BULGARIAN DEVELOPMENT BANK

BULGARIAN DEVELOPMENT BANK AD

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

31 December 2017

BULGARIAN
DEVELOPMENT BANK

ANNUAL ACTIVITY REPORT
OF BULGARIAN DEVELOPMENT BANK AD
FOR 2017

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TABLE OF CONTENT

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. BDB is among the four banks with the highest credit rating in Bulgaria: "BBB" with a stable perspective provided by the international rating agency Fitch. This is the only Bulgarian bank, that, other than direct financing, also provides financing through other credit institutions (on-lending). BDB is the best positioned bank among other banks in the country for attracting funds from international partners. In the fulfillment of its strategy BDB has established a financial group jointly with its subsidiaries – „National Guarantee Fund" EAD (NGF) and "Micro Financing Institution Jobs" EAD (MFI Jobs).

The Bulgarian Development Bank Act (BDBA) was adopted on 23 April 2008. It regulates the scope of Bank's activities, including those of its subsidiaries envisaged for incorporation.

As of 31 December 2017 the paid-in capital was BGN 601 774 thousand (31 December 2016: BGN 601 774 thousand), and it consists of 6 017 735 ordinary registered voting shares of par value BGN 100. The Bank has complied with the requirements of the Bulgarian National Bank (BNB) for minimum statutory capital in order to carry out banking activity, as well as the capital requirements of BDBA. As of the date of preparation of this report the ownership of the capital is distributed as follows: 99.9999% of it is held by the Republic of Bulgaria, represented by the Ministry of the Economy, 0.0001% is held by DSK Bank.

The Bulgarian Development Bank Act regulates the participation of the State in the share capital of the bank, where the share of the state shall be no less than 51% of the registered share capital. In addition, a specific limitation is established on the composition of the other shareholders, registered outside the Bulgarian state. Such shareholders may be: The Council of Europe Development Bank (CEB), the European Investment Bank, the European Investment Fund, as well as other development banks of Member States of European Union. The Bank's shares cannot be pledged and the rights attached thereto may not be subject to transfer. In these cases, Art. 31 of the Credit Institutions Act does not apply.

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.

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 pursuant to Art. 5 of the BDB Act, according to 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 the Economy. Outside the powers of the Minister of the Economy, any amendments to the BDB Act in its capacity as Memorandum of Association and the right to issue or buy back shares, shall be possible only by voting a new Act or amending the current Act by the National Assembly of the Republic of Bulgaria.

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 legislation and the specific provisions of the Bulgarian National Bank.

In 2017 BDB has not incurred any liabilities under existing or new issues of securities.

As of 31 December 2017 there are no pending court, administrative or arbitration proceedings concerning liabilities or receivables of the BDB Group amounting to 10 per cent or more of its equity.

Pursuant to the Statute, the lending activity of the Bank is focused on:

Pre-export and export financing of small and medium-sized enterprises (SMEs), financing other operations of SMEs, either through intermediary banks or directly, refinancing of banks granting loans to SMEs, financing of investments by SMEs abroad, participation in public and public-private projects or partnerships of strategic, national or regional importance.

The Bank extends also other types of loans according to a procedure set by the Management Board and within requirements and limitations pursuant to Regulation 575/2013/EU, whereas the exposure to one customer or a group of related customers, other than credit institutions, central governments and central banks, after taking into account the effect of credit risk reduction.

The Bank shall not lend funds for the following activities/borrowers:

1. Activities not compliant with the National law, including for environment protection;
2. Business companies with unknown ultimate controlling owner;
3. Political parties and persons related to them. Pursuant to the latter, persons related to political parties may be: youth, women's and other organizations, which the parties may establish according to law, as well as entities, established by the political parties for performing the only business activities, which they are legally allowed to do - publishing activity, copyrights and using intellectual property, as well as the sale and distribution of printed, audio and audiovisual materials with party campaigning content;
4. Non-profit enterprises and organizations;
5. Media;
6. Activities related to sport and sports initiatives;
7. Other activities, which are prohibited by law.

The Bank provides loans directly or through intermediary commercial banks.

The terms and conditions for granting loans shall be set forth by the Management Board.

BDB finances deals within its scope of activity, more specifically under programs with provided mandate by the government of the Republic of Bulgaria. When such programs envision the disbursement of funds under non-market conditions, where it is possible to incur losses and lost opportunities, these amounts must be specified in the relevant program.

The Bank may finance or re-finance companies with liabilities classified in the credit registry at BNB into the groups "Substandard" or "Loss" (or the equivalent of such classification should there be legislative changes), at the time of filing a credit application to BDB and after obtaining the approval of the Supervisory Board.

The Bulgarian Development Bank performs services while acting as investment intermediary pursuant to the provisions of the Public Offering of Securities Act (POSA). As an investment intermediary the Bank must comply with certain requirements towards the protection of the interests of the clients pursuant to the Markets in Financial Instruments Act (MFIA) and Ordinance No. 38 issued by the Financial Supervision Commission (FSC). The Bank must also observe the requirements of Directive 2014/65/EU on the Markets in Financial Instruments (MiFID II), Regulation 600/2014 of the EU regarding the Markets in Financial Instruments (MiFIR), Regulation 2016/679 on personal data protection (GDPR) and the Payment Services Directive 2015/2366 (PSD 2). The Bank has established and is applying organization related to the execution and performance of contracts with clients, to the client information requirement, to keeping accountability and the safekeeping of client assets, pursuant to the requirements of the above mentioned national and European legislative acts. The Bank has built a system of internal rules and procedures for internal control, which ensure full compliance with the legislative provisions specified above.

The seat and registered address of the Bulgarian Development Bank AD is city of Sofia 1000, Sredetz District, 1 Dyakon Ignatii St. As of 31 December 2017 the staff of the Bank is 171 employees.

As of 31 December 2017 Bulgarian Development Bank AD had no branches.

MAIN FOCUS, ACTIVITIES AND PROJECTS FOR 2017

In 2017 changes took place in Bulgarian Development Bank (BDB) and the governor of the Bank was replaced, the members of the Management Board (MB) changed, as well as the bodies representing the Company. By resolution of the National Assembly of the Republic of Bulgaria, promulgated in the State Gazette, issue 63 of 04 August 2017, the Minister of the Economy of the Republic of Bulgaria assumed control over 99.9999% of the capital of the Company, while as of 6 October 2017, Mr. Stoyan Mavrodiev is acting as Chief Executive Director, Mr. Rumen Mitrov and Mr. Nikolay Dimitrov, both acting as Executive Directors, became MB members of BDB, while Mr. Iliya Kirchev remained member of the MB of BDB.

The new management of Bulgarian Development Bank presented its vision about the development and management of BDB at a meeting of the Economic Commission in parliament on 6 December 2017. Along with the main priority of the bank set forth in the BDB Act – the financing of small and medium-sized enterprises, the Bank plans to expand the range of its financing activity by directing funds towards projects important for the state. BDB will continue to be partner of the government in the execution of large publicly significant projects.

On 04 December 2017 the Bulgarian National Bank (BNB) approved the amendments to the Statute of BDB, which were unanimously adopted by the General Assembly of Shareholders (the Ministry of the Economy and DSK Bank) held on 13 November 2017. With the amendments, registered in the Commercial Registrar several interpretations were clarified, regulating the lending activity of BDB and allowing the Bank to develop new aspects in its operations following the model of the European Development Banks. The amendments in this document reflect the European practice and limits for bank lending, as well as the priorities set forth in the Strategy for the activity of BDB adopted by the MB in July 2017. As a public financial institution, the mission of BDB is to assist the growth and the development of the small and medium-sized businesses in the country, as well as mobilize public and private funding resources for investments in industries having priority for the state. The Bank will continue to improve the access to financing through new programs to support energy efficiency, the agricultural farms, the export-oriented and startups. The new Statute facilitates to enlarge portfolio of financial instruments by participation in the financing of public and public-private infrastructural projects of national and regional importance. The possibilities expand to a more large-scale on-lending financing, which will create an even better environment for the development of small and medium-sized enterprises as a main objective set forth in the BDB Act. The requirements on the credit activity under Regulation 575/2013/EU, which are valid for all banks in the Republic of Bulgaria and in the EU, are applied directly by the Bank. A new change is the introduction of a threshold where a permission from the Supervisory Board (SB) is required to approve exposures, which exceed 5% of the Bank's own equity. The aim is to establish better control on the lending activity and a clear distinction of the controlling functions of the SB. For the first time the Statute of a Bulgarian bank includes a definition for politically exposed persons in compliance with the supervision recommendations of the BNB. These changes introduce a high transparency standard in the operations of the Bank and the possibility for providing loans to persons and organizations, directly related to political parties, is excluded. The document specifies the roles of the Chief Executive Director, which is a well-established practice among all leading Bulgarian and international banks.

In relation to the introduction of the requirement to appoint a second independent external auditor, in Novermber 2017, a second auditor was elected - specialized auditing enterprise "Zaharinova and Partners" OOD at the General Assembly of the Shareholders of BDB, where together with the appointed first auditor "Ernst & Young Audit" OOD, they have performed audit of the Annual Financial Statements of BDB for 2017 and of the Consolidated Annual Financial Statements of the Group of BDB for 2017.

In December 2017 the international rating agency "Fitch Ratings" performed its regular annual review and updated the credit rating of Bulgarian Development Bank AD:

Rating	as of 31.12.2016	Updated on 13.12.2017
Long-term Rating	BBB -	BBB
Perspective	Stable	Stable
Short-term Rating	F3	F2
Perspective	Stable	Stable

The assessment of the rating agency reflects the reliable support of the sovereign – the Bulgarian state, by the good financial results of the Bank, as well as by the role of BDB in support of the economic policy of the Government. The stable perspective represents the balance in the risks related to the assessment of the credit rating.

The stable equity base contributes significantly to the high capital adequacy. BDB is the institution with the highest level of capitalization in the banking system of Bulgaria, significantly above the statutory minimum.

Upgraded credit rating of the Bank is a natural consequence of the successful development of BDB and it reflects the leading role of BDB in the carrying out of the state policies in the field of economics. The analysis brings forward the participation of the Bank as a paying agent under the National Program for Energy Efficiency of Multi-Family Residential Buildings (NPEEMFB/ NPEE) and the bank's support for the Bulgarian business, incl. through the European Fund for Strategic Investments ("the Juncker Plan").

During the General Assembly of BDB held in May 2017 the audited financial statements of the institution for 2016 were adopted, audited by Ernst & Young Audit OOD. The Bulgarian Development Bank recorded a profit of BGN 42.9 million for 2016, where the increase as compared to the previous year was BGN 5.1 million, or 14%. The General Assembly resolved to distribute dividends amounting to 50% of the financial result, while the remaining part of the profit shall be allocated to the reserves of BDB. Thus, the practice of investing in the strengthening of the potential of the Bank in advance, and not after the occurrence of an urgent necessity, was confirmed. Following this resolution, the capital adequacy of Bulgarian Development Bank remained the highest in the Bulgarian banking system.

BDB became co-founder of the China-CEEC Interbank Association of China and the Central and Eastern European countries (CEEC). The agreement on its establishment was signed during the Sixth Annual Meeting of the Heads of States under the „16+1"initiative, which was held in Budapest. Bulgarian Development Bank became a founding member of the Association, in which the partners will cooperate under projects of mutual interest, following the principles of independent management and decision making, as well as independent risk taking. Under its umbrella, China will provide an amount of more than USD 3 billion for the development of projects in Central and Eastern Europe and will strengthen the trade and economic cooperation between the member countries.

In 2017 an annex was signed to a loan agreement with the Ministry of Finance for financing of commercial banks subsequently funding loans to micro, small and medium-sized enterprises. The Management Board of BDB approved the amendment to the terms of the 10 years loan in order to update the mechanism and terms for SME on-lending, thus making it more attractive.

In 2017 BDB fully utilized the loan from CEB for the National Program for Energy Efficiency (NPEE). The financing has a 5-year repayment period and a fixed interest rate.

Under the KfW 2017 loan, EUR 100 million were utilized in two tranches, first of EUR 60 million in March 2017, and a second tranche of EUR 40 million in March 2017, at an interest rate equal to 6M Euribor + 1.1% margin. The funds are special purpose financing for National Program for Energy Efficiency /NPEE/.

On 28 September 2017, BDB signed a Facility agreement with the Chinese Exim Bank amounting to EUR 50 million for financing of the general lending activity of the Bank, short-term and mid-term corporate financing, as well as for cross-border economic and trade transactions between Bulgaria and China. The tenor of the facility is 5 years as from the date of first drawdown. The loan is unsecured.

On 12 May 2017, BDB signed a EUR 80 million Facility Agreement with the Chinese Development Bank. The funds shall be used for BDB's general lending activity– investment and working capital loans. The loan is unsecured. The interest rate is floating, based on 6M Euribor + margin. The repayment period is 10 years with 2 years grace period. As of 31 December 2017, the full loan amount has been utilized.

In 2017 the Bulgarian Development Bank made a selection of commercial banks for partners within the framework of the new on-lending program of BDB under the Juncker Plan. At present the process of signing financial agreements under the program is envisioned to continue with Allianz Bulgaria, DSK Bank, Piraeus Bank Bulgaria, the merged UBB and CI Bank, D Commerce Bank and Eurobank Bulgaria.

In 2017 the process of preparation for implementation of the requirements of IFRS 9 as of 01 January 2018 and adapting the Bank systems for classification of the financial assets and liabilities, as well as the calculation of impairment and provisions individually and on a collective basis was successfully finalized with the appointment of a professional external consultant - Mazars.

In view of Regulation of the EU 2016/ 679 on personal data protection (GDPR), entering into force as of 25 May 2018, the Management Board of the Bank approved an approach for introduction of the requirements of the regulation within the Bank's procedures.

The Bank successfully introduced the required accounting under the Tax Insurance Procedures Code (TIPC) for the purposes of the global standard for data exchange (Common Reporting Standards - CRS), which expands and upgrades the currently existing standard requiring reporting with respect to tax subjects in the USA (FATCA).

OVERVIEW OF THE EXTERNAL ENVIRONMENT - MACROECONOMIC ENVIRONMENT AND BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2017 the Bulgarian economy recorded a relatively high economic growth, improvement in the labor market, annual inflation for the first time in three years, reducing the external debt of the economy as a whole and a drop in foreign investments.

According to the accelerated valuations of the NSI (National Statistical Institute), GDP of Bulgaria grew by 3.6% during the fourth quarter of 2017. This growth is lower as compared to the previous three quarters, mainly due to a strong tourist season and construction in the beginning and middle of the year. The driver for this growth is the internal demand (fully due to end consumption). All components of the internal demand show growth, where the greatest increase comes from the end consumption by the households. There is a sharp upheave in the export and import of goods and services where the import shows greater growth than the export, which leads to increasing the trade deficit.

By business sectors what mostly contributed for the growth of the Bulgarian economy during the entire year was the industries from the services sector, construction and the real estate transactions. The low interest rates on residential loans and the improving environment on the labor market are the instruments to the record-high growth in construction and real estate transactions since the crisis till the present. The services sector continues to mark a serious growth establishing itself as the most important sector of the economy for the country during the last years. The manufacturing industry also registers a relatively high growth both of the Gross Added Value (GAV) produced in the sector, and in sales, and is also one of the sectors, main driver of the economic growth during the year. The agricultural sector has a negative growth for 2017 while since 2015 this sector has a volatile growth trend.

The maintenance of a relatively high economic growth for a second year in a row lead to further improvement of the situation on the labor market. During the fourth quarter of 2017 the level of unemployment dropped to 5.6%, i.e. it was lower by 1.1% as compared to the same quarter of 2016. The economic activity of the population is 71.6% (population between15 and 64 years of age), which is higher by 3.6% as compared to the fourth quarter of 2016, the employment ratio for the population aged between 15 and 64 was increased by 4.1% to 67.5% as compared to the same quarter of 2016, while being ahead of the times of greatest dynamics on the labor market of the period 2007-2008. It must be noted that the employed people were reduced by about 200 thousand people as compared to 2008, and furthermore the age of the working population has been increasing with a fast pace during the last 10 years. The average monthly working salary as of December is BGN 1 123, which is an increase by BGN 111 (11.0%) as compared to December 2016. The main factors for the salary increases are the developing economy and the increasing competition for experts on the labor market, these factors will continue to support a growth of the salaries ahead of the inflation, and especially the compensation for experts during 2018-2020. Along with the declining unemployment in the country, during the second half of 2017 the employment in the country remained relatively stable despite the growing demand for work force in the area of the entrepreneurs, which is an additional indicator that the work force is close to its optimal capacity of use. With respect to the above, the Government undertook measures by negotiating with Armenia, Moldova and the Ukraine to sign treaties in order to regulate the workforce, as well as by making a proposal to the employers to make specific offers of employment to Bulgarians who are currently working abroad, but occupying positions that need lower than their own qualification.

During 2017 the net export and import marked a serious surge. The net export increased by 10.7% to BGN 52.2 billion, while the export to the EU represented 2/3 of the total export of the country. Along with the increase in consumption the imports increased by 15.4% to BGN 59.1 billion as of the end of 2017. The deficit in the trade balance has increased during the year to BGN 6.9 billion and has a negative impact on the growth of the economy. The trend of increase in imports over the export of goods is likely to continue until the end of the projection horizon, which will lead to a smooth increase in the trade deficit until 2020.

In 2017 the process of reduction of the external debt for the country continues. As compared to December 2016 the total gross external debt has decreased by EUR 1.658 billion, and as of November it was EUR 32.389 billion. The external debt of the public sector has decreased by EUR 0.949 billion to EUR 6.282 billion, while the one of the private sector - by EUR 0.709 billion to EUR 26.107 billion.

The attracted direct foreign investments in Bulgaria remain at low levels. According to the preliminary data of the BNB, DFI in Bulgaria during the previous year were EUR 901.9 million (1.8% of GDP), which was EUR 241.9 million more than last year's level. It is expected DFI to surge after the audit in 2018, but nevertheless, they are not expected to surpass 2.0% of GDP as compared to the average of 17.7% of the pre-crisis levels.

The average annual inflation for the period January-December 2017 as compared to the period January - December 2016 was 2.1%. The main groups of goods, which contributed for increasing the overall price index during the period were again heating (10.7% increase), gaseous fuels (9.9% increase), education (4.5% increase), food and non-alcoholic beverages (4.0% increase), as well as transport (3.7% increase). The group with most significant deflation impact on the dynamics of the national average yearly CPI during 2017 included communications (2.6% decrease), entertainment and culture (2.5% decrease) and clothes and shoes (1.4% decrease).

BANKING SECTOR

In 2017 the Belgian financial group KBC announced the acquisition of the fourth largest bank in Bulgaria - UBB, from its incumbent owner, the Greek NBG (National Bank of Greece). The deal also included 100% of the equity of Interlease, which is the third largest leasing company in the country with 13% market share. Following this deal Cibank merged into UBB, which resulted in the largest banking and insurance group in Bulgaria. In December CPC (Commission on the Protection of Competition) allowed the sale of the majority interest of 67.7% of Municipal Bank by Sofia Municipality to Liechtenstein Fund "Novito Opportunities" with main investor Insa Oil Company.

In December 2017 the assets of the banking system increased by BGN 1.96 billion to BGN 97.81 billion, which represented a year-to-year increase of BGN 5,7 billion. Increases are observed in all groups of assets, while the greatest dynamics belongs to the loans and receivables, by BGN 3.60 billion, and cash by BGN 1.35 billion. The increases in the financial assets were BGN 500 million, while for the other assets they were BGN 245 million.

The expenses for impairment have decreased by BGN 70 million, the total and administrative expenses have dropped by BGN 16 million, while there was a year-to-year increase in the personnel expenses by BGN 41 million and the administrative expenses by BGN 26 million. The net income from fees and commissions has increased by BGN 75 million over the year, while there is a drop in net interest income by BGN 130 million, and in the operating revenues by BGN 193 million. The profit before taxes of the banking system was reduced by BGN 102 million less than December 2016 (the most profitable year since 2008).

As of the end of the year the borrowed funds grew by BGN 1.84 billion to the amount of BGN 83.71 billion, while the annual increase was BGN 5.12 billion. As compared to December 2016 the private deposits increased by BGN 2.26 billion, while the non-financial enterprise deposits - by BGN 2.81 billion. With the economic recovery the trend of the deposits to increase was observed despite the eextremely low interest rates.

The personal and household loans as of December 2017 amounted to BGN 19.79 billion, which is an annual increase of BGN 1.21 billion. The loans to non-financial enterprises dropped by BGN 20 million to BGN 33.16 billion.

The information by bank supervision for the last quarter of 2017 presents preservation of the trend towards reduction in the loans more than 90 days overdue to the non-financial sector, and during the year they decreased from 12.83% to 10.07%, but nevertheless Bulgaria is still among the first of the EU countries with most default loans. The fiscal year marked a record in the number of more than 90 days overdue loans sold, which is the fundamental cause for reducing their relative share in the overall analytics of the loan portfolios of banks.

During the last 12 months the interest rates on loans, new businesses, have dropped by 0.20% in BGN, reaching levels of 3.71% as of 31 December 2017and reductions in loans for new businesses disbursed in euros by 0.78% in euro, reaching rates at 3.38% at the end of the year.

In December 2017 the interest rates for businesses on deposits - new business, showed a decrease by 0.05% in BGN and 0.21% in EURO as compared to December 2016 and reaching levels of up to 0.09% in BGN, and up to 0.05% in EURO.

ACTIVITY OVERVIEW

Bulgarian Development Bank AD continues to work actively towards the set forth objectives while maintaining high levels of liquidity and capitalization. The Bank focuses on the adequate management of the basic risk categories, to which it is exposed, mainly: credit, interest, market and operational risks. For this purpose, BDB uses a set of methods and procedures for identifying, measuring and controlling its risk exposures. Every quarter, the Risk Department of the Bank prepares detailed stress tests for all types of risks using various scenarios and assumptions, which are presented before the Bank's management and are part of the assessment process of the internal capital adequacy and liquidity.

For 2017 BDB recorded a profit before taxes amounting to BGN 22 266 thousand while for the same period in the previous year it was BGN 47 584 thousand or a decrease by 53.2%. Main factor for the recorded financial result were accrued impairment and provision costs during the year.

The net interest income for 2017 marked a minimal drop by 2.8% less versus 2016 while its value amounts to BGN 54 994 thousand (as of 31 December 2016: BGN 56 572 thousand). The main reason for this is the higher interest expenses recorded in 2017 as compared to the previous accounting year, following the increased amount of borrowed long-term resources from international financial institutions in support of the primary business lines of the Bank for financing SMEs and the National Program for Energy Efficiency of multi-family residential buildings.

The realized net income from fees and commissions as of 31 December 2017 amounted to BGN 2 181 thousand while it marked a drop by 4.3% versus 2016 when the recorded income was BGN 2 279 thousand.

As of 31 December 2017 the total and administrative expenses, including the expenses for personnel and depreciation and amortization for the Bank amount to BGN 16 430 thousand (as of 31 December 2016: BGN 15 873 thousand). The ratio of expenses to operating income preserved one of the lowest levels for the bank system - under 30% (2017: 27.6% as compared to 2016: 26.3%).

Considering the preparation works to implement the new IFRS 9 and in order to be consistent with the policy of the Bank of conservative risk assessment and maintaining high regulatory buffers, in 2017 expenses for impairment and provisions were accrued and amounted to BGN 20 774 thousand as compared to positive result from impairment and provisions amounting to BGN 3 147 thousand in 2016. As a result, the Bank has provided coverage at the end of the year with impairment of the credit portfolio amounting to 7.3% following the recommendations of ECB and the best banking practices in the EU.

As of 31 December 2017 Bank's assets amounted to BGN 2 472 243 thousand versus BGN 1 911 985 thousand at the end of 2016, or an increase of 29.3% over the previous year.

The credit activity of BDB consists of both direct lending and indirect financing through programs for funding commercial banks, which use the received funds to provide loans to SMEs and agricultural producers, i.e. the so called on-lending.

As of 31 December 2017 the amount of the provided funds for on-lending to businesses through the mediation of the commercial banks amounts to BGN 157 326 thousand, a decrease versus the volume at the end of 2016 (BGN 170 102 thousand) following the maturity of the installments under part of the loans. In 2017 BDB started a new program for indirect financing by undertaking up to 100 % guarantee commitment towards the commercial banks in Bulgaria with the support of EIB and EFSI under the Juncker Plan. Several banks were approved for participation in the Program, while the first utilizations under the Program will begin in 2018.

As of the end of December 2017 the gross amount of the corporate portfolio of the Bank from direct lending (excluding the financing under the National Program of Energy Efficiency (NPEE) is less by 6.3% as compared to the end of 2016 (BGN 845 668 thousand), reaching BGN 792 322 thousand.

Under the National Program on Energy Efficiency (the Program, NPEE) that started at the end of 2015, as of December 2017, the total amount of the agreed financing under the signed contracts was BGN 1 667 156 thousand (for comparison at the end of 2016 – BGN 851 039 thousand). The utilized amount was BGN 1 273 137 thousand, while the balance sheet debt – BGN 722 862 thousand (as of 31 December 2016 the balance sheet receivables were BGN 395 169 thousand.). During 2017 BGN 554 919 thousand were repaid under the NPEE with funds of the state budget, out of which BGN 4 802 thousand was interest paid off.

The ratio of grossof gross loans granted to customers in arrears more than 90 days to total corporate credit portfolio of the Bank (direct lending, excluding claims from state and municipal budgets, employees and non-bank financial institutions) as of 31 December 2017 was 10.8% while the share is increasing versus the end of 2016 (6.3%). Higher ratio is mainly due to reclassification of a large credit exposure from regular to more than 90 days overdue. BDB continues the policy of conservative risk management by providing high coverage with impairment of the loans in arrears by more than 90 days, where the coverage ratio as of the end of 2017 amounted to 48.95% versus 53.3% at the end of 2016.

At the end of 2017, the portfolio of securities available for sale decreased nominally by BGN 33 465 thousand (12.7 %) compared to the end of 2016 following the maturity of part of the issued securities held and optimizing the liquidity profile of the Bank.

As of 31 December 2017 the Bank also recorded a drop in the receivables from banks by about BGN 75 632 thousand or 27.6% in connection with directing a liquid resource of the Bank mainly for financing the National program on energy efficiency.

The item "cash on hand" and balances in current account at the Central Bank marked a significant growth and reached BGN 447 648 thousand at the end of 2017 (31 December 2016: BGN 78 521 thousand). This was mainly due to received financing from MFI, and also funds from the state budget under the NPEE under contracts for financing of fully completed and weather conditioned (insulated) multi-family residential buildings corresponding to the requirements of the provisions of the Program.

As of 31 December 2017 the amount of the liabilities of the Bank was BGN 1 715 242 thousand, which is a growth of 48.2% compared to BGN 1 157 218 thousand at the end of 2016.

As of 31 December 2017 the largest share in the liabilities of the Bank belongs to borrowed funds from international financial institutions – 50.7% (32.8% towards the end of 2016) while their value amounted to BGN 869 822 thousand (31 December 2016: BGN 379 998 thousand). The increased share in the liabilities of the Bank of the funds borrowed from MFI was triggered by the significant amount of funds utilized from various international institutions in 2017, mainly targeted utilizations from financing the National Program on Energy Efficiency.

The deposits from clients other than credit institutions have increased to BGN 790 590 thousand for 2017 versus the end of 2016 (BGN 709 549 thousand) or a growth of 11.4%.

BDB continues to maintain high level of liquidity. As of 31 December 2017 the ratio of the liquid assets of the Bank is maintained at high level amounting to 43.3 % (31.5 % at the end of 2016).

The Bank continuously support the development and training of its employees, creating prerequisites for their professional growth as financial specialists within the framework of the only financial group in Bulgaria, which does not prioritize the generation of profit, but is focused on social goals.

RISK MANAGEMENT

In the course of its ordinary activity the Bank is exposed to various types of risks, the occurrence of which may lead to losses and deterioration of the financial stability of the institution. Such risks are identified, estimated and assessed with the help of control mechanisms, so that they can be managed and to avoid the concentration of unjustified risk. The process of management of the risks is crucial for the profitability of the Bank and its existence. The main risks, to which BDB is exposed, are credit, market and operational risks.

CREDIT RISK

The credit risk management takes place in compliance with the applicable legal and sublegal legislative acts of the Republic of Bulgaria, regulating the credit activity, the established international norms and best banking practices.

The Bank uses internal rating for the evaluation and management of the credit risk (incl. from counterparties) under the exposures. Bodies for monitoring, control and assessment of the quality of the credit portfolio have been created and are functioning at BDB. Procedures and mechanisms have been introduced for ongoing monitoring, recording and management of the credit portfolio, requiring periodic, and if necessary, extraordinary reports on the financial and legal status of each borrower and the physical bodies in debt. When new circumstances are established, which may lead to a change to the risk profile of the borrowers, including to increasing the risk of non-collectability of the credit exposure, adequate measures, which are in line with the risk parameters of the debtor, are undertaken. When managing the credit risk of the Bank, a system of internal bank limits by economic sectors, by instruments, as well as other credit limitations and thresholds for concentration are followed, while the results from the monitoring of their compliance are reported to the competent bodies. The system of limits is reviewed and updated periodically.

MARKET RISK

When managing the currency risk BDB follows the principle of maintaining minimum open currency positions through the observing of established limits. The positions of the Bank in various currencies, as well as the general currency position are monitored on a daily basis. The currency positions are not formed for speculative purposes, but are the consequence of the currency transactions, occurring in the course of the ordinary bank activity. The Bank does not perform significant deals and does not keep considerable open positions in currencies other than the euro and the BGN.

Regular reports, distributed periodically according to their sensitivity to changes in the interest rates, are prepared on the financial assets and liabilities in order to manage the interest risk. A system of limits was introduced in connection with the fluctuations in the interest curve, while stress scenarios are applied to the discrepancies by periods, thus estimating the potential risk for the interest revenues and the capital of the Bank.

The risks from the transactions on the money and capital markets are managed by a system of limits reflecting the risk profile of the investments and determined according to parameters of the portfolio, like counterparty, financial instrument, maturity, etc. The system of limits is periodically reviewed, while the compliance with the limits is subject to daily monitoring. The securities portfolio, created by BDB in order to invest the available funds, has a relatively low interest risk and has relatively liquid securities issued by reliable institutions, i.e. low price risk. Due to the absence of a trade portfolio pursuant to the statutory regulations BDB does not allocate capital for market risk.

The liquidity of BDB is managed by strictly monitoring the ratios, indicating the liquidity position by periods. The liquidity risk is measured by applying additional scenarios for the cash flows from operations. In addition, the liquid buffers of the Bank are measured and monitored, as well as the additional sources of financing upon market and idiosyncratic shocks. The observing of the limits for liquidity ratios is monitored and reported regularly before the relevant bank's bodies.

OPERATIONAL RISK

The management of the operational risk takes place by strictly monitoring and registering all operational events occurring in the activity of the various units and processes in the operations of the Bank, both events, which are more frequent, and the ones having great impact, serve as the basis for the analysis of the operational risk in various scenarios. The operational risk is measurable and controllable, while a registry of the operational events is maintained in the process, and it serves as basis for analysis and improvement of the bank's processes and for minimizing the conditions, which could potentially lead to operational events and loss for the Bank. The necessary capital for operational risk is calculated by using the base indicator approach pursuant to the applicable regulatory framework.

CONTROL ENVIRONMENT

BDB follows management philosophy and operating style, subject to the principles of conservatism when performing the strategic goals of the Bank set forth by the BDB Act. In connection with the special role of the Bank as an instrument for carrying out the governmental policy, the management of the Bank has adopted the approach of specialized control with respect to the control environment, where several directorates were established as part of the structure of the Bank, which have specific controlling functions – Risk Management Department, Liquidity Management Department, Planning, Analysis and Regulations Department, Legal Department, Classified Information Department, Compliance Department. Along with the periodic updating of the internal normative basis, this approach allows the management to undertake timely measures for risk control along with the traditional components of the control environment provided by the direct involvement of the management of the Bank in the preparation and verification of the financial statements and in the activity of the Accountancy Department and the Internal Audit Department, acting in full compliance with the principles of the system of three controlling pillars introduced by the European legislative acts.

The management assigns authorities and responsibilities for the operating activity in line with a detailed internal normative set of documents, which are in conformity with the current national and European legislations, where in order to guarantee the relationships in accountancy and reporting, and the hierarchy of authorities, various specialized committees were formed to the MB and SB of BDB as stated in the Corporate Governance Statement, being part of the current financial statements.

BDB has developed an internal set of documents, which includes policy and communications focused on ensuring that all employees understand the goals of the Bank, knows how individual actions are interconnected and contribute towards these goals, and who and how is reporting and what is their responsibility.

The Bank has established an information system, including business processes related to it, providing the necessary quality and control of the financial accountability and communication.

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

BANK SUPERVISION AUTHORITIES PURSUANT TO THE BULGARIAN LEGISLATION

In compliance with the requirements of the framework of the laws and by-laws, regulating the banking activity in the country, BDB must follow limitations, related to certain ratios. As of 31 December 2017, the Bank has observed all regulatory requirements of BNB and the Bulgarian legislation.

The capital adequacy ratio on an individual basis as of 31 December 2017 is 55.30 % (31 December 2016 was 49.13%). The coverage of assets with capital buffers significantly exceeds the statutory requirements and it was confirmed by the performed stress tests and asset quality review, as well as upon the upgrade of the credit rating of the Bank assigned by Fitch Ratings on 11 December 2017.

CREDIT RATING AND INTERNATIONAL ACTVITIES

As of the end of 2017 Bulgarian Development Bank AD has the highest possible credit rating for a Bulgarian financial institution –long-term BBB rating with stable perspective, and short-term rating - grade F2. The long-term investment rating of the Bank is equal also to that of the state. The upgrade of the BDB rating reflects both the trustworthy commitment for support of the Bank by the Bulgarian state, the strong financial results of the institution and its key role in the support of the economic strategy of the government.

BDB continues to develop successful partnerships with leading European and international , including through participating in reputable associations. This cooperation enables the Bank to take advantage of the best banking practices, know-how, information on financial products, and also to participate in their development and implementation.

BDB has direct access to up-to-date general and specific information about the latest changes in the legislative framework at European level and its implementation in the area of the development banks, and has the opportunity to participate in the process of negotiating these amendments. The membership in international specialized associations allows BDB to take part in seminars and meetings with the European Commission and its Directorates.

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

Since 2007, BDB is a full member of the Network of European Financial Institutions (NEFI), including representatives from 19 institutions from various European countries. The mission of NEFI is to improve the exchange of information and ideas in order to facilitate SME's access to financing.

In 2017 BDB continued its participation in the activity of the European Association of Long-term Investors (ELTI). BDB is a co-founder of this organization.

In 2017, BDB became a co-founder of the China-CEEC Interbank Association.

BDB is a shareholder of the European Investment Fund (EIF), holding 3 shares of its equity, and regularly participates in the discussions of the Group of Financial Institutions – shareholders, where the guidelines for development of the activities and policy of EIF are discussed. BDB regularity votes on various topics – the admission of new shareholders and other organizational issues.

BANK GOVERNANCE

Bulgarian Development Bank AD has a two-tier management structure, which consists of Supervisory Board (SB) and Management Board (MB).

In the beginning of 2017 members of the Supervisory Board of BDB (SB) were: Atanas Slavchev Katzarchev – Chairman and member of the SB, Kiril Milanov Ananiev – Deputy Chairman and member of the SB, and Dimitar Kirilov Dimitrov - member of SB.

By a resolution at an extraordinary General Assembly of Shareholders (GAS) of BDB held on 02 March 2017 changes to the Supervisory Board of the Bank were introduced. GAS of the Bank released Kiril Milanov Ananiev as member of the SB of BDB and elected Krassimir Totev Angarski in his stead. By resolution of the Supervisory Board of 02 March 2017 Krassimir Totev Angarski was elected Deputy Chairman of the SB.

At an extraordinary General Assembly of Shareholders of Bulgarian Development Bank AD, held on 23 May 2017 a resolution was adopted on changes in the Supervisory Board of the Banka. GAS of the Bank released Krassimir Totev Angarski and Dimitar Kirilov Dimitrov as members of the Supervisory Board of BDB and elected new members: Mr. Luchezar Dimitrov Borisov and Kiril Milanov Ananiev. By resolution of the SB of 14 June 2017 Kiril Milanov Ananiev was elected Deputy Chairman of the Supervisory Board.

By a resolution at an extraordinary General Assembly of Shareholders of BDB held on 13 November 2017 changes were introduced to the Supervisory Board of the Bank. GAS of the Bank released Kiril Milanov Ananiev and Atanas Slavchev Katzarchev as members of the SB of BDB and elected Velina Ilieva Burska and Mitko Emilov Simeonov as new members of the Supervisory Board. By resolution of SB of 13 November 2017 Luchezar Dimitrov Borisov was elected as Chairman of the Supervisory Board, while Mitko Emilov Simeonov was elected Deputy Chairman of SB.

At the end of 2017 following individuals were members the Supervisory Board of BDB (SB): Luchezar Dimitrov Borisov – Chairman and member of SB, Mitko Emilov Simeonov - Deputy Chairman and member of SB, Velina Ilieva Burska – member of SB.

In the beginning of 2017 the Management Board /MB/ of the Bank the following members: Angel Kirilov Gekov – Chairman of MB and Executive Director, Bilian Lyubomirov Balev – Deputy Chairman of MB and Executive Director, Iliya Vassilev Kirchev – member of MB and Executive Director. The Bank is represented jointly by each two of the three executive directors.

By resolution of the Supervisory Board of Bulgarian Development Bank AD of 29 September 2017 Angel Kirilov Gekov and Bilian Lyubomirov Balev were released as members of the Management Board. The same resolution of SB of BDB elected Stoyan Todorov Mavrodiev, Rumen Dimitrov Mitrov and Nikolay Dimitrov Dimitrov as members of MB. By resolution of MB of 29 September 2017, approved by resolution of SB of the same date, StoyanTodorov Mavrodiev, Rumen Dimitrov Mitrov and Nikolay Dimitrov Dimitrov were elected executive directors. By resolution of MB of 04 October 2017, approved by resolution of SB of the same date, the authority of Iliya Vassilev Kirchev as Executive Director was released and he remained solely member of the MB of the Bank. BDB is represented jointly by each two of the three executive directors.

By resolutions of the Management Board of 27 November 2017, approved by resolution of SB of the same date, StoyanTodorov Mavrodiev was elected Chief Executive Director of Bulgarian Development Bank.

Upon the adopted resolution of the Supervisory Board , as well as in conjunction with resolutions from meeting of the Management Board of BDB held on 27 November 2017, the members of the Management Board of BDB at the end of 2017 were the following: StoyanTodorov Mavrodiev – Chairman of the MB and Chief Executive Director; Rumen Dimitrov Mitrov – Deputy Chairman of the MB and Executive Director, Nikolay Dimitrov Dimitrov - member of MB and Executive Director and Iliya Vassilev Kirchev – member of MB.

In relation to the election of a Chief Executive Director, the Companies Statute was updated, though this does not mean any change in the manner of representation of the Bank. A resolution thereof was adopted by MB on 05 December 2017, as approved by resolution of SB of the same date. The Bank is represented jointly by each two of the Chief Executive Director, the Executive Directors and a Procurator.

BGN 1 738 to persons who have managed the Bank during the year 2017. No contracts were concluded under the provisions of Art. 240b of the Companies Act were concluded among the members of the SB and MB or persons related to them, on the one hand, and the Bank, on the other, which fall outside the scope of their ordinary activity, or which materially deviate from the market conditions.

The participations, pursuant to Art.247, Para.2, item 4 of the Companies Act, of members of the SB and MB in commercial companies as general partners holding more than 25 per cent of the capital of another company, as well as their participation in the management of other business companies or cooperatives as procurators, managers or members of boards, is as follows:

Members of SB of BDB since the beginning of the year have the following stakes in the capital or participation in the management of other companies:
Atanas Slavchev Katzarchev – he has no participations in the capital and management of other companies.

Kiril Milanov Ananiev - he has no participations in the capital and management of other companies

Dimitar Kirilov Dimitrov is:

- member of the Board of Directors of "ANDEMA" AD;
- partner in "PGD"OOD, with UIC 175247211, and owns 50% share in the company capital. The company has no operations.
- member of the Management Board of "Eurohold Bulgaria" AD, with UIC 175187337.

The members of the SB of BDB, as of the end of 2017 have the following interest in the capital or participation in the management of other companies or cooperatives as procurators, managers or members of boards:

Luchezar Borisov – Chairman – he has no participations in the capital and management of other companies

Mitko Simeonov - Deputy Chairman - he has no participations in the capital and management of other companies

Velina Burska - Member of SB – she has no participations in the capital and management of other companies

The members of the MB have the following participations in the capital or management of other companies since the beginning of the year:

Angel Kirilov Gekov participates in the management of the National Guarantee Fund EAD, UIC 200321435, as Chairman of the Board of Directors (until October 2017). As of now he is in the management of Municipal Bank AD, UIC 121086224, as executive director and member of the Board of Directors.
Angel Gekov is:

- partner in "PCA" OOD, UIC 201477526 and owns 25% of the company capital.
- partner holding 19.28% of the capital of "Bulgarplod BG Cherry" OOD, UIC 200204916.

Bilian Lyubomirov Balev has participated in the management of Micro Financing Institution Jobs EAD, UIC 201390740 as Chairman of the Board of Directors until October 2017. He is:

- executive director and member of the Board of Directors of "Finanko" EAD,with UIC 204666375;

member of the board of directors of "Vino" AD (in liquidation), with UIC 121397741;

manager of Company under the Law on Obligations and Contracts "CONSORTIUM FOREM CONSULTING BULGARIA OOD-ITC E OOD ";

- partner in Fininvest OOD and owns 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;
- sole owner of the capital and manager of the company "Fin Yachting", established and existing pursuant to the laws of Malta.

Iliya Vassilev Kirchev participates in the management of Micro-Financing Institution Jobs EAD, UIC 201390740 as Deputy Chairman of the Board of Directors (until October 2017) - he has no interest or participations in other companies or cooperatives pursuant to Art. 247 Par. 2 item 4 of the Companies Act.

The members of the Management Board of BDB at the end of 2017 have the following participations in the capital or management of other companies or cooperatives as procurators, managers or members of boards:

Stoyan Mavrodiev is part of the management of NATIONAL GUARANTEE FUND EAD, UIC 200321435 as Chairman of the Board of Directors (BoD) and he is sole owner of REAL ESTATE VENTURES EOOD, Sofia, UIC 131160908.

Rumen Mitrov is member of the BoD of MICRO FINANCING INSTITUTION JOBS EAD, Sofia, UIC 201390740

Nikolay Dimitrov is member of the BoD of MICRO FINANCING INSTITUTION JOBS EAD, Sofia, UIC 201390740

Iliya Kirchev - none.

TRANSACTIONS WITH RELATED PARTIES AND COMPANIES UNDER CONTROL OF THE STATE

The owner of BDB is the Bulgarian state, hence the Bank is related party to the government authorities of the Republic of Bulgaria and the companies over which it exercises control. Transactions with related parties and companies under the common control with the state are disclosed in Note № 38 to the separate financial statements of BDB for 2017.

DEVELOPMENT STRATEGY AND BUSINESS GOALS. FINANCIAL GOALS AND OBJECTIVES

The 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 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, financing public and public-private project or partnerships of strategic national or regional importance, incl. infrastructural projects, 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.

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

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

With respect to direct lending, the Bank will further develop credit lines, focused on problem areas of the SMEs' activities, which need special support. In this respect, priorities are the pre-export, export and bridge financing. Traditionally, the Bank will continue to provide funding to the small and medium-sized businesses upon extended grace periods 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 BDBA.

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. The target ratio between indirect (on-lending) and direct financing should be 60:40, where the calculation of this ratio does not include the participation of the bank in public and public-private projects or partnerships of strategic, national or regional importance
- 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 initiatives of the Bulgarian state in support of the economic and social development of the country. In 2018 the activity of BDB will continue in the implementation of the NPEE for insulating and conditioning multi-family residential buildings.

In 2017 BDB has no activities performed in the field of R&D.

EVENTS AFTER THE BALANCE SHEET DATE

On 06 March 2018 Iliya Vasilev Kirchev was released as member of the Management Board of Bulgarian Development Bank AD.

In connection with the introduction and implementation as of 01 January 2018 of IFRS 9, during the fiscal year the process of preparation for introducing the Standard and adoption of BDB systems for classifying the financial assets and liabilities was successfully finalized.

INTERNAL CONTROL

The internal control includes the following components:

(a) control environment – description of the control environment can be found in items Risk Management, Control Environment, and in the на Corporate Governance Statement, section Control Environment of this Report.

(b) process of entity risk assessment - description of the control assessment of the risks of the Bank may be found in Corporate Governance Statement, sections Risk Management of the Group of BDB;

(c) information system, including the business processes related to interest, material for the financial accountability, and communication - description of the information system of the Bank may be found in the Risk Management sections of this report;

(d) control activities - description of the control activities of the Bank may be found in sections Risk Management, part of Corporate Governance Statement, section Structures for Risk Management and Committees to the MB;

(e) ongoing monitoring of controls - description of the ongoing monitoring and control of the Bank may be found in Corporate Governance Statement, section Structure for Risk Management and Committees to the MB.

MANAGEMENT STATEMENT

The management of the Bank declares that the enclosed annual financial statements give true and fair view of the property and financial position of the Bank at the end of 2017 and the calculation of the financial result for the year in compliance with the applicable legislation. Suitable accounting policies have been used and applied consistently. The necessary judgments are made in accordance with principle of prudence in the preparation of the annual financial statements at year-end. The management applies consistently the applicable accounting standards and the annual financial statements have been prepared on a going concern basis.

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

All measures have been undertaken to preserve the assets of the Bank, to prevent fraud and violations of the laws in the country and regulations of BNB on the bank activity.

The current Activity Report was approved on 20 April 2018 by MB of the Bulgarian Development Bank, and it was signed by:

EXECUTIVE DIRECTORS:

STOYAN MAVRODIEV **RUMEN MITROV**

BULGARIAN DEVELOPMENT BANK
BULGARIAN DEVELOPMENT BANK

CORPORATE GOVERNANCE STATEMENT

Principles of corporate governance

As a financial institution established pursuant to a special act, and at the same time applying all regulatory requirements of BNB and the European legislation, and in performing its mission of being a sustainable instrument of state policy for enhancing the development of the small and medium-sized businesses in Bulgaria, the Group of BDB has set as its goal to be an example for good corporate governance and corporate responsibility while consistently and strictly observing the National Corporate Management Code of 2007, The Code of Professional Conduct of 2017 (it replaced the Code of Ethics of BDB of 2013, The Code of Ethics of the Internal Audit of the BDB Group of 2015, the laws and the regulatory requirements in the Republic of Bulgaria, the requirements of the European legislation, as well as the good corporate and bank practices

Bulgarian Development Bank performs services in its capacity of investment intermediary pursuant to the regulations of the Public Offering of Securities Act (POSA). As an investment intermediary the Bank must correspond to certain requirements for the protection of the interests of the clients pursuant to the Markets in Financial Instrument Act (MiFIA) and Ordinance 38 issued by the Financial Supervision Commission (FSC). In 2018 the Bank must also observe the requirements of Directive 2014/65/EU on the Markets in Financial Instruments (MiFID II), Regulation 600/2014 of EU regarding the Markets in Financial Instruments (MiFIR), Regulation 2016/679 on personal data protection (GDPR) and the Payment Services Directive 2015/2366 (PSD 2). The Bank has created and applies an organization related to the signing of contracts with clients, to the requesting of information from clients, to the keeping of records and storing client's assets, pursuant to the requirements of the above national and European legislative acts. The Bank has built a system of internal rules and internal control procedures, which to provide the full compliance with the regulations specified above.

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

Apart from the subsidiaries included in the BDB group, NGF and MFI Jobs, BDB does not have any significant direct or indirect shareholding interests (including indirect shareholding interests through pyramid structures and cross shareholding interests) pursuant to Art. 85 of Directive 2001/34/EU.

Bulgarian Development Bank AD

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

On 23 April 2008 the Bulgarian Development Bank Act (BDBA) was adopted. It arranges the scope of activity of the Bank and its subsidiaries that may be established.

The seat and registered address of Bulgarian Development Bank AD (BDB, the Bank) is Sofia 1000, Sredetz Region, 1 Dyakon Ignatii St.

As of 31 December 2017 the Bulgarian Development Bank AD has no branches.

BDB is the key instrument and a channel for conducting government economic policies, incl. in specific areas, regions, sectors and social groups. The Bank intensively interacts with all remaining governmental structures in order to provide maximum impact of the public funds directed in support of the development of the economy. Priority focus in the activity of the Bank are the pre-export, export and bridge financing. Traditionally, the Bank will continue to provide investment financing by nature for the small and medium-sized businesses with extended initial maturity and relaxed collateral requirements.

The Bank has fulfilled the requirements of BNB of minimum statutory shareholding capital for exercising bank activity, as well as the capital requirements of BDBA. Since its establishment and until August 2017, 99.9% of the share capital of the Bank is property of the Ministry of Finance of the Republic of Bulgaria. On 04 August 2017, by amendment of the BDB Act pursuant to SG, issue 63 of 2017, 99.9999% of the capital of the company went under the control of the Minister of the Economy of the Republic of Bulgaria, and as of the date of preparation of the statement, the ownership of the capital is allocated as follows: 99.9999% is owned by the Republic of Bulgaria, represented by the Ministry of the Economy, 0.0001% is owned by DSK Bank. The performed stress tests and asset quality review of the bank institutions confirmed the exceptionally high capital adequacy and sustainability to shocks of the Group, surpasses many times the regulatory requirements.

The capital of the parent company (the Bank) consists of 6 017 735 common, registered voting shares of par value BGN 100 each. The shares of BDB are not offered on stock exchange markets.

The Bulgarian Development Bank Act sets forth that a package of at least 51% of the shares of the capital of the Bank shall be state owned, where the shares of the State in the amount of no less than 51% of the subscribed shareholding capital shall be non-transferable. Furthermore, a specific restriction was established regarding the composition of the remaining shareholders, other than the Bulgarian state, through the Ministry of the Economy. Such shareholders may be the Council of Europe Development Bank, the European Investment Bank, the European Investment Fund and other development banks of Member States of European Union. The shares of the Bank cannot be pledged, and the rights attached thereto cannot be subject to transfer agreements.

Regarding the acquisition of its own shares, pursuant to Arts. 187e and 247 of the Companies Act, BDB declares that such an acquisition has not taken place, as well as that there are no shares or bonds of the company acquired, held or assigned by the Board Members of the during the reported year, and that pursuant to Art. 6 Par. 4 of the BDB Act the shares in the capital of the Bank, besides the Bulgarian state, may be acquired and owned by the Council of Europe Development Bank, the European Investment Bank and the European Investment Fund, by development banks of Member States of European Union . In these cases art. 31 of the Credit Institutions Act does not apply.

Pursuant to Art. 6 Par. 4 of the BDB Act the members of the Management and controlling bodies, the procurators and the senior management cannot hold shares and cannot be provided with options for shares of BDB, and in subsequent accounting periods no agreements may be concluded as a result of which in any future period changes may occur the relative volume of shares held by current shareholders.

The Management of BDB is carried out in compliance with Art. 5 of the BDB Act, pursuant to which the Bank has a two-tier system of governance and the rights of the state during the General assembly of shareholders of the Bank are exercised by the Minister of the Economy. Outside the powers of the Minister of the Economy, any amendment to the BDB Act, as changes of the articles of association, and the right to issue or buy back shares are only possible by voting a new act or by amending the current act by the National Assembly. Under this article, only the Minister of the Economy, acting as representative of the majority shareholder in BDB, may decide to reduce the share capital through the redemption of shares.

At the end of 2017 BDB has not liabilities under existing or new issues of securities.

As of 31 December 2017 there are no pending court, administrative or arbitration proceedings related to liabilities or receivables of the BDB Group, amounting to 10 per cent or more from its equity.

Pursuant to the Statute of BDB, the lending activity of the Bank is focused on:

Pre-export and export financing of small and medium-sized enterprises (SMEs), financing other operations of SMEs, either through intermediary banks or directly, refinancing of banks granting loans to SMEs, financing of investments by SMEs abroad, participation in public and public-private projects or partnerships of strategic, national or regional importance.

The Bank extends also other types of loans according to a procedure set by the Management Board and within requirements and limitations pursuant to Regulation 575/2013/EU, whereas the exposure to one customer or a group of related customers, other than credit institutions, central governments and central banks, after taking into account the effect of credit risk reduction.

The Bank shall not lend funds for the following activities/borrowers:

1. Activities not compliant with the National law, including for environment protection;
2. Business companies with unknown ultimate controlling owner;
3. Political parties and persons related to them. Pursuant to the latter, persons related to political parties may be: youth, women's and other organizations, which the parties may establish according to law, as well as entities, established by the political parties for performing the only business activities, which they are legally allowed to do - publishing activity, copyrights and using intellectual property, as well as the sale and distribution of printed, audio and audiovisual materials with party campaigning content;
4. Non-profit enterprises and organizations;
5. Media;
6. Activities related to sport and sports initiatives;
7. Other activities, which are prohibited by law.

The Bank provides loans directly or through commercial banks - intermediaries.

The terms and conditions for providing loans are determined by the Management Board.

In support of the development of the economy and in order to provide financial support for each business, the Bank may finance/refinance companies with liabilities, classified in the credit registry at BNB into the groups "Substandard" or "Loss" (or the equivalent of such classification should there be legislative changes at the time of filing a credit application to BDB and after obtaining the approval of the Supervisory Board.

The Management Board passes unanimous decision to form exposures to one client or a group of related clients, if it exceeds 5% of the Bank's equity, in compliance with requirements of the Credit Institutions Act and the internal rules of the Bank.

In view with its specific function related to carrying out state policy on promoting the business BDD, BDB prioritizes its activity programs and products to promote SMEs, on-lending programs, export financing and financing under assigned mandates. The biggest credit exposure of the Bank, provided to a group of related parties /other than bank institutions/, amounts to BGN 69 239 thousand according at amortized cost (2016: BGN 62 202 thousand.), which represents 10.88% of the Bank's equity (2016: 9.99%). Analysis of the structure of the credit portfolio by segments is provided in the individual financial statements.

Bearing in mind the specific activity of the Bank, as of 31 December 2017 the funds attracted from 20 largest non-bank depositors represent 97.13% of the total amount of liabilities to other clients (31 December 2016: 97.26%).

In view of its specific activity, the BDB Group utilizes 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 founded on 12 August 2008 on the basis of the Bulgarian Development Bank Act (BDBA) and was registered at the Companies Registry on 22 August 2008. According to the Credit Institutions Act (CIA), the National Guarantee Fund EAD is a financial institutions entered in 2009 into the Registry by BNB under Art.3, Par.2 of the Credit Institutions Act (CIA). In compliance with the Statute of the company the scope of activity is:

- issuing guarantees for supplementing the collateral under loans to small and medium-sized enterprises;
- offering other products to small and medium-sized enterprises, like: guarantee for participation in a tender; performance guarantee; advance payment guarantee; guarantee for payment of a loan of an exporter, etc;
- issuing guarantees for supplementing collateral under loans to small and medium-sized enterprises, carrying out research and development and for implementing these products and scientific developments into the industry;
- other activities, not particularly prohibited by law.

The seat and registered address of the National Guarantee Fund EAD (NGF) is Sofia, 1 Dyakon Ignatii St.

As of 31 December 2017 NGF has no branches.

Micro Financing Institution Jobs EAD (MFI Jobs)

Micro Financing Institution JOBS EAD (MFI Jobs) was recorded into the Companies Registry on 14 January 2011. The scope of activity is micro-financing, including providing micro-loans, acquiring from third parties and leasing industrial equipment, automobiles and other vehicles, as well as other items /finance lease/, purchase and sale, and import of such items, consulting services, trade representation and mediation for local and foreign physical and legal bodies performing their activity in the country, as well as any other activity not forbidden by law.

The seat and registered address of the National Guarantee Fund EAD (NGF) is Sofia, 1 Dyakon Ignatii St.

As of 31 December 2017 MFI JOBS has no registered branches. The company performs its activity through four offices on the territory of the country – one for each of the cities of Sofia, Pleven, Shumen and Nova Zagora.

RISK MANAGEMENT WITHIN THE GROUP OF BDB

In the course of the ordinary activity, the companies from the BDB Group are exposed to various financial risks, the occurrence of which may lead to losses and to deterioration of the financial stability of the Group. These risks are identified in order to be managed and to avoid any unjustified concentration of a particular risk. The risk management process is important for profitability and for its existence. The most significant risks, to which the Group is exposed, are following credit, market and operational risks.

When managing the risk, the Group follows the principles of conservatism, objectivity and full compliance with all applicable national and European legislative acts and regulatory recommendations. In support of this policy, the Group maintains substantially higher levels of liquid buffers and capital adequacy than the statutorily required.

Credit risk

The credit risk is the main risk, to which BDB is exposed, therefore its management is crucial for its activity. The credit risk management takes place in compliance with the BDB Act and the effective laws and regulations of the Republic of Bulgaria that regulate the credit activity, as well is preformed according to approved international standards and established best banking practices.

The Group uses internal rating model for the assessment and management of the credit risk (incl. from counterparties) under the exposures. Bodies for monitoring, control and assessment of the quality of the credit portfolio have been created and are functioning in the Group. Procedures and mechanisms have been introduced for ongoing monitoring, recording and management of the credit portfolio requiring periodic and, if necessary, extraordinary reports on the financial and legal status of each borrower and liable persons. If new circumstances are established, which may lead to a change to the risk profile of the borrowers, including increasing the risk of default of the credit exposure, adequate and conforming measures risk profile of the debtor, are undertaken.

In managing the credit risk Bank applies a system of internal limits by economic sectors, by instruments, as well as other credit restrictions and limits on concentration, while the results from the monitoring of their compliance are reported to the competent bodies. The system of limits is reviewed and updated periodically.

The credit risk management of the commitments recoded off-balance sheet (guarantees) of NGF takes place at two levels – at the level of the individual deal (guarantee) and at portfolio level. The credit risk at individual level is managed according to the internal rules and procedures for guarantee activity where the proposal for issuing a guarantee (undertaking a guarantee commitment) is reviewed and approved by the risk manager of NGF, then it is handed over for approval by two of the members of the Board of Directors of NGF. After having collected all approvals, the confirmation for issuing the guarantee is signed by the representatives of NGF. Under the guarantee scheme under the Rural Development Program there is a second level of approval – the so called Advisory Committee comprised of representatives of the Ministry of Agriculture and Foods and BDB, which approves each undertaken guarantee commitment under the program. At portfolio level, the credit risk is managed by set up limits for payment (caps), limiting the commitment of NGF to paying to a given bank up to a certain share of the size of the portfolio of guarantees issued under a specific program. The subsequent management of the credit risk assumed by NGF is through monitoring procedures, within which the Fund may exclude from coverage certain loans, which do not correspond to specific requirements of the signed guarantee agreements, from the guarantee portfolio.

The policy, which MFI JOBS has adopted in order to minimize the credit risk, is to make a preliminary assessment of the creditworthiness of the clients, as well as to request additional collateral under the lease and loan contracts and the transferred entitlements – insurances of lease assets, registration of the lease contracts in the Central Registrar of Special Pledges (CRSP), suretyships, promissory notes and special pledges on receivables, as well as mortgage of real estate and/or pledge on movable property when granting the loan.

Market risks of the BDB Group

When managing the foreign currency risk, the BDB Group follows the principle of maintaining minimum open currency exchange positions by observing defined limits. The positions of the Bank in various currencies, as well as the general currency position, are monitored on a daily basis. The currency exchange positions are not formed for speculative purposes, but are the consequence of the currency transactions, occurring in the course of the ordinary bank activity. The BDB Group does not perform large transactions and does not keep significant open positions in currencies other than the euro and the BGN.

Regular reports are prepared on the financial assets and liabilities, distributed periodically according to their sensitivity to changes in the interest rates in order to manage the interest risk. An estimate of the expected fluctuations in the interest curve is applied to the discrepancies by periods, thus estimating the potential risk for the interest revenues and the equity of the Bank.

The risks from transactions on the money and capital markets are managed by a system of limits reflecting the risk profile of the investments and determined according to parameters of the portfolio, like counterparty, financial instrument, maturity, etc. The system of limits is periodically reviewed, while the compliance with the limits is subject to daily monitoring. The portfolio of securities, created by the companies in the Group in order to invest the available funds, has a relatively low duration, low interest risk and has relatively liquid securities issued by reliable institutions, i.e. low price risk. Due to the absence of a trading portfolio pursuant to the statutory regulations, no capital for market risk is allocated.

The liquidity of the BDB Group is managed by strictly monitoring the ratios, indicating the liquidity position by periods. The liquidity risk is measured by applying additional scenarios to the cash flows from operations.

Measured and monitored are also the liquid buffers of the BDB Group, as well as the additional sources of financing upon market and idiosyncratic shocks. The observing of the limits for liquidity ratios is monitored and reported regularly before the relevant bodies.

Operational risk

The management of the operational risk takes place by strictly monitoring and registration of all operational events occurring in the activity of the various sections and processes in the operations of the Group, both the events, which are frequent, and the ones having significant impact, serve as the basis for analysis of the operational risk in various scenarios. The operational risk is measurable and controllable, where a register of the operational events is maintained in the process, and it serves as a basis for analysis and improvement of the work processes and for minimizing the pre-conditions, which could potentially lead to operational events and loss for the Group. The required capital for operational risk is calculated by using the basic indicator approach pursuant to the applicable regulatory framework.

Structure of risk management

The main units directly responsible for risk management, are the following:

- ***For the Parent Company (the Bank):***
  - *Supervisory Board* – performs overall supervision on risk management;
  - *Audit committee to the Supervisory Board* – implements best practices of independent audit control and the establishment of system of the three pillars for control in the financial sectors according to the recommendations from Basel III;
  - *Management Board* – it is responsible for overall risk management approach and for approval of risk strategies, principles and the specific methods, techniques and procedures;
  - *Risk Committee* – it is responsible for the control on the implementation of the management policies of various types of risk and the adequacy of the risk profile of the Bank to the assigned tasks to it;
  - Committee of Assets and Liabilities Management (ALCO) – it is responsible for the strategic management of the assets and liabilities, and for the management of the market risks, incl. liquidity risk, related to assets and liabilities;
  - Committee on Remunerations and Committee on Recruitment– responsible for the management of activities in the field of human resources.
  - Executive Directors and Members of the MB – exercise current operating control on maintaining and observing the specified limits for the particular types of risk and the application of the established procedures;
  - The Central Bank performs supplementary supervision on the risk management in the Bank by requesting periodic regulatory reports and subsequent control on the compliance with statutory maximum levels of exposure of the Bank to certain risks.

For the subsidiary National Guarantee Fund (the Fund):

The main units directly responsible for risk management are the following:

- *Supervisory Board* - Management Board of BDB AD (Parent Company) – performs overall supervision on risk management;
- *Board of Directors* – responsible for overall risk management approach and for approval of risk strategies, principles and the specific methods, techniques and procedures;
- *Committee on Provisions* – analyses the guaranteed portfolios in terms of overall credit risk management for the total guaranteed portfolio, as well as of each guarantee deal and beneficiary of the guarantee itself.

- *Risk and Monitoring Department* – it performs monitoring with respect to the guaranteed portfolios and the collateral on the loans. At least once a year an inspection takes place of the economic and social requirements to be fulfilled by SMEs using guarantees from the National Guarantee Fund EAD.

For the subsidiary Micro Financing Institution JOBS EAD (MFI):

The main units directly responsible for risk management are:

- *Board of Directors* – adopts rules and procedures for risk management. Controls risk factors for the activity of the Company and adopts resolutions within its powers. It also analyses the credit transactions amounting to above BGN 100 thousand in terms credit risk management;
- *Credit Committee* – it continuously monitors and analyses the credit and lease portfolio of the Company from the point of view of the credit risk, incl. on the level of individual transaction;
- *Credit Council* – analyses the credit and lease deals from the point of view of credit risk management during their authorization and/or renegotiation;
- *Operational management* (Executive Director and Member of the BoD) – organizes the activities for implementation of the Rules on Risk Management adopted by the Board of Directors. Creates a work organization, which ensures the observation of the specified limits and levels of risk. Exercises control over the compliance of the analysis, risk estimation and evaluation procedures used by the relevant employees with the internal legislative documents adopted by the Board of Directors;
- Risk Management Department – develops and implements the risk management system. Prepares and submits periodic reports to the Board of Directors in order to evaluate the risks in the business activity, incl. the keeping within the limits, and it regularly reports to the operational management of the Company. It performs initial and ongoing inspection of the risk assessment methods. It controls the input data necessary for evaluating the risk according to an applicable method of reliability and sufficiency.

Bank supervision authorities pursuant to the Bulgarian legislation

In compliance with the requirements of the framework of the laws and by-laws, regulating the banking activity in the country, BDB must follow limitations, related to certain ratios. As of 31 December 2017, the Bank has observed all regulatory requirements of BNB and the Bulgarian legislation.

In its activity the Group must observe the regulatory requirements for capital adequacy and at the same time it must fulfill the common goals set forth at its establishment – support of the economic policy of the country and the development of the small and medium-sized businesses. The values for coverage of the assets with capital buffers exceed the legislative levels multiple times.

Control environment

BDB follows a management philosophy and operating style subordinate to the principles of conservatism when performing the strategic goals of the Bank assigned pursuant to the BDB Act. In relation to the special role of the Bank as an instrument for implementing the state policy, the management of the Bank has adopted an approach of specialized control with respect to the control environment, and also numerous directorates were created within the structure of the Bank with specific controlling functions – Risk Department, Liquidity Department, Planning, Analysis and Regulations Department, Legal Department, Classified Information Section, Compliance Department. Along with the periodic updating of the internal normative base, this approach allows management to undertake timely measures for control of risks, along with the traditional components of the control environment, ensured by the direct participation of the Bank's management in the preparation and verification of the financial statements and activity of the Accounting Department and the Internal Audit Department, acting in full compliance with the principles of the three control pillar system, introduced by the European legislative acts.

The management assigns powers and responsibility for the operations in line with a detailed internal normative basis complying with the current national and European legislation where in order to guarantee the relationships on accountability and reporting and the hierarchy of the authorities, several specialized committees were developed that report to MB and SB of BDB.

The Bank has developed an internal legislative base, which includes policy and communications meant to ensure that each employee understands the goals of the Bank, knows how the individual actions of each are related and contributes to the achievement of these goals, and to whom and how to report and for what each employee is responsible for.

The Bank has established an information system, including business processes related to it, providing the necessary quality and control on the financial reporting and communication.

The Internal Audit Department and the Audit Committee of SB of the Bank perform ongoing monitoring of the controls.

CORPORATE GOVERNANCE THE BDB GROUP

Bulgarian Development Bank AD has a two-tier management structure, which consists of Supervisory Board(SB) and Management Board (MB)

As of 31 December 2017 the structure of the Management bodies has the following components:

Supervisory Board:

*Luchezar **Borisov** – Chairman*
Luchezar Borisov was born in 1987 in Samokov. He completed his Master studies in Macroeconomics and Accounting and Finance at the University of National and World Economy (UNWE). He has several specializations in Bulgaria and abroad, including in Entrepreneurship and Risk Capital in AUBG, Project Management in WIFI, Austria, Encouragement of Foreign Direct Investments in JICA, Japan, Stock-exchange and Banking in CITIBANK, etc. He has rich experience in corporative management. Mr. Borisov has been part of the management of both private and state-owned companies in the Industry, energy and financial sectors. Currently he is a Deputy Minister of Economy

Mitko Simeonov - Deputy Chairman of the SB
Mitko Simeonov has a Master degree in Law from the New Bulgarian University and a Master degree in International Economic Relations from the University of National and World Economy. He also holds a postgraduate degree in financial management from the University of National and World Economy. He was Deputy Executive and Executive Director of the Agency for Privatization and Post-Privatization Control.

Velina Burska - Member of SB
Velina Burska has a Master Degree in Economics and Organization of Internal Trade from the University of National and World Economy. From 2002 to 2017 she was the director of the Post-Privatization Control Directorate at the Agency for Privatization and Post-Privatization Control.

In fulfillment of the good practices of control and the system of the three pillars recommended within Basel III, a specialized body made up of Audit Committee, Risk Committee, Remunerations Committee and Recruitment Committee functions to the Supervisory Body.

	Risk Committee	***Recruitment Committee***	***Remunerations Committee***
Luchezar Borisov	Chairman	Chairman	Chairman
Mitko Simeonov	Member	Member	Member
Velina Burska	Member	Member	Member

Audit Committee:
Ms. Valya Yordanova - Chairman of the Committee
Ms. Ruslanna Radomirova – Member of the Committee;
Mr. Ognyan Todorov - Member of the Committee.

Additional auditing services

The auditing companies performing audit of the annual financial statements of the Bank (separate and consolidated), in addition publish also a Report on the Real Findings with respect to the reliability of the internal control systems under Art.76, Par.7, item 1 of the Credit Institutions Act and Ordinance 14, Art.5 on the content of the auditor's report for the purposes of supervision as of 31 December 2017(Ernst & Young Audit OOD has issued such report for the Bank also as of 31 December 2016). In 2017, Ernst & Young Audit OOD has performed also approved training services.

Management Board:

***Stoyan Mavrodiev** - Chairman of the Management Board and Chief Executive Director*

Stoyan Mavrodiev holds a Master of Law from Sofia University "St. Kliment Ohridski" and a Master in Finance from the University of National and World Economy. He attended a series of courses at the International Tax Academy in Amsterdam, and has also trained in the US Department of State's International Program of Leaders. His career started as a legal, tax and business consultant at PriceWaterhouse Co. In the period 1996-2006, he worked as a financial and legal consultant in the United Consulting, which he also managed. From 2009 to 2010 he is Deputy Chairman of the Commission for Economic Policy, Energy and Tourism and member of the Budget and Finance Committee of the 41st National Assembly. For 6 years (2010-2016), he is Chairman of the Financial Supervision Commission (FSC), which oversees and regulates the financial system and the non-banking financial sector in Bulgaria. From 2010 to 2016 he is a member of the Advisory Financial Stability Board (FSF). In this period, it is also a member of a number of international organizations, including ESMA, EIOPA, ESRB, IOSCO, IAIS and IOPS.

***Rumen Mitrov** - Deputy Chairman of the Management Board and Executive Director*

Rumen Mitrov holds a Master in Accounting and Control from the University of National and World Economy. His professional experience began in 1994 at NRA Sofia. In the period 2000-2003 he is the manager of the petroleum products import company "GMN GAZ", and from 2003 to 2011 he is engaged in financial and tax consultancy as manager of the two accounting companies "Eurotim Bulgaria" and "RM Consult". From 2011 to 2016, he was consecutively appointed Director of "Investment Activity Supervision", "Regulatory Policy", and "Coordination, Analysis and Policy of Supervisory and Supervision Activities" divisions in the Financial Supervision Commission (FSC).

***Nikolay Dimitrov** - Member of the Management Board and Executive Director*

Nikolay Dimitrov holds a Ph.D. in Economics from the University of National and World Economy (UNWE) with specializations "International Economic Relations" and "Finance". Between 2007 and 2015, he completed a number of additional courses and qualifications at the Judge Business School at Cambridge University (UK), the Investment Banking Institute (USA), among others. His banking career started at the end of 2003 and went through Raiffeisen Bank and United Bulgarian Bank. He joined the Bulgarian Development Bank in July 2011, in January 2012 become Head of the Investment Banking and Project Finance Department, and since April 2013 he is Head of the Corporate Banking Division. Alongside, he has been an associated professor at the Department of International Economic Relations at UNWE for the last seven years

***Iliya Kirchev** - Member of the Management Board*

Iliya Kirchev is master in Finance from the University of National and World Economy. His career began in 1995 at Agrobusinessbank in Plovdiv. Between 1999 and 2003, he is manager of the Plovdiv branch of Allianz Bank Bulgaria. Between 2003 and 2005, he occupies management positions at HVB Bank Biochim. Between 2005 and 2010, he consecutively headed two of the Plovdiv branches of Eurobank Bulgaria, while in 2011 he became regional manager for corporate clients in the bank. Between 2012 and 2013, he is manager of Plovdiv Branch of First Investment Bank. At the moment, he is assistant in the Higher School of Agrobusiness and Rural Development in Plovdiv.

Committees of the Managemnet Board

The BDB Management Board, in conformity to the current legislation in Bulgaria and in EU, and following the best banking practices, has delegated part of its authorities to specialized committees - Committee on Assets and Liabilities Management and Commission on Complaints and Signals.

Meetings of the Committee on Assets and Liabilities Management (ALCO) take place on a monthly basis, at which meetings the main indicators having relevance to the strategic management of the assets and liabilities of the bank are reviewed. The main functions of ALCO are to identify, manage and monitor the liquidity risk of the Bank, to determine the strategy for attracting resources, to determine the pricing policy for the loans in order to ensure adequate margin above the costs of funds , to decide on the strategic liquidity of the Bank in order to ensure a regular and timely settlement of the current and future liabilities, both during normal circumstances and in event of liquidity crisis, to determine the structure of the liquidity buffers and the sources of additional funding. The materials reviewed at the meetings of the ALCO, along with the minutes from them, are reported to the Management Board of BDB on a timely basis after each session. In addition to the board members, participants in these meetings are also the heads of key departments in the Bank.

	Committee on Assets and Liabilities Management (ALCO)	Commission on Complaints and Signals*
Stoyan Mavrodiev	Member	
Rumen Mitrov	Chairman	
Nikolay Dimitrov	Member	
Iliya Kirchev	Member	
Head of Risk Department	Member	Member
Head of Legal Department		Member
Head of Bank Security Department		Member
Head of the Planning, Analysis and Regulations Department	Member	Member
Head of the Group Internal Audit Department		Member
Head of the Liquidity Department	Member	
Head of the Compliance Department		Chairman
Head of the International Financial Institutions Department	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 among the Chief Executive Director, the Executive Directors and the Procurator.

In 2017 no changes took place in the basic principles of management of the BDB Group.

CONTRACTS WITH RELATED PARTIES INVOLVED IN THE MANAGEMENT AND PARTICIPATION OF MEMBERS OF THE MB AND SB IN OTHER COMPANIES

There are no signed contracts pursuant to Art. 240b of the Companies Act between the members of the SB and MB or persons related to them, on one hand, and the Bank, on the other, which fall beyond the ordinary course of business or which significantly deviate from the market conditions.

In 2017 there were no concluded deals between BDB and its related parties, or offers for signing such deals, which fall outside the scope of the ordinary activity, or which significantly deviate from the market conditions, to which BDB or its subsidiary is a party.

There are no material contracts of the Bank, which lead to action, are amended, or terminated, due to change in the control of the Bank, when performing a compulsory public procurement procedure. As far as there is a legal restriction regarding the acceptable range of shareholders of BDB, pursuant to the BDB Act, no such contracts are expected to be concluded.

BDB Group does not have practice and has not concluded agreements between the companies and their Management bodies or employees for the payment of compensation upon resignation or dismissal without legal grounds thereof, or upon terminating the legal employment relationships by reasons related to tender offers.

The participations, pursuant to Art.247, Para.2, item 4 of the Companies Act, of members of the SB and MB in commercial companies as general partners holding more than 25 per cent of the capital of another company, as well as their participation in the management of other business companies or cooperatives as procurators, managers or members of boards, is as follows:

Members of SB of BDB since the beginning of the year have the following stakes in the capital or participation in the management of other companies:
Atanas Slavchev Katzarchev – he has no participations in the capital and management of other companies.

Kiril Milanov Ananiev - he has no participations in the capital and management of other companies

Dimitar Kirilov Dimitrov is:

- member of the Board of Directors of "ANDEMA" AD;
- partner in "PGD"OOD, with UIC 175247211, and owns 50% share in the company capital. The company has no operations.
- member of the Management Board of "Eurohold Bulgaria" AD, with UIC 175187337.

The members of the SB of BDB, as of the end of 2017 have the following interest in the capital or participation in the management of other companies or cooperatives as procurators, managers or members of boards:

Luchezar Borisov – Chairman – he has no participations in the capital and management of other companies

Mitko Simeonov - Deputy Chairman - he has no participations in the capital and management of other companies

Velina Burska - Member of SB – she has no participations in the capital and management of other companies

The members of the MB have the following participations in the capital or management of other companies since the beginning of the year:

Angel Kirilov Gekov participates in the management of the National Guarantee Fund EAD, UIC 200321435, as Chairman of the Board of Directors (until October 2017). As of now he is in the management of Municipal Bank AD, UIC 121086224, as executive director and member of the Board of Directors.
Angel Gekov is:

- partner in "PCA" OOD, UIC 201477526 and owns 25% of the company capital.

- partner holding 19.28% of the capital of "Bulgarplod BG Cherry" OOD, UIC 200204916.

Bilian Lyubomirov Balev has participated in the management of Micro Financing Institution Jobs EAD, UIC 201390740 as Chairman of the Board of Directors until October 2017. He is:

- executive director and member of the Board of Directors of "Finanko" EAD,with UIC 204666375;
- member of the board of directors of "Vino" AD (in liquidation), with UIC 121397741;
- manager of Company under the Law on Obligations and Contracts "CONSORTIUM FOREM CONSULTING BULGARIA OOD-ITC E OOD ";
- partner in Fininvest OOD and owns 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;
- sole owner of the capital and manager of the company "Fin Yachting", established and existing pursuant to the laws of Malta.

Iliya Vassilev Kirchev participates in the management of Micro-Financing Institution Jobs EAD, UIC 201390740 as Deputy Chairman of the Board of Directors (until October 2017) - he has no interest or participations in other companies or cooperatives pursuant to Art. 247 Par. 2 item 4 of the Companies Act.

The members of the Management Board of BDB at the end of 2017 have the following participations in the capital or management of other companies or cooperatives as procurators, managers or members of boards:

Stoyan Mavrodiev is part of the management of NATIONAL GUARANTEE FUND EAD, UIC 200321435 as Chairman of the Board of Directors (BoD) and he is sole owner of REAL ESTATE VENTURES EOOD, Sofia, UIC 131160908.

Rumen Mitrov is member of the BoD of MICRO FINANCING INSTITUTION JOBS EAD, Sofia, UIC 201390740

Nikolay Dimitrov is member of the BoD of MICRO FINANCING INSTITUTION JOBS EAD, Sofia, UIC 201390740

Iliya Kirchev - none.

Comprehensive information about the full amount of the compensations, rewards and/or benefits for each member of the Management and controlling bodies for the fiscal accounting year, paid by the issuer and its subsidiaries is disclosed in the notes to the financial statements.

Management of the subsidiaries

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

National Guarantee Fund EAD

NGF EAD has a one-tier management system – Board of Directors (BoD), consisting of three members, while have the following components:

In the beginning of the year the Board of Directors had the following members – Angel Gekov - Chairman of the BoD, Aleksandar Georgiev - member of the BoD, and Samuil Shiderov – Deputy Chairman of the BoD and Executive Director of NGF.

A resolution of the Management Board of Bulgarian Development Bank registered at the Companies Registry on 23 October 2017 approved the release of Mr. Angel Gekov as member of the Board of Directors (BoD) of the National Guarantee Fund and the appointment of Mr. Stoyan Mavrodiev as member of the BoD of NGF. At a meeting of the BoD of NGF on 17 October 2017, Mr. Stoyan Mavrodiev was elected Chairman of the BoD.

On 26 January 2018 by resolution of the Management Board of Bulgarian Development Bank AD, the release of Mr.Samuil Shiderovas member of the Board of Directors (BoD) and Executive Director of the National Guarantee Fund and the appointment of Mr. Angel Djalazov as member of the BoD of NGF and Executive Director was approved.

At a meeting of the Management Board of Bulgarian Development Bank AD held on 15 March 2018 a resolution was adopted to release Mr. Aleksandar Georgiev as member of the Board of Directors (BoD) of the National Guarantee Fund and the appointment of Mr. Andon Georgiev as member of the BoD of NGF.

Board of Directors

Stoyan Mavrodiev - Chairman of the Board of Directors

Samuil Shiderov - Deputy Chairman of the Board of Directors and Executive Director

Samuil Shiderov is Executive Director of the National Guarantee Fund. He holds a bachelor's degree in Banking and a master's degree in Finance from the Economic University in Varna. He began his career at the end of 2001 in SG Expressbank, Sofia. Between 2003 and 2011 he worked at the Risk Management Department of Raiffeisenbank Buglaria where he consecutively occupied the positions of loan administrator, specialist problem loans, Head of sector and Deputy Head of Department. Since October 2011 until December 2012 he is manager of section at DSK Bank. He is executive director of the National Guarantee Fund since the beginning of 2013. On 18 June 2015 Samuil Shiderov was elected member of the Board of Directors of the European Association of Guarantee Institutions (AECM).

Aleksandar Georgiev - member of the Board of Directors

Aleksander Georgiev is member of the Board of Directors of the National Guarantee Fund since March 2015. He is master in Economy and Industry Management from Business Academy Dimitar Apostolov Tsenov at Svishtov. He has extensive experience at expert and management positions in the field of insurance and financial services.

The fund is represented jointly by any two members of the board of directors.

The members of the BoD of NGF EAD do not hold any shares of the Fund, nor do they have any special rights on the acquisition of such shares.

There are no contracts signed pursuant to Art. 240b of the Companies Act between the members of the BoD of NGF EAD or persons related to them, on one hand, and the Company on the other, which fall outside the scope of their ordinary activity, or which significantly deviate from market conditions.

The participations, pursuant to Art.247, Para.2, item 4 of the Companies Act, of members of the SB and MB in commercial companies as general partners holding more than 25 per cent of the capital of another company, as well as their participation in the management of other business companies or cooperatives as procurators, managers or members of boards, is as follows:

The members of the BoD of NGF EAD have the following interest in the capital or take part in the management of other companies:

Angel Kirilov Gekov is executive director and chairman of the Management Board of Bulgarian Development Bank AD (until October 2017).

Angel Gekov is:

- partner in "PCA" OOD, UIC 201477526 and owns 25% of the company capital;
- partner holding 19.28% of the capital of "BULGARPLOD BG CHERRY" OOD, UIC 200204916.

Aleksander Georgiev is:

- sole owner and manager of "Brandy BG" EOOD, with UIC 202605174;
- sole owner and manager of "KA SERVIS" EOOD, with UIC 114672190;
- owner of SP Aleksander Georgiev - AG, with UIC 824083350;
- member of the Board of Directors of "BALNEOLOGICAL CENTER - KAMENA" EAD, with UIC 112013405

Samuil Pavlov Shiderov has participations in capital or in management of other companies or cooperatives pursuant to Art. 247 Par. 2 item 4 of the Companies Act.

At end of the year 2017 the members of the BoD of NGF EAD have the following interest in the capital or take part in the management of other companies:

Stoyan Mavrodiev is member of the MB and Chief Executive Director of BULGARIAN DEVELOPMENT BANK. Stoyan Mavrodiev is sole owner of REAL ESTATE VENTURES EOOD, Sofia, UIC 131160908

Aleksander Georgiev is:

- sole owner and manager of "Brandy BG" EOOD, with UIC 202605174;
- sole owner and manager of "KA SERVIS" EOOD, with UIC 114672190;
- owner of SP Aleksander Georgiev - AG, with UIC 824083350;
- member of the Board of Directors of "BALNEOLOGICAL CENTER - KAMENA" EAD, with UIC 112013405

Samuil Shiderov has no interest in or participations in other companies or cooperatives pursuant to Art. 247 Par. 2 item 4 of the Companies Act

Angel Djalazov was elected Executive director and Deputy Chairman of the Board of Directors of National Guarantee Fund EAD in February 2018. This change took place, in compliance with the legal regulations, pursuant to Resolution of the sole shareholder BDB

Micro Financing Institution Jobs EAD

MFI Jobs EAD also has a one-tier management system - Board of Directors (BoD), which comprises three members.

In 2017 and up until the date of preparation of this report the following changes to the membership of the Board of Directors of the Company have taken place:

On 19 October 2017, Bilian Lyubomirov Balev was released from the Board of Directors and Rumen Dimitrov Mitrov was admitted in his stead.

On 19 October 2017, Iliya Vassilev Kirchev was released from the the Board of Directors and Nikolay Dimitrov Dimitrov was admitted as a new member.

In 2018, the following changes to the membership of the Board of Directors of the Company have taken place:

On 07 February 2018, Kostadin Bozhikov Munev was released from the Board of Directors and Angel Atanasov Djalazaov was admitted in his stead.

On 22 March 2018, an amendment in the Statute of the Company was entered, which amends the number of Members of the Board of Directors from bthree to five Members.

On 30 March 2018, Hristina Atanasova Todorova was admitted as new member of the Board of Directors. On 02 April 2018, Ms. Todorova was registered also as procurator of the Company.

Board of Directors

Rumen Mitrov - Chairman of the Board of Directors

Nikolay Dimitrov – Deputy Chairman of the Board of Directors

Kostadin Munev - Member of the Board of Directors and Executive Director

Kostadin Munev has a master's degree in finance from the University of National and World Economy in Sofia of 1996. In 2011 he was elected Procurator of Micro Financing Institution JOBS EAD and manager of the Lending and Leasing Section of the Company, since April 2013 he is member of the BoD, while since April 2014 he was elected Executive Director of Micro Financing Institution JOBS EAD. He has worked as Chief Accountant of Bulgarian enterprises and non-profit associations. He has extensive experience in the field of micro-financing, acquired as manager of finance lease under the JOBS Project of the Development Program of the UN in the period 2003 – 2010. He was participant in various international conferences on topics related to micro-financing and he is co-author of publications: "Manual for micro-lending in Europe", „From exclusion to inclusion through micro-financing", "Market research of micro-lending for the purposes of the European Investment Fund – International research in Western and Eastern Europe: "Report on Bulgaria". He is fluent in English and Russian.

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

There are no contracts signed pursuant to Art. 240b of the Companies Act between the members of the BoD or persons related to them, on one hand, and the Company on the other, which to fall outside the scope of their normal activity, or which significantly deviate from market conditions.

The participations, pursuant to Art.247, Para.2, item 4 of the Companies Act, of members of the SB and MB in commercial companies as general partners holding more than 25 per cent of the capital of another company, as well as their participation in the management of other business companies or cooperatives as procurators, managers or members of boards, is as follows:

The members of the BoD of MFI Jobs EAD since the beginning of the year have the following interest in the capital or take part in the management of other companies:

Bilian Lyubomirov Balev (released from BoD in October 2017) was Executive Director and Deputy Chairman of the Management Board of the Bulgarian Development Bank AD. Furthermore, he is also:

- Executive Director and member of the Board of Directors of "Finanko" EAD,with UIC 204666375;
- member of the Board of Directors of Vino AD (in liquidation), with UIC 121397741;
- manager of Company under the Liabilities and Contracts Act "CONSORTIUM FOREM CONSULTING BULGARIA OOD-ITC E OOD";
- partner in Fininvest OOD and owns 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;
- sole owner of the capital and managing the company "Fin Yachting", established and existing pursuant to the laws of Malta.

Iliya Vassilev Kirchev (released from the BoD in October 2017) was executive director and member of the MB of Bulgarian Development Bank AD

Kostadin Bozhikov Mounev has no participation in other companies and cooperatives pursuant to Art. 247 Par. 2 item 4 of the Companies Act.

The members of the BoD of MFI Jobs EAD at the end of the year have the following interest in the capital or participation in the management of companies:

Rumen Mitrov is Executive Director and Deputy Chairman of the Management Board of Bulgarian Development Bank AD.

Kostadin Mounev does not participate in other companies and cooperatives pursuant to Art. 247 Par. 2 item 4 of the Companies Act.

Nikolay Dimitrov is Executive Director and member of the Management Board of Bulgarian Development Bank AD.

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

Owner of BDB is the Bulgarian state, and therefore the companies from the BDB Group are related parties with the governmental bodies of the Republic of Bulgaria and the companies over which it exercises control. The consolidated and individual financial statements present detailed information regarding the deals of the BDB Group and of BDB with related parties and the companies under the common control of the state.

STRATEGY FOR DEVELOPMENT AND BUSINESS GOALS

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 analyze 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, financing public and public-private project or partnerships of strategic national or regional importance, incl. infrastructural projects, 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.

- <u>The strategic goals of BDB are:</u>

- 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 POLICY OF DIVERSITY

In 2017 Bulgarian Development Bank continues developing corporate social responsibility by concentrating its efforts most of all towards areas "Vulnerable social groups, "Culture and Art" and "Science and Education".

In order to perform strictly specific functions as set forth by the BDB Act, the Bank implements a policy of diversity with respect to the administrative, Management and Supervisory Bodies within the powers delegated by the state. The Bank strictly observed the good practices of non-discrimination with respect to age, sex and education.

A cause of the BDB Group is the support of socially vulnerable groups like children and youth deprived of parental care and disadvantaged persons. They believe that charity is a compulsory element not only of corporate social responsibility, but also of the everyday life of each of us, and the employees of the bank concur with this idea.

Vulnerable social groups

Among the initiatives in support of vulnerable social groups the Bank distinguishes the partnership of Bulgarian Development Bank with the **Foundation for social change and inclusion (FSCI),** which manages a network of observed homes called **"Home Opportunity"** and works as a social enterprise through the initiative HOPe Restaurant.

The protected homes are not just shelter for youth leaving the specialized institutions for children deprived of parental care, but they also provide support in education and qualification, the finding of jobs, the development of social and labor skills for coping with the "real" life after the children's home. HOPe Restaurant is a social enterprise, which upgrades the efforts of the foundation for social inclusion of vulnerable groups. This facility provides jobs for youth from "Home Possibility", agreed with some of the best cooks in Sofia. Bulgarian Development Bank supports this initiative by paying the compensation of one young man, working in the facility.

The Bank perceives **social entrepreneurship** as a successful business model for coping with various public challenges and serious social problems, part of the strategy for intelligent, sustainable and inclusive growth "Europe 2020", where one of the set goals is evacuating at least 20 million people from the state of poverty and social exclusion. In this respect, BDB endeavors to support social enterprises by purchasing corporate materials and souvenirs from non-profit organizations.

The Group successfully partners with **National Fund "St. Nikola"** when performing various initiatives. The Bank supports the fund when organizing creative studios for children and youth, summer rehabilitation camps for children with disabilities deprived of parental care, thematic trips, Christmas and New Year celebrations and other initiatives.

BDB established a successful partnership with association **"Liberal ideas for development and adaption" (LIDA)**, by supporting the celebrations conducted by the Easter Holidays organization for children and adults with severe disabilities .

The Bank has also recognized **"Bulgarian Christmas"** as part of its corporate social responsibility, and in 2017 it continued to provide support to the initiative.

Culture and art

The philosophy of BDB is that culture and art unite, cultivate, bring national pride and sense of belonging. Part of the efforts of the Bank are dedicated to supporting cultural and art-making projects where priority is given to initiatives integrating vulnerable groups through art, motivating young creators, the preservation and promotion of Bulgarian traditions, history, culture.

Among the campaigns of BDB with such focus is **"Culture for me also"**, which keeps developing in 2017. Within this initiative more than 150 children and youth deprived of parental care attended theatrical performances in Sofia put up by theatrical workshop "Arcadia Art Fusion".

In furthering its policy of support for Bulgarian art, the building of BDB hosted **temporary exhibitions of paintings and sculptures** both of young and of established Bulgarian authors.

The BDB Group also organized a **photo exhibition with key projects of the development banks all over the world**, the role of which was increasing the awareness about the specific activity, which these institutions perform in their countries. The selected projects present both interesting starters and micro-businesses, and large scale transport, energy and infrastructural projects.

The Bulgarian Development Bank has undertaken as its cause also the preservation and promotion of the Bulgarian spiritual, cultural and historic heritage. The Bank supports initiatives and events in this respect, like the **International Easter Festival** in the town of Bossilegrad where every year, children from Bulgarian communities both in the country and from Bulgarian diasporas in Serbia, Macedonia, Ukraine, Moldova, and other, take part. Among the goals of the event is the preservation of the customs and traditions in the region.

Education

The Bulgarian Development Bank believes that the investments in education and science are investments in the future. Therefore, we have adopted as our own the mission of support for the knowledge seekers, intelligent, talented, ambitious and promising young people in Bulgaria.

BDB traditionally supports the teams from **Sofia High School of Mathematics** in their participation in international competition and mathematical, computer science and physics olympiads. In 2017, with the support of the Bank they attended the International Mathematics Tournament "The Harvard – MIT mathematics tournament", which took place in Boston, USA.

The Bank also supports the initiative of association **„SOS Children's Villages"** – *SOS centers for prevention of abandonment,* which assists more than 200 children at risk annually, so that they can stay in their own families, to have equal opportunity for education and socializing. In 2017 focus of the charity organization was the provision of specialists for expert work with these children – pedagogues, psychologists, therapist, who would contribute to their additional preparation for the learning process.

The management team in the BDB Group implements focused and consistent actions dedicated to building corporate culture concentrating on the individual and team contribution of the employees towards the realization of the business goals of the Group, as well as the achievement of competitive compensation of the employees as compared to the labor market.

In 2017 the "Handbook on the Management and Development of Human Resources in the BDB Group" adopted in 2015 continued to be effective, and it is harmonized with the best practices in the field of HR management. The Handbook aims to ensure integrated approach and upgrading actions in the BDB Group on attracting, hiring, developing, motivating and keeping the employees with superior expertise since they are the basis for shared success. The motivation and keeping of the employees as function of this integrated approach is achieved by a set of interlinked elements, like: policy about remunerations treating the types of remunerations; internal rules on the working salary regulating the mechanism of calculation and payment of the basic and additional regular payments and remunerations; evaluating the work performance, motivating the good performance and professional fulfillment of the employees bound by a relevant basic and additional remuneration; social measures and bonuses, training and development, in an irrevocable bond with the corporate culture and the business strategy of the Bank/Companies.

The “Social measures and bonuses“ program covers all employees of the Bank hired by an labor contract and includes: additional health insurance (medical insurance), life insurance, business attire, telecommunication services, sports activities, alleviated terms on the loans for employees of the Bank, assuming the cost of membership in professional organizations, support for the family environment of the employees (a one-time benefit when entering into marriage, giving birth to a child, support for medical treatment of an employee or member of his/her family).

The Bulgarian Development Bank Group focuses on ongoing support for the development and training of its employees, creating prerequisites for professional growth of the financial specialists within the only financial group in Bulgaria, which does not prioritize profit maximization, while main focus of its activity is the support for small and medium-sized enterprises in Bulgaria. The system of training and development is focused on the Bank employees and includes various instruments, programs, activities and initiatives aiming at the development of the potential of the employees so that they can respond to the fullest degree to the demands necessary for achieving the strategic goals of the Bank. The Bank strives to build and maintain a culture of constant refining and upgrading the knowledge of its employees and their self-development.

The current Corporate Governance Statement is an integral part of the Activity Report approved on 20 April 2018 by the Management Board of the Bulgarian Development Bank.

EXECUTIVE DIRECTORS:

STOYAN MAVRODIEV **RUMEN MITROV**

BULGARIAN DEVELOPMENT BANK
BULGARIAN
DEVELOPMENT BANK

Building a better working world

Zaharinova & Partners

audit, analysis and consulting

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1124 Sofia, Bulgaria

Statutory Audit Firm # 0138
Zaharinova & partners OOD
157-159, Konstantin Velichkov blvd.
1309 Sofia

Independent auditors' 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 2017, 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 2017, 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.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the separate financial statements of the current period. These matters were addressed in the context of our audit of the separate financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the* separate *financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying separate financial statements.

Key audit matter	How our audit addressed the key audit matter
Impairment of loans and advances to customers The Bank's disclosures about impairment of loans to customers are included in Note 4.1. Credit risk, Note 18 Loans and advances to customers and Note 12 Impairment gain/loss to the separate financial statements.	
Loans and advances to customers represent a significant part (28%) from the total assets of the Bank as at 31 December 2017. As disclosed in Note 4.1. Credit risk, Note 18 Loans and advances to customers and Note 12 Impairment gain/loss to the separate financial statements, the Bank's management determines impairment loss estimate on loans for which there is identified objective evidence of impairment on an individual basis. The gross value of such loans as at 31 December 2017 is BGN 228,995 thousand (27% from total gross value of loans and advances to customers) and the respective accumulated loss allowance for these loans is BGN 155,173 thousand. For the loan impairment assessment, significant management judgement is required, especially to determine the timing and amount of the expected cash flows, including when determining the value of the respective collaterals as well as credit risk category.	In this area, our key audit procedures included, amongst others: • Assessment and tests of the design and operating effectiveness of controls over the calculation of the impairment and the monitoring processes of the Bank. We have used our IT experts to assess and test the IT general controls of the Bank's internal system used for the monitoring process. • Performance of analytical procedures on a disaggregated data to evaluate if the relationship in the trends in the recorded impairment expense and allowance follow the tendencies of development of the loan portfolios. • For loans and advances to customers for which the Bank has not identified any objective evidence of impairment, we tested a risk-based sample of exposures to

Due to the significance of the loans and advances to customers for which there is identified objective evidence of impairment as an element of the separate financial statements of the Bank and the related estimation uncertainty in the calculation of the impairment, we have determined this matter as a key audit matter.	assess and analyze their proper credit risk category classification. • For a risk-based sample of loans and advances to customers focusing on those with the most significant potential impact on the separate financial statements, we specifically assessed the Bank's assumptions on the expected future cash flows, including the realizable value of collateral based on our own understanding and available market information. We have involved internal valuation experts to assist us in assessing the value of realizable collateral on a sample basis. • Performance of subsequent events procedures focused on the development of the sampled loans as per the previous paragraph, post balance sheet date to assess the Bank's assumptions on the expected future cash flows. • Assessment of the relevance and adequacy of the separate financial statement disclosures related to the Bank's exposure to credit risk as well as the impairment losses on loans and advances to customers.

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

Management is responsible for the other information. The other information, which we have obtained prior the date of our auditor's report, comprises the management report, including information about the activities of the Bank as an investment intermediary, the 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.

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 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 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.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the separate financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

We are jointly and severally responsible for the performance of our audit and for the expressed by us audit opinion as per the requirements of the IFAA applicable in Bulgaria. In accepting and executing the joint audit engagement, in connection with which we report hereby, we also have followed the Guidance on Performing a Joint Audit issued on 13 June 2017 by the Institute of Certified Public Accountants in Bulgaria and the Commission for Public Oversight of Statutory Auditors in Bulgaria.

Report on Other Legal and Regulatory Requirements

Additional Matters to be Reported under the Accountancy Act

In addition to our responsibilities and reporting in accordance with ISAs, described above in the *Information Other than the Separate Financial Statements and Auditor's Report Thereon* section, in relation to the management report, including information about the activities of the Bank as an investment intermediary and the corporate governance statement, we have also performed the procedures added to those required under ISAs in accordance with the Guidelines on New and Expanded Auditor's Reports and Auditor's Communication of the professional organisation of certified public accountants and registered auditors in Bulgaria, i.e. the Institute of Certified Public Accountants (ICPA). These procedures refer to testing the existence, form and content of this other information to assist us in forming 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 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) The management report has been prepared in accordance with the requirements of Chapter Seven of the Accountancy Act.
c) The corporate governance statement 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.

Reporting in accordance with Art. 10 of Regulation (EU) No 537/2014 in connection with the requirements of Art. 59 of the Independent Financial Audit Act

In accordance with the requirements of the Independent Financial Audit Act in connection with Art. 10 of Regulation (EU) No 537/2014, we hereby additionally report the information stated below.

— Ernst & Young Audit OOD and Zaharinova & partners OOD were appointed as statutory auditors of the separate financial statements of Bulgarian Development Bank AD for the year ended 31 December 2017 by the General meeting of shareholders held respectively on 23 May 2017 and 13 November 2017 for a period of one year.

— The audit of the separate financial statements of the Bank for the year ended 31 December 2017 represents third total uninterrupted statutory audit engagement for that entity carried out by Ernst & Young Audit OOD and first total uninterrupted statutory audit engagement for that entity carried by Zaharinova & partners OOD.

— We hereby confirm that the audit opinion expressed by us is consistent with the additional report, provided to the audit committee of Bulgarian Development Bank AD, in compliance with the requirements of Art. 60 of the Independent Financial Audit Act.

— We hereby confirm that we have not provided the prohibited non-audit services referred to in Art. 64 of the Independent Financial Audit Act.

— We hereby confirm that in conducting the audit we have remained independent of the Bank.

Audit Firm Ernst & Young Audit OOD:	Audit Firm Zaharinova & Partners OOD:
Nikolay Garnev	Dimitrina Zaharinova
Legal Representative and	Legal Representative
Registered Auditor in charge of the audit	Registered Auditor in charge of the audit

Sofia, Bulgaria

23 April 2018

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

BULGARIAN DEVELOPMENT GROUP AD

SEPARATE STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2017
All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

	Note	As of 31.12.2017	As of 31.12.2016
Assets			
Cash in hand and balances in current account with the Central Bank	16	447,648	78,521
Receivables from banks	17	198,379	274,011
Available-for-sale securities	21	230,903	264,368
Loans and advances to customers	18	699,680	722,744
Assets held for sale	25	9,924	4,657
Current tax receivables	26	1,596	-
Securities, held to maturity	20	594	1,384
Other assets	26	686	150
Receivables from the State budget	19	737,516	424,470
Assets, acquired from collateral foreclosure	26	15,875	11,372
Investment property	24	7,702	7,702
Investments in subsidiaries	22	87,643	87,643
Property, plant and equipment, intangible assets	23	32,949	33,698
Deferred tax assets	14	1,148	1,265
Total assets		**2,472,243**	**1,911,985**
Liabilities			
Deposits from credit institutions	27	33,909	43,737
Current tax liabilities		-	1,813
Deposits from customers other than credit institutions	28	790,590	709,549
Other liabilities	32	2,499	1,123
Provisions	31	930	3,319
Borrowings from international institutions	29	869,822	379,998
Other borrowings	30	17,492	17,679
Total liabilities		**1,715,242**	**1,157,218**
Equity			
Share capital	33	601,774	601,774
Retained earnings		20,145	42,920
Revaluation reserve on available-for-sale securities	34	4,947	3,481
Reserves	34	130,135	106,592
Total equity		**757,001**	**754,767**
Total liabilities and equity		**2,472,243**	**1,911,985**

The notes 1 to 38 are an integral part of these financial statements. The separate financial statements were approved by the Management Board of Bulgarian Development Bank AD on 20 April 2018.

Stoyan Mavrodiev	Rumen Mitrov	Nikolay Dimitrov	Ivan Lichev
Chief Executive Director	*Executive Director*	*Executive Director*	*Chief Accountant*
			Preparer

BULGARIAN DEVELOPMENT BANK

Financial statements on which our auditors' report was issued dated 23rd of April 2018

"Ernst & Young Audit" OOD	"Zaharinova & Partners" OOD

BULGARIAN DEVELOPMENT BANK AD

SEPARATE STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2017
All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

	Note	2017	2016
Interest income	6	60,748	60,237
Interest expense	6	(5,754)	(3,665)
Net interest income	6	**54,994**	**56,572**
Fee and commission income	7	2,215	2,314
Fee and commission expense	7	(34)	(35)
Net fee and commission income	7	**2,181**	**2,279**
Net income on foreign exchange deals	8	409	760
Net gain/(loss) on available-for-sale securities	9	188	20
Net gain on financial instruments held-for-trading	10	-	45
Other operating income	11A	2,514	2,469
Other operating expenses	11B	(816)	(1,835)
(Expenses)/income on / from reversed impairment and provisions	12	(20,774)	3,147
Operating income		**38,696**	**63,457**
Costs of personnel	13A	(9,932)	(8,382)
General and administrative expenses	13Б	(5,407)	(6,946)
Depreciation / amortisation expenses	23	(1,091)	(545)
Profit before income tax		**22,266**	**47,584**
Income tax expense	14	(2,121)	(4,664)
Net profit for the year		**20,145**	**42,920**
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	32	(63)	23
Items to be reclassified to profit or loss in subsequent periods			
Net change in fair value of available-for-sale financial assets	15	1,466	2,903
Total other comprehensive income for the year, net of tax		**1,403**	**2,926**
Total comprehensive income for the year		**21,548**	**45,846**

The notes 1 to 38 are an integral part of these financial statements. The separate financial statements were approved by the Management Board of Bulgarian Development Bank AD on 20 April 2018.

Stoyan Mavrodiev *Chief Executive Director*	Rumen Mitrov *Executive Director*	Nikolay Dimitrov *Executive Director*	Ivan Lichev *Chief Accountant* *Preparer*

BULGARIAN DEVELOPMENT BANK

Financial statements on which our auditors' report was issued dated 23rd of April 2018

"Ernst & Young Audit" OOD

"Zaharinova & Partners" OOD

SEPARATE STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2017
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
As of 1 January 2016	**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, net of taxes	-	-	23	2,903	-	2,926
Total comprehensive income for the period	-	-	23	2,903	42,920	45,846
Transactions with owners, recognised in equity						
Dividends to equity holders	-	-	-	-	-	-
Transfer to Reserves based on shareholders' decision	-	3,776	33,989	-	(37,765)	-
Total transactions with owners	-	3,776	33,989	-	(37,765)	-
As of 31 December 2016	**601,774**	**58,705**	**47,887**	**3,481**	**42,920**	**754,767**
Total comprehensive income for the period						
Profit	-	-	-	-	20,145	20,145
Other comprehensive income	-	-	(63)	1,466	-	1,403
Total comprehensive income for the period	-	-	(63)	1,466	20,145	21,548
Transactions with owners, recognised in equity						
Dividends to equity holders					(19,314)	(19,314)
Profit distribution	-	4,292	19,314	-	(23,606)	-
Total transactions with owners	-	4,292	19,314	-	(42,920)	(19,314)
As of 31 December 2017	**601,774**	**62,997**	**67,138**	**4,947**	**20,145**	**757,001**

The notes 1 to 38 are an integral part of these financial statements. The separate financial statements were approved by the Management Board of Bulgarian Development Bank AD on 20 April 2018.

Stoyan Mavrodiev
Chief Executive Director

Rumen Mitrov
Executive Director

Nikolay Dimitrov
Executive Director

Ivan Lichev
Chief Accountant
Preparer

Financial statements on which our auditors' report was issued dated 23rd of April 2018

"Ernst & Young Audit" OOD

"Zaharinova & Partners" OOD

BULGARIAN DEVELOPMENT BANK

BULGARIAN DEVELOPMENT BANK AD
SEPARATE STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2017
All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

	Note	2017	2016
Cash flows from operating activities			
Profit for the year		20,145	42,920
Adjustments for:			
Dividend income	11	(1,393)	(983)
Expenses / (Income) on / from reversed loan impairment	12	23,091	(5,108)
Expenses / Income on/from guarantee provisions	12	(2,514)	1,542
Impairment loss on available-for-sale securities	9	-	-
Loss on revaluation of investment property	11	-	240
Impairment loss and sale of other assets	12	194	419
Gain on revaluation of financial instruments held-for-trading		-	(312)
Net gain on revaluation of foreign currency assets and liabilities	8	10	(58)
Depreciation / amortisation expenses	23	1,091	545
Gain on sale of assets, acquired from collateral foreclosure		(196)	-
Carrying amount of written-off assets	23	32	33
Income tax expense	14	2,121	4,664
		42,581	**43,902**
Changes in:			
Reserve Guarantee Fund with BNB		-	47
Receivables from banks		35,020	24,151
Loans and receivables		(1,724)	(84,295)
Loans to the State budget		(312,350)	(394,585)
Available-for-sale securities		34,931	(41,285)
Held-for-trading financial instruments		-	(305)
Assets held for sale	25	(9,417)	(2,755)
Other assets		(536)	(1,598)
Deposits from credit institutions		(9,828)	41,664
Deposits from customers other than credit institutions		81,030	12,704
Provisions		122	-
Other liabilities		1,376	420
Cash flows used in operating activities		**(138,795)**	**(401,935)**
Corporate income tax paid		(5,413)	(3,400)
Net cash flows used in operating activities		**(144,208)**	**(405,335)**
Cash flows from investing activities			
Cash payments for acquisition of property, plant and equipment, and intangible assets		(348)	(9,749)
Cash proceeds from sale of property, plant and equipment, and intangible assets		7	28
Cash proceeds from matured securities, held to maturity		791	610
Proceeds from sale of assets, acquired from collateral foreclosure		796	-
Proceeds from investment property		480	-
Dividends received from investments in subsidiaries		1,393	982
Net cash flows used in investing activities		**3,119**	**(8,129)**
Cash flows from financing activities			
Dividends paid to the equity owners		(19,313)	-
Cash paid on issued debenture loans		-	-
Cash paid on other borrowings		(186)	(10,302)
Cash received from other borrowings		-	-
Cash received from borrowings from international institutions		556,939	285,435
Cash paid on borrowings from international institutions		(67,837)	(89,704)
Net cash flows from/used in financing activities		**469,603**	**185,429**

Financial statements on which our auditors' report was issued dated 23rd of April 2018

"Ernst & Young Audit" OOD

"Zaharinova & Partners" OOD

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

Net decrease in cash and cash equivalents		328,514	(228,035)
Cash and cash equivalents at the beginning of period	36	193,102	421,137
Cash and cash equivalents at end of period	36	521,616	193,102

Operating interest-related cash flows		
Proceeds from interest	49,294	50,026
Interest paid	(5,290)	(2,696)

The notes 1 to 38 are an integral part of these financial statements. The separate financial statements were approved by the Management Board of Bulgarian Development Bank AD on 20 April 2018.

Stoyan Mavrodiev	Rumen Mitrov	Nikolay Dimitrov	Ivan Lichev
Chief Executive Director	*Executive Director*	*Executive Director*	*Chief Accountant*
			Preparer

BULGARIAN DEVELOPMENT BANK
BULGARIAN DEVELOPMENT BANK

Financial statements on which our auditors' report was issued dated 23rd of April 2018

"Ernst & Young Audit" OOD	"Zaharinova & Partners" OOD

1. ORGANISATION AND OPERATING POLICIES

The financial statements of Bulgarian Development Bank AD (the „Company") for the year ended 31 December 2017 were approved for issue by decision of the Management Board dated 20 April 2018.

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 2017. The Supervisory Board and the Audit Committee represent those charged with governance. As of 31 December 2017, the members of the Supervisory Board of BDB (SB) were: Lachezar Dimitrov Borisov – Chairman of SB, Mitko Emilov Simeonov – Vice Chariman and member of SB, Velina Ilieva Burska – member of SB.

The composition of the Management Board of BDB as of 31 December 2017 was as follows: Stoyan Todorov Mavrodiev - Chairman of MB and Chief Executive Officer; Rumen Dimitrov Mitrov - Vice Chairman / member of MB and Executive Director, Nikolay Dimitrov Dimitrov – member of MB and Executive Director, and Iliya Vasilev Kirchev - member of MB.

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

As of 31 December 2017, the Bank's employees were 171 (31 December 2016: 153).

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 had not yet been established as of 31 December 2017.

Bulgarian Development Bank AD had no branches as at 31 December 2017.

The Bank has begun the process of preparation of its consolidated financial statements for 2017 in accordance with International Financial Reporting Standards (IFRS); these separate financial statements will be included in the consolidated financial statements. According to the dates planned, management expects that the consolidated financial statements will be approved for issue not later than 27 April 2018 and then, the financial statements will be made publicly available to third parties.

2. BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

Applicable standards

These 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 Accountancy 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. (Note 4.3).

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 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.

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 2017, 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 (2016: 0 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 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)

The Bank performs analysis and assessment at each reporting period-end 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 2017, 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, 35).

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 № 32).

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 № 24).

2. BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS (CONTINUED)

Key estimates and assumptions of high uncertainty (continued)

g) Assets acquired from collateral foreclosure

Assets acquired from collateral foreclosure include assets acquired by the bank as a result of non-performing loans. 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 IFRS have been adopted by the Bank as of 1 January 2017:

IAS 12 Income taxes (Amendments): Recognition of Deferred Tax Assets for Unrealised Losses
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 no effect on the financial position or performance of the Bank.

IAS 7 Statement of Cash Flows (Amendments): Disclosure Initiative
The objective of these amendments is to enable users of financial statements to evaluate changes in liabilities arising from financing activities, including changes arising from cash flows and non-cash changes. The Amendments specify that one way to fulfil the disclosure requirement is by providing a tabular reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities, including changes from financing cash flows, changes arising from obtaining or losing control of subsidiaries or other businesses, the effect of changes in foreign exchange rates, changes in fair values and other changes. The amendments affect presentation only and have no impact on the Company's financial position or performance.

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. In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments that replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. IFRS 9 brings together all three aspects of the accounting for financial instruments project: classification and measurement, impairment and hedge accounting. Except for hedge accounting, retrospective application of the standard is required but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions.
The Bank plans to adopt the new standard on the required effective date – 1 January 2018, and will not restate comparative information. The effects of the first-time adoption of IFRS 9 will be reflected in the balance of retained earnings on 1 January 2018 and will be disclosed in the financial statements for the year ended 31 December 2018.

Preparation for the implementation of IFRS 9
Preparations for the implementation of IFRS 9 began in 2017 with the establishment of a Working Party on the implementation of IFRS 9. The work on the project was carried out under a programme approved by the Bank's management and passed through the following key phases:

- Review of the classification and measurement of financial assets in view of their compliance with the classification and measurement criteria of IFRS 9, and introduction of new accounts of the Bank in accounting terms;
- Development of a new financial asset impairment methodology;
- Introduction of changes in information systems and processes.

In December 2017, in order to ensure a smooth transition to the new standard and to assess any potential effects of its entry into force, the Bank performed a parallel year closing with the aim to test the new module for calculation of impairments and provisions. By the end of January 2018, all scheduled project activities were finalized and tests completed successfully, and the new impairments and provisions under IFRS 9 were duly reported as of 01 January 2018.
The Bank recognizes a financial asset or financial liability in its statement of financial position when, and only when, it is a part of an existing contractual relationship regulating the instrument.
The Bank classifies financial assets as subsequently measured at amortised cost, at fair value in other comprehensive income or at fair value through profit or loss, as the case may be, on the grounds of:

a) a business model of the Bank for financial assets management (or a sub-portfolio of financial assets), and
b) the features of the contractual cash flow of the financial asset.

Regardless of its election with regard to the measurement approach, the Bank has the option, at initial recognition, irrevocably designate a financial asset as measured at fair value through profit or loss if doing so eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases, as per the paragraphs below:

a) If the Bank has liabilities under insurance contracts whose measurement incorporates current information and financial assets that it considers to be related and that would otherwise be measured at either fair value through other comprehensive income or amortised cost.
b) if the Bank has financial assets, financial liabilities or both that share a risk, and that gives rise to opposite changes in fair value that tend to offset each other.
c) if the Bank has financial assets, financial liabilities or both that share a risk, , that gives rise to opposite changes in fair value that tend to offset each other and none of the financial assets or financial liabilities qualifies for designation as a hedging instrument because they are not measured at fair value through profit or loss.

A financial asset is measured at amortised cost, if both of the following two criteria are met simultaneously:

a) The financial asset is held within a business model with the objective to collect their contractual cash flows (Hold to Collect business model); and
b) The contractual terms of the financial asset lead to generation of cash flows that are solely payments of principal and interest on the outstanding interest, on specific dates.

2. BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS (CONTINUED)

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

IFRS 9 Financial instruments: classification and measurement (continued)

A financial asset is measured at fair value in other comprehensive income, if both of the following two criteria are met simultaneously:

a) The financial asset is held within a business model with the objective to collect the contractual cash flows and sell the financial asset, and

b) The contractual terms of the financial asset lead to generation of cash flows that are solely payments of principal and interest on the outstanding interest, on specific dates.

A financial asset is measured at fair value through profit or loss, unless it is measured at amortised cost or at fair value in other comprehensive income in accordance with the above criteria.

Upon initial recognition, the Bank may make an irrevocable choice to include in fair value in other comprehensive income subsequent changes to an investment in an equity instrument that is not held for trading or is not a contingent remuneration recognised by a transferee in a business combination to which IFRS 3 applies.

Reclassification of financial assets

When and only when the Bank changes its business model for financial asset management, it reclassifies all financial assets affected, in line with the asset classification requirements. If the Bank applies such reclassification to financial assets, it shall apply it in the future from the reclassification date. The Bank does not recalculate previously recognised profits, losses (including gains or impairment losses) or interest.

Assessment and measurement

Upon initial recognition, in the case of a financial asset or financial liability not measured at fair value through profit or loss, the Bank measures a financial asset or a financial liability at fair value, taking into account as a probable increase and/or decrease of the transaction costs which are directly related to the acquisition or creation of the financial asset or financial liability.

Determination of a business model

The Bank defines the business model with the objective to collect their contractual cash flows (Hold to Collect business model) as a business model where the Bank's financial assets are managed with the objective to generate cash flows through collection of contractual cash flows over the instrument's lifetime. The Bank may use this business model in the event of converting the sale of assets with increased credit risk or in order to reduce the concentration risk.

The Bank defines the business model with the objective to collect the contractual cash flows and sell the financial asset as a business model where the Bank's key management staff have decided that the collection of contractual cash flows and the sale of financial assets are an integral part of the achievement of the business model's objective and includes much more frequent and of higher value sales of financial assets than a business model with the main purpose of holding financial assets to collect contractual cash flows.

The Bank defines other business models as a business model that does not include the holding of financial assets for the purpose of collecting contractual cash flows or for the simultaneous collecting of contractual cash flows and selling financial assets. Typically, this process involves actively buying and selling financial assets.

In this respect, as of 1 January 2018, the Bank has defined the following classification of the main financial assets:

- Financial assets at fair value through profit and loss – they will be recognised as financial assets at fair value through profit or loss;
- Financial assets available for sale – they will be recognised as financial assets at fair value in other comprehensive income;
- Loans and advances to clients – they will be recognised as financial assets at amortised cost;
- Financial assets held to maturity - they will be recognised as financial assets at amortised cost;
- Other receivables - they will be recognised as financial assets at amortised cost;

The Bank derecognises financial asset when, and only when:

a) the contractual cash flows from the financial asset have expired, or

b) the financial asset has been transferred and this transfer meets the derecognition criteria.

2. BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS (CONTINUED)

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

IFRS 9 Financial instruments: classification and measurement (continued)

Impairment of financial assets

IFRS 9 changes fundamentally financial asset impairment reporting, by replacing the existing incurred credit loss model with a forward-looking expected credit loss (ECL) model. IFRS 9 requires that impairment is recognized not only for non-performing loans, but instead for all loans, receivables from banks, receivables under leased contracts and debt instruments not measured at fair value in other comprehensive income, as well as the accrual of provisions for credit engagements and financial guarantees. The amount of the impairment depends on the probability of default of the debtor over the next 12 months after initial recognition, unless there has been a significant increase in credit risk, which requires the estimation of expected credit losses over the lifetime of the financial asset.

The estimate of expected credit losses is based on all available, reasonable and justified information at the reporting date for past events, the current situation and the use of relevant macroeconomic indicators and reliable forecasts of future economic conditions. The key macroeconomic indicators, used by the Bank, are gross domestic product, unemployment, inflation, changes in oil prices, and changes in the USD exchange rate and 3M EURIBOR. The expected credit losses is measured on the basis of three macroeconomic scenarios – a realistic, negative and optimistic scenario, which are used in the calculation of the impairment by applying different weights. The results obtained can be further adjusted and expected credit losses increased or reduced to reflect future risks that cannot be modelled (mainly, legislative or regulatory).

The Bank has drawn up a methodology that introduces criteria for classifying financial assets in three categories (the so-called "phases"), transfer criteria between them and setting an impairment amount depending on the phase in which the underlying asset is classified. The phases and their characteristics are described below:

- ✓ Phase 1 – includes performing loans without a significant increase in credit risk after initial recognition. The impairment of those assets is based on the probability of default of the debtor over the next 12 months or for a shorter period if the life of the instrument is shorter than one year.
- ✓ Phase 2 – includes assets with a significant increase in credit risk after initial recognition. Such an increase is presumed if the loan is past due for more than 30 days; the debtor is placed on watch; the debtor's credit rating has deteriorated at the reporting date compared to its rating on the date of recognition of the instrument, or the Bank expects the credit to be restructured. In this case, the expected credit losses are calculated for the entire lifetime of the asset;
- ✓ Phase 3 – includes assets, for which objective evidence exists that they are impaired, such as non-performing loans. The Bank has set specific criteria that determine when a debtor is in default. The expected credit losses for these instruments are also calculated for the entire lifetime of the instrument.

The absolute threshold for the transfer of credits among the levels is linked to the internal credit rating determined by the Bank of the borrower concerned. Depending on the type of borrower – a corporate client or financial institution, the Bank has set a credit rating of 7 as a transition limit to move to Phase 2 for corporate clients and a rating of 8 for exposures to financial entities.

Moreover, the Bank has also defined relative thresholds, which are also used for exposures subject to the absolute thresholds and those for which no specific thresholds have been set. They are based on TTC matrices and the change in the likelihood of non-compliance with the relevant exposures from Moody's external aggregate data (before that the Bank has established a methodology for the reconciliation of internal credit ratings to those of the rating agency).

The amount of the expected credit loss is a function of the probability of default of the instrument, the realized loss and the amount of balance sheet and off-balance sheet exposure. The probability of default (PD) and the realized LGD are the parameters employed in determining the provisioning rate and those parameters are determined on the basis of an individual review of the early warning signs that are homogeneous in terms of their credit characteristics and their relation to international and domestic macroeconomic variables that could affect them.

2. BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS (CONTINUED)

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

IFRS 9 Financial instruments: classification and measurement (continued)

In 2017, the Bank assessed the effects of the implementation of IFRS 9. This assessment is based on information currently available and may change if, in 2018, when the Bank will adopt IFRS 9, the Bank received additional information regarding the value and quality of financial assets at the initial date of application of the standard. According to preliminary calculation of management, IFRS 9 will result in additional impairment costs, which will reduce the carrying amount of loans to customers as of 1 January 2018 by about 0.5-1% due to the increase in the accumulated impairment balance by about 6-8%. The additional costs of provisions for bank guarantees issued and credit commitments taken will increase the balance of provisions by more than 100%, mainly through the guarantees and unutilized commitments under the National Programme for Energy Efficiency. The change in the measurement of loans and provisions at the transition date will be taken to the balance of accumulated profits (comprising retained earnings and additional reserves), which will decrease by about 12-14% as of 1 January 2018, which will affect also the equity section in the statement of financial position.

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 was issued in May 2014, and amended in April 2016, including standard clarifications. 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). Under IFRS 15, revenue is recognized to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. 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 new revenue standard will supersede all current revenue recognition requirements under IFRS – IAS 11 Construction contracts and IAS 18 Revenue, as well as related interpretations. The standard requires either a full retrospective application or a modified retrospective application.

The Bank plans to adopt the new standard on the required effective date 1 January 2018. During 2017, the Bank started an assessment of the effects from adoption of IFRS 15, and at the date of issuing its 2017 financial statements is in the process of finalizing this analysis. As such, the disclosed below information on the possible impact that application of IFRS 15 will have on the Bank's financial statements in the period of initial application may be subject to further changes in 2018.

The preliminary conclusions from the ongoing assessment indicated that there would be no significant impact on the Bank's equity as of 31 December 2017 and 1 January 2017 as a result of the implementation of the standard.

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 Bank will analyse and assess the impact of the new standard on its financial position or performance.

2. BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS (CONTINUED)

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

IFRS 17: Insurance Contracts
The standard is effective for annual periods beginning on or after 1 January 2021 with earlier application permitted if both IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments have also been applied. IFRS 17 Insurance Contracts establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts issued. It also requires similar principles to be applied to reinsurance contracts held and investment contracts with discretionary participation features issued. The objective is to ensure that entities provide relevant information in a way that faithfully represents those contracts. This information gives a basis for users of financial statements to assess the effect that contracts within the scope of IFRS 17 have on the financial position, financial performance and cash flows of the Bank. The standard has not been yet endorsed by the EU.

Amendments to 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.

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. The amendments have not yet been endorsed by the EU.

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. They are not relevant for 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 u//se 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.

IFRIC 23 Uncertainty over Income Tax Treatments
The Interpretation is effective for annual periods beginning on or after 1 January 2019 with earlier application permitted. The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12. The Interpretation provides guidance on considering uncertain tax treatments separately or together, examination by tax authorities, the appropriate method to reflect uncertainty and accounting for changes in facts and circumstances. This interpretation has not yet been endorsed by the EU.

2. BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS (CONTINUED)

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

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. The amendments have not yet been endorsed by the EU. It is not expected that these amendments would affect the financial position or performance of the Bank.

IFRS 9 Financial Instruments: Classification and Measurement (Amendments): Prepayment Features with Negative Compensation
The Amendments, effective for annual periods beginning on or after 1 January 2019 with earlier application permitted, propose a change to IFRS 9 for particular financial assets that would otherwise have contractual cash flows that are solely payments of principal and interest but do not meet that condition only as a result of a negative prepayment feature. Specifically, for a financial asset that contains a prepayment option that may result in the payment of a reasonable negative compensation amount, the Amendments require the financial asset to be measured at amortised cost or at fair value in other comprehensive income, subject to the assessment of the business model in which it is held. These amendments have not yet been endorsed by the EU. It is not expected that these amendments would affect the financial position or performance of the Bank.

IAS 28 Investments in associates (Amendments): Long-term Interests in Associates and Joint Ventures
The amendments are effective for annual periods beginning on or after 1 January 2019 with earlier application permitted. The Amendments clarify that an entity applies IFRS 9 Financial Instruments to long-term interests in an associate or joint venture that, in substance, form part of the net investment in the associate or joint venture but to which the equity method is not applied. An entity applies IFRS 9 to such long-term interests before it applies IAS 28. In applying IFRS 9, the entity does not take account of any adjustments to the carrying amount of long-term interests that arise from applying IAS 28. These amendments have not yet been endorsed by the EU.

Annual Improvements to IFRSs 2014-2016 Cycle
In the 2014-2016 annual improvements cycle, the IASB issued amendments to standards, which are effective for annual periods beginning on or after 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;
- IFRS 12 Disclosure of Interests in Other Entities - clarification of the scope of the Standard (IASB effective date: 1 January 2017, however the EU endorsement is after that date)
- IAS 28 Investments in Associates and Joint Ventures - measuring an associate or joint venture at fair value.

The annual improvements to IFRSs 2014 – 2016 Cycle have not yet been endorsed by EU. It is not expected that these amendments would impact the financial position or performance of the Bank.

Annual Improvements to IFRSs 2015-2017 Cycle
In the 2015-2017 annual improvements cycle, the IASB issued amendments to standards which are effective for annual periods beginning on or after 1 January 2019. Summary of amendments and related standards are provided below:

- IFRS 3 Business Combinations and IFRS 11 Joint Arrangements – clarifying previously held interest in a joint operation;
- IAS 12 Income taxes – clarifying income tax consequences of payments on financial instruments classified as equity;
- IAS 23 Borrowing costs - clarifying borrowing costs eligible for capitalization.

The annual improvements to IFRSs 2015 – 2017 Cycle have not yet been endorsed by EU. It is not expected that these amendments would affect the financial position or performance of the Bank.

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 2017 and also in 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 acquired as a result of non-performing loans. These assets are measured at the lower of cost and net realisable value.

Investments in subsidiaries

Long-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 2017	31 December 2016
USD	1.63081	1.85545
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, incl. country (sovereign) risk, contractor's risk and settlement risk, and credit risk of concentration.

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 internal rating models depend on the specifics of the object being rated. The so-developed rating models for credit risk assessment of corporate clients of the Bank 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. There is an „Early Warning Procedure for Corporate Credit Clients", which includes an early warning system of signals and actions. 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 corporate 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 the case of customers, for which there are currently no indications of increased risk, the Bank periodically (at least once a year) reviews the financial and legal status, including the collateral accepted, in order to establish the need for a change in the percentage of impairment for loss risk and / or change in the assessment of the degree of credit risk. Clients with a higher credit risk are subject to a review in every 6 months and those classified as „problematic/non-preforming", in every three months. 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.

Aiming at minimizing and reducing the credit risk, the Bank accepts collateral in accordance with its in-house rules. 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, and valuations from accredited independent valuers are required.

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 5,659 thousand (31 December 2016: BGN 5,974 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 2016: BGN 3,563 thousand), whereas the losses covered by EIF amount to BGN 2,773 thousand (31 December 2016: BGN 2, 887 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 2017, there was no commitment on the counter-guarantee agreement.

Off-balance sheet commitments, primarily the unutilised portion of authorized loan facilities, letters of guarantee and letters of credit, which represent an irrevocable commitment of the Bank to make payment if a client is not able to fulfil its obligations to third parties represent another source of credit risk for the Bank and bear the same credit risk as the balance sheet loan exposures.

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 –portfolio of credit commitments with debtors-legal entities, other than bank financial institutions, and loans to individuals (loans to Bank's employees), as well as subjects from the public sector;
- ✓ 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;
- ✓ Financing by the National Programme for Energy Efficiency of Multi-Family Residential Buildings in compliance with CMD 18 of the CM..

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 criteria, and also by individual counterparty and insurance companies ensuring coverage. Regarding the Bank's direct credit portfolio, the allocation by economic sectors is monitored, as also that to clients and groups of related parties, by observing internal limitations (limits) for concentration of the corporate credit portfolio by economic sectors.

Maximum exposure to credit risk

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

	2017		2016	
Financial asset	maximum	net	maximum	net
Receivables from banks	198,379	198,379	274,011	274,011
Loans and advances to customers	854,853	762,938	863,888	647,435
Receivables from the State budget	737,516	737,516	424,470	424,470
Available-for-sale securities	230,903	230,903	264,368	264,368
Securities held to maturity	594	594	1,384	1,384
Other financial assets	36	36	47	47
	2,022,281	**1,930,366**	**1,828,168**	**1,611,715**

The heading *Receivables from the State Budget* comprise loans on the National Programme for Energy Efficiency of Multi-Family Residential Buildings amounting to BGN 728,010 thousand (2016: BGN 397,568 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:

	2017		2016	
	maximum	net	maximum	net
Bank guarantees and letters of credit	71,531	62,059	80,366	76,513
Unutilised amount of authorized loans	447,976	447,976	557,152	557,152
Participation in the SIA investment program	1,603	1,603	1,724	1,724
	521,110	**511,638**	**639,242**	**635,389**
Maximum exposure to credit risk	**2,543,391**	**2,442,004**	**2,326,266**	**2,247,104**

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:

	2017	%	2016	%
Sectors				
Government	997,809	40.40	673,104	35.30
Financial services	726,911	29.43	415,598	21.80
Industry, total	300,669	12.17	326,829	17.15
Industry – energy generation and distribution	*85,046*	*3.44*	*103,520*	*5.43*
Industry – other industries	*44,076*	*1.78*	*65,545*	*3.44*
Industry – manufacture of foodstuffs	*50,032*	*2.03*	*60,962*	*3.20*
Industry – manufacture of tobacco products	*58,773*	*2.38*	*55,675*	*2.92*
Industry – manufacture of plant and equipment	*62,742*	*2.54*	*41,127*	*2.16*
Construction	146,346	5.93	136,626	7.17
Transport	105,615	4.28	107,192	5.62
Real estate transactions	49,286	2.00	41,829	2.19
Administrative and office activities	48,815	1.98	48,816	2.56
Trade	35,848	1.45	53,994	2.83
Agriculture	26,984	1.09	26,474	1.39
Tourist services	16,282	0.66	17,573	0.92
Collection and disposal of garbage	8,399	0.34	12,602	0.65
Other industries	6,965	0.28	46,052	2.42
	2,469,929	**100**	**1,906,689**	**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 69,239 thousand (2016: BGN 62,202 thousand) at amortised cost, which represents 10.88 per cent of Bank's capital base (2016: 9.99 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:

	2017		2016	
	(BGN'000)	*% of Total**	*(BGN'000)*	*% of Total**
The biggest total exposure to a customer group	69,239	9.49%	62,202	6.19%
Total amount of the ten biggest exposures	494,609	62.11%	488,547	48.65%
Total amount of the twenty biggest exposures	714,417	88.62%	708,750	70.58%

There is no exposure to a customer or a group of related customers as at 31 December 2017, exceeding 25 per cent of Bank's capital base.

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

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

As of 31 December 2017	Standard	Watch	Non-performing	Total
Cash in hand and balances in current account with the Central Bank	447,648	-	-	447,648
Receivables from banks	198,379	-	-	198,379
Receivables from the State budget	737,516	-	-	737,516
Loans for commercial property and construction	267,005	84,936	54,680	406,621
Trade loans	217,368	52,873	71,868	342,109
Agricultural loans	-	-	2,103	2,103
Consumer loans	900	28	-	928
Residential mortgage loans to individuals	1,972	-	-	1,972
Loans to other financial institutions	32,915	-	44,541	77,456
Other loans and receivables	6,805	16,769	90	23,664
Available-for-sale securities	230,903	-	-	230,903
Securities, held to maturity	594	-	-	594
Other financial assets	36	-	-	36
Total financial assets	**2,142,041**	**154,606**	**173,282**	**2,469,929**

As of 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)

The table below presents the types of collaterals, received by the Bank in relation to loans granted, at fair value determined by accredited independent valuers and confirmed by a Bank's employee holding the necessary licence:

Type of collateral	2017 Fair value	%	2016 Fair value	%
Mortgages	252,215	42.18	255,007	42.00
Mortgages on ships	111,711	18.68	100,438	16.54
Pledge of plant, machinery, equipment, and inventories	213,538	35.71	188,990	31.12
Securities quoted on a stock market	-	-	35,426	5.83
Credit risk insurance	16,237	2.72	22,475	3.70
Bank guarantees	1,064	0.18	4,076	0.67
Restricted deposits	3,176	0.53	790	0.13
Total collateral	**597,941**	**100**	**607,202**	**100**

Credit exposures 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.

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, these are cases of changes in the initial parameters, purpose and scope, and respectively, the time schedule of projects. Upon renegotiation, the changes in preliminary terms and conditions are analysed in order to establish whether these changes represent a relief (discount) in favour of the debtor and the exposure should be accepted as restructured. 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 after 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		Securities, held to maturity	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Impaired on an individual basis														
-watch	78,208	131,881	-	-	-	-	28	31	-	-	-	-	-	-
-non-performing	150,787	105,277	-	-	-	-	-	-	-	-	-	-	-	-
Gross amount	**228,995**	**237,158**	**-**	**-**	**-**	**-**	**28**	**31**	**-**	**-**	**-**	**-**	**-**	**-**
Incl. renegotiated	177,625	171,904	-	-	-	-	-	-	-	-	-	-	-	-
Past due but not impaired														
- standard	46,280	24,223	-	-	-	-	-	-	-	-	-	-	-	-
-watch	33,295	9,797	-	-	-	-	-	-	-	-	-	-	-	-
- non-performing	23,325	6,905	-	-	-	-	-	-	-	-	-	-	-	-
Gross amount	**102,900**	**40,925**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Incl. renegotiated	65,290	23,822	-	-	-	-	-	-	-	-	-	-	-	-
Within 30 days	*51,710*	35,403	-	-	-	-	-	-	-	-	-	-	-	-
From 30- 90 days	*17,269*	2,067	-	-	-	-	-	-	-	-	-	-	-	-
Over 90 days	*33,920*	3,455	-	-	-	-	-	-	-	-	-	-	-	-
Not past due and not impaired														
-------high class	414,487	536,736	737,516	424,470	198,379	274,011	2,872	3,746	447,648	78,521	230,903	264,368	594	1,384
-------standard class	101,091	42,073	-	-	-	-	-	-	-	-	-	-	-	-
-------low class	4,509	3,266	-	-	-	-	-	-	-	-	-	-	-	-
Gross amount	**520,087**	**582,075**	**737,516**	**424,470**	**198,379**	**274,011**	**2,872**	**3,746**	**447,648**	78,521	**230,903**	**264,368**	**594**	**1,384**
Incl. renegotiated	360,961	340,581	-		66,269	-	494	680	-	-	-	-	-	-
Gross amount	**851,981**	**860,158**	**737,516**	**424,470**	**198,379**	**274,011**	**2,900**	**3,777**	**447,648**	78,521	**230,903**	**264,368**	**594**	**1,384**
Incl. renegotiated	**603,876**	**536,307**	-	-	66,269	-	494	680	-	-	-	-	-	-

The Bank classifies not past due and not impaired exposures to the above classes depending on their internal credit rating, as follows:

- high class – credit rating from 1 to 3
- standard class – credit rating from 4 to 5
- low class – credit rating from 6 to 7

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

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 5,127 thousand (2016 : BGN 8,013 thousand), which were provided by BGN 833 thousand (2016: BGN 3,145 thousand) (Note 31).

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

	2017	2016
Loans for commercial property and construction	84,936	94,091
Trade loans	52,873	72,902
Consumer loans	28	31
Other loans and receivables	16,768	16,759
	154,605	**183,783**

A loan is classified as "restructured" when the initial terms of the agreement have been modified by the Bank by granting relief (discounts) to a debtor experiencing difficulties in performing its financial obligations.

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

In BGN'000	2017	2016
Loans for commercial property and construction	**56,955**	**66,963**
incl. Standard	*5,443*	*17 965*
Watch	*14,068*	*25 443*
Non-performing	*37,444*	*23 555*
Other loans and receivables	**67,867**	**13,839**
incl. Standard	*53,330*	*90*
Watch	*1,548*	*10 670*
Non-performing	*12,989*	*3 079*
	124,822	**80,802**

4.1.1. Country (sovereign) risk

The Bank has formed a portfolio of securities classified as available-for-sale financial assets, comprising only government securities issued by the Republic of Bulgaria. The Bank's exposure to sovereign was BGN 227,917 thousand as of 31 December 2017 and BGN 248,634 thousand as of 31 December 2016.

Standard & Poor's credit rating for Republic of Bulgaria stands at BBB- with stable outlook (1 December 2017). Fitch's credit rating for Republic of Bulgaria is BBB with stable outlook (1 December 2017). Moody's credit rating for Republic of Bulgaria was last set at Baa2 with stable outlook (26 May 2017).

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 the 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 2017	*With floating interest rate %*	*With fixed interest rate %*	*Interest-free*	*Total*
Financial assets				
Receivables from banks	5,665	182,172	10,542	**198,379**
Loans and advances to customers	649,617	50,063	-	**699,680**
Receivables from the State budget	728,010	9,506	-	**737,516**
Securities, held to maturity	594	-	-	**594**
Available-for-sale securities	-	227,917	2,986	**230,903**
Other financial assets	-	-	36	**36**
Total financial assets	**1,383,886**	**469,658**	**13,564**	**1,867,108**
Financial liabilities				
Deposits from credit institutions	3,897	30,012	-	**33,909**
Deposits from customers other than credit institutions	584,538	183,878	22,174	**790,590**
Borrowings from international institutions	663,490	206,332	-	**869,822**
Other borrowings	11,236	6,256	-	**17,492**
Total financial liabilities	**1,263,161**	**426,478**	**22,174**	**1,711,813**
Total balance sheet interest exposure	**120,725**	**43,180**	**(8,610)**	**155,295**
Contingencies and commitments	**444,394**	**3,582**	**73,134**	**521,110**

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**
Contingencies and commitments	**529,814**	**27,338**	**82,090**	**639,242**

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 2017	*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	2,182	3,483	-	-	-	-	182,172	10,542	198,379
Loans and advances to customers	82,352	567,265	-	-	-	-	50,063	-	699,680
Receivables from the State budget	728,010	-	-	-	-	-	9,506	-	737,516
Securities, held to maturity	594	-	-	-	-	-	-	-	594
Available-for-sale securities	67,346	-	-	-	133,797	26,774	-	2,986	230,903
Other financial assets	-	-	-	-	-	-	-	36	36
Total financial assets	**880,484**	**570,748**	**-**	**-**	133,797	**26,774**	**241,741**	**13,564**	**1,867,108**
Financial liabilities									
Deposits from credit institutions	3,897	30,012	-	-	-	-	-	-	33,909
Deposits from customers other than credit institutions	638,862	1,406	436	16,330	111,382	-	-	22,174	790,590
Borrowings from international institutions	1,838	23,255	4,053	48,519	293,848	291,977	206,332	-	869,822
Other borrowings	-	11,236	-	-	-	6,256	-	-	17,492
Total financial liabilities	**644,597**	**65,909**	**4,489**	**64,849**	**405,230**	**298,233**	**206,332**	**22,174**	**1,711,813**
Total exposure to interest rate sensitivity	**235,887**	**504,839**	**(4,489)**	**(64,849)**	**(271,433)**	**(271,459)**	**35,409**	**(8,610)**	**155,295**
Contingencies and commitments	**1,355**	**12**	**9,274**	**31,413**	**405,922**	**-**	**-**	**73,134**	**521,110**

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.2. Market risk (continued)

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*	*T*
Financial assets									
Receivables from banks	90,479	28,747	-	-	-	-	145,014	9,771	274,
Loans and advances to customers	110,973	554,813	-	-	-	-	56,958	-	722,
Receivables from the State budget	397,568	-	-	-	26,902	-	-	-	424,
Securities, held to maturity	1,384	-	-	-	-	-	-	-	1,
Available-for-sale securities	38,363	10,223	3,019	32,145	142,561	35,169	-	2,888	264,
Other financial assets	-	-	-	-	-	-	-	47	
Total financial assets	**638,767**	**593,783**	**3,019**	**32,145**	**169,463**	**35,169**	**201,972**	**12,706**	**1,687,**
Financial liabilities									
Deposits from credit institutions	43,737	-	-	-	-	-	-	-	43,
Deposits from customers other than credit institutions	147,352	21,358	4,678	479,527	28,013	-	-	28,621	709,
Borrowings from international institutions	8,259	179,259	184,887	4,315	-	-	3,278	-	379,
Other borrowings	-	11,236	-	-	-	6,443	-	-	17,
Total financial liabilities	**199,348**	**211,853**	**189,565**	**483,842**	**28,013**	**6,443**	**3,278**	**28,621**	**1,150,**
Total exposure to interest rate sensitivity	**439,419**	**381,930**	**(186,546)**	**(451,697)**	**141,450**	**28,726**	**198,694**	**(15,915)**	**536,**
Contingencies and commitments	**23,925**	**546**	**9,274**	**55,359**	**468,048**	**-**	**-**	**82,090**	**639,**

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.

	2017			2016		
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%	1,981	(689)	0.50%	2,467	(725)
EUR	0.50%	(1,291)	(1,551)	0.50%	288	(1,742)
USD	0.50%	(153)	-	0.50%	(82)	-
BGN	-0.50%	(1,981)	689	-0.50%	(2,467)	725
EUR	-0.50%	1,291	1,551	-0.50%	(288)	1,742
USD	-0.50%	153	-	-0.50%	82	-

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

	31.12.2017	**31.12.2016**
Financial assets	2,35%	3,65%
Financial liabilities	0,43%	0,38%

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.

As of 31 December 2017	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	30	4,748	-	442,870	447,648
Receivables from banks	76,461	23,864	144	97,910	198,379
Loans and advances to customers	-	479,136	1,009	219,535	699,680
Receivables from the State budget	-	-	-	737,516	737,516
Securities, held to maturity	-	594	-	-	594
Available-for-sale securities	-	111,382	-	119,521	230,903
Other financial assets	-	-	-	36	36
Total financial assets	**76,491**	**619,724**	**1,153**	**1,617,388**	**2,314,756**
Financial liabilities					
Deposits from credit institutions	-	2,013	-	31,896	33,909
Deposits from customers other than credit institutions	76,484	69,886	92	644,128	790,590
Borrowings from international institutions	-	868,802	1,020	-	869,822
Other borrowings	-	17,492	-	-	17,492
Total financial liabilities	76,484	**958,193**	**1,112**	**676,024**	**1,711,813**
Net balance sheet currency position	**7**	**(338,469)**	**41**	**941,364**	**602,943**
Contingencies and commitments	**408**	**56,899**	**-**	**463,833**	**521,110**

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.2. Market risk (continued)

As of 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**
Contingencies and commitments	**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)

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:

2017

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	1.6308	-1.270	+2.068	31	(51)	-
JPY	0.0145	-15	+18	(3)	4	-
GBP	2.2044	-2.524	+1.987	(3)	2	-
Total effect				**25**	**(44)**	**-**

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)**	**-**

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

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:

	2017	2016
As of 31 December	43.75%	31.45%
Average for the period	31.93%	38.36%
Highest for the period	43.30%	48.53%
Lowest for the period	25.95%	29.50%

	2017	2016
Cash and cash balances with BNB	447,648	78,521
Balances in current accounts with other banks and international deposits of up to 7 days	73,968	90,477
Government securities	227,917	193,916
Liquid assets	**749,533**	**362,914**
Financial liabilities held for trading	-	-
Financial liabilities measured at amortised cost	1,711,813	1,150,963
Provisions	930	3,319
Employee retirement benefits	366	228
Liabilities	**1,713,109**	**1,154,510**
Liquidity assets ratio (LAR)	**43,75%**	**31.45%**

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:

As of 31 December 2017	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	447,648	-	-	-	-	-	447,648
Receivables from banks	75,286	122	19,377	10,947	92,647	-	198,379
Loans and advances to customers	8,428	13,820	132,400	326,628	218,404		699,680
Receivables from the State budget	-	-	-	737,516	-	-	737,516
Available-for-sale securities	67,346	-	-	133,797	26,774	2,986	230,903
Assets held for sale	-	-	9,924	-	-	-	9,924
Current tax receivables			1,596				1,596
Securities, held to maturity	7	-	587	-	-	-	594
Other assets	-	-	686	-	-	-	686
Assets, acquired from collateral foreclosure	-	-	-	15,875	-	-	15,875
Investment property	-	-	-	-	-	7,702	7,702
Investments in subsidiaries	-	-	-	-	-	87,643	87,643
Property, plant and equipment, intangible assets	-	-	-	-	-	32,949	32,949
Deferred tax assets	-	-	1,148	-	-	-	1,148
Total financial assets	**600,227**	**13,942**	**165,718**	**1,224,763**	**337,825**	**131,280**	**2,472,243**
Financial liabilities							
Deposits from credit institutions	3,897	30,012	-	-	-	-	33,909
Current tax liabilities	-	-	-	-	-	-	-
Deposits from customers other than credit institutions	641,390	1,406	24,016	123,778	-	-	790,590
Provisions	-	-	-	-	-	930	930
Other liabilities	1,562	-	-	510	-	427	2,499
Borrowings from international institutions	1,838	23,255	94,613	458,138	291,978	-	869,822
Other borrowings	-	-	213	853	16,426	-	17,492
Total financial liabilities	**648,687**	**54,673**	**118,842**	**583,279**	**308,404**	**1,357**	**1,715,242**
Gap in maturity thresholds of assets and liabilities	**(48,460)**	**(40,021)**	**46,876**	**641,484**	**29,131**	**(26,276)**	**757,001**
Contingencies and commitments	**6,295**	**1,890**	**62,989**	**439,610**	**-**	**4,694**	**515,478**

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.3. Liquidity risk (continued)

As of 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**	**190,277**	**918,311**	**392,497**	**131,931**	**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**	**(366,786)**	**731,856**	**205,594**	**128,026**	**754,767**
Contingencies and commitments	**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)

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

As of 31 December 2017	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	33,909	33,912	3,897	30,015	-	-	-
Deposits from customers other than credit institutions	790,590	791,508	641,391	1,407	24,075	124,635	-
Financial liabilities, held for trading	-	-	-	-	-	-	-
Borrowings from international institutions	869,822	905,278	1,838	23,379	95,187	465,399	319,475
Other borrowings	17,492	19,202	-	31	306	1,307	17,558
	1,711,813	**1,749,900**	**647,126**	**54,832**	**119,568**	**591,341**	**337,033**
Bank guarantee provisions	833	833	45	-	171	617	-
Unutilised loan commitments	447,976	447,976	1,355	12	40,687	405,922	-

As of 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	-

Considering the specific activity of the Bank, the funds attracted from the biggest 20 non-bank depositors at 31 December 2017 represent 97.13 per cent of the total amount of payables to other customers (31 December 2016: 97.26 per cent). The share of the biggest non-bank depositor of the total amount of payables to other customers is 46.07 per cent (31 December 2016: 53.92 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:

As of 31 December 2017

Financial assets	Pledged as collateral*	Available for collateral	Other**	Total
Cash in hand and balances in current account with the Central Bank	-	327,248	120,400	**447,648**
Receivables from banks	10,542	187,837	-	**198,379**
Loans and advances to customers	-	526,965	172,715	**699,680**
Receivables from the State budget	-	737,516	-	**737,516**
Available-for-sale securities	7,515	220,768	2,620	**230,903**
Securities, held to maturity	-	594	-	**594**
Other financial assets	-	-	36	**36**
Total financial assets	**18,057**	**2,000,928**	**295,771**	**2,314,756**

As of 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**

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 2017, funds amounting to BGN 10,542 thousand were blocked on counter-guarantees of two corporate customers, maturing as follows:

Maturity interval	Receivables from banks pledged as collateral
On demand	1,236
From 91 to 180 days	189
From 181 to one year	4,357
Over one year	4,760

At 31 December 2017, restricted securities on a legal requirement to provide for funds of the State budget amount to BGN 7,515 thousand (2016: BGN 8,022 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 case of excess above the limits approved by the Management Board, ALCO reports back to the MB for undertaking corrective actions.

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".

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

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:

	2017	**2016**
OWN FUNDS	636,570	622,579
TIER I CAPITAL	636,570	622,579
COMMON EQUITY TIER I CAPITAL	636,570	622,579
Share capital	601,774	601,774
Statutory reserves	62,997	58,705
Additional reserves	67,180	47,866
Accumulated other comprehensive income	4,905	3,502
Intangible assets	(268)	(226)
Investments in subsidiaries	(87,643)	(87,643)
Transitional adjustments to CET1 Capital	(994)	(1,399)
Components of or deductions from CET1 Capital - other	(11,381)	
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)

	2017	2016
TOTAL RISK EXPOSURES	1,151,075	1,267,103
Credit risk - Standardised approach	1,041,637	1,161,628
Central governments or central banks	-	-
Regional governments or local authorities	202	265
Public sector entities	9,506	26,902
Multilateral development banks	939	939
Institutions	125,576	187,362
Corporates	530,416	632,843
Retail	7,734	15,090
Secured by mortgages on immovable property	101,621	87,819
Exposures in default	188,827	146,809
Items associated with particular high risk	2,936	2,934
Equity exposures	152	150
Other items	73,728	60,515
Foreign exchange and commodity risk	-	-
Operational risk - Basic indicator approach	109,438	105,475
CET 1 Capital Ratio	**55.30%**	**49.13%**
Total Capital Ratio	**55.30%**	**49.13%**
Capital conservation buffer	*28,777*	*31,678*
Systemic risk buffer	*34,532*	*38,013*
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 of 31.12.2017		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	-	-	-	230,903	-	230,903	230,412	-	-	230,412
Assets, acquired from collateral foreclosure	27	-	-	-	-	15,875	15,875	-	-	15,875	15,875
Investment property	25	-	-	-	-	7,702	7,702	-	-	7,702	7,702
			-	-	230,903	**23,577**	**254,480**	**230,412**	-	**23,577**	**253,989**
Assets not measured at fair value											
Cash in hand and balances in current account with the Central Bank	16	-	447,648	-	-	-	447,648	-	447,648	-	447,648
Loans to banks	17	-	113,869	-	-	-	113,869	-	116,576	-	116,576
Current accounts and term deposits of banks	17	-	84,510	-	-	-	84,510	-	84,510	-	84,510
Loans and advances to customers	18	-	699,680	-	-	-	699,680	-	710,313	-	710,313
Receivables from the State budget		-	737,516	-	-	-	737,516	-	799,661	-	799,661
Securities, held to maturity	20	594	-	-	-	-	594	-	598	-	598
		594	**2,083,223**	-	-	-	**2,083,817**	-	**2,159,306**	-	**2,159,306**
Liabilities not measured at fair value											
Deposits from credit institutions - Current accounts and term deposits from banks	28	-	-	-	-	33,909	33,909	-	33,909	-	33,909
Deposits from customers other than credit institutions	29	-	-	-	-	790,590	790,590	-	791,212	-	791,212
Borrowings from international institutions	30	-	-	-	-	869,822	869,822	-	899,003	-	899,003
Other borrowings	31	-	-	-	-	17,492	17,492	-	18,385	-	18,385
		-	-	-	-	**1,711,813**	**1,711,813**	-	**1,742,509**	-	**1,742,509**

The fair value of securities classified as available-for-sale investments with carrying amount of BGN 491 thousand at 31 December 2017 (2016: BGN 370 thousand) carried at cost is not disclosed as the Bank is of the opinion that their fair value cannot be measured reliably.

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

5. FAIR VALUE DISCLOSURE (CONTINUED)

As of 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**
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**

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:

<table>
<tr><th>Financial instrument</th><th>Fair value as of</th><th>Fair value as of</th><th>Fair value hierarchy</th><th>Valuation techniques</th><th>Significant unobservable inputs</th><th>Relationship of unobservable inputs to fair value</th></tr>
<tr><td></td><td>31.12.2017</td><td>31.12.2016</td><td></td><td></td><td></td><td></td></tr>
<tr><td rowspan="2">Investment property

Assets, acquired from collateral foreclosure</td><td rowspan="2">7,702

15,875</td><td rowspan="2">7,702

11,372</td><td rowspan="2">Level 3</td><td>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.</td><td>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)</td><td>The higher (lower) fair value if:
• Higher (lower) market realisation coefficient
• Higher (lower) location coefficient
• Higher (lower) coefficient of specific features (status)</td></tr>
<tr><td>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.</td><td>Offer market adequacy adjustment coefficient (from -10% to +5%)</td><td>The higher (lower) fair value if:
• Higher (lower) offer market adequacy adjustment coefficient</td></tr>
</table>

The Bank discloses voluntary the fair values the assets acquired from collateral foreclosure as of 31 December 2017 and 31 December 2016.

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

5. FAIR VALUE DISCLOSURE (CONTINUED)

Fair values of financial assets and liabilities that are not measured at fair value, but a disclosure at fair value is required.

Financial instrument	Fair value as of 31.12.2017	Fair value as of 31.12.2016	Fair value hierarchy	Valuation techniques	Significant unobservable inputs	Relationship of unobservable inputs to fair value
Loans to banks	116,576	150,886	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	710,313	739,757	Level 2	Discounted cash flows Future cash flows are measured using the officially published by BNB interest rates (unadjusted) of new loans for December 2017.	N/A	N/A
Receivables from the State budget	799,661	469,168	Level 2	Discounted cash flows Future cash flows are measured using the officially published by BNB yield of Bulgarian government securities (unadjusted) for December 2017	N/A	N/A
Securities, held to maturity	598	1,403	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 2017	N/A	N/A
Other borrowings	18,385	18,693	Level 2	Discounted cash flows Future cash flows are measured using the officially published by BNB yield of Bulgarian government securities (unadjusted) for December 2017	N/A	N/A
Borrowings from international institutions	899,003	380,991	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

	2017	2016
Interest income		
Loans and advances to customers	44,994	49,714
Receivables from the State budget	10,157	4,743
Loans to banks	2,507	3,409
Available-for-sale securities	2,005	1,840
Deposits placed with other banks	945	350
Securities, held to maturity	52	97
Other liabilities (effect of negative interest)	88	84
	60,748	**60,237**
Incl. Interest income on impaired loans and receivables	**4,567**	**8,067**
Interest expenses		
Borrowings from international institutions	(4,464)	(2,410)
Deposits from customers other than credit institutions	(891)	(924)
Other borrowings	(128)	(268)
Other liabilities (effect of negative interest)	(255)	(60)
Deposits from credit institutions	(16)	(3)
	(5,754)	**(3,665)**
Net interest income	**54,994**	**56,572**

The yield on the assets, as a ratio of net profit to the balance sheet figure, is 0,64% (2016: 2.24%).

7. NET FEE AND COMMISSION INCOME

	2017	2016
Fee and commission income		
Guarantees and letters of credit	1,329	1,356
Customers' accounts, bank transfers, cash operations of customers, etc.	570	622
Servicing of debenture issues	252	270
Special-purpose funds of the Ministry of Finance (Note 31)	64	66
	2,215	**2,314**
Fee and commission expense		
Agent's commissions	(1)	-
Servicing of accounts in other banks	(30)	(26)
Bank transfers and cash operations with other banks	(3)	(9)
	(34)	**(35)**
Net fee and commission income	**2,181**	**2,279**

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

8. NET GAIN ON FOREIGN EXCHANGE DEALS

	2017	2016
Net gain on dealing in foreign currencies	419	483
Net gain/(loss) on foreign currency swap transactions and revaluation	-	219
Net gain/(loss)on foreign currency translation of assets and liabilities	(10)	58
	409	**760**

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

	2017	2016
Net gain on dealing in available-for-sale securities, incl. revaluation reserve realised	188	20
	188	**20**

10. NET GAIN ON FINANCIAL INSTRUMENTS, HELD FOR TRADING

	2017	2016
Interest expense on financial instruments held for trading	-	(267)
Net gain on revaluation of held-for-trading financial instruments	-	312
	-	**45**

11A. OTHER OPERATING INCOME

	2017	2016
Dividends received	1,393	983
Income from rent of investment property	480	836
Refunded litigation expenses	348	309
Proceeds from disposal of assets held for sale	197	150
Proceeds from disposal of FTA	7	38
Other income	89	153
	2,514	**2,469**

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

11B. OTHER OPERATING EXPENSES

	2017	2016
Expenses on assets held for sale	(335)	(301)
Litigation expenses	(62)	(579)
Loss on revaluation of investment property	-	(240)
Withholding tax	(223)	(28)
Direct operating expenses relating to investment property	(165)	(168)
Expenses on disposal of FTA	(31)	(33)
Other expenses	-	(486)
	(816)	**(1,835)**

12. EXPENSES ON/(INCOME FROM REVERSED) IMPAIRMENT LOSSES AND PROVISIONS

	2017	2016
Expenses / Income on / from reversed impairment losses on individually impaired assets, net	(23,091)	(10,692)
(Income from reversed) / Expenses on impairment of loans relating to common credit risk on portfolio basis, net	-	15,800
Expenses on /(Income from reversed) guarantee provisions, net	2,511	(1,542)
Expenses on / (Income from reversed) impairment of assets acquired from collateral foreclosure	(194)	(419)
	(20,774)	**3,147**

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

13A. COSTS OF PERSONNEL

	2017	2016
Staff remuneration and social security	(8,302)	(7,213)
Remuneration to members of the Management and Supervisory Boards	(1,630)	(1,169)
	(9,932)	**(8,382)**

	2017	2016
Personnel costs consist of:		
Salaries	(7,195)	(6,218)
Social security	(936)	(845)
Social benefits	(96)	(96)
Amounts accrued on retirement benefits	(75)	(54)
	(8,302)	**(7,213)**

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

13B. GENERAL AND ADMINISTRATIVE EXPENSES

	2017	2016
Contribution to the Fund for Orderly Bank Restructuring	(3,180)	(3,814)
Contribution to the Deposit Insurance Fund	(39)	(36)
Rents	(10)	(811)
Communications and IT services	(494)	(508)
Office and office equipment maintenance	(550)	(536)
Legal and consulting services	(226)	(479)
Advertising and entertainment expenses	(320)	(333)
Taxes and government charges	(199)	(139)
Hired services	(204)	(131)
Advisory services by the registered audit firm	(9)	(12)
Business trips	(45)	(68)
Audit services by the registered auditor	(131)	(79)
	(5,407)	**(6,946)**

14. TAXATION

	2017	2016
Current tax expense	2,004	5,204
Deferred tax (benefit)/expense due to temporary differences	117	(540)
Total tax expense	**2,121**	**4,664**

	2017	2016
Accounting profit	22,266	47,584
Income tax calculated at the effective tax rate (10 per cent for 2016, 10 per cent for 2015)	2,226	4,758
Expense on non-deductible expenses	34	4
Non-deductible income	(139)	(98)
Total tax expense	**2,121**	**4,664**
Effective tax rate	**9.53%**	**9.80%**

In 2017, the Bank paid advance corporate income taxes of BGN 3,600 thousand.

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		
	2017	**2016**	**2017**	**2016**	**Changes in the statement of comprehensive income**
Property and equipment	(15)	(14)	-	-	(1)
Other assets	(444)	(479)	-	-	35
Investment property	-	(57)	-	-	57
Guarantee portfolio	206	26	-	-	180
Other liabilities	(55)	(48)	-	-	(7)
Available-for-sale securities	(840)	(693)	-	-	(147)
	(1,148)	**(1,265)**	**-**	**-**	**117**

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

	2017	**2016**
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	1,278	2,883
Income recycling	188	20
Other comprehensive income for the year	**1,466**	**2,903**

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

	2017	2016
Cash in hand	244	120
Current accounts	447,404	78,401
Incl. Minimum statutory reserves	*120,400*	*76,551*
Total cash with the Central Bank	**447,404**	**78,401**
Total cash in hand and in accounts with the Central Bank	**447,648**	**78,521**

Deposits with the Central Bank bear interest rate of -0.60 % on the excess over 105% of MRR (2016: interest-free).

17. RECEIVABLES FROM BANKS

	2017	2016
Current accounts and demand deposits with local banks	212	189
Current accounts and demand deposits with foreign banks	12,512	13,570
incl. Current accounts with an original maturity of less than 90 days	2,182	3,988
Term deposits with local banks (incl. repo deals)	71,786	86,490
Term deposits with foreign banks (incl. repo deals)	-	24,102
incl. Term deposits with an original maturity of less than 90 days	71,786	110,592
Loans to local banks	101,270	135,574
Loans to foreign banks	12,599	14,086
	198,379	**274,011**

At 31 December 2017, 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 (2016:1.49 per cent to 4.40 per cent), were extended to local banks with the aim to develop small and medium-sized enterprises.

Funds amounting to BGN 10,542 thousand were blocked to cover letters of credit (2016: BGN 9,770 thousand).

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

18. LOANS AND ADVANCES TO CUSTOMERS

	2017	2016
Loans (gross amount)	854,853	863,888
Allowance for impairment and uncollectability of loans	(155,173)	(141,144)
	699,680	**722,744**

	2017	2016
A. Analysis by customer type		
Corporate and sole traders	850,855	858,784
Municipalities	1,099	1,327
Individuals	2,899	3,777
	854,853	**863,888**

	2017	2016
B. Analysis by industry sector depending on the purpose of the loan		
Industry, total	300,655	316,989
Industry – energy generation and distribution	*85,046*	*103,520*
Industry – manufacture of plant and equipment	*62,742*	*41,127*
Industry – manufacture of tobacco products	*58,773*	*55,675*
Industry – manufacture of foodstuffs	*50,032*	*60,962*
Industry – other industries	*44,062*	*55,705*
Construction	146,346	136,626
Transport	105,615	107,192
Financial services	77,456	55,926
Real estate transactions	49,286	41,829
Administrative and office activities	48,815	48,816
Trade	35,848	53,994
Government sector	32,376	31,144
Agriculture	26,984	26,474
Tourist services	16,282	17,573
Collection and disposal of garbage	8,399	12,602
Other industries	6,791	14,723
	854,853	**863,888**

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

	2017			2016		
	Individually impaired	Collectively impaired	Total	Individually impaired	Collectively impaired	Total
At 1 January	**141,144**	**-**	**141,144**	**130,114**	**15,800**	**145,914**
Impairment costs	42,644	-	**46,644**	54,413	-	54,413
Reversed impairment	(19,553)	-	**(19,553)**	(43,721)	(15,800)	**(59,521)**
Written-off against impairment	(9,062)	-	**(9,062)**	338	-	338
At 31 December	**155,173**	**-**	**155,173**	**141,144**	**-**	**141,144**

19. RECEIVABLES FROM THE STATE BUDGET

	2017	2016
Acquired receivables	9,506	26,902
Energy Efficiency Program	728,010	397,568
	737,516	**424,470**

At 31 December 2017 (and at 31 December 2016 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 2017 amounted to BGN 728,010 thousand (at 31 December 2016: BGN 397,568 thousand).

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

20. SECURITIES HELD TO MATURITY

	2017	2016
Corporate bonds of financial entities	594	1,384
	594	**1,384**

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

	2017	2016
Government securities	227,917	248,634
Corporate bonds	-	12,846
Non-public companies' shares	2,620	2,643
Participation in the SIA investment program (note 36)	352	232
Public companies' shares	14	13
	230,903	**264,368**

Movement in Available-for-sale securities

	2017	2016
At 1 January	264,368	220,180
Additions (purchases)	53,258	156,382
Disposals (sale and/or maturity)	(88,189)	(115,097)
Net increase due to revaluation of available-for-sale securities to fair value	1,466	2,903
At 31 December	**230,903**	**264,368**

The non-public companies' shares held by the Bank include shares of the European Investment Fund (EIF) amounting to BGN 2,482 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.

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 2017 amounts to BGN 4,947 thousand.– positive value (31 December 2016: BGN 3,481- thousand - positive value) (Note 34).

In 2017, there was no allowance for impairment of available-for-sale securities transferred to and reported on the consolidated statement of comprehensive income (in current profit or loss for the year) (Note 9) (2016: there was no transferred and reported impairment of available-for-sale securities in the statement of comprehensive income).

22. 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 2017 consists of 800,000 shares of BGN 100 each (31 December 2016: 800,000 shares of BGN 100 per share). The registered capital at 31 December 2017 amounts to BGN 80,000 thousand (31 December 2016: BGN 80,000 thousand). The investment in the subsidiary at 31 December 2017 amounts to BGN 80,000 thousand (31 December 2016: 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 2017 amounts to BGN 7,643 thousand, split into 76,430 shares of BGN 100 each. The investment in the subsidiary at 31 December 2017 amounts to BGN 7,643 thousand (31 December 2016: BGN 7,643 thousand), measured at historical cost of acquisition.

At 31 December 2017 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.

23. 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 2016	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
Additions	-	196	181	-	132	509
Disposals	-	(338)	(221)	-	(5)	(564)
As of 31 December 2017	32,553	1,972	563	291	1,198	36,577
Accumulated depreciation						
As of 1 January 2016	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
Charge for the year	576	308	57	58	93	1,092
Disposals	-	(313)	(80)	-	(5)	(398)
As of 31 December 2017	1,297	988	229	181	933	3,628
Net book value						
As of 31 December 2017	31,256	984	334	110	265	32,949
As of 31 December 2016	31,832	1,121	351	168	226	33,698
At 1 January 2016	23,606	552	60	257	80	24,555

The land and buildings amounting to BGN 8,398 thousand acquired in 2016 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 2017 amounts to BGN 722 thousand at cost (2016: BGN 427 thousand) and intangible assets amount to BGN 799 thousand (2016: BGN 640 thousand) respectively.

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

24. INVESTMENT PROPERTY

	2017	2016
Carrying amount at the beginning of period	7,702	7,744
Reclassified from held for sale	-	251
Sold	-	(53)
Loss on change in the fair value included in profit and loss for the period	-	(240)
	7,702	**7,702**

The Bank holds investment properties as a result of collateral acquired on problem loans. They are leased to third parties. Rental income generated for 2017 amounts to BGN 480 thousand (2016: BGN 836 thousand) (Note 11). The fair value at 31 December 2017 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.

25. ASSETS HELD FOR SALE

Properties (land, buildings and fixtures and fittings) at 31 December 2017 amounting to BGN 9,924 thousand (2016: BGN 4,657 thousand – land, buildings and fixtures and fittings) were acquired by the Bank in 2017 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 2018.

Movement in assets held for sale in 2017 and 2016:	2017	2016
Carrying amount at the beginning of period	4,657	8,712
Acquired from collateral foreclosure	9,417	4,699
Reclassified to assets acquired from collateral foreclosure	(4,150)	(7,113)
Reclassified to investment property	-	(251)
Sold	-	(1,390)
	9,924	**4,657**

26. OTHER ASSETS И ASSETS ACQUIRED FROM COLLATERAL FORECLOSURE

	2017	2016
Assets acquired from collateral foreclosure	15,875	11,372
Other receivables	36	47
VAT refundable	439	-
Corporate income tax overpaid	1,596	-
Prepayments and advances	211	103
	18,157	**11,522**

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.

26. OTHER ASSETS И ASSETS, ACQUIRED FROM COLLATERAL FORECLOSURE (CONTINUED)

Movement in assets acquired from collateral foreclosure in 2017 and 2016:	**2017**	**2016**
Carrying amount at the beginning of period	11,372	4,714
Reclassified from held for sale	4,150	7,113
Additional costs	1,341	-
Sold	(794)	(36)
Impairment (Note 12)	(194)	(419)
Carrying amount at the period-end	**15,875**	**11,372**

27. DEPOSITS FROM CREDIT INSTITUTIONS

	2017	**2016**
Deposits from local banks	32,361	42,157
Deposits from foreign banks	1,548	1,580
	33,909	**43,737**

Interest payable on deposits from credit institutions at 31 December 2017 amounts to BGN 12 thousand (2016: BGN 1 thousand).

	2017	**2016**
Term deposits	30,012	39,576
Demand deposits	3,897	4,161
	33,909	**43,737**

28. DEPOSITS FROM CUSTOMERS OTHER THAN CREDIT INSTITUTIONS

	2017	**2016**
Individuals	8,268	4,641
Companies and sole traders	688,440	609,748
Special-purpose deposits	93,882	95,160
	790,590	**709,549**

Interest payable on deposits from other customers, other than credit institutions, at 31 December 2017 amounts to BGN 156 thousand (2016: BGN 659 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).

	2017	**2016**
Term deposits	206,052	592,689
Demand deposits	584,538	116,860
	790,590	**709,549**

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

29. BORROWINGS FROM INTERNATIONAL INSTITUTIONS

	2017	2016
Long-term frame loan agreement with the Council of Europe Development Bank	325,929	128,152
Long-term loans from European Investment Bank	146,721	146,723
Long-term loans from the Nordic investment bank	16,521	22,014
Long-term loans from the Kreditanstalt für Wiederaufbau	195,667	23,038
Sumitomo Mitsui Banking Corporation Europe	-	4,315
Long-term loan from Dexia Credit Local	-	1,951
Long-term loan from DEPFA Investment Bank - Fms Wertmanagement Aor	-	1,384
Long-term loans from JBIC Japan Bank for International Cooperation	969	3,278
European Investment Fund	7,859	9,823
Industrial and Commercial Bank of China	19,660	39,320
Chinese Development Bank	156,496	-
	869,822	**379,998**

Interest payable on borrowings from international institutions at 31 December 2017 amounts to BGN 924 thousand (2016: BGN 489 thousand). Effective interest rates on borrowings from international institutions at 31 December 2017 vary from 0 per cent to 3.39 per cent (31 December 2016: from 0.099 per cent to 3.39 per cent).

Council of Europe Development Bank

On 18 November 2009, a 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 2017, the loan was fully utilised

As of 31 December 2017, the outstanding principal under the facility amounted to EUR 5,625 thousand equivalent to BGN 11,002 thousand (31 December 2016: EUR 7,500 thousand equivalent to BGN 14,669 thousand). The interest rate is floating, based on the 3M EURIBOR plus margin.

On 30 March 2011, a new 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 2017, the loan was fully utilised.

As of 31 December 2017, the outstanding principal under the facility amounted to EUR 11,000 thousand equivalent to BGN 21,514 thousand (31 December 2016: EUR 13,000 thousand equivalent to BGN 25,426 thousand). The interest rate on the first tranche is floating, based on the 3M 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 of Multi-Family Residential Buildings (NEEMFR). 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. As of 31 December 2017, the loan was fully utilised.

The loan is secured by a State guarantee under the Public Debt Act for 2016. A Guarantee Agreement was signed between CEB and Republic of Bulgaria, represented by the Minister of Finance, which was ratified by the National Assembly. The Guarantee Agreement Ratification Act was promulgated in State Gazette on 3 May 2016.

The National Energy Efficiency Programme of Multi-Family Residential Buildings was approved by virtue of decision of the Council of Ministers of 27 January 2015.

As of 31 December 2017, the loan liability amounted to EUR 150,000 thousand equivalent to BGN 293,375 thousand (as of 31.12.2016: EUR 45,000 thousand equivalent to BGN 88,012 thousand). The interest rate on the first tranche of the loan is floating, based on the three-month EURIBOR plus margin, and on the second tranche it is fixed.

29. BORROWINGS FROM INTERNATIONAL INSTITUTIONS (CONTINUED)

European Investment Bank

On 18 November 2016, BDB signed a 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. 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.

As of 31 December 2017, the principal due on the loan amounted to EUR 75,000 thousand equivalent to BGN 146,687 thousand (as at 31 December 2016: EUR 75,000 thousand equivalent to BGN 146,687 thousand). The interest rate is floating, based on the 6M 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 (KfW). 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 2017, the loan was fully utilised.

As of 31 December 2017, the outstanding principal under the facility amounted to EUR 8,824 thousand equivalent to BGN 17,257 thousand (at 31 December 201: the outstanding principal amounted to EUR 11,765 thousand equivalent to BGN 23,010 thousand). The interest rate is floating, based on the 6M 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 NEEMFR. The loan is secured by a State guarantee under the Public Debt Act for 2016. A Guarantee Agreement was signed between CEB and Republic of Bulgaria, represented by the Minister of Finance, which was ratified by the National Assembly. The Guarantee Agreement Ratification Act was promulgated in State Gazette on 30 December 2016. The term of repayment of the loan is up to 7 years, with a grace period of 2 years. At 31 December 2017, the loan was fully utilised.

As of 31 December 2017, the outstanding principal under the facility amounted to EUR 90,909 thousand equivalent to BGN 177,803 thousand (as of 31 December 2016, no funds were utilised under the loan facility). The interest rate is floating, based on the 6M Euribor plus margin.

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.

As of 31 December 2017, the loan was fully utilised (31 December 2016: BGN 0,471 thousand equivalent to BGN 0,920 thousand).

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 201, the loan was fully utilised.

As of 31 December 2017, the outstanding principal under the facility amounted to EUR 8,489 thousand equivalent to BGN 16,603 thousand (31 December 2016: EUR 10,842 thousand equivalent to BGN 21,205 thousand). The interest rate is floating, based on 6M EURIBOR plus margin.

29. BORROWINGS FROM INTERNATIONAL INSTITUTIONS (CONTINUED)

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 2017, there was no loan liability (31 December 2016: EUR 2,200 thousand equivalent to BGN 4,303 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. The loan is secured by a Letter of Intent, signed by the Minister of Finance.

As of 31 December 2017, the loan was fully repaid (31 December 2016: EUR 1,000 thousand equivalent to BGN 1,956 thousand).

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 2017, the loan was fully repaid (31 December 2016: EUR 0,714 thousand equivalent to BGN 1,397 thousand).

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 (6M 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 2017, the outstanding principal under the loan amounted to JPY 70,149 thousand equivalent to BGN 1,016 thousand (31 December 2016: JPY 210,475 thousand equivalent to BGN 3,336 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 2017, the credit line facility was not utilised and the loan was finalised.

29. 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. The purpose of the loan is 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.

As of 31 December 2017, the loan principal due amounted to EUR 4,000 thousand equivalent to BGN 7,823 thousand (31 December 2016: EUR 5,000 thousand equivalent to BGN 9,779 thousand). 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. The loan is unsecured. As of 31 December 2017, the loan was fully utilized.

As of 31 December 2017, the loan liability amounted to EUR 10,000 thousand equivalent to BGN 19,558 thousand (at 31 December 2016: EUR 20,000 thousand equivalent to BGN 39,117 thousand). The interest rate is floating based on the 6M EURIBOR plus margin.

Chinese Development Bank

On 12 May 2017, BDB signed a loan agreement with Chinese Development Bank for the amount of EUR 80,000 thousand. The funds are intended to support the general lending activity of BDB – investment loans and working capital. BBR is able to use the financial resource to support strategic projects within the One Belt, One Road initiative. The term of loan repayment is 10 years, with a 2-years grace period. The loan is unsecured. As of 31 December 2017, the loan was fully utilized.

As of 31 December 2017, the outstanding principal under the loan amounted to EUR 80,000 000 thousand equivalent to BGN 156,466 thousand (as of 31 December 2016 no amounts were utilized under the loan). The interest rate is floating based on the 6M EURIBOR plus margin.

Chinese EXIM Bank

On 28 September 2017, signed an agreement with Chinese EXIM Bank for the amount of EUR 50,000 thousand. This is the first loan agreement between BBR and Chinese EXIM Bank, after the financial cooperation agreement, signed in 2014 between the two entities, which provides for a joint financing of key projects or areas. The funds may be used to finance the overall lending activity of BBR, a short-term and mid-term trade financing, trans-border economic and commercial transactions between China and Bulgaria. The term of loan repayment is 5 years. The loan is unsecured

As of 31 December 2017, no amounts were utilised under the loan. The interest rate is floating based on the 6M EURIBOR plus margin.

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

30. OTHER BORROWINGS

	2017	2016
Loan financing from the Ministry of Finance with funds from KfW	11,236	11,236
KfW funds provided by the Ministry of Finance for trust management	6,256	6,443
	17,492	**17,679**

Interest liabilities accrued on other borrowings at 31 December 2017: Nil (2016: Nil).

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.

On 28 April 2017, BBR and the Ministry of Finance signed Annex 1 to extend the term of the contract by 10 more years.

As of 31 December 2017, the outstanding principal and the capitalised interest amounted to EUR 5,745 thousand equivalent to BGN 11,236 thousand (as of 31 December 2016: EUR 5,745 thousand equivalent to BGN 11,236 thousand). The loan interest is capitalised quarterly and is based on 3M 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 2017, the balance of the loan with the Bank amounts to EUR 3,199 thousand equivalent to BGN 6,257 thousand (31 December 2016: EUR 3,294 thousand equivalent to BGN 6,443 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. PROVISIONS

	2017	2016
Bank guarantee provisions	833	3,145
Litigation provisions	97	174
	930	**3,319**

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 818 thousand (2016: BGN 1,045 thousand) relates to bank guarantees on "Guarantee Fund for Micro Lending" project of MLSP, and BGN 15 thousand (2016: BGN 2,100 thousand) relates to individual guarantees issued.

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

The table below presents the movements in the guarantee provisions:

	2017	2016
Balance at 1 January	3,145	1,468
Charged over the year (Note 12)	4	2,140
Utilised over the year	198	135
Reversed over the year (Note 12)	(2,514)	(598)
Balance at 31 December	**833**	**3,145**

32. OTHER LIABILITIES

	2017	2016
Payables to personnel for salaries and social security	384	269
Retirement benefit liabilities	366	229
Charges on debenture loans and guarantees	61	357
Tax liabilities	267	121
Accruals for expenses	698	115
Payables to EIF	148	-
Other creditors	575	32
	2,499	**1,123**

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 366 thousand was included in the separate statement of financial position at 31 December 2017 (31 December 2016: BGN 229 thousand).

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

32. OTHER LIABILITIES (CONTINUED)

	2017	2016
Present value of the liability at 1 January	**229**	**198**
Current service cost	49	44
Interest expense	7	7
Amounts paid in the period	-	-
Actuarial (gains)/losses from changes in demographic and financial assumptions and actual experience	81	(20)
Present value of the liability at 31 December	**366**	**229**

	Amounts on retirement for old age and length of service		Amounts on retirements due to illness		Total	
	2017	2016	2017	2016	2017	2016
Actuarial gain/(loss) at 1 January	22	(1)	-	-	22	(1)
Actuarial gain / (loss) recognized in other comprehensive income for the period	(63)	23	-	-	(63)	23
Actuarial gain/(loss) at 31 December	**(41)**	**22**	**-**	**-**	**(41)**	**22**

The following actuarial assumptions are used in calculating the present value of the liabilities as of 31 December 2017:

- 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 2014 – 2016;
- 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 – 1.4 per cent (2016: 2.5 per cent);
- assumptions for the future level of working salaries in the Bank are based on the Bank's development plan for 2018 – 5 per cent compared to the 2016 level and for 2018 and subsequent years – 5 per cent compared to the previous year level.

The effect for 2017 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:

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

32. OTHER LIABILITIES (CONTINUED)

	Increase by 1% of salary growth	Decrease by 1% of salary growth
Change in the interest and current service costs ("+"- increase, "–"- decrease)	13	(11)
Change in the present value of the liability as of 31 December 2017 ("+"- increase, "–"- decrease)	52	(43)

	Increase by 1% of interest rate	Decrease by 1% of interest rate
Change in the interest and current service costs ("+"- increase, "–"- decrease)	(7)	9
Change in the present value of the liability as of 31 December 2017 ("+"- increase, "–"- decrease)	(44)	54

	Increase by 1% of staff turnover rate	Decrease by 1% of staff turnover rate
Change in the interest and current service costs ("+"- increase, "–"- decrease)	(12)	14
Change in the present value of the liability as of 31 December 2017 ("+"- increase, "–"- decrease)	(46)	56

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

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

33. SHARE CAPITAL

	2017	2016
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.

In August 2017, by decision of the SB, the Bank's shares were transferred from the Ministry of Finance to the Ministry of Economy and as of 31 December 2017, 99.99 per cent of the Bank's shares were held by the State through the Ministry of Economy (31 December 2016: 99.99 per cent of the Bank's shares were held by the State through the Ministry of Finance).

34. 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 2017, the Reserve Fund of the Bank amounted to BGN 62,997 thousand. (31 December 2016: BGN 58,705 thousand).

As of 31 December 2017, the Additional Reserves of the Bank amounted to BGN 67,138 thousand (31 December 2016: BGN 47,887 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 2017, after a regular General Meeting of Shareholders of the Bank and in accordance with the provision of article 91, paragraph 2 of the State Budget Law of the Republic of Bulgaria for 2017, a decision was passed to distribute dividends from profits after deduction of the contribution to the Reserve Fund of BGN 19,314 thousand (2016: no dividend was paid).

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 2017, the reserve is a positive value amounting to BGN 4,947 thousand (31 December 2016: BGN 3,481 thousand – positive value) .

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

35. CONTINGENCIES AND COMMITMENTS

	2017	2016
Contingent liabilities		
Bank guarantees and letters of credit	71,510	80,366
incl. with cash collateral	(9,472)	(3,853)
Letters of credit with borrowed funds, accounted as loan commitment	21	-
Guarantee provisions (Note 31)	(833)	(3,145)
	61,226	**73,368**
Irrevocable commitments		
Unutilised amount of approved loans	447,976	557,152
incl. letters of credit with borrowed funds	*(21)*	-
Participation in the SIA investment program	1,603	1,724
Unclaimed portion of par value of EIF shares	4,694	4,694
	454,252	**563,570**
	515,478	**636,938**

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 2017, agreements with five partner banks were concluded by the Bank and bank guarantees amounting to BGN 1,818 thousand (31 December 2016: seven partner banks and bank guarantees issued amounting to BGN 2,321 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 2017, seven equity contributions were made under the initiative amounting to EUR 180 thousand equivalent to BGN 353 thousand (2016: BGN 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 2017, the Bank signed agreements with five partner banks and the so-formed portfolio of guarantees amounted to BGN 3,576 thousand (31 December 2016: five partner banks and portfolio of guarantees amounting to BGN 3,566 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.

35. CONTINGENCIES AND COMMITMENTS (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.

36. CASH AND CASH EQUIVALENTS

	2017	**2016**
Cash in hand (Note 16)	244	120
Current accounts with the Central Bank (Note 16)	447,404	78,401
Receivables from banks with original maturity up to 3 months (Note 17)	73,968	114,581
	521,616	**193,102**

The following table summarises the movements in the liabilities arising from financing activity, including cash-flow and non-monetary changes, with a reconciliation between the opening and closing balances in the statement of financial position of the liabilities arising from financing activity for the year ended December 31, 2017.

	January 1, 2017	Cash inflows	Cash outflows	Effect of changes in exchange rates	Accruals under the effective interest rate method*	Other	31 December 2017
Current borrowings from international institutions	379,998	556,939	(67,837)	-	-	721	869,821
Current liabilities on other borrowings	17,679	-	(187)	-	-	-	17,492
Total liabilities from financing activity	**397,677**	**556,939**	**(68,024)**	**-**	**-**	**721**	**887,313**

*The interest accruals of BGN 4,464 thousand are included in the operating cash flows of the Bank.

37. TRANSACTIONS WITH RELATED PARTIES AND COMPANIES UNDER JOINT CONTROL WITH THE STATE

Entity/person	*Type of control*
Ministry of Economy	Majority shareholder of the capital of the Bank representing the State
Ministry of Finance	Under common control with 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
State Consolidation Company EAD	Company under common control with the State
Eco Anthracite EAD	Company under common control with the State

The table above shows the companies with which the Bank had transactions during the reporting period. All related party transactions are at arm's length.

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

37. TRANSACTIONS WITH RELATED PARTIES AND COMPANIES UNDER JOINT CONTROL WITH THE STATE (CONTINUED)

Related party balances in the statement of financial position :

Assets

Entity/person	***Type of balance***	**2017**	**2016**
Ministry of Finance	Available-for-sale securities	227,917	248,634
Micro Financing Institution EAD	Loans and advances to customers	8,148	3,671
National Guarantee Fund EAD	Other assets	-	-
Company under common control with the State	Loans and advances to customers	98,006	165,537
Company under common control with the State	Other assets	-	3
Total for the subsidiaries		***8,148***	***3,671***

Liabilities

Entity/person	***Type of balance***	**2017**	**2016**
National Guarantee Fund EAD	Liabilities to customers on deposits	130,268	131,126
Ministry of Finance	Other borrowings	17,492	17,679
Micro Financing Institution JOBS EAD	Liabilities to customers on deposits	338	1,302
Companies under common control with the State	Liabilities to customers on deposits	510,682	440,392
Total for the subsidiaries		***130,606***	***132,428***

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

37. TRANSACTIONS WITH RELATED PARTIES AND COMPANIES UNDER JOINT CONTROL WITH THE STATE (CONTINUED)

Related party transactions:

Entity/person	***Type of relationship***	**2017**	**2016**
	Fee and commission income	64	66
Ministry of Finance	Interest income	1,611	1,642
	Interest expense	(128)	(141)
	Fee and commission income	2	1
	Interest income	-	-
National Guarantee Fund EAD	Interest expenses	(154)	(200)
	Rental income	-	41
	Dividend income	1,246	888
	Fee and commission income	3	6
	Interest income	88	15
Micro Financing Institution JOBS EAD	Interest expenses	-	-
	Rental income	-	19
	Dividend income	69	42
Total income from transactions with subsidiaries		***1,408***	***1,012***
Total expenses on transactions with subsidiaries		***(154)***	***(200)***
Companies under common control with the State	Interest income	7,830	6,705
	Fee and commission income	498	355
	Interest expenses	(739)	(404)
	Other operating income	210	-

Commitments and contingencies with related parties:

Entity/person	***Type***	**2017**	**2016**
National Guarantee Fund EAD	Unutilised amount of a loan approved	-	23,000
Micro Financing Institution JOBS EAD	Unutilised amount of a loan approved	2,800	3,300
Micro Financing Institution JOBS EAD	Bank guarantees issued	2	2
Company under common control with the State	Unutilised amount of loans approved	27,290	6,262
Company under common control with the State	Bank guarantees issued	4,993	3,621
Company under common control with the State	Letters of credit	-	14,746
Total for the subsidiaries		**2,802**	**26,302**

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

37. TRANSACTIONS WITH RELATED PARTIES AND COMPANIES UNDER JOINT CONTROL WITH THE STATE (CONTINUED)

Relations with key management personnel:

Balances with key management personnel	**2017**	**2016**
Payables to customers on deposits	288	329
Remuneration payable	53	31
Loans and advances to customers	142	281

Transactions with key management personnel	**2017**	**2016**
Remuneration and social security contributions	(1,630)	(1,169)
Interest expense	-	(1)
Interest income	4	11

38. EVENTS AFTER THE DATE OF THE FINANCIAL STATEMENTS

On 06 March 2018, Ilia Vasilev Kirchev was discharged as a member of the Management Board of Bulgarian Development Bank AD.

There were no other events.