and advances to customers	165,537	95,451
Company under common control with the State	Other assets	3	-
Total for the subsidiaries		***3,671***	-

Liabilities

Entity/person	***Type of balance***	**2016**	**2015**
National Guarantee Fund EAD	Liabilities to customers on deposits	131,126	128,020
Ministry of Finance	Other borrowings	17,679	17,856
Micro Financing Institution JOBS EAD	Liabilities to customers on deposits	1,302	943
Companies under common control with the State	Liabilities to customers on deposits	440,392	451,659
Total for the subsidiaries		***132,428***	***128,963***

Related party transactions:

Entity/person	***Type of transaction***	**2016**	**2015**
Ministry of Finance	Fee and commission income	66	68
	Interest income	1,642	1,581
	Interest expense	(141)	(172)
National Guarantee Fund EAD	Fee and commission income	1	2
	Interest income	-	10
	Interest expenses	(200)	(226)
	Rental income	41	54
	Dividend income	888	1,115
Micro Financing Institution JOBS EAD	Fee and commission income	6	3
	Interest income	15	-
	Interest expenses	-	(33)
	Rental income	19	9
	Dividend income	42	41
Total income from transactions with subsidiaries		***1,012***	***1,234***
Total expenses on transactions with subsidiaries		***(200)***	***(259)***

All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

Companies under common control with the State	Interest income	6,705	1,521
	Fee and commission income	355	344
	Interest expenses	(404)	(121)

38. TRANSACTIONS WITH RELATED PARTIES AND COMPANIES UNDER JOINT CONTROL WITH THE STATE (continued)

Commitments and contingencies with related parties:

Entity/person	***Type***	**2016**	**2015**
National Guarantee Fund EAD	Unutilised amount of a loan approved	23,000	23,000
Micro Financing Institution JOBS EAD	Unutilised amount of a loan approved	3,300	-
Micro Financing Institution JOBS EAD	Bank guarantees issued	2	2
Company under common control with the State	Unutilised amount of loans approved	6,262	18,730
Company under common control with the State	Bank guarantees issued	3,621	-
Company under common control with the State	Letters of credit	14,746	-
Total for the subsidiaries		**26,302**	***23,002***

Relations with key management personnel:

Balances with key management personnel	**2016**	**2015**
Payables to customers on deposits	329	299
Remuneration payable	31	11
Loans and advances to customers	281	212

Transactions with key management personnel	**2016**	**2015**
Remuneration and social security contributions	(1,169)	1,691
Interest expense	(1)	(2)
Interest income	11	9

39. EVENTS AFTER THE DATE OF THE FINANCIAL STATEMENTS

The financier Assoc. Prof. Krasimir Angarski was elected as a member of the Supervisory Board of the Bulgarian Development Bank (BDB) at an extraordinary general meeting of the shareholders. He replaced Kiril Ananiev, who was appointed Finance Minister in the caretaker government. The replacement was done in compliance with the legal provisions, as in his capacity as Minister of the Ministry of Finance, which is the principal of BDB, Kiril Ananiev is not allowed to be a member of the Supervisory Board of BDB.

Assoc. Prof. Krasimir Angarski was born in 1953 in Sofia. He graduated from the University of Economics "Karl Marx". Since 1980 he had worked in the Ministry of Finance, reaching the position of tax administration director for the Sofia district and of Sofia. In 1994-1995 Assoc. Prof. Angarski was the CEO of the Bank Consolidation Company and participated in the management of various state enterprises.

From 24 March to 21 May 1997 he was a minister without portfolio in the cabinet of Stefan Sofiyanski and was actively involved in the preparation for the introduction of the currency board. Then he became secretary for economic affairs of President Petar Stoyanov.

In 2001-2004, Assoc. Prof. Krasimir Angarski was the CEO of DSK Bank and in early 2005 he took the lead of DZI Bank. In early 2007 he became an adviser at Postbank. He teaches at the University of National and World Economy and is the Leader of the group developing the currency board laws.