BULGARIAN DEVELOPMENT BANK

BULGARIAN DEVELOPMENT BANK GROUP

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

31 December 2017

BULGARIAN
DEVELOPMENT BANK

CONSOLIDATED ANNUAL ACTIVITY REPORT

OF THE BULGARIAN DEVELOPMENT BANK GROUP

FOR 2017

„We help business in Bulgaria to grow and become stronger"

Translation in English of the official Consolidated Annual Activity Report of Bulgarian Development Bank Group, issued In Bulgarian

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GENERAL INFORMATION

Bulgarian Development Bank AD

Shareholding structure as at 31 December 2017 – Ministry of Economy – 99,9999% and DSK Bank PLC (0.0001%)

Supervisory board as at 31 December 2017:
- Luchezar Borisov – Chairman
- Mitko Simeonov – Deputy Chairman
- Velina Burska – Member of the Supervisory Board

Management Board as at 31 December 2017:
- Stoyan Mavrodiev - Chairman of the Management Board and Chief Executive Director
- Rumen Mitrov – Deputy Chairman of the Management Board and Executive Director
- Nikolay Dimitrov - Member of the Management Board and Executive Director
- Iliya Kirchev – Member of the Management Board

Seat and management address:
Sofia 1000, Sredets district, 1, Diakon Ignatii Street
Registration number – UIC 121856059

Joint auditors of the Bulgarian Development Bank AD
Earnst&Young Audit Ltd.
Poligraphia Office Center
47A, Tzarigradsko Shose Blvd., floor 4
Sofia 1124

Zaharinova & Partners Ltd.
157-159, Konstantin Velichkov Blvd.
floor 1, office 3
Sofia 1309

Auditor of the National Guarantee Fund EAD and Micro Financing Institution JOBS EAD
Earns&Young Audit Ltd.
Poligraphia Office Center
47A, Tzarigradsko Shose Blvd., floor 4
Sofia 1124

STATEMENT TO SHAREHOLDERS

Dear Shareholders,

The Bulgarian Development Bank Group believes in the need to support the growth of small and medium-sized enterprises and in its role for the achievement of those objectives.

The fast absorption of funds under the National Energy Efficiency Program, the programs of the National Guarantee Fund for 2016 and 2017, the Rural Development Program for 2016 and the indirect lending, indicate an increased demand and insufficient resource for SMEs, and the commitment of BDB to fill that gap. Moreover, the BDB is committed to attract additional funds from international financial institutions to support the SMEs.

Despite the fact that in the past three years the national economy has been showing a stable recovery, the price differences in funding of SMEs and large corporate loans is significant and creates a disbalance in the access to funding especially for small companies. The development of the entrepreneurship startup ecosystem based on knowledge and innovations calls for the establishment of innovative mechanisms for investments and access to funding in this sector in Bulgaria.

In 2017 the BDB Group continued to address those disbalances both through financial intermediaries with indirect funding and through its subsidiaries, the NGF and MFI Jobs, and continued its work for improving not only the access of SMEs, but also the terms and conditions for their financing. BDB continued to work also to identify new sources of funding, new guarantee schemes and hedging instruments.

In 2017 the BDB Group financed, directly or indirectly, 7,847 end customers, and the amount of funding reached approximately BGN 3 billion.

The operating income of BDB before impairment and provisions for 2017amounts to BGN 63,496 thousand, whereas for 2016 it amounted to BGN 63,771 thousand.

The 2017 net profit amounts to BGN 20,680 thousand where the net cost of impairment and provisions throughout the year amounted to BGN 22,095 thousand.

In late 2017 the management of BDB presented to the Economic Policy and Tourism Commission of the National Assembly of the Republic of Bulgaria its vision for development of the Group. Along with our main priority, namely funding for small and medium-sized enterprises, we plan to extend the range of investment instruments and mechanisms by directing them towards projects that are important for the state and strategic for the development of the region. In a long run this will result in economic growth in general, capitalization of enhanced investment activity and creation of new jobs.

In December 2017 the international rating agency Fitch Ratings upgraded the credit rating of BDB from "BBB-" to "BBB".

Thanks to the established brand, the good image and traditionally good relationships with various international financial institutions, BDB has established itself as a reliable partner not only for small and medium-sized enterprises, but also for European and International public banks. BDB remains inseparably linked to the principles and values of the institution built over the years that provide long-term and sustainable business partnerships.

We begin 2018 as a solid institution capable of delivering value-added solutions to both our customers and our shareholders.

For these achievments, I want to thank the management and all the employees for their commitment and great contribution, as well as our clients, partner organizations and shareholders for the voted confidence.

Stoyan Mavrodiev

Chairman of Management Board

Chief Executive Director

BULGARIAN DEVELOPMENT BANK
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WHO IS THE BDB GROUP?

The Bulgarian Development Bank Group AD (the BDB Group / the Group) includes the parent company, the Bulgarian Development Bank AD (BDB, the Bank) and two subsidiaries of which the Bank is the sole owner of the capital, namely the National Guarantee Fund EAD (NGF) and Micro Financing Institution Jobs EAD (MFI Jobs).

Bulgarian Development Bank AD

The Bulgarian Development Bank AD was established on 11 March 1999 as a joint-stock company under the name of Encouragement Bank. Almost 10 years later, on 23 April 2008, with the Bulgarian Development Bank Act (BDBA) its name and scope of activity were changed so as to apply schemes and instruments for financing of public investments and projects that are a priority for the national economy.

The mission of BDB Bank is to encourage the Bulgarian business through loans and guarantees for SMEs, public companies and equity participation in companies and equity funds, thus supporting also the Bulgarian economy. The Bank's lending activity is oriented towards pre-export and export lending to small and medium-sized enterprises; financing, through intermediary banks or directly, of other types of activities of small and medium-sized enterprises; refinancing of banks lending to small and medium-sized enterprises, financing of investments of small and medium-sized enterprises abroad, participation in public and public-private projects or partnerships of strategic, national and/or regional importance. Exposures to a single client or group of related clients other than credit institutions, central governments or central banks shall be subject to requirements and restrictions of Regulation (EU) 575/2013, while taking into account the effect of credit risk mitigation in accordance with procedure set forth by the Management Board.

As the only state-owned bank, BDB receives its funding under programs specifically assigned to it by the government of the Republic of Bulgaria. Where such programs provide for the disposal of funds under non-market conditions where losses or loss of profits may occur, their amount shall be determined in the relevant program.

BDB also holds a license for provision of investment intermediary services in accordance with the Public Offering of Securities Act (POSA), Markets in Financial Instruments Act (MFIA) and Ordinance No 38 issued by the Financial Supervision Commission (FSC).

As at 31 December2017, the paid-in share capital was BGN 601 774 thousand (31 December 2016: BGN 601 774 thousand), consisting of 6,017,735 ordinary registered shares with a voting right and nominal value of BGN 100. As of the date of this report, the ownership of the capital was distributed as follows: 99.9999% owned by the Republic of Bulgaria represented by the Ministry of Economy, 0.0001% owned by DSK Bank. The Bulgarian Development Bank Act regulates the participation of the State in the Bank's capital, where the share of the State shall be no less than 51% of the total share capital. The composition of the remaining shareholders, other than the Bulgarian state, is limited to the Development Bank of the Council of Europe, the European Investment Bank, the European Investment Fund and other development banks of the European Union Member States. The ownership specifics of BDB exempts it from the application of Article 31 of the Credit Institutions Act - the shares of the Bank cannot be pledged and the rights thereon cannot be subject to transfer transactions.

With regard to the acquisition of its own shares in accordance with procedure of Article 187 (e) and Article 247 of the Commerce Act, BDB declares that such acquisition was not made. During the year no company shares were acquired, owned or transferred by the members of the management bodies.

According to Article 6, para. 4 of the BDB Act, members of the management and supervisory bodies, procurators and senior management cannot hold shares and cannot be given options on BDB securities, and in subsequent reporting periods there cannot be any arrangements that result in future changes in the relative percentage of shares held by current shareholders.

The governance of BDB shall be carried out in accordance with Article 5 of the BDB Act whereby the Bank shall have a two-tier management system and the rights of the State in the general meeting of shareholders of the Bank shall be exercised by the Minister of Economy. Outside the powers of the Minister of Economy, any changes to the

BDB Act, as a constitutional document, and the right to issue or repurchase shares, shall be possible only through the passing of a new law or amendments to the existing one, by the National Assembly of the Republic of Bulgaria.

Members of the management bodies of the BDB Group shall be appointed in accordance with the generally applicable provisions of the national legislation and the specific provisions of the Bulgarian National Bank.

For the fulfillment of its objectives, BDB forms a financial group together with its two subsidiaries: the National Guarantee Fund EAD (NGF) and the Micro Financing Institution Jobs" EAD (MFI Jobs).

On 04 December 2017 changes and amendments to the Statutes of BDB were entered in the Trade Register of the Registry Agency.

In 2017 BDB had no obligations under existing or new issues of securities.

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

As at 31 December 2017 the average staff number of the Bank was 171 employees.

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

National Guarantee Fund EAD (NGF)

The National Guarantee Fund EAD is a company incorporated on 12.08.2008 pursuant to the Bulgarian Development Bank Act, entered in the Trade Register on 22.08.2008. According to the Credit Institutions Act (CIA) the National Guarantee Fund EAD is a financial institution which in 2009 was entered by the BNB in the Register under Article 3, para. 2 of the Credit Institutions Act (CIA). In accordance with the company's Articles of Incorporation, it has the following scope of business:

- to issue guarantees to supplement the collateral of loans of small and medium-sized enterprises;
- to offer other products to small and medium-sized enterprises, such as: tender guarantee; performance bond; advance payment guarantee; loan repayment guarantee for exporters, etc.;
- to issue guarantees to supplement the collateral of loans of small and medium-sized enterprises carrying out research and development activities, and for implementation of such products and scientific developments in the industry;
- other activities that are not expressly prohibited by law.

As at 31 December 2017 the registered capital of the Company amounted to BGN 80 000 000 divided in 800 000 shares with nominal value of BGN 100 each. The shares are ordinary, materialized, registered and indivisible, and each share is entitled to one vote. The capital of the Company is fully paid in.

The head office of National Guarantee Fund EAD (NGF) is at Sofia, 1, Diakon Ignatii Street.

As at 31 December 2017 the average staff number of NGF was 12 employees.

As at 31 December 2017 the National Guarantee Fund had no branches.

Micro Financing Institution JOBS EAD (MFI Jobs)

Micro Financing Institution JOBS EAD (MFI Jobs) was entered in the Trade Register on 14 January 2011. Its scope of business is microfinancing, including microcredits, acquisition by third parties and lease of industrial equipment, cars and other vehicles, as well as other assets /financial leasing/, purchase, sale and import of such assets, consulting services, trade representation of and intermediation on behalf of local and foreign individuals and legal entities performing their business in the country, as well as any other activities not prohibited by law.

As at 31 December 2017, the registered capital of MFI Jobs was BGN 7 643 000 divided into 76 430 shares with a nominal value of BGN 100 each. The shares are ordinary, materialized, registered and indivisible, and each share is entitled to one vote. The capital of the Company is fully paid in.

The head office of Micro Financing Institution JOBS EAD (MFI Jobs) is at Sofia, 1, Diakon Ignatii Street.

As at 31 December 2017 the average staff number of MFI Jobs was 14 employees.

As at 31 December 2017 the Micro Financing Institution JOBS EAD had no branches.

The Bulgarian Development Bank Group

As at 31 December 2017 the BDB Group had 197 employees, compared to 185 employees as at 31 December 2016.

In 2017 the BDB Group had no liabilities on existing or new issues of securities.

As at 31 December 2017 there are no pending court, administrative or arbitration proceedings concerning any liabilities or claims of the BDB Group amounting to 10 percent or more of its equity.

The Bulgarian Development Bank Group complies with the Bulgarian and EU environmental laws. The Group carries out a detailed environmental impact analysis of all projects for which this is required under the applicable legal framework. In the project implementation process, the BDB Group requires the submission of all necessary permits and documents and strictly monitors the exact project implementation. Where there are more stringent environmental requirements under loan agreement with external creditors, the Group requires by its clients to comply with those higher standards and monitors their performance.

In the area of human resources development, the BDB Group focuses on continuous support for employee development and training by creating prerequisites for professional growth of financial professionals within the only financial group in Bulgaria that does not prioritize the generation of profits but is rather focused on social goals.

The BDB Group does not take any action in the field of research and development, other than staff training.

The Group's financial standing and performance are stable; there are no non-financial indicators that would affect the results of its core business.

MAJOR ACHIEVEMENTS, ACTIVITIES AND PROJECTS FOR 2017

In line with Strategy 2017 - 2020, the efforts of the BDB Group during the year were aimed at increasing the share of indirect financing (including the volume of loans with guarantees issued by the NGF).

The reporting year 2017 was particularly important due to a significant regulatory change - the preparation and enforcement of the new IFRS 9 on 01 January2018 and the adjustment of the Groups's systems for classification of financial assets and liabilities as well as calculation of impairments and provisions on individual and portfolio basis with the appointment of a professional external consultant - Mazars.

Preparation for the implementation of Directive 2014/65/EU about financial instruments markets (MiFID II), EU Regulation 600/2014 on markets in financial instruments (MIFIR), Regulation 2016/679 on personal data protection (GDPR) and Directive 2015/2366 on payment services (PSD 2) also took place for their implementation in the second half of 2018. The Bank successfully introduced the reporting required under the TIPC for the purposes of the global data sharing standard (Common Reporting Standards - CRS), which extends and builds upon the existing standard requiring reporting on persons who are US residents for tax purposes (FATCA). The Bank has established and is implementing an organization related to the conclusion and execution of contracts with customers, requesting of information from customers, keeping of accounts and storage of client assets in accordance with the requirements of the above-mentioned national and EU legislation. The Bank has established a system of internal rules and internal control procedures to ensure full compliance with the regulatory framework referred to above.

In 2017, IT activities focused on the optimization and modernization of business processes and introduction of new technologies and applications, as well as work on regulatory projects - IFRS9, MiFID II, FATCA/CRS. An assessment of the condition of Bank's core system was made and the process and document management system DocuWare was introduced to service over 20 processes. In the IT infrastructure improvement area, a major upgrade of MS Exchange 2007 was made as of 2016, replacement of infrastructure components and upgrade of the PC environment, protection of the internal network in terms of IT security, and an entirely new virtual PBX.

In 2017, changes took place in the Bulgarian Development Bank (BDB) and replacement of the principal of the Bank, changes in the composition of the Management Board and the persons representing the company. By decision of the National Assembly promulgated in State Gazette N63/04.08.2017, 99.9999% of the company's capital was transferred under the control of the Minister of Economy of the Republic of Bulgaria, and from October 6, 2017 Mr. Stoyan Mavrodiev joined the Management Board of BDB as Chief Executive Director, Mr. Rumen Mitrov and Mr. Nikolay Dimitrov, as Executive Directors, whereas Mr. Iliya Kirchev remained a member of the Management Board of BDB.

The new leadership of the Bulgarian Development Bank presented its vision for development and management of BDB at a meeting of the Economic Commission in the Parliament held on December 6, 2017. Along with Bank's main priority set out in the BDB Act, i.e. the financing of small and medium-sized enterprises, the Bank plans to expand the range of its investment products by focusing on state-relevant projects. BDB will continue to be a partner of the government in the implementation of publicly significant projects.

On 04 December 2017, the Bulgarian National Bank approved the amendments to the Statutes of BDB, which were adopted unanimously by the General Meeting of Shareholders (Ministry of Economy and DSK Bank), held on November 13, 2017. With the amendments that were entered in the Trade Register, a number of interpretations that guide the credit operations of BDB were clarified allowing it to develop new business directions following the model of European development banks. The changes in the document reflect the European practice and bank lending limits, as well as the priorities set out in the Operational Strategy of BDB adopted by the Council of Ministers in July 2017. The credit requirements under Regulation 575/201/EU which are valid to all banks in the Republic of Bulgaria and the EU, shall apply directly. The introduction of a threshold requiring the Supervisory Board to approve exposures exceeding 5% of Banks's equity is a new addition in its Statutes. The goal is to establish a better control over the lending activity and a clear distinction of the supervisory functions of the Supervisory Board.

For the first time, in the Statutes of a Bulgarian bank, a definition of persons related to political parties was introduced in pursuance of the BNB's supervisory recommendations. Those changes create a high standard of transparency in Banks's activity and exclude the possibility of granting any credit exposures to individuals or organizations that are directly related to political parties. The document regulates the role of the Chief Executive Director, which is an established practice among all leading Bulgarian and international banks.

In relation to the introduction of a requirement for the appointment of a second independent external auditor, in November 2017, at the General Meeting of Shareholders of BDB, a second auditor, namely the specialized audit company "Zaharinova & Partners" Ltd. was appointed, and jointly with the first appointed auditor, i.e. Ernst and Young Audit Ltd., they will verify and certify the Annual Financial Statements of BDB for 2017 and the Consolidated Annual Financial Statements of the Group of BDB for 2017.

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

Rating	As at 31 December 2016	Updated on 13 December 2017
Long-term rating	„BBB -“	„BBB“
Outlook	Stable	Stable
Short-term rating r	'F3'	'F2'
Outlook	Stable	Stable

The assessment of the rating agency is based on the support of the sovereign - the Bulgarian state, the good financial results of the Bank, its good capitalization and the successful implementation of its mission and policy. The stable outlook shows the balance of risks associated with the credit rating assessment. Improvement of the BDB's rating reflects both the credible commitment for support to the Bank by the Bulgarian state, and the strong financial performance of the institution and its key role in supporting the government's economic strategy. The analysis highlights the involvement of the Bank as a paying agent in the National Energy Efficiency Program for Multifamily Residential Buildings / NEEPMRB or NEEP or NPEE / and its support for the Bulgarian business, also through the European Fund for Strategic Investments (the Juncker Plan).

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

The audited financial statements of the institution for 2016, certified by Earnst&Young Audit OOD, were adopted at the General Assembly of BDB held in May. The Bulgarian Development Bank reported a profit of BGN 42,9 million for 2016, with an increase of BGN 5,1 million or 14% compared to the previous year. The General Meeting decided to distribute a dividend of 50% of the financial result, with the remainder of the profit being allocated to BDB's reserves. As a result of this decision, the capital adequacy of the Bulgarian Development Bank remains 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 Energy Efficiency Program /NEEP/.

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.

At the beginning of 2017, agreements were signed between the National Guarantee Fund EAD and the partner banks for extension of the NGF EAD's own risk scheme to guarantee a portfolio of loans, namely the Guarantee scheme 2015-2017. This program is a continuation of a successful cooperation with commercial banks and is a product created by the NGF on a portfolio basis without prior approval in support of micro, small and medium-sized enterprises. The deadline for inclusion in the program is 30 September 2018. The scheme allows to guarantee almost all credit products offered by commercial banks, such as bank guarantees, investment and working capital loans, loans for implementation of projects under operational programs without restrictions. The guarantees issued in 2017 amounted to BGN 126 million on loans amounting to BGN 289 million.

The NGF Guarantee Program, launched at the end of 2016 and developed jointly with the Ministry of Agriculture and Food which is the Managing Authority of the Rural Development Program for 2014-2020, was actively developed in 2017, and guarantees worth BGN 34 million on loans amounting to BGN 69 million were issued thereunder, which is more than 50% of all guarantees issued under the scheme. The deadline for inclusion of loans in the scheme is 31.08.2018.

In 2017, the new Guarantee Scheme of the National Guarantee Fund EAD, with a counter-guarantee under the COSME Program of the EIF, was launched, with a total limit of EUR 20 million aimed at improving the competitiveness of SMEs. The guarantee is without limit for loans exceeding EUR 150,000 and 15% for loans up to EUR 150,000. Guarantees are issued on a portfolio basis, where the exposures exceeding EUR 150,000 require prior approval by the NGF. The period for inclusion of transactions is 3 years. The loans so guaranteed amount to BGN 7 million, and the guarantees issued amount to BGN 3.5 million.

On 23 June 2017, Micro Financing Institution Jobs EAD signed an agreement with the National Guarantee Fund EAD to guarantee a portfolio of transactions under the COSME Program. The purpose of this Agreement is to implement a guarantee scheme to facilitate the access of SMEs to finance through a risk-sharing scheme implemented through the guarantee provided by the EIF under the COSME Program and the European Fund for Strategic Investments (EFSI) established under of the Investment Plan for Europe.

The agreed guarantee line will facilitate the access to finance for Bulgarian micro, small and medium-sized enterprises by reducing the loan servicing cost to beneficiaries included in the guaranteed portfolio /annual interest rate, etc./, reducing the value of collaterals offered, and funding of beneficiaries whose projects are not supported by commercial banks due to high credit risk or lack of sufficient collateral.

Successfully implemented programs and projects

Bulgarian Development Bank AD

National Energy Efficiency Program - Bulgarian Development Bank AD provides grants under the National Program for Energy Efficiency of Multifamily Residential Buildings (the Program) adopted with Decree No. 18 of 2 February 2015 of the Council of Ministers of the Republic of Bulgaria. It is aimed at renovating multifamily residential buildings to ensure better living conditions for individuals in multifamily residential buildings, thermal comfort and higher quality of the living environment. The implementation of energy efficiency measures in multifamily residential buildings will contribute to a higher level of energy efficiency of multifamily residential buildings and reduce the energy costs, improve the lifecycle performance of buildings and provide living conditions compliant with the sustainable development criteria. The expected results and effects of the Program are reduced heating costs of households, improved housing infrastructure and change in the appearance of cities, a cleaner environment - saved greenhouse gas emissions (CO_2 etc.) and extended life of the building, which will also have a higher price. Implementing energy efficiency measures results in reduced household energy consumption and cost savings. The economic effect is related to the provision of more economic activity opportunities to businesses such as designers, construction industry, technical survey companies, energy efficiency auditing firms, producers of materials, etc., as well as participation of small and medium-sized companies from all over the country in the implementation of the Program. The program also has its own social effect by providing additional employment, establishing traditions in the management of multifamily residential buildings, raising public awareness of the ways to increase energy efficiency. Activities under the Program are carried out within the territory of the Republic of Bulgaria, within 265 municipalities. Initially, the financial resources allocated from the state budget under the Program amounted to BGN 1 billion. In 2017, the government approved additional costs of BGN 1 billion under the budget of the Ministry of Regional Development and Public Works for the implementation of the Program.

Design and construction of the road section of LOT 3.1 of Struma highway, 12.6 km long, financed by Transport and Transport Infrastructure Operational Program 2014-2020. The completion of the highway will improve significantly the road network in the Southeastern Europe and will create conditions for enhanced cooperation between the countries in the southern Balkans. Completion of the highway is of strategic importance for the development of the regions and provision of a direct route through Bulgaria to the Aegean Sea. The route of Struma highway is the busiest route passing through Bulgaria in the direction of the Republican road I-1 (E79), north to south.

A project for Modernization of a canning enterprise, through the implementation of which sustainability of agricultural production will be achieved and innovations in the production, processing and marketing of agricultural products will be introduced. In the project implementation, in addition to a bank loan, funding under sub-measure 4.2 "Investment in processing/ marketing of agricultural products" under the Rural Development Program for the period 2014-2020, co-financed by the European Agricultural Fund for Rural Development, was used. Investments included the purchase of machinery, plant and equipment for the main and subsidiary activities of the enterprise, as well as construction and assembly works.

Funding for an investment project for construction of a fully automated factory for production of interior and exterior doors, window frames and curtain walls with high capacity of production aimed at both the internal and external markets, also outside the European Union. Technology and equipment have been developed, consulted and produced by leading global companies in the industry. The raw materials used in the products are renewable and environmentally friendly, free from harmful emissions and are supplied by the most reputable manufacturers.

Financing of a business expansion through the purchase of a similar business enterprise, namely logistics services specializing in the field of refrigeration logistics and transportation targeting large retail chains, restaurants and hotels, importers, producers, distributors of food products. It includes also purchase and sale of groceries for fast food restaurants. It provides temperature-controlled logistics and refrigerated transport for all types of fresh, chilled or frozen products throughout Bulgaria from/to 100 different points within the country with temperature-controlled vehicles and full-time online information about the cargoes. The main activities are warehousing, inventory control and inventory management, timely distribution and other value-added services (including direct deliveries from a manufacturer to customers or retail chains, without processing or storage; commissioning; palletizing; packaging and repackaging; insurance of transported and stored goods; labeling)

Micro Financing Institutions Jobs EAD

During the year, the subsidiary MFI Jobs implemented a number of successful projects or funding for 106 end customers.

Financing the production of ice cream with lime and soda, which has only 90 calories in 100 grams. The "Ice`N`go" ice cream is made with carbonated water, but the more notable is that it is granulated. It is natural, without any coloring or preservatives. It is patent-protected and is manufactured with a special cryogenic technology.

With the support of MFI Jobs, a customer of the company has launched the production of innovative design handbags - with embedded gramophone records, and more. Those Bulgarian accessories have found their space on the website of the Italian fashion icon "Vogue". Currently they are working to develop a model to be used in a campaign against the air pollution.

Another successful project of MFI Jobs is funding of the production of cold-pressed oil from white thistle and black cumin, both known for their healing properties. The production is being sold in Bulgaria and abroad, and high vitamin E content is achieved by selecting the seeds. It offers a high-quality product in the form of capsules, regenerating cream and a derma cream. There is also a by-product from this production - an expeller which is a feed additive for animals.

Apart from those three projects, MFI has funded another 136 loans and lease agreements.

National Guarantee Fund EAD

2017 is the year when NGF reported the highest volume of guarantees issued since its establishment, namely BGN 223 million in guarantees and more than BGN 500 in secured loans.

The main volume of guarantees - BGN 186 million, was achieved through the two NGF own risk schemes: the Guarantee Scheme 2015-2017 (guarantees issued for the amount of BGN 59 million on loans amounting to BGN 135 million) and the Guarantee Scheme 2017-2018 (guarantees issued for the amount of BGN 126 million on loans amounting to BGN 289 million). Under the Rural Development Program guarantees for BGN 34 million on loans amounting to BGN 69 million were issued. The other loan guarantees are under the new guarantee scheme of the National Guarantee Fund EAD with a counter-guarantee under the COSME Program of the EIF.

OVERVIEW OF THE ECONOMIC ENVIRONMENT AND BANKING SECTOR IN 2017

In 2017, the Bulgarian economy reported a relatively high economic growth, improved labor market, annual inflation for the first time in three years, reduced external indebtedness of the economy as a whole, and reduced foreign investment.

According to NSI's expert assessments, Bulgaria's GDP increased by 3.5% in the fourth quarter of 2017. Growth is lower than the previous three quarters, largely due to the strong tourist season and construction in the early and mid-year. The engine of growth is the domestic demand (entirely due to end-use consumption). All domestic demand components reported growth, with households' end-use consumption being the highest. High growth rates are seen in exports and imports of goods and services, with imports registering higher growth than the export, resulting in an increased 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.

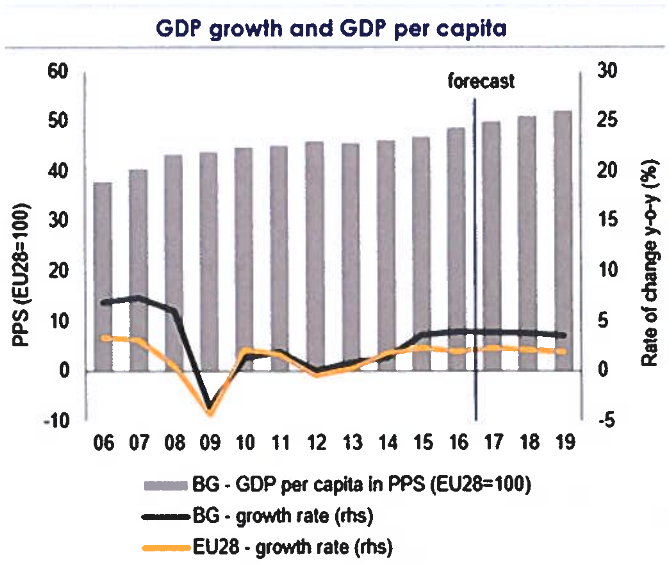
The maintenance of a relatively high economic growth for a second year in a row lead to further improvement of the situation on the labor market. During the fourth quarter of 2017 the level of unemployment dropped to 5.6%, i.e. it was lower by 1.1% as compared to the same quarter of 2016. The economic 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 reducing the country's external debt continued. Compared to December 2016, the total gross external debt decreased by EUR 1,658 billion and as of November it was EUR 32,389 billion. The external debt of the public sector decreased by EUR 0,949 billion to EUR 6,282 billion, while that of the private sector decreased by EUR 0,709 billion to EUR 26,107 billion.

Gross capital formation remains at the 2011 levels, reaching 21% of GDP by the end of 2017. Attracted foreign direct investments (FDI) in Bulgaria remain at low levels. According to preliminary data of BNB, for the past year the FDI in Bulgaria were EUR 901,9 million (1,8% of GDP), which is an increase of EUR 241,9 million compared to the past year's level. FDI is expected to increase after the revision in 2018, however, they are not expected to exceed 2,0% of GDP compared to an average of 17,7% for pre-crisis levels.

The average annual inflation for the period January - December 2017, compared to January - December 2016, was 2.1%. Major commodity groups contributing to increase in the total price index during the period remain the heating (10,7% increase), gaseous fuels (9,9% increase), education (4,5% increase), food and non-alcoholic beverages (4,0% increase) and transport (3,7% increase). In the group with the most significant deflationary contribution to the dynamics of the national average CPI in 2017 are the telecommunications (2,6% decrease), entertainment and culture (2,5% decrease) and clothing and footwear (1,4% decrease).



European Central Bank

According to ECB, the contribution of investment to economic growth is expected to increase upon faster absorption of EU funds. Public sector consumption is expected to increase, driven mainly by the planned public-sector wage increase. Wages will continue to have a positive impact on consumption.

BANKING SECTOR

In 2017, the Belgian financial group KBC announced the acquisition of the fourth largest bank in Bulgaria - UBB, from its former owner, the Greek NBG (National Bank of Greece). The deal also included 100% of the capital of Interlease, the country's third largest leasing company with 13% market share. As a result of this transaction, CIBank merged with UBB thus forming the largest bank and insurance group in Bulgaria. In December, the Commission for Protection of Competition allowed the sale of the majority share of 67.7% of Municipal Bank by Sofia Municipality to Liechtenstein Fund "Novito Opportunities" where the main investor is Insa Oil Company.

In December, the assets of the banking system increased by BGN 1,96 billion, up to BGN 97,81 billion, which is an increase of BGN 5,7 billion per year. An increase is observed in all groups of assets with the greatest dynamics in loans and receivables, by BGN 3,60 billion, and cash by BGN 1,35 billion. The increase in financial assets amounted to BGN 500 million, whereas in the other assets it was 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 an 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 increased by BGN 75 million during the year, with a decrease of BGN 130 million in the net interest income and BGN 193 million in the operating income. Profit before tax of the banking system decreased by BGN 102 million compared to December 2016 (the most profitable year since 2008).

By the end of the year the borrowed funds increased by BGN 1,84 billion, up to BGN 83,71 billion, with an annual increase of BGN 5,12 billion. Deposits by individuals increased by BGN 2,26 billion compared to December 2016, and deposits by non-financial corporations increased by BGN 2,81 billion. The economic recovery reveals the trend of increased deposits despite the record low interest rates.

In December 2017, the loans to individuals and households amounted to BGN 19,79 billion, which is an annual increase of BGN 1,21 billion. Loans to non-financial corporations decreased by BGN 20 million to BGN 33,16 billion.

Banking supervision data for the last quarter of 2017 show a continued downward trend in loans in arrears for more than 90 days in the non-financial sector, and during the year they decreased from 12,83% to 10,07%, while Bulgaria is still ranking in the EU's top positions on problem loans. The reporting year was record-breaking in terms of the number of loans in arrears of over 90 days sold, which is in the basis of their declined relative share.

Over the past 12 months, the interest rates on loans for new businesses decreased by 0,20% in BGN, reaching the levels of 3,71% as of 31 December 2017 and there was a decrease in loans for new businesses in EUR by 0, 78% in EUR, reaching levels of 3,38% at the end of the year.

In December, the corporate interest rates on deposits - new businesses decreased by 0,05% in BGN and 0,21% in EUR compared to December 2016 and reached levels of 0,09% in BGN and up to 0,05% in EUR.

OVERVIEW OF ACTIVITIES AND SELECTED FINANCIAL INFORMATION

The group of the Bulgarian Development Bank AD continues to actively pursue its objectives by maintaining high levels of liquidity and capitalization. In 2017, the process of modernization and upgrading of BDB's activities continued, while the Bank continued to increase its business volumes.

As at 31 December 2017, the financial result of the Bulgarian Development Bank Group after tax is a profit of BGN 20 680 thousand, compared to the previous reporting year of BGN 44 911 thousand.

The 2017 net interest income had a minor decrease and was by 2.1% lower than in 2016, amounting to BGN 57 666 thousand (as of 31 December 2016: BGN 59 110 thousand). The main reason for this was the increase in interest expense in 2017 compared to the previous accounting year due to the increased amount of long-term funds borrowed from international financial institutions to support the Group's core business lines, i.e. financing of SMEs and the National Program for Energy Efficiency of Multifamily Residential Buildings.

As at 31 December 2017, the net fee and commission income amounted to BGN 4,842 thousand compared to BGN 4,085 thousand in 2016, which is a growth of 18,5% as a result of an increased volume of loans in 2017.

As at 31 December 2017 the general and administrative expenses (excluding labor costs) of the Group amounted to BGN 5,797 thousand, compared to the expenses incurred in 2016 and amounting to BGN 7,357 thousand. Impact on the decrease of general and administrative expenses during the reporting year is mainly due to the reduced contribution to the Bank's Restructuring Fund paid in 2017.

Labor costs for 2017 amounted to BGN 11 479 thousand and show an increase of 17,6% compared to the previous year, where for 2016 they amounted to BGN 9 762 thousand. The increase is due to the increased number of personnel in the last quarter of 2017, which shows optimization of the strategy and changed governance model of the Group.

The operating cost (including personnel costs) to operating income ratio remained at the previous year's levels, amounting to 29% in 2017 (for comparison, in 2016 it was 28%).

In connection with the preparation for transition to the new IFRS 9 and as a follow up on the Banks's policy for conservative risk assessment and maintenance of high regulatory buffers, in 2017 impairment and provisioning costs amounting to BGN 22 095 thousand were allocated, compared to reintegrated impairments and provisions in the amount of BGN 3 832 thousand, allocated in 2016. Detailed information on impairment and provisions is provided in Notes 12, 18 C and 32 of the consolidated financial statements.

As at 31 December 2017, the Group's assets amounted to BGN 2 458 601 thousand, which is a growth of 29,8% compared to the previous year or BGN 1 893 723 thousand at the end of 2016.

Banking activities of the Group

BDB's lending activities consist of either direct lending of borrowed funds or financing through lending programs for commercial banks that are further using such funds to grant loans to SMEs and farmers, or to the so-called on-lending.

As at the end of December 2017, the gross amount of the Banks's corporate portfolio of direct loans (excluding funding granted under the National Energy Efficiency Program) decreased by 6,3% compared to late 2016 (BGN 845 668 thousand), reaching BGN 792 322 thousand.

In 2017, the Bank continued to actively develop its activities to support the Bulgarian business by continuing to maintain a diversified sectoral structure of its loan portfolio. Stronger dynamics was observed in the relative shares of construction (growth of 7,1%), industry (decrease by 5,2%), financial services (growth of 38%), real estate transactions (growth of 17,8% %), Transport (decrease by 1,5%) and other sectors (decrease by 14,5%). (Note 18B to the financial statements).

As at 31 December 2017, the amount of funds provided for indirect lending to the business through the intermediation of commercial banks amounted to BGN 157 326 thousand, which is a decrease compared to the volume in late 2016 (BGN 170 102 thousand) due to maturity of installments on some of the loans. In 2017, BDB launched a new indirect lending program with a 100% guarantee commitment to commercial banks in Bulgaria, supported by the EIB and EFSI under the Juncker Plan. Six commercial banks were approved for participation in the Program and the first withdrawals under this program will be in 2018.

Under the National Energy Efficiency Program (the Program) launched in 2015, in late 2017 the total funding agreed under contracts already signed was BGN 1 667 156 thousand (for comparison, in late 2016 it was BGN 851 039 thousand). The absorbed funds amounted to BGN 1 273 137 thousand and the balance sheet debt amounted to BGN 722 862 thousand (as at 31 December 2016, the balance sheet debt amounted to BGN 395 169 thousand). In 2017, under the National Program, BGN 554 919 thousand were repaid with funds from the state budget, out of which BGN 4 802 thousand were paid as interest.

BDB continued the specialized export financing program supporting exports, also through joint programs with the Bulgarian Export Insurance Agency (BAEZ). Thus, the Bank helps to promote the competitiveness of Bulgarian exporters.

The management of the Bank adheres to a consistent conservative policy assessing the risk consistent with the economic environment and specific characteristics of the BDB's loan portfolio. At the end of 2017, the coverage ratio with impairment of the Bank loan portfolio exposures was 18.15% (2016: 16,34%).

As at 31 December 2017, the ratio of gross loans to customers in arrears of more than 90 days, to the total corporate loan portfolio of the Bank (direct lending excluding claims from the state and municipal budgets, employees and non-bank financial institutions), was 10.8%, where their share increased compared to the end of 2016 (6,3%). The increase was mainly due to a reclassified large credit exposure from regular to overdue by more than 90 days. BDB continues its risk management policy ensuring high coverage with impairment of loans overdue by more than 90 days, with a coverage ratio of 48,95% as at late 2017, compared to 53,3% as at late 2016.

At the end of 2017, the available-for-sale securities portfolio decreased by BGN 33 465 thousand (12,7%) compared to the end of 2016 due to maturity of some of the securities issues held and optimization of the Bank's liquidity profile. The volume of securities portfolio held by BDB amounted to BGN 230 903 thousand (2016: BGN 264 268 thousand), with most of it consisting of government securities.

At the end of December 2017, the Bank reported a decrease in receivables from banks by about BGN 75 632 thousand or 27 ,6%, due to channeling a Bank's liquidity resource mainly to finance the National Energy Efficiency Program.

The cash in hand and in current account with the Central Bank line item registered a significant increase and reached BGN 447 648 thousand at the end of 2017 (31 December 2016: BGN 78 521 thousand). This was mainly due to funding received from international financial institutions.

As at 31 December 2017, the largest share in the Bank's liabilities was of funds borrowed from international financial institutions – 50,7% (32,8% at the end of 2016), amounting to BGN 869 822 thousand (31 December 2016: BGN 379 998 thousand). The increased share of funds borrowed from IFIs in the Bank's liabilities was due to the significant amount of funds from different international institutions absorbed in 2017, mainly targeted utilization to fund the National Energy Efficiency Program.

Deposits of customers other than credit institutions increased to BGN 790 590 thousand in 2017 compared to the end of 2016 (BGN 709 549 thousand) or an increase by 11,4%, with most of them (BGN 448 million or about 57%) consisting of funds provided by two clients under projects of national importance.

BDB continues to maintain a good level of liquidity. As at 31 December 2016 the Group's liquid assets ratio increased to 43,3% (compared to 31,5% at the end of 2016).

The Banks capital adequacy significantly exceeds the regulatory requirements. As at 31 December 2017 the capital base (own funds) of the Bank amounted to BGN 636 570 thousand, and the total capital adequacy of BDB amounted to 55,30% compared to 49,13% at the end of 2016.

Micro lending activities of the Group

In 2017, end-customer financing was provided under 139 loan and lease agreements amounting to BGN 9 463 thousand.

As at 31 December 2017, the company's active loan and lease portfolio amounted to BGN 17 719 thousand, presented at amortized cost before impairment, and consisted of 386 loan and lease transactions. Moreover, the Company also had receivables from 12 non-profit associations worth BGN 470 thousand before impairment.

The financial result reported for 2017 is a profit before tax amounting to BGN 296 thousand.

In 2017, the total revenue of the company amounted to BGN 1 375 thousand, where the interest income amounted to BGN 1 329 thousand or 97% of the total revenue.

Activities of the Group regarding guarantee schemes

The National Guarantee Fund has as its primary objective the provision of guarantees in favor of SMEs, thus facilitating the enterprises' access to funding.

Guarantees issued by the Fund at its own risk may cover up to 50 per cent of the obligation. With the amendments to the Bulgarian Development Bank Act, promulgated in State Gazette No. 102/21 December 2012, the guarantees issued by the NGF EAD in connection with guarantee schemes under the Rural Development Program for the period 2007 - 2013 and under the Operational Program for Development of the Fisheries Sector 2007-2013, may cover up to 80 per cent of the obligation.

From the beginning of its activities in 2008 through the end of 2017, NGF EAD has implemented 9 guarantee programs and has issued guarantees worth BGN 897 million. The funding used by SMEs with the support of NGF amounted to a total of BGN 1 883 million. The SMEs so supported were more than 7,300.

The first guarantee scheme of the NGF - Guarantee Scheme 2009-2013, was launched in 2009, and loans could have been included by February 2013. Under the first guarantee scheme, agreements were signed with 11 commercial banks. Under the scheme, NGF issued guarantees on loans to SMEs amounting to up to BGN 500 thousand on investment and working capital loans, as well as bank guarantees. The maximum period of guarantees was up to 10 years and the NGF approved the inclusion of loans in the guaranteed portfolio on a case by case basis. During the period of inclusion of loans in the guaranteed portfolio, the NGF approved guarantees worth BGN 168 000 thousand on loans amounting to BGN 391 000 thousand. The total number of enterprises supported under the scheme was 2,325. As per book value, the Fund's commitment as at 31 December 2017 was BGN 4,983 thousand.

The guaranteed portfolio under the Guarantee Scheme 2014-2015 included only new loans to small and medium-sized enterprises with a maximum amount of the guarantee granted by NGF EAD up to 50% of the loan amount and no more than BGN 500 thousand. For the period of inclusion of loans under the program, i.e. from March 2014 to September 2015, the guarantees issued amounted to BGN 87,000 thousand on loans amounting to BGN 200,000 thousand. The SMEs supported were 770, half of which were micro-enterprises, 40% were small and 10% were medium-sized enterprises. As at 31 December 2017, the approved amount of the guarantees included in the partner banks' portfolios amounted to BGN 49,047 thousand and the amount of debt so guaranteed was BGN 39,009 thousand.

From early October 2015 until the beginning of January 2016, under Guarantee Scheme 2015-2017 between the NGF EAD and 10 commercial banks, guarantee agreements for the total amount of BGN 326,000 thousand were signed. Under the scheme, the NGF guaranteed up to 50% of the amount of the loan, but not more than BGN 1 million. The deadline for inclusion of loans in the guaranteed portfolio was until 31 March 2017. Until the expiry of the deadline for inclusion of loans in the guaranteed portfolio, i.e. March 31, 2017, NGF EAD has guaranteed loans totaling BGN 581,500 thousand, the guarantees were for the amount of BGN 258,080 thousand granted to 2,024 SMEs. As at 31 December 2017, the approved amount of all guarantees included in the partner banks' portfolios was BGN 209,598 thousand, whereas the amount of debt so guaranteed was BGN 169,038 thousand.

In March and April 2017, guarantee agreements amounting to BGN 328,000 thousand were signed between NGF EAD and 10 commercial banks. The guarantee scheme 2017-2018 is a continuation of NGF 2015. The scheme guarantees up to 50% the loan amount but not more than BGN 1 million. The term for inclusion of loans in the guaranteed portfolio is until 30 September 2018. From the beginning of the guarantee scheme until 31 December 2017, 1,266 SMEs were supported, and guarantees worth BGN 126,493 thousand were issued. As at 31 December 2017, the approved amount of all guarantees included in the partner banks' portfolios was BGN 126,493 thousand, whereas the amount of debt so guaranteed was BGN 123,907 thousand.

The Guarantee Program to support beneficiaries under the Operational Program for Fisheries Sector 2007-2013 (OPFS) is a financial engineering instrument and is a process of issuing guarantees to supplement collaterals on loans granted by banks to borrowers for implementation of projects approved to be supported under the following OPFS measures:

Measure 1.3: Investments on board fishing vessels and selectivity

Measure 2.1: Production investments in aquaculture

Measure 2.5: Inland fishing

Measure 2.6: Investments in fishery and aquaculture products' processing and marketing

Measure 3.3: Investments for reconstruction and modernization of fishing ports, unloading sites and covered boat berths.

As well as under Priority Axis 4: Sustainable Development of Fisheries Areas, of projects of some beneficiaries under priority axes one, two and three, and all beneficiaries under axis four of OPFS.

During the period for inclusion of loans in the guaranteed portfolio, NGF EAD has approved guarantees amounting to BGN 21 million on loans amounting to BGN 31 million. The total number of enterprises supported under the scheme is 25. As of 31 December 2017 the amount of guaranteed debt at book value was BGN 4 959 thousand.

The Guarantee Scheme to support beneficiaries under the Rural Development Program 2007 - 2013 (RDP) is a financial engineering instrument approved by the Eighth Amendment of RDP and is a process of issuing guarantees to supplement the collateral of loans granted by banks to borrowers for the implementation of projects approved for support under measure 121 "Modernization of agricultural holdings", measure 122 "Improving the economic value of forests" and measure 123 "Adding value to agricultural and forestry products" under RDP of the Republic of Bulgaria (2007 - 2013).

During the period for inclusion of loans in the guaranteed portfolio, from early 2013 to 30 November 2015, the NGF has approved guarantees worth BGN 185,606 thousand on loans amounting to BGN 238 111 thousand. Within the scheme, 544 beneficiaries were supported under the project implementation program amounting to BGN 375 000 thousand. As at 31 December 2017 the amount of the guaranteed debt at book value was BGN 24 254 thousand.

The Guarantee Scheme to support beneficiaries under the Rural Development Program 2007-2013, 2014-2020 and enterprises from the plant growing and stock-breeding sector - Guarantee Scheme - MAF 2016-2018 is a joint program with MAF and is implemented with funds available from the Guarantee Scheme under the RDP 2007-2013 amounting to BGN 50 million. During the second quarter, NGF and MAF negotiated the parameters of the new guarantee scheme and calls for participation in the scheme were sent to commercial banks. Under the Guarantee Scheme agreements were signed with 17 commercial banks and MFI Jobs as part of the BDB Group providing financing of up to BGN 300,000. From the launching of the Scheme until 31 December 2017, the NGF has issued guarantees worth BGN 45 750 thousand on loans amounting to BGN 92 028 thousand. As at 31 December 2017 the amount of the guaranteed debt at book value was BGN 34 483 thousand.

Guarantee Scheme under the COSME Program of the European Commission - in December 2016, an agreement was signed between the European Investment Fund (EIF) and the National Guarantee Fund EAD (NGF EAD) to provide additional funding of EUR 40 million for small and medium-sized enterprises in Bulgaria under the COSME Program of the European Commission. The funds were provided with the support of the European Fund for Strategic Investments (EFSI), which is the basis of the Investment Plan for Europe (known as the "Juncker Plan"). The EIF provided a guarantee line of EUR 20 million, to be used by the NGF to support EUR 40 million in funding for SMEs in Bulgaria experiencing difficulties in securing the required collateral. As at 31 December 2017, NGF EAD has concluded agreements with TBI Bank, Bulgarian-American Credit Bank and MFI Jobs. As at 31 December 2017, 63 loans of 49 small and medium-sized enterprises were secured for the amount of 7,147 thousand. As at 31 December 2017 the amount of the guaranteed debt at book value was BGN 2,992 thousand.

Guarantees for micro-loans issued by the Bulgarian Development Bank and administered by NGF EAD - the transfer of the Guarantee Fund for Micro-Crediting project from the Ministry of Labor and Social Policy to the Bulgarian Development Bank AD was made pursuant to § 2 of the Transitional and Final Provisions of the Bulgarian Development Bank Act and Decision No. 309 of 3 May 2007 of the Council of Ministers of the Republic of Bulgaria. Following the acceptance of the project by the BDB Group, the administration of loan guarantees was assigned to the NGF. As of 31 December 2017, the portfolio guaranteed by BDB AD included 228 micro-loans, and the Banks's commitment thereon amounted to BGN 1,818 thousand.

RISK MANAGEMENT

In the course of its ordinary activity the Group 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 Group and its existence. The main risks, to which BDB is exposed, are credit, market and operational risks

CREDIT RISK

Credit risk is the main risk to which the Group is exposed, hence its management is essential in Group's activities. Credit risk management is carried out in accordance with the BDB Act, the applicable laws and regulations of the Republic of Bulgaria regulating the credit activity, as well as the established international provisions and best practices in banking.

The BDB Group uses internal rating generation models for the assessment and management of credit (including counterparty) risk on exposures. The BDB Group has established and operating bodies to monitor, control and assess the quality of the loan portfolio. Procedures and mechanisms for ongoing monitoring, reporting and management of the loan portfolio requiring periodic and, where necessary, extraordinary reports on the financial and legal standing of each borrower and liable persons, have been introduced. When new circumstances have been identified that may result in changes in the risk profile of borrowers, including an increased risk of inability to collect the credit exposure, appropriate and risk-adjusted measures are taken with regard to the debtor. The credit risk management of the BD Group adheres to a system of limits, set forth in internal regulations of the Group, on a consolidated basis by economic sectors, by instruments, as well as other credit restrictions and concentration limits, and the results of their compliance monitoring are reported to the competent authorities. The system of limits is reviewed and updated on a regular basis.

MARKET RISK

In managing foreign exchange risk, the BDB Group follows the principle of maintaining minimum open foreign exchange positions, through adherence to established limits. The positions of the Group in different currencies, as well as the general currency position, are monitored on a daily basis. Foreign currency positions are not formed for speculative purposes but are the result of foreign exchange transactions occurring in the course of ordinary banking activities. The Group does not perform any significant transactions and does not hold any significant open positions in currencies other than EUR and BGN. While the BGN exchange rate is permanently fixed to the EUR, the euro is not considered to be a currency bearing any currency risk for the cash flows and the Group's financial position.

For the interest rate risk management, regular reports are prepared with regard to financial assets and liabilities, broken down into time intervals, according to their sensitivity to interest rate fluctuations. A system of limits has been introduced in relation to the interest rate curve changes, where stress scenarios are applied to inconsistencies by periods to measure the potential risk to the Group's interest income and capital.

The risks from transactions on the money and capital markets are managed with a system of limits reflecting the risk profile of investments and defined by portfolio parameters such as counterparty, financial instrument, maturity, etc. The system of limits is reviewed from time to time, whereas the execution of limits is subject to day-to-day monitoring. The securities portfolio formed by the BDB Group for the purpose of investing free funds is characterized by a relatively low interest rate risk and relatively liquid securities issued by reliable institutions, i.e. low-price risk. Due to the absence of a trading portfolio, according to regulatory provisions, the BDB Group does not allocate any market risk capital.

The liquidity of the BDB Group is managed by strictly monitoring the ratios indicating the liquidity position by periods. Liquidity risk is measured by applying additional operating cash flow scenarios. The Group's liquidity buffers and additional sources of funding for market and idiosyncratic shocks are also measured and monitored. Compliance with liquidity ratio limits is monitored and reported regularly to the relevant authorities.

OPERATIONAL RISK

Operational risk management is carried out through strict monitoring and recording of all operational events in the activities of various units and processes within the Group, where the higher frequency and large effect events serve as a basis for operational risk analyzes in different scenarios. Operational risk is measurable and controllable, and in the course of work an operational event log is maintained that serves as a basis for analyzing and improving the work processes, as well as minimizing the conditions that could potentially lead to operational events and loss for the Group, the required operational risk capital is calculated by using the basic indicator approach in accordance with the applicable regulatory framework.

CONTROL ENVIRONMENT

The BDB Group follows a management philosophy and an operational style in line with the principles of conservatism in implementing the Banks's strategic goals set forth by the BDB Act. In connection with the special role of the BDB Group as a state policy implementing tool, the management of the Group has adopted a specialized control approach with regard to the control environment, with a number of units with specific control functions established within the organizational structure of the Group, namely the Risk Management Department, Liquidity Management Department, Planning, Analysis and Regulation Department, Legal Department, Classified Information Department, Compliance Department. Along with the periodic updates of the internal regulatory framework, this approach allows the management to take timely risk control measures alongside the traditional control environment components guaranteed by the direct involvement of the Bank's management in the preparation and verification of financial statements and the activities of the Accounting Directorate and Internal Audit Department, operating in full compliance with the principles of the three control pillar system Department by the European regulatory legislative acts.

The management assigns the powers and responsibilities for the operational activity in accordance with a detailed internal regulatory framework compliant with the acting national and European legislation, where in order to ensure the relationship regarding the accountability and reporting, and the hierarchy of competences, a number of specialized committees have been set up to the Management Board and Supervisory Board of BDB, as disclosed in the Corporate Governance Statement, which is an integral part of these financial statements.

The Group has developed internal regulatory provisions including policies and communications aimed to make sure that all employees understand the objectives of the Group, know how each individual's actions are intrinsically linked and contribute to these objectives, and who and how is reporting and what is their responsibility.

The Group has set up an information system, including the related business processes, providing the necessary quality and control of financial reporting and communication.

The Internal Audit Department and the Audit Committee at the Banks's Supervisory Board carry out ongoing monitoring 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 at 31 December 2017, the Group has met all regulatory requirements of the Bulgarian National Bank and the Bulgarian legislation.

As at 31 December 2017 the reported capital adequacy on a consolidated basis was 49,63% (31 December 2016: 48,45%). The asset coverage by capital buffers repeatedly exceed the normative levels required.

INTERNATIONAL ACTIVITIES

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.

GROUP GOVERNANCE

Bulgarian Development Bank AD has a two-tier governance structure, consisting of a Supervisory Board and a Management Board.

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

By a decision of the Extraordinary General Meeting of Shareholders (GMS) of BDB held on 02 March 2017, a decision for changes in the Supervisory Board of the Bank was made. The GMS of the Group dismissed Kiril Milanov Ananiev as Member of the SB of BDB and replaced him with Krassimir Totev Angarsky. By decision of the Supervisory Board of 02 March 2017, Krassimir Totev Angarsky was elected as Deputy Chairman of the Supervisory Board.

At the Extraordinary General Meeting of Shareholders of the Bulgarian Development Bank AD, held on 23 May 2017, a decision for changes in the Supervisory Board of the Bank was made. The GMS of the Bank dismissed Krasimir Totev Angarsky and Dimitar Kirilov Dimitrov as members of the Supervisory Board of BDB and elected Mr. Luchezar Dimitrov Borisov and Kiril Milanov Ananiev as new members. By a decision of the SB of 14 June 2017 Kiril Milanov Ananiev was elected as Deputy Chairman of the Supervisory Board.

By resolution of an Extraordinary General Meeting of Shareholders of BDB, held on 13 November 2017, a decision for changes in the Supervisory Board of the Bank was made. The GMS of the Group dismissed Kiril Milanov Ananiev and Atanas Slavchev Katzarchev as SB members and elected Velina Ilieva Burska and Mitko Emilov Simeonov as new members of the Supervisory Board. By decision of the SB of 13 November 2017 Luchezar Dimitrov Borisov was elected as Chairman of the Supervisory Board and Mitko Emilov Simeonov was elected as Deputy Chairman of the Supervisory Board.

In late 2017 the Supervisory Board of BDB (SB) had the following composition: Luchezar Dimitrov Borisov, Chairman and SB Member, Mitko Emilov Simeonov, Deputy Chairman and SB Member, Velina Ilieva Burska, SB Member.

In the beginning of 2017 the Bank's Management Board /MB/ had the following composition: Angel Kirilov Gekov, Chairman of the Management Board and Executive Director, Bilian Lyubomirov Balev, Deputy Chairman of the Management Board and Executive Director, Iliya Vassilev Kirchev, Member of the Management Board and Executive Director. The Group is represented jointly by any two of the three Executive Directors.

By decision of the Supervisory Board of Bulgarian Development Bank AD dated 29 September 2017, Angel Kirilov Gekov and Bilian Lyubomirov Balev were dismissed as members of the Management Board of the Bank. By the same decision of SB of BDB AD, Stoyan Todorov Mavrodiev, Rumen Dimitrov Mitrov and Nikolay Dimitrov Dimitrov were elected as members of the Management Board. By decision of the Management Board dated 29 September 2017 confirmed by decision of the Supervisory Board of the same date, Stoyan Todorov Mavrodiev, Rumen Dimitrov Mitrov and Nikolay Dimitrov Dimitrov were elected as Executive Directors. By a decision of the Management Board dated 04 October 2017, confirmed by a decision of the Supervisory Board of the same date, the authorization of Ilia Vassilev Kirchev as Executive Director was withdrawn and he remained only a member of the Management Board of the Bank. The BDB is represented jointly by any two of the three Executive Directors.

By decision of the Management Board dated 27 November 2017, confirmed by decision of the Supervisory Board of the same date, Stoyan Todorov Mavrodiev was elected as Chief Executive Director of Bulgarian Development Bank.

Following the decision so made by the Supervisory Board, as well as in connection with decisions of the meeting of the Management Board of BDB held on 27 November 2017, the composition of the Management Board of BDB as at the end of 2017 was as follows: Stoyan Todorov Mavrodiev, Chairman of the Management Board and Chief Executive Director; Rumen Dimitrov Mitrov, Deputy Chairman of the Management Board and Executive Director; Nikolay Dimitrov Dimitrov, Member of the Management Board and Executive Director and Iliya Vassilev Kirchev, Member of the Management Board.

In connection with the election of the Chief Executive Director, the manner of representation of the Bank was updated in the Trade Register, which did not mean any change. A decision of the MB of 05 December 2017, confirmed by decision of the SB of the same date was made in this effect. The Bank is represented jointly by any two of the Chief Executive Director, the Executive Directors and the Procurator.

In 2017 the persons managing the Bank were paid BGN 1,738 thousand. There are no contracts within the meaning of Article 240 (b) of the Commerce Act between the members of the Supervisory Board and the Management Board or persons related to them, on the one hand, and the Bank, on the other hand, which go beyond their normal activity or significantly deviate from the market conditions.

Participation, within the meaning of Article 247, para. 2, item 4 of the Commerce Act, of members of the Supervisory Board and the Management Board in trade companies as unlimited liability partners, possession of more than 25 per cent of the capital of another company or involvement in the management of other trade companies or cooperatives as procurators, managers or board members, is as follows:

From the beginning of the year the BDB's SB members have the following share in the capital or participate in the management of other companies:

Atanas Slavchev Katzarchev - no share in the capital or participation in the management of other companies.

Kiril Milanov Ananiev - no share in the capital or participation in the management of other companies.

Dimitar Kirilov Dimitrov is:

- Member of the Board of Directors of ANDEMA AD;
- Partner in PGD Ltd., UIC 175247211, where he owns 50% of shares of the capital of the company. The company is not active.
- Member of the Management Board of Eurohold Bulgaria AD, UIC 175187337

As at late 2017 the members of the BDB's SB members have the following share in the capital or participate in the management of other companies or cooperatives as procurators, managers or board members:

Luchezar Borisov – Chairman – no share in the capital or participation in the management of other companies.

Mitko Simeonov - Deputy Chairman - no share in the capital or participation in the management of other companies.

Velina Burska - MB Member – no share in the capital or participation in the management of other companies.

From the beginning of the year the BDB's MB members have the following share in the capital or participation in the management of other companies:

Angel Kirilov Gekov took part in the management of the National Guarantee Fund EAD, UIC 200321435 as Chairman of the Board of Directors (until October 2017). Currently he is part of the management of Municipal Bank AD, UIC 121086224, as Executive Director and Member of the Board of Directors.

Angel Gekov is:

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

Bilian Lyubomirov Balev took part 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, UIC 204666375;
- Member of the Board of Directors of Wine AD (in liquidation), UIC 121397741;
- Manager of UNINCORPORATED PARTNERSHIP CONSORTIUM FOREM CONSULTING BULGARIA LTD.-ITC & LTD.;
- partner in Fininvest Ltd. 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 under the laws of Malta.

Iliya Vassilev Kirchev was part of the management of Micro Financing Institution Jobs EAD, UIC 201390740 as Deputy Chairman of the Board of Directors (until October 2017). He has no shares in other companies or cooperatives in accordance with Article 247, para. 2, item 4 of the Commerce Act.

As at late 2017 the members of the BDB's MB have the following share in the capital or participate in the management of other companies or cooperatives as procurators, managers or board members:

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

Rumen Mitrov is Member of the BD of MICRO FINANCING INSTITUTION JOBS EAD, Sofia, UIC 201390740.

Nikolay Dimitrov is Member of the BD of MICRO FINANCING INSTITUTION JOBS EAD, Sofia, UIC 201390740.

Iliya Kirchev - none.

National Guarantee Fund EAD (NGF)

NGF EAD has a one-tier management system – Board of Directors (BD), consisting of three members, and has the following composition:

At the beginning of the year, the Board of Directors was composed of the following members: Angel Gekov, Chairman of the Board of Directors, Alexandar Georgiev, Member of the Board of Directors and Samuil Shiderov, Deputy Chairman of the Board of Directors 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 January2018, by decision of the Management Board of Bulgarian Development Bank AD dismissal of Mr. Samuil Shiderov as Member of the Board of Directors and Executive Director of the National Guarantee Fund was approved, and Mr. Angel Djalozov was appointed as Member of the Board of Directors of NGF and Executive Director.

On 15 March 2018, at a meeting of the Management Board of Bulgarian Development Bank AD, a decision was made to dismiss Mr. Alexandar Georgiev as Member of the Board of Directors (BD) of the National Guarantee Fund and to appoint Mr. Andon Georgiev as Member of the Board of Directors of NGF.

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

The remunerations received by the members of the Board of Directors and the Executive Director in 2017 amounted to BGN 247 000.

BD members do not hold shares in the Fund, nor do they have any special rights to acquire such shares.

There are no contracts within the meaning of Article 240 (b) of the Commerce Act, concluded between the members of the Board of Directors or their related parties on the one hand, and the company, on the other hand, that go beyond their normal activities or substantially deviate from the market conditions.

Participation, within the meaning of Article 247, para. 2, item 4 of the Commerce Act, of Members of the Company's Board of Directors in trade companies as unlimited liability partners, possession of more than 25 per cent of the capital of another company or involvement in the management of other trade companies or cooperatives as procurators, managers or board members, is as follows:

From the beginning of the year the members of the Board of Directors of NGF EAD have the following share in the capital or participation 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 Ltd., UIC 201477526 and owns 25% of the capital of the company.
- a partner holding 19.28% of the capital of BULGARPLOD BG CHERRY Ltd., UIC 200204916.

Alexandar Georgiev is:

- sole owner and manager of Brandi BG EOOD, UIC 202605174;
- sole owner and manager of KA SERVICE EOOD, UIC 114672190;
- owner of ET Alexandar Georgiev – AG, UIC 824083350;
- member of the Board of Directors of BALNEOLOGICAL CENTER - KAMENA EAD, UIC 112013405

Samuil Pavlov Shiderov has no shares in other companies or cooperatives pursuant to Article 247, para. 2, item 4 of the Commerce Act.

As at the end of the year the members of the Board of Directors of NGF EAD have the following share participation in the capital or involvement in the management of other companies:

Stoyan Mavrodiev is MB Member and Chief Executive Director of the Bulgarian Development Bank. Stoyan Mavrodiev is sole owner of REAL ESTATE VENTURES EOOD, Sofia, UIC 131160908

Alexandar Georgiev is:

- sole owner and manager of Brandi BG EOOD, UIC 202605174;
- sole owner and manager of KA SERVICE EOOD, UIC 114672190;
- owner of ET Alexandar Georgiev – AG, UIC 824083350;
- member of the Board of Directors of BALNEOLOGICAL CENTER - KAMENA EAD, UIC 112013405

Samuil Shiderov – has no shares in other companies or cooperatives pursuant to Article 247, para. 2, item 4 of the Commerce Act.

In February 2018, Mr. Angel Djalazov was elected as Executive Director of the National Guarantee Fund EAD. The change was made pursuant to Decision of the sole owner of the capital, in accordance with legal provisions.

Micro Financing Institution Jobs EAD

MFI Jobs EAD also has a one-tier governance system - the Board of Directors (BD), which consists of three members.

In 2017 and up to the date of this report, the following changes were made in the composition of the Board of Directors of the Company:

On 19 October 2017, Bilyan Lyubomirov Balev was dismissed from the Board of Directors and replaced by Rumen Dimitrov Mitrov.

On 19 October 2017, Ilia Vassilev Kirchev was dismissed from the Board of Directors and replaced by a new member, Nikolay Dimitrov Dimitrov.

In 2018 the following changes in the composition of the Board of Directors of the Company were made:

On 07 February 2018, Kostadin Bozhikov Munev was dismissed from the Board of Directors and replaced by Angel Atanasov Djalazov.

On 22 March 2018, an amendment to the company's Articles of Association was registered, whereby the composition of the Board of Directors was changed from three to five members.

On 30 March 2018, Hristina Atanasova Todorova was entered as a new member of the Board of Directors. On 02 April 2018, Mrs. Todorova was registered as a 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 took his Master's degree in Finance from the University of National and World Economy in Sofia in 1996. In 2011 he was appointed as Procurator of Micro Financing Institution JOBS EAD and Head of Lending and Leasing Department of the company. In April 2013 he became a BD Member, and in April 2014 he was elected as 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 microfinancing gained as a finance lease manager under the JOBS project of the United Nations Development Program 2003-2010. He took part in various international conferences on topics related to microfinance and is a co-author of the following publications: "Guide on Micro crediting in Europe", "From Exclusion to Inclusion through Microfinancing", "Market Research on Micro-Crediting for the purposes of the European Investment Fund - International Study in Western and Eastern Europe: Bulgaria Report. He speaks English and Russian.

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

There are no contracts concluded within the meaning of Article 240 b of the Commerce Act between the members of the Board of Directors or their related parties, on the one hand, and the Company, on the other hand, that go beyond their normal business or substantially deviate from the market conditions.

Participation within the meaning of Article 247, para. 2, item 4 of the Commerce Act of members of the Company's Board of Directors in trade companies as unlimited liability partners, possession of more than 25 per cent of the capital of another company or involvement in the management of other trade companies or cooperatives as procurators, managers or board members, is as follows:

From the beginning of the year the members of the Board of Directors of MFI Jobs EAD have the following share in the capital or participation in the management of other companies

Bilian Lyubomirov Balev (dismissed from the BD in October 2017) was Executive Director and Deputy Chairman of the Management Board of Bulgarian Development Bank AD. He is also:

- Executive Director and Member of the Board of Directors of Finanko EAD, UIC 204666375;
- Member of the Board of Directors of Wine AD (in liquidation), UIC 121397741;
- Manager of UNINCORPORATED PARTNERSHIP CONSORTIUM FOREM CONSULTING BULGARIA LTD.-ITC & LTD.;
- partner in Fininvest Ltd. 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 under the laws of Malta.

Iliya Vassilev Kirchev (dismissed from the BD in October 2017) was Executive Director and Member of the Management Board of Bulgarian Development Bank AD.

Kostadin Bojikov Munev has no shares in other companies or cooperatives pursuant to Article 247, para. 2, item 4 of the Commerce Act.

As at the end of the year the members of the Board of Directors of MFI Jobs EAD have the following share participation in the capital or involvement in the management of other companies:

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

Kostadin Munev has no shares in other companies or cooperatives pursuant to Article 247, para. 2, item 4 of the Commerce Act.

Nikolay Dimitrov is Executive Director and Member of the Management Board of Bulgarian development Bank AD.

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

The owner of BDB is the Bulgarian state, therefore, the Bank is a related party to the state bodies of the Republic of Bulgaria and the companies in which it exercises control. Note № 37 to the Consolidated Financial Statements of BDB for 2017 shows the transactions with related parties and companies under the joint control of the State.

STRATEGY FOR DEVELOPMENT AND BUSINESS GOALS. FINANCIAL GOALS AND OBJECTIVES

The BDB Group is a major instrument and channel for government policy-making in the economy, including specific areas, regions, sectors and social groups. The Bank interacts actively with all other state structures to maximize the impact of targeted public funding supporting the development of the economy.

The BDB Group operates with full transparency and implements the best management and banking practices. The main objective of the Bank;s operation is to identify and analyze economic sectors experiencing difficult access to funding and take measures to facilitate such access.

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 in the BDB's operations is to complement the market and not allow the traditional commercial banks to be pushed out of the market. The purpose of the Bank's business is to compensate an existing market shortage in funding of certain segments, thus adjusting their risk profile and encouraging commercial banks to develop their exposure to these segments.

<u>The strategic objectives of the BD Group are:</u>

- To enhance economic growth by supporting regions and sectors with identified market deficiencies and growth potential;
- To stimulate the investors' economic activity to modernize the equipment and technological base and increase the competitiveness of the economy;
- To support economic growth through funding, including syndicated one, of large-scale, strategic or infrastructure-related projects and investments;
- Support the development of competitive industries and sectors of the economy with a proven potential;
- To facilitate, in cooperation with the other institutions in the country, the access to financing of innovation and newly established companies;
- To facilitate and support the channeling of capital flows to the Bulgarian economy;

BDB's trade policy will preserve the two approaches to supporting the SME sector in the country, namely direct lending and indirect programs. In addition, the Bank will strictly adhere to its core principles:

- Complementing the market and avoiding competition with commercial banks;
- Conducting a liberal pricing policy with adequate coverage of the risks taken.

With regard to direct lending, the Bank will further develop targeted product lines focusing on SME problematic areas and areas in need of support. In this regard, priorities are pre-export, export and bridge financing.

Traditionally, the Bank will continue to provide funding for small and medium-sized businesses, with extended initial maturity and relaxed collateral requirements.

Considering the specifics of both its product lines and the limited branch network, the Group will realize its priorities using all available legal forms, including through the establishment of the Equity Investment Fund envisaged in BDBA

A key priority in commercial efforts of the BDB Group will be the continued development of indirect funding programs for the SME sector. The programs offered will be significantly varied in terms of sectors targeted and duration. Product lines with greater maturity structure, interest rate, etc. flexibility will be developed to help them adapt more easily to dynamic market conditions and hence to the requirements of partner banks. The main emphasis will be on combining the provision of resources with risk sharing that is in line with the BDB's objectives.

The Group believes that, given the high liquidity in the bankiing sector, the assumption of incremental risk (the additional risk that deters commercial banks from financing) jointly with partner banks, would be a key success factor of indirect programs.

The Group will interact with the Operational Programs' Management Bodies in Bulgaria to identify existing problems in funding of specific measures, and will propose solutions for their removal, including specific forms of their financing. Consultations will be held swiftly in order to adequately incorporate BDB in the overall public resource management model to support the development of economy in the country. The Bank considers its involvement as an essential step in increasing the effectiveness of measures in support of the Bulgarian economy.

The main strategic objectives and policies of the Group in the 2017-2020 horizon will be as follows:

- Restructuring of the asset in order to achieve a dominant contribution of indirect financing to the SME sector. The target ratio of indirect to direct funding is 60:40, but this calculation does not include the involvement of the Bank in public and public-private projects or partnerships of strategic, national or regional importance;
- Conducting a sustainable process for establishment and development of targeted product lines, within the two main SME financing approaches;
- Conservative risk assessment and maintenance of a high level of coverage of problem receivables with provisions.

The Bank intends to significantly diversify the sources of funding. Expectations are for increase in debt instruments in the formation of liabilities, as the balancing of the international and domestic markets will be made on a daily basis depending on the specific market conditions.

BDB will continue to support initiatives of the Bulgarian government in support of the country's economic and social development. In 2018, BDB will continue to implement the Program for Rehabilitation of Multifamily Residential Buildings.

Development of the **National Guarantee Fund EAD** in 2018.

The main tasks of the Fund for 2018 are as follows:

Effective implementation of guarantee programs to support enterprises from the Agriculture, Forestry and Fishery sectors through guarantee schemes under the Rural Development Program in the Republic of Bulgaria and Operational Program for Development of the Fisheries Sector 2007 - 2013;

Continuation of active work on the implementation of guarantee programs in support of micro, small and medium-sized enterprises in the Republic of Bulgaria;

Organizational and technical establishment of the NGF's structure in the context of new commitments;

Optimization and improvement of the Fund's operating procedures.

In order to fulfill its tasks and objectives, NGF EAD will work actively with partner banks under the guarantee agreements, national and EU bodies and institutions directly involved in the implementation of financial engineering schemes, will seek to attract new partners and will look for cooperation with SME business associations at national and regional level.

The management of Micro **Financing Institution Jobs EAD** engages with the future sustainable development of activities and growth of the company's assets.

EVENTS AFTER THE BALANCE SHEET DATE

On 06 March 2018, Iliya Vassilev Kirchev was dismissed as member of the Management Board of Bulgarian Development Bank AD.

On 07 February 2018, Kostadin Bojikov Munev, in his capacity as Executive Director and Member of the Board of Directors of Micro Financing Institutions Jobs EAD was dismissed and replaced by Angel Atanasov Djalazov as Executive Director and Member of the Board of Directors.

On 22 March 2018 the Statutes of Micro Financing Institution Jobs EAD was amended, whereby the composition of the Board of Directors was changed from three to five members.

On 30 March 2018, Hristina Atanasova Todorova was entered as a new Member of the Board of Directors of Micro Financing Institution Jobs EAD. On 02 April 2018 Mrs. Todorova was entered as a Procurator of Micro Financing Institution Jobs EAD.

As of 07 April 2018, Samuil Pavlov Shiderov, Executive Director and Member of the Board of Directors of the National Guarantee Fund EAD was dismissed and replaced by the legal adviser Angel Atanasov Djalazov as Executive Director and Member of the Board of Directors.

Angel Djalazov has a long-term experience in the international investment banking, asset management, capital markets, project financing, investment products, supervision and management of financial instruments.

On 22 February 2018, Andon Georgiev Georgiev was entered as Procurator of the National Guarantee Fund EAD, replacing Alexandar Angelov Georgiev at this position.

In relation to the introduction and enforcement as of 01 January 2018 of IFRS 9, during the reporting year the Bank successfully finalized the preparation process for introduction of the Standard and adjustment of BDB's financial assets and liabilities classification systems.

INTERNAL CONTROL

Internal control includes the following components:

(a) control environment - description of the control environment can be found in Risk Management, Control Environment, sections, as well as the Corporate Governance Statement, Control Environment section of this report.

(b) enterprise risk assessment process - description of the Group's control risk assessment can be found in the Corporate Governance Statement, Risk Management of the BDB Group section;

(c) information system, including its related business processes relevant to financial reporting and communication - a description of the Group's information system can be found in the Risk Management section;

(d) control activities - description control activities of the Group can be found in the Risk Management section of the Corporate Governance Statement, Risk Management Structure and Management Board Committees sections;

(e) ongoing monitoring of controls - description of the Group's ongoing monitoring and control can be found in the Corporate Governance Statement, Risk Management Structures and Management Board Committees sections.

STATEMENT OF THE MANAGEMENT

The management of BDB Group declares that the enclosed consolidated annual financial statements give true and fair view of the property and financial position of the BBD Group at the end of 2017 and the financial result for the year in accordance with the applicable legislation. Appropriate accounting policies have been applied consistently. In the preparation of annual consolidated financial statements at the year-end, appropriate judgments were made in accordance with the prudential principle. The management consistently uses the applicable accounting standards and the annual financial statements are compiled on a going concern basis.

The management of the Group endeavors to maintain appropriate accounting system compliant with the applicable accounting standards. The annual consolidated financial statement discloses the Group's position with a reasonable degree of accuracy.

All measures have been taken to protect the assets of the Group, prevent fraud and not allow any violations of the local laws and the BNB's banking regulations.

This activity report was adopted on *April 27, 2018* by the Board of Directors of Bulgarian Development Bank AD and was signed by

EXECUTIVE DIRECTORS:

STOYAN MAVRODIEV **RUMEN MITROV** **NIKOLAY DIMITROV**

BULGARIAN DEVELOPMENT BANK
BULGARIAN DEVELOPMENT BANK

CORPORATE GOVERNANCE STATEMENT

Principles of Corporate Governance

As a financial institution set up under a special law and applying all regulatory provisions of the BNB and the EU legislation, and in pursuance of its mission to be a sustainable state policy instrument for the promotion of small and medium-sized business development in Bulgaria, the BDB Group has set the goal to be a benchmark for good corporate governance and corporate responsibility by consistently and strictly following the Corporate Governance Code of 2007, the Code of Professional Conduct of 2017 (replacing the BDB's Code of Ethics of 2013), the BDB Group Code of Ethics for Internal Audit of 2015, laws and regulatory requirements in the Republic Bulgaria, the provisions of the EU legislation, as well as good corporate and banking practices.

Bulgarian Development Bank provides services in its capacity as an investment intermediary in accordance with the provisions of the Public Offering of Securities Act (POSA). As an investment intermediary, the Bank shall meet certain requirements to protect clients' interests in accordance with the Markets in Financial Instruments Act (MFIA) and Ordinance 38 issued by the Financial Supervision Commission (FSC). In 2018, the Bank shall also comply with the requirements of Directive 2014/65/EU on markets in financial instruments (MiFID II), Markets in Financial Instruments Regulation 600/2014 (MiFIR), the General Data Protection Regulation (GDPR) (EU) 2016/679 and Directive 2015/2366 on payment services (PSD 2). The Bank has established and applies an organization related to the conclusion and execution of contracts with clients, requesting of information from clients, keeping of accounts and storage of client assets in accordance with requirements of the above-mentioned national and EU regulations. The Bank has set up a system of internal rules and internal control procedures to ensure full compliance with the regulatory framework referred to above.

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

Apart from the two subsidiaries, i.e. NGF and MFI Jobs, included in the BDB Group, BDB does not have any major direct or indirect shareholdings (including indirect shareholdings through pyramid structures or cross-shareholdings) within the meaning of Article 85 of Directive 2001/34/EC.

Bulgarian Development Bank AD

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

On 23 April 2008 the Bulgarian Development Bank Act (BDB Act) was adopted. It regulates the scope of activities of the Bank and the subsidiaries provided for to be established.

The seat and registerd address of the Bulgarian Development Bank AD (BDB, the Group) is at Sofia 1000, Sredetz district, 1, Diakon Ignatii Street.

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

BDB is the main tool and channel for implementation of the government policies in the economy, including target areas, regions, sectors and social groups. The Bank interacts actively with all other state structures in order to maximize the impact of targeted public funds to support the development of economy. Priority focus of the Bank activities are the pre-export, export and bridge financing. Traditionally, the Bank will continue to offer investment funding for small and medium-sized businesses with extended initial maturity and relaxed collateral requirements.

The Bank has fulfilled all BNB requirements for the minimum required share capital in order to pursue banking activities, as well as the capital requirements of the BDB Act. From its establishment to August 2017, 99.9% of the Bank's capital was owned by the Ministry of Finance of the Republic of Bulgaria. On 04 August 2017 with amendments to the BDB Act, SG No. 63/2017, 99,9999% of the capital of the company was transferred under the control of the Minister of Economy of the Republic of Bulgaria. and at the date of preparation of the declaration, the ownership of the capital was distributed as follows: 99.9999% owned by the Republic of Bulgaria, represented by the Ministry of Economy, 0.0001% owned by DSK Bank. The stress tests and banking institutions' asset quality review confirmed the exceptionally high capital adequacy and shock resilience of the Group exceeding repeatedly the regulatory requirements.

The capital of the parent company (the Bank) consists of 6,017,735 ordinary, materialized, registered shares with one voting right and face value of BGN 100 each. The shares of BDB are not quoted on the stock market.

The Bulgarian Development Bank Act regulates that a package of at least 51% of the shares in the Bank's capital shall be owned by the State, where the State's shares of at least 51% of the registered share capital shall be non-transferrable. Moreover, a specific restriction is set forth with regard to the composition of the remaining shareholders, other than the Bulgarian state, through the Ministry of Economy. They can only be the Development Bank of the Council of Europe, the European Investment Bank, the European Investment Fund and other development banks of the European Union Member States. The shares of the Bank cannot be pledged and the rights thereon cannot be subject to transfer transactions.

BDB declares that with regard to the acquisition of its own shares in accordance with procedure of Article 187 (e) and Article 247 of the Commerce Act, no such acquisition was made, and that during the year there were no shares or bonds of the company acquired, owned or transferred by the Board members, and that pursuant to Article 6, para. 4 of the BDB Act the shares of the Bank's capital may be acquired and held by the Bulgarian state, but also by the Development Bank of the Council of Europe, the European Investment Bank, the European Investment Fund and other development banks of the European Union Member States, in which cases the Article 31 of the Credit Institutions Act shall not apply.

According to Art. 6, para. 4 of the BDB Act, the members of the management and supervisory bodies, procurators and senior management cannot hold shares and cannot be given options on BDB shares, and in the following reporting periods no arrangements can be made as a result of which changes in the relative share held by current shareholders can occur in any future period.

The governance of BDB shall be carried out in accordance with Article 5 of the BDB Act, whereby the Bank shall have a two-tier management system and the rights of the State in the general meeting of shareholders of the Bank shall be exercised by the Minister of Economy. Outside the powers of the Minister of Economy, any changes to the BDB Act, as a constitutional document, and the right to issue or repurchase shares, shall be possible only through the passing of a new law or amendments to the existing one, by the National Assembly. Pursuant to this article, decisions for reduction of capital through buyback of shares can be made by the Minister of Economy in its capacity as a representative of the majority shareholder in BDB.

By the end of 2017, the BDB had no obligations on existing or new issues of securities.

As of 31 December 2017, there were no pending court, administrative or arbitration proceedings concerning liabilities or claims of BDB Group amounting to 10 percent or more of its equity.

Pursuant to the Statutes of BDB, the Bank's lending activity shall be oriented towards:

Pre-export and export lending to small and medium-sized enterprises; financing, through intermediary banks or directly, of other types of activities of small and medium-sized enterprises; refinancing of banks lending to small and medium-sized enterprises; financing of investments of small and medium-sized enterprises abroad; participation in public and public-private projects or partnerships of strategic, national and/or regional importance.

The Bank shall grant also other types of loans in accordance with procedure set forth by the Management Board where the exposure to a single client or group of related clients other than credit institutions, central governments or central banks shall be subject to requirements and restrictions within the meaning of Regulation 575/2013/EU, while taking into account the effect of credit risk mitigation in accordance with procedure set forth by the Management Board.

The Bank shall not credit the following activities/borrowers:

1. Activities inconsistent with the national legislation, including environmental protection regulations;
2. Companies with an unknown ultimate beneficial owner.
3. Political parties and entities related to them. For the purposes of this paragraph, entities associated with political parties are: youth, female or other organizations which the parties may establish by law, as well as entities established by political parties to carry out solely business activity authorized by law, such as publishing, copyrights and use of intellectual property, as well as sale and distribution of printed, audio and audiovisual material with party propaganda content;
4. Non-profit legal entities and organizations;
5. Media;
6. Activities related to sports and sports events;
7. Other activities prohibited by law.

The Bank shall grant loans either directly or through commercial intermediary banks.

The terms and procedure for granting of loans shall be determined by the Management Board.

To support 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 BNB's Credit Register as "Substandard" or "Loss" (or any equivalent classification in case of regulatory changes), at the time of loan application with the BDB, subject to confirmation by the Supervisory Board.

The Management Board shall take a unanimous decision to form an exposure to a client or a group of related clients, which exposure exceeds 5% of the Bank's equity, subject to fulfillment of requirements of the Credit Institutions Act and the Bank's Internal Regulations.

In view of its specific function of conducting the state policy for promotion, in its activities BDB has prioritized programs and products to promote SMEs, on-lending programs, export financing, and mandated funding. The Bank's largest credit exposure to a group of related parties (non-banking institutions) amounted to BGN 69 239 thousand at amortized cost (BGN 2016: 62 202 thousand), representing 10.88% of the Bank's equity (2016: 9.99%). Analysis of the credit portfolio's structure by segments is provided in the individual financial statements.

Considering the specific activity of the Bank, as at 31 December 2017 the funds borrowed by the 20 largest non-bank depositors represented 97.13% of total liabilities to other clients (31 December 2016: 97,26%).

In view of its specific activity, the BDB Group uses significant external financing from international financial institutions. Detailed information on the external credit facilities is disclosed in note 29 to annual financial statements.

National Guarantee Fund EAD (NGF)

The National Guarantee Fund EAD (NGF) is a company incorporated on 12 August 2008 pursuant to the Bulgarian Development Bank Act and was registered in the Trade Register on 22 August 2008. Pursuant to the Credit Institutions Act (CIA), the National Guarantee Fund EAD is a financial institution which in 2009 was entered by the BNB in the Register under Article 3, para. 2 of the Credit Institutions Act (CIA). In accordance with the company's Articles of Incorporation, it has the following scope of business:

- to issue guarantees to supplement the collateral of loans of small and medium-sized enterprises;
- to offer other products to small and medium-sized enterprises, such as: tender guarantee; performance bond; advance payment guarantee; loan repayment guarantee for exporters, etc.;
- to issue guarantees to supplement the collateral of loans of small and medium-sized enterprises carrying out research and development activities, and for implementation of such products and scientific developments in the industry;
- other activities that are not expressly prohibited by law.

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

As at 31 Deceber 2017 NGF had no branches.

Micro Financing Institution Jobs EAD (MFI Jobs)

Micro Financing Institution JOBS EAD (MFI Jobs) was entered in the Trade Register on 14 January 2011. Its scope of business is microfinancing, including microcredits, acquisition by third parties and lease of industrial equipment, cars and other vehicles, as well as other assets /financial leasing/, purchase, sale and import of such assets, consulting services, trade representation of and intermediation on behalf of local and foreign individuals and legal entities performing their business in the country, as well as any other activities not prohibited by law.

The head office of Micro Financing Institution JOBS EAD (MFI Jobs) is at Sofia, 1, Diakon Ignatii Street.

As at 31 December 2017 the Micro Financing Institution JOBS EAD had no registered branches. The company carries out its activities through four offices within the country – one in each of the following cities: Sofia, Pleven, Shumen and Nova Zagora.

Risk management within The BDB Group

In the course of its usual activities, BDB Group is exposed to various financial risks, the occurrence of which may result in loss or deterioration of Group's financial stability. These risks are identified, measured and evaluated through control mechanisms in order to be managed and to avoid the concentration of any unjustified risk. The risk management process is essential for the Group's profitability and its existence. The main risks to which BDB Group is exposed are credit, market and operational risk.

In its risk management, the Group is guided by the principles of conservatism, objectivity and full compliance with all applicable national and EU regulations and regulatory recommendations. In support of this policy, the Group maintains a significantly higher than the required regulatory levels of liquidity buffers and capital adequacy.

Credit risk

Credit risk is the main risk to which BDB Group is exposed, hence its management is essential in the Group's activities. Credit risk management is carried out in accordance with the BDB Act, the applicable laws and regulations of the Republic of Bulgaria regulating the credit activity, as well as the established international provisions and best practices in banking.

The BDB Group uses internal rating generation models for the assessment and management of credit (including counterparty) risk on exposures. The BDB Group has established and operating bodies to monitor, control and assess the quality of the loan portfolio. Procedures and mechanisms for ongoing monitoring, reporting and management of the loan portfolio requiring periodic and, where necessary, extraordinary reports on the financial and legal standing of each borrower and liable persons, have been introduced. When new circumstances have been identified that may result in changes in the risk profile of borrowers, including an increased risk of inability to collect the credit exposure, appropriate and risk-adjusted measures are taken with regard to the debtor.

The Group's credit risk management adheres to a system of internal banking limits set by economic sectors, by instruments, as well as other credit restrictions and concentration limits, and the results of their compliance monitoring are reported to the competent authorities. The system of limits is reviewed and updated from time to time.

The credit risk management of NGF's off-balance-sheet (guarantee) commitments is two-fold - at individual transaction level (guarantee) and at portfolio level. Credit risk at individual level is managed in accordance with internal rules and procedures on guarantee-related activities, where the proposal to issue a guarantee (take a guarantee commitment) shall be reviewed and approved by the NGF Risk Manager, and then submitted for approval by two of the members of the NGF Board of Directors. Once all approvals have been collected, the guarantee issuance confirmation shall be signed by the NGF representatives. Under the RDP guarantee scheme, there is a second level of approval - the so called Advisory Committee consisting of representatives of MAF and BDB, to approve any guarantee commitment under the program. At the portfolio level, the credit risk is managed through set payment limits (caps) limiting NGF's payment commitment up to a certain proportion of the portfolio of guarantees issued under a specific program to a specific bank. Subsequent management of the credit risk assumed by NGF shall be carried out through monitoring procedures whereby the Fund may exclude from the guaranteed portfolio certain loans that do not meet the specific requirements of the guarantee agreements.

The policy that MFI JOBS has adopted to minimize credit risk is to make a preliminary assessment of customers' creditworthiness and to require additional collaterals on lease and loan agreements, assigned rights to receivables – insurance of leased assets, entry of lease agreements in the Central Register of Special Pledges, surety, promissory note and special pledges on receivables, as well as mortgage of immovable property and/or pledge of movable property upon granting of loans.

Market risks of BDB Group

In managing foreign exchange risk, the BDB Group follows the principle of maintaining minimum open foreign exchange positions, through adherence to established limits. Foreign currency positions are not formed for speculative purposes but are the result of foreign exchange transactions occurring in the course of ordinary banking activities. The BDB Group does not perform any significant transactions and does not hold any significant open positions in currencies other than EUR and BGN.

For the interest rate risk management, regular reports are prepared with regard to financial assets and liabilities, broken down into time intervals, according to their sensitivity to interest rate fluctuations. To inconsistencies by periods the estimated expected change in the interest rate curve shall apply to measure the potential risk for the interest income and the Group's capital.

Risks in money and capital market transactions are managed with a system of limits reflecting the risk profile of investments and defined by portfolio parameters such as counterparty, financial instrument, maturity, etc. The system of limits is reviewed from time to time, whereas the execution of limits is subject to day-to-day monitoring. The securities portfolio formed by the companies within the Group for the purpose of investing free funds is characterized by a relatively low duration, low interest rate risk and relatively liquid securities issued by reliable institutions, i.e. low-price risk. Due to the absence of a trading portfolio according to regulatory provisions, no market risk capital is being allocated.

The liquidity of BDB Group is managed by strictly monitoring the ratios indicating the liquidity position by periods. Liquidity risk is measured by applying additional operating cash flow scenarios.

The BDB Group's liquidity buffers and additional sources of funding for market and idiosyncratic shocks are also measured and monitored. Compliance with liquidity ratio limits is monitored and reported regularly to relevant authorities.

Operational risk

Operational risk management is carried out through strict monitoring and recording of all operational events occurring in the activities of various units and processes within the Group, where the higher frequency and large effect events serve as a basis for operational risk analyzes in different scenarios. Operational risk is measurable and controllable, and in the course of work an operational event log is maintained that serves as a basis for analyzing and improving the work processes, as well as minimizing the conditions that could potentially lead to operational events and loss for the Group, the required operational risk capital is calculated by using the basic indicator approach in accordance with the applicable regulatory framework.

Risk management structure

The main units directly responsible for risk management are as follows:

For the parent-company (the Bank):

- Supervisory Board - performs general oversight over risk management activities;
- Audit Committee with the Supervisory Board – implements the best practices for independent audit control and establishes the three-pillar financial sector controls system, as recommended by Basel III;
- Management Board - responsible for the general approach to risk management and approves the strategies, principles and specific methods, risk management techniques and procedures;
- Risk Committee - responsible for overseeing the implementation of policies for managing various types of risk and the adequacy of the Bank's risk profile of tasks assigned;
- Asset and Liability Management Committee (ALCO) - responsible for the strategic management of assets and liabilities, as well as the management of market risks, including their associated liquidity risk;
- Remuneration Committee and Committee on Recruitment - responsible for the management of HR activities;
- Executive Directors and MB Members - carry out ongoing operational control on maintaining and adhering to the limits set for specific types of risk and the implementation of procedures so developed;
- 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 that are directly responsible for risk management are the following:

- Supervisory Board – the Management Board of BDB AD (the parent company) - carries out general supervision of risk management activities;
- Board of Directors - responsible for the overall risk management approach and approves the strategies, principles and specific risk management methods, techniques and procedures;
- Provisions Committee - analyzes the guaranteed portfolios in terms of credit risk management for the guaranteed portfolio as a whole, as well as at the level of guaranteed transaction and beneficiary of the guarantee;
- Risk and Monitoring Department - monitors the guaranteed portfolios and loan collaterals. At least once a year, checks the adherence to economic and social requirements by the SMEs using guarantees from the National Guarantee Fund EAD.

For the subsidiary – Micro Financing Institution Jobs EAD:

The main units directly responsible for risk management are as follows:

- Board of Directors – adopts the risk management rules and procedures. Controls the risk factors for the Company's activities and takes decisions within its powers. It also analyzes the credit transactions worth more than BGN 100 thousand from the point of view of credit risk management, upon their approval;
- Credit Committee – performs ongoing monitoring and analysis of the loan and leasing portfolio of the Company in terms of credit risk, also by individual transactions;
- Credit Council - analyzes credit and leasing transactions in terms of credit risk management upon their approval and/or renegotiation;
- Operational management (Executive Director and BD Member) - organize the activities for implementation of the Risk Management Rules adopted by the Board of Directors. Creates a work organization that ensures compliance with certain limits and risk levels. Controls the compliance of procedures for analysis, measurement and risk assessment applied by the respective officers, with the internal regulatory documents adopted by the Board of Directors;
- Risk Management Department - develops and implements a risk management system. Prepares and submits periodic reports to the Board of Directors to assess operational risks, including compliance with limits, and reports to the operational management of the company. Performs initial and ongoing verification of risk assessment methods. Controls the incoming data necessary for risk assessment in accordance with the applicable reliability and sufficiency method.

Banking regulators under the Bulgarian legislation

Persuant with requirements of the laws and provisions regulating the Banking activity in the country, in its consolidated financial statements BDB shall comply with the restrictions related to certain ratios. As at 31 December 2017, the Group has met all regulatory requirements of the Bulgarian National Bank and the Bulgarian legislation.

In its activities, the Group shall comply with the regulatory capital adequacy requirements and also meet the general goals and objectives set out upon its establishment – to support the country's economic policy and the development of small and medium-sized businesses. The asset coverage by capital buffers repeatedly exceed the normative levels required.

Control environment

BDB Group follows a management philosophy and an operational style in line with the principles of conservatism in implementing the Bank's strategic goals assigned under the BDB Act. In connection with the special role of the Bank as a state policy implementing tool, the Bank's management has adopted a specialized control approach with regard to the control environment, with a number of units with specific control functions established within the organizational structure of the Bank, namely the Risk Management Department, Liquidity Management Department, Planning, Analysis and Regulation Department, Legal Department, Classified Information Department, Compliance Department. Along with the periodic updates of the internal regulatory framework, this approach allows the management to take timely risk control measures alongside the traditional control environment components guaranteed by the direct involvement of the Bank's management in the preparation and verification of financial statements and the activities of the Accounting Department and Internal Audit Department, operating in full compliance with the principles of the three control pillar system introduced by the European regulatory provisions.

The management assigns the powers and responsibilities for the operational activity in accordance with a detailed internal regulatory framework compliant with the acting national and European legislation, where in order to ensure the relationship regarding the accountability and reporting, and the hierarchy of competences, a number of specialized committees have been set up to the Management Board and Supervisory Board of BDB, as disclosed in the Corporate Governance Statement, which is an integral part of these financial statements.

The Group has developed internal regulatory provisions including policies and communications aimed to make sure that all employees understand the objectives of the company, know how each individual's actions are intrinsically linked and contribute to these objectives, and who/how is reporting and what is he/she responsible for.

The Group has set up an information system, including the related business processes, providing the necessary quality and control of financial reporting and communication.

The Internal Audit Department and the Audit Committee of Bank's Supervisory Board carry out ongoing monitoring of controls.

Management of the BDB Group

The Bulgarian Development Bank AD has a two-tier management structure consisting of Supervisory Board and Management Board.

As at 31 December 2017, the structure of the management bodies consists of the following members:

Supervisory Board:

Luchezar Borisov – Chairman

Luchezar Borisov was born in 1978 in Samokov. He has Master's degree in Macroeconomics and Accounting and Finance from the University of National and World Economy (UNSS). He has various specializations in Bulgaria and abroad, including those in Entrepreneurship and Risk Capital at AUBG; Project Management at WIFI, Austria; Promoting Foreign Direct Investment at JICA, Japan; Exchange and Currency Trading and Banks at CITIBANK, etc.

He has extensive experience in the field of corporate governance; he was part of the management of private and state-owned companies working in the industry, energy and financial management. He is now Deputy Minister of Economy.

Mitko Simeonov - Deputy Chairman

Mitko Simeonov has a Master's in Law from the New Bulgarian University and a Master's 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 a Deputy Executive and Executive Director of the Agency for Privatization and Post-Privatization Control.

Velina Burska - SB Member

Velina Burska has a Master's degree in Economics and Domestic Trade Organization from the University of National and World Economy. From 2002 to 2017 she was the Head of the Post-Privatization Control Directorate with the Agency for Privatization and Post-Privatization Control.

In fulfillment of the best practices for control and the three-pillar system recommended under Basel III, a specialized body consisting of the Audit Committee, Risk Committee, Remunerations Committee and Selection Committee operates to the Supervisory Board.

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

Audit Committee:

Mrs. Valya Yordanova- Committee Chairman,
Mrs. Ruslanna Radomirova – Committee Member;
Mr. Ognyan Todorov - Committee Member.

Additional audit services

The audit firms auditing the annual financial statements of the Bank (individual and consolidated) also issue a Factual Findings Report relating to reliability of internal control systems under Article 76, para. 7, item 1 of the Credit Institutions Act and Ordinance 14, Article 5 on the content of the audit report for supervisory purposes as at December 31, 2017 (Ernst & Young Audit Ltd. has issued such a report for the Bank also as of December 31, 2016). In 2017, Ernst & Young Audit Ltd. has approved and delivered 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 has a Master's in Finance at the University of National and World Economy. His career began in 1995 at Agrobusinessbank in Plovdiv. From 1999 to 2003 he was the manager of Plovdiv branch of Allianz Bank Bulgaria. From 2003 to 2005, he held senior positions in HVB Bank Biochim. From 2005 to 2010 he was the manager of two of the Plovdiv branches of Eurobank Bulgaria, and in 2011 he became a regional manager for the corporate clients. From 2012 to 2013 he was the manager of Plovdiv Branch of the First Investment Bank. At present he is an assistant professor at the Higher School of Agribusiness and Development of the Regions in Plovdiv.

Committees to the MB

The Management Board of BDB, in compliance with the current legislation in Bulgaria and the EU and following the best banking practices, has delegated some of its powers to specialized committees, namely the Assets and Liabilities Committee and the Complaints and Reports Committee.

Meetings of the Assets and Liabilities Management Committee (ALCO) are held on a monthly basis to review the main indicators relevant to the strategic management of the assets and liabilities of the Bank. The main functions of ALCO are to establish, manage and monitor the Bank's liquidity risk, determine the resource raising strategy, determine the credit pricing policy to ensure an adequate margin exceeding the cost of funding, make decisions on the strategic liquidity of the Bank in order to ensure regular and timely payment of current and future liabilities, both under normal conditions and in a liquidity crisis, determine the structure of liquidity buffers and sources of additional funding. The documents discussed at the Committee meetings, together with the minutes thereof, are reported to the Management Board of BDB promptly after each meeting.

Apart from the MB Members and heads of key units within the Bank, members of those Committee are as follows:

	Assets and Liabilities Committee	Complaints and Reports Committee*
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 Banking Security Department		Member
Head of Planning, Analysis and Regulations	Member	Member

Department		
Head of the Group's Internal Audit Department		Member
Head of Liquidity Department	Member	
Head of Compliance Department		Chairman
Head of International Financial Institutions Department	Member	

** The Committee chairman is elected by the member for a term of one year.*

The Bank is jointly represented by any two of the Chief Executive Directors, Executive Directors and the Procurator.

In 2017 there were no changes in the basic principles of the BDB Group's management.

Contracts with related parties involved in the management and involvement of MB and SB members in other companies

There are no contracts concluded within the meaning of Article 240 (b) of the Commerce Act between any members of the Supervisory Board and the Managing Board or their related parties on the one hand, and the Bank on the other hand that go beyond their normal business or substantially deviate from the market conditions.

In 2017, between BDB and related parties, there were no transactions or proposals to conclude any transactions that were beyond the normal activities or substantially deviated from the market conditions to which the BDB or its subsidiary was a party.

There are no major contracts of the company that were effective, altered or terminated due to a change in the company's control in the course of the mandatory tender offering and to the extent that there is a legal restriction as to the BDB's eligible shareholders under the BDB Act, no such contracts are expected.

The BDB has no practice to conclude and has not concluded any agreements between the companies and their management bodies or employees for payment of severance compensation upon leaving or dismissal without any legal grounds or upon termination of the employment relationship for reasons related to tender offer.

Participation, within the meaning of Article 247, para. 2, item 4 of the Commerce Act, of SB and MB members in companies as unlimited liability partners holding more than 25 per cent of the capital of another company, as well as involvement in the management of other companies or cooperatives as procurators, managers or board members, is as follows:

From the beginning of the year, the members of the BDB's Supervisory Board, have the following involvement in the capital or management of other companies:

Atanas Slavchev Katzarchev – not share in the capital or participation in the management of other companies.

Kiril Milanov Ananiev - no share in the capital or participation in the management of other companies.

Dimitar Kirilov Dimitrov is:

- Member of the Board of Directors of ANDEMA AD;
- partner in PGD Ltd. with UIC 175247211 and owner of 50% of the share capital of the company. The company is not active.
- Member of the Management Board of Eurohold Bulgaria AD with UIC 175187337.

As at late 2017, the BDB's SB members had the following shares in the capital or participation in the management of other companies or cooperatives as procurators, managers or board members:

Luchezar Borisov – Chairman – no share in the capital or participation in the management of other companies.

Mitko Simeonov - Deputy Chairman - no share in the capital or participation in the management of other companies.

Velina Burska - MB Member – no share in the capital or participation in the management of other companies.

From the beginning of the year the members had the following shares in the capital or participation in the management of other companies:

Angel Kirilov Gekov took part in the management of the National Guarantee Fund EAD, UIC 200321435 as Chairman of the Board of Directors (until October 2017). Currently he takes part 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 Ltd., UIC 201477526 and owns 25% of the capital of the company.
- a partner holding 19.28% of the capital of BULGARPLOD BG CHERRY Ltd., UIC 200204916.

Bilian Lyubomirov Balev took part 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 Unincorporated Partnership Consortium Forem Consulting Bulgaria Ltd.-AI TI SI & LTD.;
- partner in Fininvest Ltd. 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 under the laws of Malta.

Iliya Vassilev Kirchev took part 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 shares in other companies or cooperatives in accordance with Article 247, para. 2, item 4 of the Commerce Act.

As at late 2017, the members of the BDB's MB had the following share in the capital or participation in the management of other companies or cooperatives as procurators, managers or board members:

Stoyan Mavrodiev is part of the management of the National Guarantee Fund EAD, UIC 200321435 as Chairman of the Board of Directors and is a sole owner of Real Estate Ventures EOOD, Sofia, UIC 131160908.

Rumen Mitrov is member of the BD of Micro Financing Institution Jobs EAD, Sofia, UIC 201390740

Nikolay Dimitrov is member of the BD of Micro Financing Institution Jobs EAD, Sofia, UIC 201390740

Iliya Kirchev - none.

Note 37 to the financial statements discloses comprehensive information about the all remunerations, rewards and/ or benefits of each member of the management and supervisory bodies for the reporting financial year paid by the issuer and its subsidiaries.

MANAGEMENT OF SUBSIDIARIES

BDB is a sole owner of the capital of its subsidiaries NGF EAD and MFI Jobs EAD.

National Guarantee Fund EAD

NGF EAD has a one-tier management system – Board of Directors (BD), consisting of three members, and has the following composition:

At the beginning of the year, the Board of Directors was composed of the following members: Angel Gekov, Chairman of the Board of Directors, Alexandar Georgiev, Member of the Board of Directors and Samuil Shiderov, Deputy Chairman of the Board of Directors 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 decision of the Management Board of Bulgarian Development Bank AD dismissal of Mr. Samuil Shiderov as Member of the Board of Directors and Executive Director of the National Guarantee Fund was approved, and Mr. Angel Djalozov was appointed as Member of the Board of Directors of NGF and Executive Director.

On 15 March 2018, at a meeting of the Management Board of Bulgarian Development Bank AD, a decision was made to dismiss Mr. Alexandar Georgiev as Member of the Board of Directors (BD) of the National Guarantee Fund and to appoint Mr. Andon Georgiev as Member of the Board of Directors 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 has a Bachelor's degree in Banking and a Master's degree in Finance from the University of Economics in Varna. He started his career in late 2001 at SG Expressbank, Sofia. From 2003 to 2011 he worked at the Risk Management Department at Raiffeisenbank Bulgaria, where he took the position of Credit Administrator, Problem Loans Expert, Head of Sector and Deputy Head of Department. From October 2011 to December 2012 he was a Head of Section at DSK Bank. He has been Executive Director of the National Guarantee Fund since the beginning of 2013. On 18 June 2015, Samuil Shiderov was elected as Member of the Board of Directors of the European Association of Guarantee Institutions (AECM).

Alexandar Georgiev - Member of the Board of Directors

Alexandar Georgiev has been a Member of the Board of Directors of the National Guarantee Fund since March 2015. He holds a Master's degree in Economics and Industrial Management from Dimitar A. Tsenov Academy of Economics in Svistov. He has an extensive experience at expert level and managerial positions in the field of insurance and financial services.

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

The BD Members of NGF EAD do not hold any shares in the Fund and have no special rights for the acquisition of any such shares.

There are no contracts within the meaning of Article 240 (b) of the Commerce Act between the members of the Board of Directors of NGF AD or persons related to them, on the one hand, and the Group, on the other hand, which go beyond their normal activity or significantly deviate from the market conditions.

Participation, within the meaning of Article 247, para.2, item 4 of the Commerce Act, of the BD Members of NGF EAD in companies as unlimited liability partners, holding of more than 25 per cent of the capital of another company or their involvement in the management of other companies or cooperatives as procurators, managers or board members, is as follows:

Since the beginning of the year the BD Members of NGF EAD had the following participation in the capital or management of other companies:

Angel Kirilov Gekov was Executive Director and Chairman of the Management Board of the Bulgarian Development Bank AD (until October 2017).

Angel Gekov is:

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

Alexandar Georgiev is:
- sole owner and manager of Brandi BG EOOD, UIC 202605174;
- sole owner and manager of KA SERVICE EOOD, UIC 114672190;
- owner of ET Alexandar Georgiev – AG, UIC 824083350;
- Member of the Board of Directors of BALNEOLOGICAL CENTER - KAMENA EAD, with UIC 112013405.

Samuil Pavlov Shiderov has no shares in other companies or cooperatives pursuant to Article 247, para. 2, item 4 of the Commerce Act.

As at late 2017 the BD Members of NGF EAD had the following participation in the capital or management of other companies:

Stoyan Mavrodiev is Member of the MB and Chief Executive Director of the Bulgarian Development Bank. Stoyan Mavrodiev is sole owner of Real Estate Ventures EOOD, Sofia, UIC 131160908.

Alexandar Georgiev is:
- sole owner and manager of Brandi BG EOOD, UIC 202605174;
- sole owner and manager of KA SERVICE EOOD, UIC 114672190;
- owner of ET Alexandar Georgiev – AG, UIC 824083350;
- Member of the Board of Directors of BALNEOLOGICAL CENTER - KAMENA EAD, with UIC 112013405.

Samuil Shiderov – has no shares in other companies or cooperatives pursuant to Article 247, para. 2, item 4 of the Commerce Act.

In February 2018 Angel Djalazov was elected as Executive Director of the National Guarantee Fund EAD. The change was made in accordance with Decision of the sole owner of the capita, in line with all statutory provisions.

Micro Financing Institution Jobs EAD

MFI Jobs EAD too has a one-tier management system – Board of Directors (BD) consisting of three members.

In 2017 and up to the date of this report, the following changes were made in the composition of the Board of Directors of the company:

On 19 October 2017 Bilian Lyubomirov Balev was dismissed from the Board of Directors and replaced by Rumen Dimitrov Mitrov.
On 19 October 2017 Iliya Vassilev Kirchev was dismissed from the Board of Directors and Nikolay Dimitrov Dimitrov was registered as a new member.

In 2018 the following changes were made in the composition of the Board of Directors of the company:
On 07 February 2018 Kostadin Bojikov Munev was dismissed from the Board of Directors and replaced by Angel Atanasov Djalazov.
On 22 March 2018 amendments to the Statutes of the company were made whereby the composition of the Board of Directors was changed from three to five members.
On 30 March 2018 Hristina Atanasova Todorova was entered as a new Member of the Board of Directors. On 02 April 2018 Mrs. Todorova was registered 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 took his Master's degree in Finance from the University of National and World Economy in Sofia in 1996. In 2011 he was appointed as Procurator of Micro Financing Institution JOBS EAD and Head of Lending and Leasing Department of the company. In April 2013 he became a BD Member, and in April 2014 he was elected as 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 microfinancing gained as a finance lease manager under the JOBS project of the United Nations Development Program 2003-2010. He took part in various international conferences on topics related to microfinance and is a co-author of the following publications: "Guide on Micro crediting in Europe", "From Exclusion to Inclusion through Microfinancing", "Market Research on Micro-Crediting for the purposes of the European Investment Fund - International Study in Western and Eastern Europe: Bulgaria Report. He speaks English and Russian.

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

There are no contracts within the meaning of Article 240 (b) of the Commerce Act between the members of the Board of Directors or their related parties, on the one hand, and the Company, on the other hand, which go beyond their normal activity or significantly deviate from the market conditions.

Participation, within the meaning of Article 247, para.2, item 4 of the Commerce Act, of the BD Members of the Company in companies as unlimited liability partners, holding of more than 25 per cent of the capital of another company or their involvement in the management of other companies or cooperatives as procurators, managers or board members, is as follows:

Since the beginning of the year the BD Members of MFI Jobs EAD had the following participation on the capital or management of other companies:

Bilian Lyubomirov Balev (dismissed from BD in October 2017) was Executive Director and Deputy Chairman of the Management Board of the Bulgarian Development Bank AD. 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 UNINCORPORATED PARTNERSHIP CONSORTIUM FOREM CONSULTING BULGARIA LTD.-ITC & LTD.;
- partner in Fininvest Ltd. 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 under the laws of Malta.

Iliya Vassilev Kirchev (dismissed from BD in October 2017) was Executive Director and MB Member of the Bulgarian Development Bank AD.

Kostadin Bojikov Munev has no shares in other companies or cooperatives pursuant to Article 247, para. 2, item 4 of the Commerce Act.

As at the late 2017, the BD Members of MFI Jobs EAD had the following participation in the capital and management of other companies:

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

Kostadin Munev has no shares in other companies or cooperatives pursuant to Article 247, para. 2, item 4 of the Commerce Act.

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

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

The owner of BDB is the Bulgarian state, hence the companies making part of the BDB Group are related to the state bodies of the Republic of Bulgaria and the companies in which it exercises control. The consolidated and individual financial statements provide detailed information about the transactions of the BDB Group and BDB with related parties and the companies under joint control of the State.

STRATEGY FOR DEVELOPMENT AND BUSINESS OBJECTIVES

BDB is the main tool and channel for implementation of the government policies in the economy, including target areas, regions, sectors and social groups. The Bank interacts actively with all other state structures in order to maximize the impact of targeted public funds to support the development of economy.

The BDB Group operates with full transparency and implements the best management and banking practices. The main objective of the Group's operation is to identify and analyze economic sectors experiencing difficult access to funding and take measures to facilitate such access.

Facilitating the access of SMEs to bank financing is not the only main priority of the BDB's operations. The Bank supports all efforts of the government to accelerate the economic growth of the country by providing its own expertise and implementing activities in all areas of its economic policy, assisting the absorption of EU structural funds for Bulgaria, supporting the export potential, etc.

Moreover, a basic principle in the Group's activity is to complement the market and not allow the traditional commercial banks to be pushed out of the market. The purpose of the Group's business is to compensate an existing market shortage in funding of certain segments, thus adjusting their risk profile and encouraging commercial banks to develop their exposure to them.

The strategic goals of BDB are as follows:

- To enhance economic growth by supporting regions and sectors with identified market deficiencies and growth potential;
- To stimulate the investors' economic activity to modernize the equipment and technological base and increase the competitiveness of the economy;
- To support economic growth through funding, including syndicated one, of large-scale, strategic or infrastructure-related projects and investments;
- Support the development of competitive industries and sectors of the economy with a proven potential;
- To facilitate, in cooperation with the other institutions in the country, the access to financing of innovation and newly established companies;
- To facilitate and support the channeling of capital flows to the Bulgarian economy;

SOCIAL RESPONSIBILITY AND DIVERSITY POLICY

In 2017, the Bulgarian Development Bank continued to develop its corporate social responsibility by concentrating its efforts mainly on the areas of vulnerable social groups, culture and art and science and education.

In order to perform the strictly specific functions as mandated by the BDB Act, the Bank is pursuing a diversity policy with regard to the administrative, management and supervisory bodies within its powers delegated by the State. The Bank adheres strictly to the best practices of non-discrimination in terms of age, gender or education.

The cause of the BDB Group is to support socially vulnerable groups such as children and youngsters deprived of parental care and disadvantaged people. We believe that charity is a mandatory element not only of the corporate social responsibility, but also of the everyday life of each of us and the employees of the Bank are in solidarity with the idea.

Vulnerable social groups

Among the initiatives supporting vulnerable social groups, we can highlight the partnership of the Bulgarian Development Bank with the **Foundation for Social Change and Inclusion (FSSV)** that is managing a network of monitored houses, called the **House of Opportunity**, and works as a social enterprise through the HOPe Restaurant.

Monitored houses not only shelter young people leaving specialized institutions for children deprived of parental care, but also provide support with education and development of skills, finding jobs, developing social and work skills to deal with the "real" life after they have left the children care institution. HOPe Restaurant is a social enterprise that builds on the efforts of the Foundation for Social Inclusion of Vulnerable Groups. The restaurant provides work for young people from the House of Opportunities, in cooperation with some of the best chefs in Sofia. The Bulgarian Development Bank supports this initiative by paying the salary of one youngster working in the restaurant.

The Bank perceives the **social entrepreneurship** as a successful business model to deal with a number of societal challenges and major social issues, as part of the Europe 2020 strategy for smart, sustainable and inclusive growth where one of the goals is to take at least 20 million people away from poverty and social exclusion. In this regard, BDB supports social enterprises by buying corporate gifts and souvenirs from charities.

The Group has a successful collaboration with the **National Fund St. Nikola** in the implementation of a number of initiatives. The Bank supports the fund in organizing creative workshops for children and youngsters, summer rehabilitation camps for children with disabilities deprived of parental care, thematic excursions, Christmas and New Year celebrations, etc.

BDB has also successfully established a partnership with the **Liberal Ideas for Development and Adaptation Association** (LIRA), supporting the Easter holiday events for children and adults with severe disabilities.

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

Culture and art

BDB's philosophy is that culture and art unite, ennoble, foster national pride and sense of belonging. Some of the Bank's efforts are aimed at supporting cultural and artistic projects, with priority being given to initiatives integrating vulnerable groups through art, encouraging young artists, preserving and promoting Bulgarian traditions, history and culture.

Culture for Me is one of the BDB's campaigns in this area which continued and developed further in 2017. Within this initiative, more than 150 children and youngsters deprived of parental care visited theatrical performances in Sofia by Arcadia Art Fusion theatrical group.

Continuing its policy of supporting Bulgarian art, the BDB's premises hosted **temporary exhibitions of paintings and sculptures** by both young and well-established Bulgarian artists.

The BDB Group also organizes a **photo exhibition with key projects of development banks worldwide**, whose role is to raise the awareness of the specific activities of these institutions in their countries. The selected projects present both interesting start-ups and micro-businesses, and large-scale transport, energy and infrastructural projects.

The Bulgarian Development Bank has also adopted as its cause the preservation and promotion of the Bulgarian spiritual and cultural and historical heritage. The Bank supports initiatives and events in this area, such as the **International Easter Festival** in the town of Bosilegrad, where each year children from local Bulgarian communities and from the Bulgarian diasporas in Serbia, Macedonia, Ukraine, Moldova, etc. take part. Among the objectives of the event is the preservation of the customs and traditions of the region.

Education

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

Traditionally, BDB supports the teams of the **Sofia High School of Mathematics** during their participation in international competitions and mathematics, informatics and physics Olympiads. In 2017, with the support of the Bank, they took part in the International Mathematical Tournament called "The Harvard - MIT mathematics tournament" held in Boston, USA.

The Bank also supports the initiative **of SOS Children's Villages** - SOS *Centers for the Prevention of Abandonment*, which helps over 200 children at risk per year to stay in their own families, to have equal opportunities for education and socialization. In 2017, the focus of the charity organization was to hire experts such as educators, psychologists, therapists to work with these children and help their additional preparation for the learning process.

The management team of the BDB Group implements targeted and consistent actions towards the establishment of a corporate culture focusing on the individual and team contribution of employees for the achievement of business goals of the Group, as well as the achievement of competitive remuneration of employees on the labor market.

In 2017, the Manual on the Management and Development of Human Resources in the BDB Group, adopted in 2015 and aligned with the best HRM practices, remained in force. The Manual aims to ensure an integrated approach and upgraded actions within the BDB group to attract, hire, develop, motivate and retain high-skilled staff, as it is the heart of the shared success. Motivation and retention of employees as a function of this integrated approach is achieved through a set of interrelated elements such as: remuneration policy regulating the types of remuneration; internal salary rules regulating the mechanism of calculation and payment of basic salary and additional fixed payments and bonuses; evaluations that stimulate the good performance and professional development of employees, tied to the relevant basic and additional remuneration; social measures and preferences, training and development, tightly linked to the corporate culture and business strategy of the Group.

The Social Measures and Preferences program covers all employees of the Bank working on a labor contract and includes: additional health insurance (medical insurance), life insurance, official clothing, telecommunication services, sports activities, preferential conditions on loans of employees of the Bank, the cost of membership in professional organizations, support for the family environment of employees (one-off bonus for marriage, childbirth, medical treatment of an employee or member of his/her family).

The BDB Group focuses on continued support for employee development and training allowing for professional growth of financial professionals within the only financial group in Bulgaria that does not prioritize the generation of profits, but the main focus of its activities is to support small and medium-sized enterprises in Bulgaria. The Learning and Development system is designed for Bank employees and includes a variety of tools, programs, activities and initiatives aimed at developing the potential of employees in order to respond fully to the needs required to achieve the Bank's strategic goals. The Bank is striving to establish and maintain a culture of continuous improvement and build upon the knowledge of employees and their self-improvement.

This Statement of Corporate Governance is an integral part of the Activity Report adopted on *April 27, 2018* by the Bulgarian Development Bank.

EXECUTIVE DIRECTORS:

STOYAN MAVRODIEV **RUMEN MITROV** **NIKOLAY DIMITROV**

BULGARIAN DEVELOPMENT BANK
BULGARIAN
DEVELOPMENT BANK

Building a better
working world

Zaharinova & Partners
audit, analysis and consulting

Statutory Audit Firm # 108
Ernst & Young Audit OOD
Polygraphia Office Center
47A, Tsarigradsko Shose Blvd., floor 4
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 Consolidated Financial Statements

Opinion

We have audited the accompanying consolidated financial statements of Bulgarian Development Bank AD and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at 31 December 2017, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2017, and of its consolidated financial performance and its consolidated 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 Consolidated Financial Statements* section of our report. We are independent of the Group 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 consolidated 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 consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements.

Key audit matter	How our audit addressed the key audit matter
Impairment of loans and advances to customers	
The Group's disclosures about impairment of loans and advances to customers are included in in Note 18 Loans and advances to customers, Note 12 Impairment gain/loss and Note 4.1. Credit risk to the consolidated financial statements	
Loans and advances to customers represent a significant part (29%) from the total assets of the Group as at 31 December 2017. As disclosed in Note 18 Loans and advances to customers, Note 12 Impairment gain/loss and Note 4.1. Credit risk to the consolidated financial statements the Group'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 230,830 thousand (27% from total gross value of loans and advances to customers) and the respective accumulated loan loss allowance for these loans is BGN 157,975 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	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 Group. We have used our IT experts to assess and test the IT general controls of the Group'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 Group has not identified any objective evidence of impairment, we tested a

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respective collaterals as well as credit risk category. 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 consolidated financial statements of the Group and the related estimation uncertainty in the calculation of the impairment, we have determined this matter as a key audit matter.	risk-based sample of exposures to assess and analyze their proper credit risk category classification. • For a risk-based sample of loans and advances to customers and focusing on those with the most significant potential impact on the consolidated financial statements, we specifically assessed the Group'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 Group's assumptions on the expected future cash flows. • Assessment of the relevance and adequacy of the consolidated financial statement disclosures related to the Group's exposure to credit risk as well as the impairment losses on loans and advances to customers.

Information Other than the Consolidated 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 consolidated management report, including the corporate governance statement prepared by management in accordance with Chapter Seven of the Accountancy Act, but does not include the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated 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 consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated 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 Consolidated Financial Statements

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

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

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

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

Our objectives are to obtain reasonable assurance about whether the consolidated 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 consolidated 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 consolidated 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 Group'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 Group'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 consolidated 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 Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves true and fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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 consolidated 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 Consolidated Financial Statements and Auditor's Report Thereon* section, in relation to the consolidated management report, including the corporate governance statement of the Group, 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 consolidated management report referring to the financial year for which the consolidated financial statements have been prepared is consistent with those consolidated financial statements.
b) The consolidated management report has been prepared in accordance with the requirements of Chapter Seven of the Accountancy Act.
c) The corporate governance statement of the Group referring to the financial year for which the consolidated 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 consolidated financial statements of the Group 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 Group, 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 Group.

Audit Firm Ernst & Young Audit OOD:

Nikolay Garnev

Legal Representative and

Registered Auditor in charge of the audit

Audit Firm Zaharinova & partners OOD:

Dimitrina Zaharinova

Legal Representative

Registered Auditor in charge of the audit

Sofia, Bulgaria

30 March 2018

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

BULGARIAN DEVELOPMENT BANK GROUP

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

	Note	As at 31.12.2017	As at 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	198,910	274,634
Securities held to maturity	21	594	1,384
Assets held for sale	25	10,100	4,670
Available-for-sale securities	20	291,867	322,965
Loans and advances to customers	18	709,111	730,896
Current tax liabilities		1,596	-
Other assets	26	1,390	615
Receivables from the State budget	19	737,516	424,470
Net investment in finance lease	22	1,035	704
Assets, acquired from collateral foreclosure	26	15,875	11,372
Investment property	24	7,702	7,702
Property, plant and equipment, intangible assets	23	32,999	33,779
Deferred tax assets	14	2,258	2,011
Total assets		**2,458,601**	**1,893,723**
Liabilities			
Deposits from credit institutions	27	33,909	43,737
Current tax liabilities		98	1,836
Deposits from customers other than credit institutions	28	659,847	577,133
Other liabilities	32	2,839	1,420
Provisions	31	5,856	7,683
Borrowings from international institutions	29	869,822	379,998
Other borrowings	30	111,406	112,864
Total liabilities		**1,683,777**	**1,124,671**
Equity			
Share capital	33	601,774	601,774
Retained earnings		21,995	45,842
Revaluation reserve on available-for-sale securities	34	11,003	6,534
Reserves	34	140,052	114,902
Total equity		**774,824**	**769,052**
Total liabilities and equity		**2,458,601**	**1,893,723**

The notes 1 to 38 are an integral part of these consolidated financial statements. The consolidated financial statements were approved by the Management Board of Bulgarian Development Bank AD on 27 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 30th of April 2018

"Ernst & Young Audit" OOD

"Zaharinova & Partners" OOD

BULGARIAN DEVELOPMENT BANK GROUP

CONSOLIDATED 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	63,278	62,576
Interest expense	6	(5,612)	(3,466)
Net interest income		**57,666**	**59,110**
Fee and commission income	7	4,910	4,166
Fee and commission expense	7	(68)	(81)
Net fee and commission income		**4,842**	**4,085**
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	1,212	1,596
Other operating expenses	11B	(821)	(1,845)
Operating income before impairment		**63,496**	**63,771**
Costs of personnel	13A	(11,479)	(9,762)
General and administrative expenses	13B	(5,797)	(7,357)
Depreciation / amortisation expenses	23	(1,123)	(583)
(Expenses on)/ Income from reversed impairment and provisions	12	(22,095)	3,832
Profit before income tax		**23,002**	**49,901**
Income tax expense	14	(2,322)	(4,990)
Net profit for the year		**20,680**	**44,911**
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		(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	4,469	4,967
Total other comprehensive income for the year		4,406	4,990
Total comprehensive income for the year		**25,086**	**49,901**

The notes 1 to 38 are an integral part of these consolidated financial statements. The consolidated financial statements were approved by the Management Board of Bulgarian Development Bank AD on 27 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 30th of April 2018

"Ernst & Young Audit" OOD

"Zaharinova & Partners" OOD

CONSOLIDATED 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
At 01 January 2016	**601,774**	**61,289**	**14,689**	**1,567**	**39,832**	**719,151**
Comprehensive income for the period						
Profit	-	-	-	-	44,911	44,911
Other comprehensive income	-	-	23	4,967	-	4,990
Total comprehensive income	-	-	23	4,967	44,911	49,901
Transactions with owners, recognised in equity						
Dividends to equity holders	-	-	-	-		
Transfer to Reserves based on shareholders' decision	-	4,870	34,031	-	(38,901)	-
Total transactions with owners	-	4,870	34,031	-	(38,901)	
At 31 December 2016	**601,774**	**66,159**	**48,743**	**6,534**	**45,842**	**769,052**
Comprehensive income for the period						
Profit	-	-	-	-	20,680	20,680
Other comprehensive income	-	-	(63)	4,469	-	4,406
Total comprehensive income	-	-	(63)	4,469	20,680	25,086
Transactions with owners, recognised in equity						
Profit distribution	-	-	-	-	(19,314)	(19,314)
Transfer to Reserves based on shareholders' decision	-	5,830	19,383	-	(25,213)	-
Total transactions with owners	-	5,830	19,383	-	(44,527)	(19,314)
At 31 December 2017	**601,774**	**71,989**	**68,063**	**11,003**	**21,995**	**774,824**

The notes 1 to 38 are an integral part of these consolidated financial statements. The consolidated financial statements were approved by the Management Board of Bulgarian Development Bank AD on 27 April 2018.

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CONSOLIDATED 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		20,680	44,911
Adjustments for:			
Dividend income	11A	(78)	(53)
Expenses / (Income) on / from reversed loan impairment	12	23,850	(5,472)
Expenses / Income on/from guarantee provisions	12	(1,917)	1,221
Gain on sale of assets, acquired from collateral foreclosure		(196)	-
Loss on revaluation of investment property	11B	-	240
Impairment loss and sale of other receivables	26	194	419
Gain on revaluation of financial assets held-for-trading	10	-	(312)
Net gain on revaluation of foreign currency assets and liabilities	8	10	(58)
Depreciation / amortisation expenses	23	1,123	583
Carrying amount of written-off assets	23	32	31
Income tax expense	14	2,322	4,990
		46,020	**46,500**
Changes in:			
Reserve Guarantee Fund with the Central Bank	16	-	47
Receivables from banks		34,427	37,905
Loans and receivables		(2,396)	(80,635)
Loans to the State budget		(313,046)	(394,585)
Available-for-sale securities		31,734	(41,285)
Held-for-trading financial instruments		-	(305)
Net investment in finance lease		(317)	(112)
Assets held for sale		(5,430)	(2,760)
Other assets		(969)	(2,109)
Deposits from credit institutions		(9,828)	41,664
Deposits from customers other than credit institutions		82,714	9,280
Other liabilities		1,440	486
Dividends received		78	53
Income taxes (paid)		(5,908)	(4,029)
Cash flows used in operating activities		**(141,481)**	**(389,885)**
Cash flows from investing activities			
Cash payments on acquisition of tangible/ intangible assets		(349)	(9,765)
Cash proceeds from sale of tangible/ intangible assets		7	28
Proceeds from sale of assets, acquired from collateral foreclosure		796	-
Proceeds from investment property		480	-
Cash proceeds from matured securities held to maturity		791	(13,135)
Net cash flows from / (used in) investing activities		**1,725**	**(22,872)**
Cash flows from financing activities			
Dividends paid		(19,313)	-
Cash paid on issued debenture loans		-	-
Cash paid on other borrowings		(2,136)	(11,485)
Cash received from other borrowings		679	570
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 financing activities		**468,332**	**184,816**

(continued on page 12)

Financial statements on which our auditors' report was issued dated 30th of April 2018

"Ernst & Young Audit" OOD

"Zaharinova & Partners" OOD

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

(continued from page 11)

		2017	2016
Net (decrease) / increase in cash and cash equivalents		328,576	(227,941)
	36	193,724	421,665
Cash and cash equivalents at the beginning of period	36	**522,300**	**193,724**
Cash and cash equivalents at end of period			

Operating interest-related cash flows	2017	2016
Proceeds from interest	54,420	52,970
Interest paid	(5,290)	(2,926)

The notes 1 to 38 are an integral part of these consolidated financial statements. The consolidated financial statements were approved by the Management Board of Bulgarian Development Bank AD on 27 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 30th of April 2018

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

1. ORGANISATION AND OPERATING POLICIES

The consolidated financial statements of the Group of Bulgarian Development Bank AD (the „Group") for the year ended 31 December 2017 were approved for issue by decision of the Management Board dated 27 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 Group (the "Group") includes the parent-company – Bulgarian Development Bank AD (BDB AD/the "Bank") and its subsidiaries – National Guarantee Fund EAD (NGF/ the "Fund") and Micro Financing Institution JOBS EAD (MFI).

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.

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 Director; Rumen Dimitrov Mitrov - Vice Chairman 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.

1. ORGANISATION AND OPERATING POLICIES (CONTINUED)

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.

The Equity Investment Fund had not yet been established as of 31 December 2017.

The National Guarantee Fund (NGF) was established on 12 August 2008 as a sole owner joint-stock company with 100 per cent ownership of BDB. The registered office of the Fund is at 1 Dyakon Ignatii Street, Sofia. As of 31 December 2017, the registered share capital consisted of 800,000 registered nominal shares with par value of BGN 100 each (31 December 2016: 800,000 registered nominal shares with par value of BGN 100 each); the paid-in capital amounted to BGN 80,000,000 as of 31 December 2017 (31 December 2016: BGN 80,000,000).

The scope of NGF's principal activities is defined by the Bulgarian Development Bank Act. It includes:

a) Issue of guarantees to supplement the collaterals for SME loans;

b) Provide other guarantee products, such as:

- guarantees for participation in tenders
- good performance guarantees;

c) guarantees for advance payments and for payment of loans to exporters;

d) other similar services.

The National Guarantee Fund is managed by Board of Directors (BD). In 2017, changes were made in the structure of the management bodies. Members of the board are: Stoyan Mavrodiev- Chairman, Alexander Georgiev and Samuil Shiderov.

At 31 December 2017, the NGF employees were 12 (31 December 2016: 12).

Micro Financing Institution JOBS EAD (MFI) was incorporated on 23 December 2010 and registered on 14 January 2011 as a sole owner joint stock company, 100 per cent owned by BDB. The registered address of the MFI is at 1 Dyakon Ignatii Street, Sofia. As of 31 December 2017, the registered share capital comprised of 76,430 registered shares with par value of BGN 100 each, and the paid-in capital as of 31 December 2017 amounted to BGN 7,643,000 (as of 31 December 2016, the registered share capital comprised of 76,430 registered shares with par value of BGN 100 each, and the paid-in capital as of 31 December 2016 amounted to BGN 7,643,000.)

The scope of activities of Micro Financing Institution JOBS EAD includes:

micro-financing including, but not limited to, provision of loans; purchase from third parties and leasing of industrial equipment, automobiles and other vehicles, as well as other assets (financial leasing); sale and purchase of such items; consultancy; trade representation and mediation for local and foreign persons operating in the country, as well as any other activities not prohibited by law.

MFI JOBS EAD is managed by Board of Directors (BD). In 2017, changes were made in the structure of the management bodies.
Members of the board are Rumen Mitrov – Chairman, Nikolay Dimitrov – Vice Chairman, and Kostadin Munev.

At 31 December 2016 the MFI employees were 14 (31 December 2016: 14).
Bulgarian Development Bank had no branches as of 31 December 2017.

The consolidated financial statements were approved by the parent company's ("the Bank's) Management board on 27 April 2017.

2. BASIS OF PREPARATION OF THE CONSOLIDATED FINANCIAL STATEMENTS, ACCOUNTING ESTIMATES, CHANGES IN ACCOUNTING POLICIES AND PUBLISHED STANDARDS NOT YET EFFECTIVE

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

2.1. Basis of preparation

Statement of compliance

The consolidated financial statements of the Group 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 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 (Note 3, 5)

Going concern

The Group'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 believes there is no 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 Group presents its consolidated 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 consolidated financial statements.

2. BASIS OF PREPARATION OF THE CONSOLIDATED FINANCIAL STATEMENTS, ACCOUNTING ESTIMATES, CHANGES IN ACCOUNTING POLICIES AND PUBLISHED STANDARDS NOT YET EFFECTIVE (CONTINUED)

Presentation currency

These consolidated financial statements are presented in thousands of Bulgarian leva (BGN'000), which is the functional currency of BDB and its subsidiaries.

Basis of consolidation

These consolidated financial statements have been prepared in accordance with IFRS 10 "Consolidated financial statements", as all entities over which Bulgarian Development Bank AD has control through ownership of:

- rights to manage all important activities of the investee;
- exposure or rights to variable return (to obtain benefits or to suffer losses from the activity) from its participation in the entity;
- possibility to exercise control over the investee in order to influence the amount of the return, have been consolidated through the full consolidation method.

The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes in one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control over the subsidiary. Assets, liabilities, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated financial statements from the date the Group gains control until the date the Group ceases to control the subsidiary.

Upon consolidation all receivables and liabilities, income and expenses, arising from transactions between the Bank and its subsidiaries, are eliminated. Unrealised losses are eliminated in the same way as the unrealised profit in case there are no indications of impairment.

The subsidiaries' financial statements have been prepared for the same reporting period as that of the parent company (the Bank) by applying consistent accounting policies.

The consolidated entities and the consolidation method applied as of 31 December 2017 are as follows:

Entity	Capital ownership	Consolidation method
National Guarantee Fund	100%	Full consolidation
Microfinance Institution "JOBS"	100%	Full consolidation

2.2 Accounting estimates

The preparation of the consolidated 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.

2. BASIS OF PREPARATION OF THE CONSOLIDATED FINANCIAL STATEMENTS, ACCOUNTING ESTIMATES, CHANGES IN ACCOUNTING POLICIES AND PUBLISHED STANDARDS NOT YET EFFECTIVE (CONTINUED)

Key estimates and assumptions of high uncertainty

a) Impairment losses on loans and advances

Monthly, the Group reviews its loan portfolio in order to detect the existence and calculates impairment losses. When assessing whether to include the impairment loss in the consolidated statement of comprehensive income, the Group'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 European Investment Fund, 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 Group'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 Group 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.

Analysis and assessment are performed by the Group at each end of reporting period as to whether indications of impairment of its investments exist. The significant and continuous decrease in equity, including below the level of the registered share capital of the company/entity, subject to investment, is regarded as a main indicator. In such cases, impairment is determined with the assistance of a certified appraiser, but the smallest amount that is reported is that of the difference between the acquisition price (cost) and the assessment of participation under the equity method, including with additional adjustments of net assets, if necessary. In the cases of partial sales of similar shares in the reporting period, those from the same issuer, but remaining in the Group's statement of financial position, are revalued at the selling price (Notes № 9, 20).

2. BASIS OF PREPARATION OF THE CONSOLIDATED FINANCIAL STATEMENTS, ACCOUNTING ESTIMATES, CHANGES IN ACCOUNTING POLICIES AND PUBLISHED STANDARDS NOT YET EFFECTIVE (CONTINUED)

Key estimates and assumptions of high uncertainty (continued)

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

As of 31 December 2016 the Group 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 consolidated financial statements. (Notes 9, 15, 21).

For investments in securities available for sale, held by the Group 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

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

e) Actuarial calculations

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

f) Valuation of investment property

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

g) Assets acquired from collateral foreclosure

Assets acquired from collateral foreclosure include assets acquired by the Group 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 Group, is determined by certified independent appraisers.

2. BASIS OF PREPARATION OF THE CONSOLIDATED FINANCIAL STATEMENTS, ACCOUNTING ESTIMATES, CHANGES IN ACCOUNTING POLICIES AND PUBLISHED STANDARDS NOT YET EFFECTIVE (CONTINUED)

Key estimates and assumptions of high uncertainty (continued)

h) Fair value of financial instruments

Where the fair values of financial assets and liabilities on the consolidated 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 Group 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 Group.

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 Group's financial position or performance.

2. BASIS OF PREPARATION OF THE CONSOLIDATED FINANCIAL STATEMENTS, ACCOUNTING ESTIMATES, CHANGES IN ACCOUNTING POLICIES AND PUBLISHED STANDARDS NOT YET EFFECTIVE (CONTINUED)

2.4 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 Group's financial statements are listed below. This listing is of standards and interpretations issued, which the Group reasonably expects to have an impact on disclosures, financial position or performance when applied at a future date. The Group 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 Group 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 Group'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 Group 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 Group 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 Group 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 Group 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 Group 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 Group 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 Group 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 Group 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 Group 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.

2. BASIS OF PREPARATION OF THE CONSOLIDATED FINANCIAL STATEMENTS, ACCOUNTING ESTIMATES, CHANGES IN ACCOUNTING POLICIES AND PUBLISHED STANDARDS NOT YET EFFECTIVE (CONTINUED)

2.4. 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 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.

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 Group 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 Group changes its business model for financial asset management, it reclassifies all financial assets affected, in line with the asset classification requirements. If the Group applies such reclassification to financial assets, it shall apply it in the future from the reclassification date. The Group 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 Group 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 Group defines the business model with the objective to collect their contractual cash flows (Hold to Collect business model) as a business model where the Group's financial assets are managed with the objective to generate cash flows through collection of contractual cash flows over the instrument's lifetime. The Group 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 Group defines the business model with the objective to collect the contractual cash flows and sell the financial asset as a business model where the Group'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 Group 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 Group 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;

2. BASIS OF PREPARATION OF THE CONSOLIDATED FINANCIAL STATEMENTS, ACCOUNTING ESTIMATES, CHANGES IN ACCOUNTING POLICIES AND PUBLISHED STANDARDS NOT YET EFFECTIVE (CONTINUED)

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

IFRS 9 Financial Instruments: Classification and Measurement (continued)

- 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 Group 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.

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 Group, 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 Group 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 Group 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 Group 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 Group of the borrower concerned. Depending on the type of borrower – a corporate client or financial institution, the Group 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 Group 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 Group has established a methodology for the reconciliation of internal credit ratings to those of the rating agency).

2. BASIS OF PREPARATION OF THE CONSOLIDATED FINANCIAL STATEMENTS, ACCOUNTING ESTIMATES, CHANGES IN ACCOUNTING POLICIES AND PUBLISHED STANDARDS NOT YET EFFECTIVE (CONTINUED)

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

IFRS 9 Financial Instruments: Classification and Measurement (continued)

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.

In 2017, the Group 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 Group will adopt IFRS 9, the Group 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 0.1-1% 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 30%. 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 Group plans to adopt the new standard on the required effective date 1 January 2018. During 2017, the Group 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 Group'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 Group's equity as of 31 December 2017 and 1 January 2017 as a result of the implementation of the standard.

2. BASIS OF PREPARATION OF THE CONSOLIDATED FINANCIAL STATEMENTS, ACCOUNTING ESTIMATES, CHANGES IN ACCOUNTING POLICIES AND PUBLISHED STANDARDS NOT YET EFFECTIVE (CONTINUED)

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

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

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 Group. 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.

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 to the Group.

2. BASIS OF PREPARATION OF THE CONSOLIDATED FINANCIAL STATEMENTS, ACCOUNTING ESTIMATES, CHANGES IN ACCOUNTING POLICIES AND PUBLISHED STANDARDS NOT YET EFFECTIVE (CONTINUED)

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

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.

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.

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. It is not expected that these amendments would affect the financial position or performance of the Group.

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. It is not expected that these amendments would affect the financial position or performance of the Group.

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.

2. BASIS OF PREPARATION OF THE CONSOLIDATED FINANCIAL STATEMENTS, ACCOUNTING ESTIMATES, CHANGES IN ACCOUNTING POLICIES AND PUBLISHED STANDARDS NOT YET EFFECTIVE (CONTINUED)

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

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.

It is not expected that these amendments would impact the financial position or performance of the Group.

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

3. SIGNIFICANT ACCOUNTING POLICIES

Financial instruments

Financial assets

The Group 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 Group becomes a party to the contractual provisions of the instrument.

The Group derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or the Group 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 Group, is recognised as a separate asset or liability.

Financial assets and liabilities are offset and the net amount presented in the consolidated statement of financial position when, and only when, the Group 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 Group 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 Group 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 Group. 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 Group'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 Group 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)

Financial assets (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 Group 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 Group assesses, for individual assets or collectively, 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). Those of them, for which there are no indications of impairment, are subject to collective impairment, which has occurred but is not yet identified. Assets that are not individually significant are included in a group of financial assets with similar credit risk characteristics and are collectively assessed for impairment (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.

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 consolidated 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)

Financial assets (continued)

Held-to-maturity financial assets

When the Group 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 Group 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 Group's financial statements since they are not assets of the Group.

The parent company (the 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.

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 Group 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 Group 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 consolidated statement of financial position when, and only when, the Group 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.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial instruments (continued)

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 Group has transferred substantially all the risks and rewards of the financial asset, or

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

When the Group 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 Group's continuing involvement in the asset. In this case, the Group recognises the related obligation. The transferred asset and the concomitant obligation are evaluated to reflect the rights and obligations which the Group 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 Group could be required to repay.

A financial liability is derecognised from the consolidated 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 consolidated statement of comprehensive income.

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 Group on terms that the Group 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 Group 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. All individually significant assets are assessed for specific impairment. Those found not to be specifically impaired are then collectively assessed for impairment by grouping together assets with similar risk characteristics.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial instruments (continued)

Derecognition of financial instruments (continued)

In assessing collective impairment the Group 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 Group 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 Group 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 Group accepts that the fair value is the price of acquisition. The Group 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)

Financial instruments (continued)
Fair value of financial assets and liabilities (continued)

Fair Value Hierarchy

The Group 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.

Finance lease receivables

Lease activity in the Group is associated with leasing out of industrial equipment, vehicles, agricultural machinery etc. on financial lease terms. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership.

All other leases, which do not transfer risk and rewards incident to ownership of the asset, are classified as operating lease.

Minimum lease payments

Minimum lease payments are the payments over the lease term that the lessee is or can be required to make. From the Group's perspective, the minimum lease payments also include the residual value of the asset, which is guaranteed by a third party unrelated to the Group, under the condition that this third party is financially capable of discharging the obligation under the guarantee or the sale back agreement. The minimum lease payments comprise also the price of exercising an option of the lessee to purchase the asset, when at the inception of the lease it is virtually certain that this option will be exercised.

Minimum lease payments exclude any contingent rent, cost for services and taxes paid by the Group and subsequently re-invoiced to the lessee.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Finance lease receivables (continued)

Commencement of the lease contract and commencement of the lease term

There is a distinction between the commencement of the lease contract and the commencement of the lease term:

- The commencement of the lease contract is the earlier of the two dates: the date of the lease contract or the date of the commitment by the parties to the main terms and conditions of the lease contract.
- The commencement of the lease term is the date from which the lessee may exercise the right to use the leased asset. This is the date at which the Group initially recognises the lease receivable.

Initial measurement and subsequent recognition

Initially, the Group recognises a finance lease receivable, which is equal to its net investment in the lease comprising the present value of the minimum lease payments and any unguaranteed residual value for the Group. The present value is calculated by discounting the minimum lease payments at the interest rate implicit in the lease. Any initial direct costs are added to the finance lease receivable. During the lease term, the Group accrues financial income (interest income on finance lease) over the net investment. The lease payments received are treated as a reduction of net investment (repayment of the principal) and recognition of finance income in such a way that ensures a constant rate of return on the net investment.

Subsequently, the net investment in finance leases is presented net, less any individual and portfolio allowance for uncollectability.

The impairment loss is measured as the difference between the 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 finance lease 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.

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 consolidated statement of financial position at amortised cost.
For the purposes of preparation of the consolidated cash flow statement, bank overdrafts payable on demand and forming an integral part of the Group'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 Group'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.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Assets held for sale (continued)

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 consolidated 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.

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.

Taxes
Current income taxes are determined by the Group 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 consolidated statement of comprehensive income is recognised also in the consolidated 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.

Property, plant and equipment

Items of property, plant and equipment are presented on the consolidated 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.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property, plant and equipment (continued)

Subsequent measurement

The approach chosen by the Group 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 Group 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 2016.

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.

Intangible assets

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

The Group 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 consolidated 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.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investment property

The Group'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 Group is obliged to pay contributions to social security and health insurance funds. The employment relations of the employees with the Group, 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 Group in the form of salaries, bonuses and social payments and benefits are recognised as an expense in the consolidated 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 Group'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 Group 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 consolidated financial statements, at which they are included in the consolidated 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)

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

Long-term retirement benefits (continued)

Past service costs are recognised immediately in the consolidated statement of comprehensive income in the period in which they were incurred. At the end of each reporting period, the Group 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 consolidated 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 Group 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 consolidated statement of financial position at present value.

Impairment of non-financial assets

The carrying amounts of the Group'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.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Impairment of non-financial assets (continued)

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.

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 Group. The corresponding amount is written off directly from equity.

Interest income and interest expenses

Interest income and interest expenses are recognised in the consolidated 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 Group also holds investments and assets in countries with negative interest rate levels. The Group discloses the interest paid on such assets as interest expense with additional disclosure.

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.

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 financial statements are the following:

Foreign currency	31 December 2016	31 December 2015
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 consolidated statement of comprehensive income in the period in which they have occurred.

Provisions and contingent liabilities

Provisions are recognised when the Group 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 Group, or it is not probable that an outflow of resources will be required to settle the obligation. They are not recognised in the consolidated statement of financial position but are subject to special disclosure.

Segment reporting

The Group 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 Group operates in the territory of the country. All Group entities are financial entities possessing similar economic characteristics in view of the nature of services, the type and category of customers, the methods of service provision, and the nature of the regulatory environment. If these factors change in the future and the Group starts to report operating segments, they will be determined and presented in accordance with the requirements of IFRS 8 Operating Segments.

Guarantee policy

In its normal activities, the Group issues financial guarantees. Financial guarantees are recognized initially in the financial statements and stated at fair value, which is equal to the guarantee fee. Subsequent to initial recognition, the Group's obligations on each guarantee are measured at the higher of the initially recognized amount less any accumulated amortisation recognized in the statement of comprehensive income and the best estimate of costs that would be necessary to settle any financial liabilities, which have occurred as a result of the guarantee.

Any increase in provisions relating to financial guarantees is reported in the statement of comprehensive income as costs of provisions in accordance with IAS 37. The fee received is recognized in the statements of comprehensive income – as *Fee and commission income,* and deferred over the guarantee term on a straight-line basis.

4. FINANCIAL RISK MANAGEMENT

In the ordinary course of business, the Group is exposed to a variety of risks that, if occur, could result in formation of losses and deterioration of the Group'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 Group's profitability and existence.

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

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

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

Risk management structure

The main units that are directly responsible for risk management are as follows:

For the parent company (the Bank):

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

The main units responsible for the management of risks are:

- *Supervisory Board* - Management Board of BDB AD (the parent company) – performs overall supervision of risk management;
- *Board of Directors* – responsible for the overall approach towards risk and approves risk management strategies, principles and specific methods, risk management techniques and procedures;
- *Provisions Committee* – analyses the guaranteed portfolio in terms of overall credit risk management of the whole portfolio, as well as of each guarantee deal and each beneficiary of the guarantee itself.
- *Risk and Monitoring Department — performs monitoring of the guaranteed portfolios and the collateral provided. At least annually an inspection over the fulfilment of the economic and social requirements for the SME using a guarantee from National Guarantee Fund EAD is carried out.*

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

For the subsidiary Microfinance Institution "JOBS" EAD (MFI):

The main units responsible for the risk management are:

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

Measurement and management of major risks

Management of the Group companies has adopted a set of internal rules and procedures for measuring various risks, which are based on statistical models and best international banking practices, as well as on the historical experience of the Group itself.

Risk monitoring and management are primarily based on limits. Those limits reflect on the Group's strategy and its market position, as well as on the level of risk that can be borne. Reports on the specific types of risks are periodically prepared for the purpose of subsequent analysis and possible adjustments of already set limits.

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

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 Group, incl. country (sovereign) risk, contractor's risk and settlement risk, and credit risk of concentration.

Credit risk is the main risk for the Group 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 Group 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 Group 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 Group, and other parameters specific to a particular transaction. Credit portfolio quality monitoring, control and assessment units are established and function within Bulgarian Development Bank (the parent company). 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 Group applies an intra-bank system of limits that is subject to periodic review and updating.

There is a specialized unit functioning within the Group, 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 accepting different types of collateral, where at any point in time the valuation of collateral shall not be older than 12 months.

Following a decision of the Provisions Committee, the Group forms impairment on exposures both at an individual and collective basis depending on the borrower's risk profile.

The exposures in the Group'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 Group 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.

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

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 Group 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, and Credit activity manual, 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 and its recoverable amount.

Aiming at minimizing and reducing the credit risk, the Group accepts collateral in accordance with its in-house rules. It is a common practice of the Group 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 parent company (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 parent company (the "Bank") has applied reduced requirements in accepting collaterals for the EIF-guaranteed portfolio of loans. As of 31 December 2017, 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 Group'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, the parent company (the Bank) 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". The parent company (the Bank) 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 the parent company (the Bank) 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.

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

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 Group to make payment if a client is not able to fulfil its obligations to third parties represent another source of credit risk for the Group and bear the same credit risk as the loan exposures.

The parent company (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 Group's activity is exposed to credit risk also with respect to exposures related to other activities of the Group:

- portfolio of financial instruments, other than loans, formed in connection with the Group'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 Group 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 Group'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.

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

Maximum exposure to credit risk

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

	2017		2016	
Financial asset	maximum	net	maximum	net
Cash in Central Bank	447,648	447,648	78,521	78,521
Receivables from banks	198,910	198,910	274,634	274,634
Loans and advances to customers	867,086	775,171	874,194	655,587
Receivables from the State budget	737,516	737,516	424,470	424,470
Net investment in finance lease	1,035	1,035	1,178	704
Available-for-sale securities	291,867	291,867	322,965	322,965
Securities held to maturity	594	594	1,384	1,384
Other financial assets	727	727	499	499
	2,545,383	**2,453,468**	**1,977,845**	**1,758,764**

The amount in the net amount of "Loans and advances to customers" is presented net of highly liquid collateral.

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
Guarantees and letters of credit	407,746	398,274	323,869	320,016
Unutilised amount of authorized loans	446,223	446,223	531,646	531,646
Participation in the SIA investment program	1,603	1,603	1,724	1,724
	855,572	846,100	857,239	853,386
Maximum exposure to credit risk	3,400,955	3,299,568	2,835,084	2,612,150

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 Group, classified by industry sectors, are presented in the table below. Loans and receivables, as also finance leases are stated at amortised cost before impairment:

Sectors	***2017***	%	***2016***	%
Government	1,058,773	40.40	731,701	36.99
Financial services	718,994	29.43	415,019	20.98
Construction	146,790	5.93	137,357	6.94
Transport	106,835	4.28	108,266	5.47
Industry, total	304,023	12.17	328,735	16.62
Industry – energy generation and distribution	*85,437*	*3.44*	*103,520*	*5.23*
Industry – other industries	*47,039*	*1.78*	*67,451*	*3.41*
Industry – manufacture of foodstuffs	*50,032*	*2.03*	*60,962*	*3.08*
Industry – manufacture of tobacco products	*58,773*	*2.38*	*55,675*	*2.81*
Industry – manufacture of plant and equipment	*62,742*	*2.54*	*41,127*	*2.08*
Trade	39,005	1.45	55,407	2.80
Administrative and office activities	49,342	1.98	49,400	2.50
Other industries	12,476	0.28	47,635	2.41
Real estate transactions	49,475	2.00	41,874	2.12
Agriculture	33,905	1.09	31,325	1.58
Tourist services	17,366	0.66	18,524	0.94
Collection and disposal of garbage	8,399	0.34	12,602	0.64
	2,545,383	**100.00**	**1,977,845**	**100.00**

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

The largest credit exposure of the Group 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 Group's capital base (2016: 8.64 per cent).

At 31 December 2017, there was no exposure of a customer or a group of related parties exceeding by more than 25 per cent the Group's equity.

	2017		2016	
	(BGN'000)	*% of Total**	*(BGN'000)*	*% of Total**
The biggest total exposure to a customer group	69,239	5.05%	62 202	5.05%
Total amount of the ten biggest exposures	494,609	39.68%	488 547	39.68%
Total amount of the twenty biggest exposures	714,417	57.57%	708 750	57.57%

* The ratio has been calculated to the total gross amount of all exposures.

Quality of loans and receivables

The structure of the financial assets of the Bank by risk classification groups is as follows (at amortised cost before 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	198,910	-	-	198,910
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 and mortgage loans to individuals	1,972	-	-	1,972
Loans to other financial institutions	24,767	-	44,541	69,308
Other loans and receivables	21,666	17,436	4,485	43,587
Net investment in finance lease	981	63	449	1,493
Receivables from the State budget	737,516	-	-	737,516
Available-for-sale securities	291,867	-	-	291,867
Securities held to maturity	594	-	-	594
Other financial assets	727	-	-	727
Total financial assets	**2,211,921**	**155,336**	**178,126**	**2,545,383**

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

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	274,634	-	-	274,634
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 and mortgage loans to individuals	2,509	-	-	2,509
Loans to other financial institutions	8,440	-	43,815	52,255
Other loans and receivables	49,214	16,808	3,289	69,311
Net investment in finance lease	704	12	462	1,178
Receivables from the State budget	424,470	-	-	424,470
Available-for-sale securities	322,965	-	-	322,965
Securities held to maturity	1,384	-	-	1,384
Other financial assets	499	-	-	499
Total financial assets	**1,674,802**	**183,844**	**119,199**	**1,977,845**

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
Restricted deposits	3,176	0.53	790	0.13
Credit risk insurances	16,237	2.72	22,475	3.70
Bank guarantees	1,064	0.18	4,076	0,67
Securities quoted on a stock market	-	-	35,426	5.83
Total collateral	**597,941**	100.00	**607,202**	100.00

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.

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

At the request of the contractors, the Group 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.

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

	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 in current account with CB**	**Available-for-sale securities**	**Financial assets held for trading**	**Securities held for maturity**	**Net investment in finance lease**
			As of 31 December 2017						
Impaired on an individual basis									
-watch	78,875	-	-	28	-	-	-	-	63
-non-performing	151,955	-	-	-	-	-	-	-	449
Gross amount	**230,830**	-	-	**28**	-	-	-	-	**512**
Incl. renegotiated	177,625	-	-	-	-	-	-	-	-
Past due but not impaired									
- standard	46,280	-	-	-	-	-	-	-	-
-watch	33,295	-	-	-	-	-	-	-	-
- non-performing	23,325	-	-	-	-	-	-	-	-
Gross amount	**102,900**	-	-	-	-	-	-	-	-
Incl. renegotiated	*65,290*	-	-	-	-	-	-	-	-
Within 30 days	*51,710*	-	-	-	-	-	-	-	-
From 30- 90 days	*17,269*	-	-	-	-	-	-	-	-
Over 90 days	*33,921*	-	-	-	-	-	-	-	-
Not past due and not impaired									
-------high class	424,885	737,516	198,910	2,872	447,648	291,867	-	594	981
-------standard class	101,062	-	-	-	-	-	-	-	-
-------low class	4,509	-	-	-	-	-	-	-	-
Gross amount	**530,456**	737,516	198,910	2,872	447,648	291,867	-	594	1,493
Incl. renegotiated	*360,961*	-	*66,269*	494	-	-	-	-	-
Gross amount	**864,186**	737,516	198,910	**2,900**	447,648	291,867	-	594	1,493
Incl. renegotiated	*603,876*	-	*66,269*	*494*	-	-	-	-	-

Loans with carrying amount that is lower than the amount of the valid collateral provided are included under heading B „Past due but not impaired".

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

The Group 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

The Group assesses the credit quality of provided contingent commitments by applying a methodology, which estimates whether events indicating with a high probability that outflow of Group's resources might take place have occurred. If any such events occur, the Group 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 statement of financial position the Group identified commitments amounting to BGN 407,746 thousand (2016 : BGN 251,517 thousand),which were provided by BGN 5,829 thousand (2016: BGN 7,509 thousand) (Note 32).

	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 in current account with CB**	**Available-for-sale securities**	**Financial assets held for trading**	**Securities held for maturity**	**Net investment in finance lease**
				As of 31 December 2016					
Impaired on an individual basis									
-watch	131,931	-	-	31	-	-	-	-	12
-non-performing	108,566	-	-	-	-	-	-	-	462
Gross amount	**240,497**	-	-	**31**	-	-	-	-	**474**
Incl. renegotiated	*171,904*	-	-	-	-	-	-	-	-
Past due but not impaired									
- standard	24,223	-	-	-	-	-	-	-	-
-watch	9,797	-	-	-	-	-	-	-	-
- non-performing	6,905	-	-	-	-	-	-	-	-
Gross amount	**40,925**	-	-	-	-	-	-	-	-
Incl. renegotiated	*23,822*	-	-	-	-	-	-	-	-
Within 30 days	*35,403*	-	-	-	-	-	-	-	-
From 30- 90 days	*2,067*	-	-	-	-	-	-	-	-
Over 90 days	*3,455*	-	-	-	-	-	-	-	-
Not past due and not impaired									
-------high class	544,155	424,470	274,634	3,746	78,521	322,965	-	1,384	704
-------standard class	42,073	-	-	-	-	-	-	-	-
-------low class	3,266	-	-	-	-	-	-	-	-
Gross amount	**589,494**	**424,470**	**274,634**	**3,746**	**78,521**	**322,965**	-	**1,384**	**704**
Incl. renegotiated	*340,581*	-	-	680-	-	-	-	-	-
Gross amount	**870,916**	**424,470**	**274,634**	**3,777**	**78,521**	**322,965**	-	**1,384**	**1,178**
Incl. renegotiated	*536,307*	-	-	*680*	-	-	-	-	-

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

The Group may re-negotiate the initial conditions under the contacts upon request by counterparties. Usually, these conditions regulate the loan disbursement, loan amounts, interest rates and/or repayment schedules with regard to the amounts of the repayment instalments. This is often observed in the case of changes in projects' original parameters, objectives and scope, including the time schedule for their completion.

The watched loans and receivables, presented at amortised cost before impairment, 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	17,499	16,808
	155,336	**183,832**

A loan is classified as "restructured" when the initial terms of the agreement have been modified by the parent-company (the Bank) by granting 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. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

4.1.1. Country (sovereign) risk

The Group has formed a portfolio of securities classified as available-for-sale financial assets, comprising only government securities issued by the Republic of Bulgaria. The Group's exposure to sovereign was BGN 288,881 thousand as of 31 December 2017 and BGN 307,231 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).

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 Group'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 Group. 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 Group's net income;
- Analysis of the interest rate sensitivity of economic capital (Duration GAP Analysis) – measuring the interest rate sensitivity of the Group's economic value;
- Determination, application and reporting of limits for interest rate risk reflecting the volatility of the respective interest rate curve and the Group'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 Group'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.

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.2. Market risk

Besides the interest rate sensitivity analyses, for the interest risk management main sources related to the change in the net interest spread of the Group are also identified. This helps decision making on the interest rates policies of the Group, 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 Group is exposed and develops measures for its coverage and maintenance within the Group's permitted levels and limits.

The table on the next page summarises the interest exposure and risk of the Group. It includes information on the Group'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	6,196	182,172	10,542	198,910
Loans and advances to customers	658,611	50,500	-	709,111
Receivables from the State budget	728,010	9,506	-	737,516
Available-for-sale securities	-	288,881	2,986	291,867
Net investment in finance lease	1,035	-	-	1,035
Securities held to maturity	594	-	-	594
Other financial assets	-	-	727	727
	1,394,446	**531,059**	**14,255**	**1,939,760**
Financial liabilities				
Deposits from credit institutions	3,897	30,012	-	33,909
Deposits from customers other than credit institutions	577,760	59,913	22,174	659,847
Borrowings from international institutions	663,490	206,332	-	869,822
Other borrowings	11,236	6,256	93,914	111,406
	1,256,383	**302,513**	**116,088**	**1,674,984**
Total interest rate exposure	**138,063**	**228,546**	**(101,833)**	**264,776**
Contingencies and commitments	**442,641**	**3,582**	**409,349**	**855,572**

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	*With floating interest rate %*	*With fixed interest rate %*	*Interest-free*	*Total*
Financial assets				
Receivables from banks	119,849	145,014	9,771	274,634
Loans and advances to customers	671,492	58,402	1,002	730,896
Receivables from the State budget	397,568	26,902	-	424,470
Available-for-sale securities	-	320,077	2,888	322,965
Net investment in finance lease	704	-	-	704
Securities held to maturity	1,384	-	-	1,384
Other financial assets	-	-	499	499
	1,190,997	550,395	14,160	1,755,552
Financial liabilities				
Deposits from credit institutions	4,161	39,576	-	43,737
Deposits from customers other than credit institutions	79,429	469,083	28,621	577,133
Borrowings from international institutions	376,720	3,278	-	379,998
Other borrowings	11,236	6,443	95,185	112,864
	471,546	518,380	123,806	1,113,732
Total interest rate exposure	719,451	32,015	(109,646)	641,820

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.2. Market risk (continued)

Analysis of interest rate sensitivity and risk

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*	*With fixed interest rate*	*Interest-free*	*Total*
Financial assets								
Receivables from banks	2,713	3,483	-	-	-	182,172	10,542	198,910
Loans and advances to customers	89,475	567,333	103	220	1,480	50,500	-	709,111
Receivables from the State budget	728,010	-	-	-	-	9,506	-	737,516
Available-for-sale securities	67,346	-	-	-	151,728	69,807	2,986	291 867
Net investment in finance lease	1,035	-	-	-	-	-	-	1,035
Securities held to maturity	594	-	-	-	-	-	-	594
Other financial assets	-	-	-	-	-	-	727	727
Total financial assets	**889,173**	**570,816**	**103**	**220**	**153,208**	**311,985**	**14,255**	**1,939,760**
Financial liabilities								
Deposits from credit institutions	3,897	30,012	-	-	-	-	-	33,909
Deposits from customers other than credit institutions	508,119	1,406	436	16,330	111,382	-	22,174	659,847
Borrowings from international institutions	1,838	23,255	4,053	48,519	293,848	498,309	-	869,822
Other borrowings	-	11,236	-	-	-	6,256	93,914	111,406
Total financial liabilities	**513,854**	**65,909**	**4,489**	**64,849**	**405,230**	**504,565**	**116,088**	**1,674,984**
Total exposure to interest rate sensitivity	**375,319**	**504,907**	**(4,386)**	**(64,629)**	**(252,022)**	**(192,580)**	**(101,833)**	**264,776**
Contingencies and commitments	**1,355**	**12**	**9,274**	**31,413**	**404,169**	**-**	**409,349**	**855,572**

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.2. Market risk (continued)

Analysis of interest rate sensitivity and 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*	*Total*
Financial assets									
Receivables from banks	91,102	28,747	-	-	-	-	145,014	9,771	274,634
Loans and advances to customers	115,276	554,898	128	268	922	-	58,402	1,002	730,896
Receivables from the State budget	397,568	-	-	-	26,902	-	-	-	424,470
Available-for-sale securities	38,363	10,223	3,019	32,145	142,561	93,766	-	2,888	322,965
Net investment in finance lease	704	-	-	-	-	-	-	-	704
Securities held to maturity	1,384	-	-	-	-	-	-	-	1,384
Other financial assets	-	-	-	-	-	-	-	499	499
Total financial assets	**644,397**	**593,868**	**3,147**	**32,413**	**170,385**	**93,766**	**203,416**	**14,160**	**1,755,552**
Financial liabilities									
Deposits from credit institutions	43,737	-	-	-	-	-	-	-	43,737
Deposits from customers other than credit institutions	14,936	21,358	4,678	479,527	28,013	-	-	28,621	577,133
Borrowings from international institutions	8,259	179,259	184,887	4,315	-	-	3,278	-	379,998
Other borrowings	-	11,236	-	-	95,185	6,443	-	-	112,864
Total financial liabilities	**66,932**	**211,853**	**189,565**	**483,842**	**123,198**	**6,443**	**3,278**	**28,621**	**1,113,732**
Total exposure to interest rate sensitivity	**577,465**	**382,015**	**(186,418)**	**(451,429)**	**47,187**	**87,323**	**200,138**	**(14,461)**	**641,820**

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 Group 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 Group, 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	(2,221)	0.50%	2,467	(725)
EUR	0.50%	(1,291)	(1,627)	0.50%	288	(1,742)
USD	0.50%	(153)	-	0.50%	(82)	-
BGN	-0.50%	(1,981)	2,221	-0.50%	(2,467)	725
EUR	-0.50%	1,291	1,627	-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%	3.64%
Financial liabilities	0,43%	0.36%

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.2. Market risk (continued)

Currency risk

The currency risk is the risk that the financial position and cash flows of the Group might be affected adversely by changes in exchange rates due to open currency positions. In managing the foreign currency risk, the Group 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 Group. 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 Group 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 Group's cash flows and financial performance.

The following table summarises the Group 's exposure to currency risk. The table includes the Group'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	98,441	198,910
Loans and advances to customers	-	479,156	1,009	228,946	709,111
Receivables from the State budget	-	-	-	737,516	737,516
Available-for-sale securities	-	111,382	-	180,485	291,867
Net investment in finance lease	-	-	-	1,035	1,035
Securities held to maturity	-	594	-	-	594
Other financial assets	-	-	-	727	727
Total financial assets	**76,491**	**619,744**	**1,153**	**1,690,020**	**2,387,408**
Financial liabilities					
Deposits from credit institutions	-	2,013	-	31,896	33,909
Deposits from customers other than credit institutions	76,484	69,886	92	513,385	659,847
Borrowings from international institutions	-	868,802	1,020	-	869,822
Other borrowings	-	17,492	-	93,914	111,406
Total financial liabilities	**76,484**	**958,193**	**1,112**	**639,195**	**1,674,984**
Net balance sheet currency position	**7**	**(338,449)**	**41**	**1,050,825**	**712,424**
Contingencies and commitments	**408**	**59,176**	**-**	**795,988**	**855,572**

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.2. Market risk (continued)

Currency 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	125,843	274,634
Loans and advances to customers	-	492,226	3,313	235,357	730,896
Receivables from the State budget	-	-	-	424,470	424,470
Available-for-sale securities	-	129,709	-	193,256	322,965
Net investment in finance lease	-	-	-	704	704
Securities held to maturity	-	1,384	-	-	1,384
Other financial assets	-	-	-	499	499
Total financial assets	**93,470**	**680,423**	**3,427**	**1,056,753**	**1,834,073**
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	451,638	577,133
Borrowings from international institutions	-	376,720	3,278	-	379,998
Other borrowings	-	112,864	-	-	112,864
Total financial liabilities	**93,436**	**533,009**	**3,282**	**484,005**	**1,113,732**
Net balance sheet currency position	**34**	**147,414**	**145**	**572,748**	**720,341**
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)

Currency risk (continued)

The following table presents the Group'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 Group's equity as the Group does not hold available-for-sale financial instruments denominated in USD, JPY or GBP.

Price risk of shares quoted on the Stock Exchange

The Group is exposed to price risk with respect to the shares it holds, classified as available-for-sale investments. Management of the parent company (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, due to the economic and financial crisis, management of the parent company (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 Group will not be able to meet its current and potential payment obligations as they fall due without suffering losses.

The Group'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 parent company's (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 Group's liquidity. In order to manage this risk, the Group 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 having an impact on the Group's liquid position and certain ratios enacted by Bulgarian National Bank. 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 parent company (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 in compliance with the Guidelines on liquidity buffers and survival periods of Bulgarian National Bank.

The table below presents the amounts in percentage of the ratio of liquid assets to liabilities of parent company (the "Bank"):

	2017	2016
At 31 December	48.25%	31.45%
Average for the period	31.93%	38.36%
Highest for the period	48.25%	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	74,652	90,477
Government securities	288,881	193,916
Liquid assets	**811,181**	**362,914**
Financial liabilities held for trading	-	-
Financial liabilities measured at amortised cost	1,674,984	1,150,963
Provisions	5,856	3,319
Employee retirement benefits	366	228
Liabilities	**1,681,206**	**1,154,510**
Liquidity assets ratio (LAR)	**48.25%**	**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 Group grouped by remaining maturity (assets with indefinite maturity have a long-term period of realisation):

As of 31 December 2017	Within 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite maturity	Total
Assets							
Cash in hand and balances in current account with the Central Bank	447,648	-	-	-	-	-	447,648
Receivables from banks	75,817	122	19,377	10,947	92,647	-	198,910
Loans and advances to customers	23,699	13,141	131,990	321,877	218,404	-	709,111
Receivables from the State budget	-	-	-	737,516	-	-	737,516
Available-for-sale securities	67,346	-	-	137,562	83,973	2,986	291,867
Net investment in finance lease	17	39	174	767	38		1,035
Assets held for sale	-	-	10,100	-	-	-	10,100
Current tax liabilities	-	-	1,596	-	-	-	1,596
Securities held to maturity	7	-	587	-	-	-	594
Other assets	-	-	1,390	-	-	-	1,390
Assets, acquired from collateral foreclosure	-	-	-	15,875	-	-	15,875
Investment property	-	-	-	-	-	7,702	7,702
Property, plant and equipment, intangible assets	-	-	-	-	-	32,999	32,999
Deferred tax assets	-	-	2,258	-	-	-	2,258
Total assets	**614,534**	**13,302**	**167,472**	**1,224,544**	**395,062**	**43,687**	**2,458,601**
Liabilities							
Deposits from credit institutions	3,897	30,012	-	-	-	-	33,909
Current tax liabilities	-	98	-	-	-	-	98
Deposits from customers other than credit institutions	635,529	1,044	9,873	13,401	-	-	659,847
Provisions	-	-	-	-	-	5,856	5,856
Other liabilities	1,902	-	-	510	-	427	2,839
Borrowings from international institutions	1,838	23,255	94,613	458,138	291,978	-	869,822
Other borrowings	-	-	213	94,767	16,426	-	111,406
Total liabilities	**643,166**	**54,409**	**104,699**	**566,816**	**308,404**	**6,283**	**1,683,777**
Gap in maturity thresholds of assets and liabilities	**(28,632)**	**(41,107)**	**62,773**	**657,728**	**86,658**	**37,404**	**774,824**
Contingencies and commitments	**6,304**	**1,891**	**64,026**	**439,610**	**-**	**333,134**	**844,965**

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
Assets							
Cash in hand and balances in current account with the Central Bank	78,521	-	-	-	-	-	78,521
Receivables from banks	91,280	28,400	1,904	38,050	115,000	-	274,634
Loans and advances to customers	8,334	19,959	148,531	309,616	244,456	-	730,896
Receivables from the State budget	-	-	-	424,470	-	-	424,470
Available-for-sale securities	39,760	13,761	32,274	199,544	34,738	2,888	322,965
Net investment in finance lease	25	59	197	372	51	-	704
Assets held for sale	-	-	-	-	-	4,670	4,670
Securities held to maturity	211	-	587	586	-	-	1,384
Other assets	-	-	615	-	-	-	615
Assets, acquired from collateral foreclosure	-	-	-	-	-	11,372	11,372
Investment property	-	-	-	-	-	7,702	7,702
Property, plant and equipment, intangible assets	-	-	-	-	-	33,779	33,779
Deferred tax assets	-	-	-	-	-	2,011	2,011
Total assets	**218,131**	**62,179**	**184,108**	**972,638**	**394,245**	**62,422**	**1,893,723**
Liabilities							
Deposits from credit institutions	43,737	-	-	-	-	-	43,737
Current tax liabilities	-	1,836	-	-	-	-	1,836
Deposits from customers other than credit institutions	140,009	23,853	403,755	9,516	-	-	577,133
Provisions	-	-	-	-	-	7,683	7,683
Other liabilities	651	-	-	31	-	738	1,420
Borrowings from international institutions	2,298	3,155	44,976	148,042	181,527	-	379,998
Other borrowings	-	-	11,450	96,038	5,376	-	112,864
Total liabilities	**186,695**	**28,844**	**460,181**	**253,627**	**186,903**	**8,421**	**1,124,671**
Gap in maturity thresholds of assets and liabilities	**31,436**	**33,335**	**(276,073)**	**719,011**	**207,342**	**54,001**	**769,052**
Contingencies and commitments	**30,905**	**7,612**	**79,679**	**510,482**	**3,566**	**218,327**	**850,571**

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 Group'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	659,847	660,765	635,530	1,045	9,932	14,258	
Borrowings from international institutions	869,822	905,278	1,838	23,379	95,187	465,399	319,475
Other borrowings	111,406	113,116	-	31	306	95,221	17,558
	1,674,984	**1,713,071**	**641,265**	**54,470**	**105,425**	**574,878**	**337,033**

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	577,133	578,583	139,431	23,857	405,779	9, 516	-
Borrowings from international institutions	379,998	394,724	2,302	3,005	45,765	150,847	192,805
Other borrowings	112,864	114,688	-	32	11,543	96,507	6,606
	1,113,732	**1,131,736**	**185,474**	**26,894**	**463,087**	**256,870**	**199,411**

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.3. Liquidity risk (continued)

Considering the specific activity of the Group, 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: 97.10 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: 56.91 per cent).

The financial assets 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	240,762	24,101	**274,634**
Loans and advances to customers	-	599,710	131,186	**730,896**
Receivables from the State budget	-	424,470	-	**424,470**
Available-for-sale securities	54,718	265,604	2,643	**322,965**
Net investment in finance lease		704	-	**704**
Securities held to maturity	-	1,384	-	**1,384**
Other financial assets	-	-	499	**499**
Total financial assets	**64,489**	**1,534,604**	**234,980**	**1,834,073**

"Other" are financial assets that are not encumbered and there are no restrictions to be used as collateral, but the Group would not consider them as available for future financing in the normal course of business.

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 in 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, securities on a legal requirement to provide for funds of the State budget amounting to BGN 7,515 thousand (2016: BGN 8,022 thousand) were blocked.

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

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

4.4. Operational risk

The main sources of operational risk within the Group are its personnel, processes, systems and external events. The Group 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 Group 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 Group.

In operational risk management all operational events, which occur in the activity of various units and processes of the Group, 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 Group. For the purposes of measuring its operational risk, the Group 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 Group'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 Group should observe the regulatory requirements for capital adequacy (Note №. 33,34), 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 on a consolidated group (as a Bank group) level.

	2017	**2016**
OWN FUNDS	739,513	720,342
TIER I CAPITAL	739,513	720,342
COMMON EQUITY TIER I CAPITAL	739,513	720,342
Share capital	601,774	601,774
Statutory reserves	71,989	66,159
Additional reserves	68,105	48,722
Accumulated other comprehensive income	10,961	6,555
Intangible assets	(282)	(248)
Other transitional adjustments to CET1 Capital	(2,620)	(2,620)
Components of or deductions from CET 1 Capital - other	(10,829)	-
ADDITIONAL TIER I CAPITAL	-	-
TIER II CAPITAL	-	-
TOTAL RISK EXPOSURES	1,495,506	1,486,798
Credit risk - Standardised approach	1,380,418	1,374,510
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	125,719	187,362
Corporates	852,895	842,009
Retail	17,325	15,090
Secured by mortgages on immovable property	101,621	87,819
Exposures in default	191,704	148,122
Items associated with particular high risk	2,936	2,934
Equity exposures	152	150
Other items	77,419	62,918
Foreign exchange and commodity risk	-	-
Operational risk - Basic indicator approach	115,088	112,288
CET 1 Capital Ratio	49,45%	48,45%
Total Capital Ratio	49,45%	48,45%

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.5 Capital management (continued)

Capital conservation buffer	*37,388*	*37,170*
Systemic risk buffer	*44,863*	*44,604*
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:

At 31 December 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	-	-	-	291,867	-	291,867	291,867	-	-	291,867
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
		-	-	-	**291,867**	**23,577**	**315,444**	**291,867**	-	**23,577**	**315,444**
Financial 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	-	85,041	-	-		85,041	-	85,042	-	85,042
Loans and advances to customers	18	-	709,111	-	-		709,111	-	722,807	-	722,807
Receivables from the State budget	19	-	737,516	-	-		737,516	-	799,661	-	799,661
Securities held to maturity	20	594	-	-	-		594	-	598	-	598
		594	**2,093,185**	-			**2,093,779**		**2,172,332**		**2,172,332**
Financial liabilities not measured at fair value											
Deposits from credit institutions - Current accounts and term deposits of banks	28	-	--	-	-	33,909	33,909	-	33,909	-	33,909
Deposits from customers other than credit institutions	29	-	-	-	-	659,847	659,847	-	659,841	-	659,841
Borrowings from international institutions	30	-	-	-	-	869,822	869,822	-	899,003	-	899,003
Other borrowings	31	-	-	-	-	111,406	111,406	-	112,299	-	112,299
		-	-	-	-	**1,674,984**	**1,674,984**	-	**1,705,052**	-	**1,705,052**

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 has not been disclosed as the Banks deems it cannot be measured reliably.

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

5. FAIR VALUE DISCLOSURE (CONTINUED)

At 31 December 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	20	-	-	-	322,965	-	322,965	310,250	12,345	-	322,595
Financial assets held for trading	21	-	-	-	-	-	-	-	-	-	-
Investment property	25	-	-	-	-	7,702	7,702	-	-	7,702	7,702
		-	-	-	**322,965**	**7,702**	**330,667**	**310,250**	**12,345**	**7,702**	**330,297**
Financial assets not measured at fair value											
Cash in hand and balances in current account with the Central Bank	16	-	78,521	-	-	-	78,521	-	78,521	-	78,521
Loans to banks	17	-	149,660	-	-	-	149,660	-	150,886	-	150,886
Current accounts and term deposits of banks	17	-	124,974	-	-	-	124,974	-	124,974	-	124,974
Loans and advances to customers	18	-	730,896	-	-	-	730,896	-	749,794	-	749,794
Receivables from the State budget	19	-	424,470	-	-	-	424,470	-	469,168	-	469,168
Securities held to maturity	22	1,384	-	-	-	-	1,384	-	1,403	-	1,403
Other financial receivables	27	-	-	-	-	-	-	-	-	-	-
		1,384	1,508,521	-	-	-	1,509,905	-	1,574,746	-	1,574,746
Liabilities measured at fair value											
Financial liabilities held for trading	21	-	-	-	-	-	-	-	-	-	-
		-	-	-	-	-	-	-	-	-	-
Financial liabilities not measured at fair value											
Deposits from credit institutions - Current accounts and term deposits of banks	28	-	-	-	-	43,737	43,737	-	43,884	-	43,884
Deposits from customers other than credit institutions	29	-	-	-	-	577,133	577,133	-	585,791	-	585,791
Borrowings from international institutions	30	-	-	-	-	379,998	379,998	-	380,991	-	380,991
Other borrowings	31	-	-	-	-	112,864	112,864	-	113,878	-	113,878
		-	-	-	-	**1,113,732**	**1,113,732**	-	**1,124,544**	-	**1,124,544**

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

<table>
<tr><th>Financial instrument</th><th>Fair value as of
31.12.2017</th><th>Fair value as of
31.12.2016</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 rowspan="2">Investment property</td><td rowspan="2">7,702</td><td rowspan="2">7,702</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>

BULGARIAN DEVELOPMENT BANK GROUP

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017
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
Assets, acquired from collateral foreclosure	15,875	11,372	Level 3	Income capitalisation method (revenue method) The revenue method, used for assessing the real estate value, consists of an analysis of the value of the real estate based on its ability to generate income through capitalisation of the net income derived from the property over a given period. For the determination of the evaluated property's amount, the permanently generated net annual income is used and its amount is calculated on the basis of the actual or possible permanently achieved rental income, which it turn is calculated on the basis of the average offered rent in the area (observable inputs), by taking into account the condition of the building fund and the residual term of use.	Offer market adequacy adjustment coefficient (from -10% to +5%)	The higher (lower) fair value if: • Higher (lower) offer market adequacy adjustment coefficient
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	722,807	749,794	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 2015	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 2015	N/A	N/A
Other borrowings	112,299	113,878	Level 2	Discounted cash flows Future cash flows are measured using the officially published by BNB yield of Bulgarian government securities (unadjusted) for December 2015	N/A	N/A
Borrowings from international institutions	899,003	380,991	Level 2	Discounted cash flows Future cash flows are measured using the officially published by BNB yield of Bulgarian government securities (unadjusted) for December 2015	N/A	N/A

For the balance sheet assets and liabilities not disclosed in the table the Group'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	46,113	50,494
Loans to banks	2,507	3,409
Deposits placed with other banks	945	472
Available-for-sale securities	3,293	3,127
Net investment in finance lease	123	150
Receivables from the State budget	10,157	4,743
Securities held to maturity	52	97
Other liabilities (income from negative interest)	88	84-
	63,278	**62,576**
Incl. Interest income on impaired loans and receivables	4,567	8,067
Interest expense		
Borrowings from international institutions	(4,464)	(2,410)
Deposits from customers	(749)	(725)
Deposits from other banks	(16)	(3)
Other borrowings	(128)	(268)
Other assets (expenses on negative interest)	(255)	(60)
	(5,612)	**(3,466)**
Net interest income	**57,666**	**59,110**

The yield on the assets, as a ratio of net profit to the balance sheet figure, is 0.84 per cent (2016: 2.39 per cent).

7. NET INTEREST INCOME

	2017	2016
Fee and commission income		
Guarantees and letters of credit	3,323	2,615
Customers' accounts, bank transfers, cash operations of customers, etc.	560	619
Servicing of debenture issues	252	270
Special-purpose funds of the Ministry of Agriculture and Food and the Executive Agency on Fisheries and Aquaculture (Note 31)	679	571
Special-purpose funds of the Ministry of Finance (Note 31)	64	91
Other	32	-
	4,910	**4,166**
Fee and commission expense		
Agency commissions	(30)	(41)
Bank transfers and cash operations with other banks	(3)	(9)
Servicing of accounts in other banks	(35)	(31)
	(68)	**(81)**
Net fee and commission income	**4,842**	**4,085**

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 loss on foreign currency swap revaluation	-	219
Net gain 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 HELD-FOR-TRADING FINANCIAL INSTRUMENTS

	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	75	52
Refunded litigation expenses	354	322
Income from rent of investment property	480	776
Gain on disposal of assets held for sale	197	150
Gain on disposal of FTA	7	38
Other income	99	258
	1,212	**1,596**

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

11B. OTHER OPERATING EXPENSES

	2017	2016
Losses on revaluation of investment property (Note 25)	-	(240)
Expenses on assets held for sale	(335)	(301)
Litigation expenses	(62)	(579)
Withholding tax	(223)	(28)
Direct operating expenses relating to investment property	(165)	(168)
Expenses on disposal of FTA	(31)	(33)
Other expenses	(5)	(496)
	(821)	**(1,845)**

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

	2017	2016
(Expenses on) impairment of individually impaired loans, net	(23,864)	(10,144)
(Expenses) / Income on / from reversed impairment of loans relating to common credit risk on a portfolio basis, net	-	15,800
Income from / (expenses on) reversed impairment on finance lease	14	(184)
(Expenses) / Income on / from reversed guarantee provisions, net	1,949	(1,221)
Expenses on impairment of assets acquired from collateral foreclosure	(194)	(419)
	(22,095)	**3,832**

The movement in the balance sheet accumulated expenses on impairment and provisions is disclosed in Notes 18, 23, 27 and 32.

13A. COSTS OF PERSONNEL

	2017	2016
Staff remuneration and social security	(9,404)	(8,205)
Remuneration to members of the Management and Supervisory Boards	(2,075)	(1,557)
	(11,479)	**(9,762)**

	2017	2016
Personnel costs consist of:		
Salaries	(8,121)	(7,072)
Social security	(1,080)	(976)
Social benefits	(104)	(103)
Amounts accrued on retirement benefits	(99)	(54)
	(9,404)	**(8,205)**

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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	(16)	(797)
Communications and IT services	(560)	(575)
Office and office equipment maintenance	(576)	(585)
Legal and consulting services	(227)	(498)
Advertising and entertainment expenses	(368)	(406)
Taxes and government charges	(219)	(160)
Hired services	(388)	(290)
Advisory services by the registered audit firm	(9)	(12)
Business trips	(67)	(87)
Audit services by the registered auditors	(148)	(97)
	(5,797)	**(7,357)**

14. TAXATION

	2017	2016
Current tax expense	2,569	5,697
Deferred tax benefit due to temporary differences	(247)	(707)
Total tax expense	**2,322**	**4,990**

In BGN'000	2017	2016
Accounting profit	23,002	49,901
Income tax calculated at the effective tax rate (10 per cent for 2017, 10 per cent for 2016)	2 427	5,084
Non-deductible expenses	34	4
Non-deductible income	(139)	(98)
Total tax expense	**2,322**	**4,299**
Effective tax rate	**10.10%**	**8.61%**

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 consolidated statement of financial position and changes in the statement of comprehensive income:

	Assets		Liabilities		Changes in the income statement	
	2017	2016	2017	2016	2017	2016
Property and equipment	(15)	(14)	-	-	(1)	(3)
Other assets	(444)	(479)	-	-	35	(33)
Guarantee portfolio	(290)	(411)	-	-	121	206
Other liabilities	(63)	(52)	-	-	(11)	(1)
Securities	(1,446)	(998)	-	-	(448)	(852)
Investment property	-	(57)	-	-	57	(24)
	(2,258)	**(2,011)**	-	-	**(247)**	**(707)**

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

The probability that the individual differences might reverse in the future and the Group'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, NET OF TAXES

	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	4,281	4,967
Income recycling	188	-
Other comprehensive income for the year	**4,469**	**4,967**

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 per cent on the excess over 105 per cent of MRR (2016: interest-free).

17. RECEIVABLES FROM BANKS

In BGN'000	**2017**	**2016**
Current accounts with local banks	516	688
Current accounts with foreign banks	12,512	13,570
incl. Current accounts with an original maturity of less than 90 days	*2,485*	*3,988*
Term deposits with local banks (incl. repo deals)	72,013	86,614
Term deposits with foreign banks	-	24,102
incl. Term deposits with an original maturity of less than 90 days	*71,786*	*111,214*
Loans to local banks	101,270	135,574
Loans to foreign banks	12,599	14,086
	198,910	**274,634**

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, were extended to local banks to extend loans to customers. (2016 levels from 1.49 per cent to 4.40 per cent)

Funds amounting to BGN 10,542 thousand were blocked in current accounts in foreign banks to cover letters of credit (2016: BGN 9,771 thousand).

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

18. LOANS AND ADVANCES TO CUSTOMERS

	2017	**2016**
Loans (gross amount)	867,086	874,194
Allowance for impairment and uncollectability of loans	(157,975)	(143,298)
	709,111	**730,896**

	2017	**2016**
A. Analysis by customer type		
Corporate and sole traders	863,088	869,090
Municipalities	1,099	1,327
Individuals	2,899	3,777
	867,086	**874,194**

B. Analysis by industry sector depending on the purpose of the loan	**2017**	**2016**
Construction	146,728	137,289
Transport	106,678	108,148
Industry, total	**303,770**	**318,732**
Industry – energy generation and distribution	*85,437*	*103,520*
	50,032	*60,962*
Industry – manufacture of foodstuffs		
Industry – other industries	*46,786*	*57,448*
Industry – manufacture of tobacco products	*58,773*	*55,675*
Industry – manufacture of plant and equipment	*62,742*	*41,127*
Financial services	69,312	55,943
Trade	38,612	55,254
Administrative and office activities	49,342	49,393
Real estate transactions	49,475	41,874
Agriculture	33,357	31,193
Government sector	32,376	31,144
Tourist services	17,342	17,899
Other industries	11,695	14,723
Collection and disposal of garbage	8,399	12,602
	867 086	**874,194**

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

In BGN'000	2017			2016		
	Individually impaired	**Collectively impaired**	**Total**	**Individually impaired**	**Collectively impaired**	**Total**
At 1 January	143,135	163	143 298	132,660	15,800	148,623
Impairment costs	43,843	-	43,843	55,240	-	55,240
Reversed impairment	(19,979)	-	(19,979)	(45,096)	(15,800)	(60,896)
Written-off against impairment	(9,187)	-	(9,187)	331	-	331
At 31 December As of 31 December	**157,812**	**163**	**157,975**	**143,135**	**-**	**143,298**

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. AVAILABLE-FOR-SALE SECURITIES

	2017	2016
Government securities	288,881	307,231
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
	291,867	**322,965**

Movement in available-for-sale securities

	2017	2016
At 1 January	322,965	262,968
Additions (purchases)	53,258	170,623
Disposals (sale and/or maturity)	(88,825)	(115,593)
Net increase due to revaluation of available-for-sale securities to fair value	4,469	4.967
At 31 December	**291,867**	**322,965**

The non-public companies' shares held by the Group 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 (Note 36).

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

The reserve formed on available-for-sale financial assets as of 31 December 2017 amounts to BGN 11,003 thousand – a positive value (31 December 2016: BGN 4,967 thousand - a positive value) (Note 35).

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

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

21. SECURITIES HELD TO MATURITY

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

Corporate bonds of financial entities represent bonds issued by a Bulgarian company denominated in EUR with nominal value EUR 1,000 thousand.

22. NET INVESTMENT IN FINANCE LEASE

The net investment in finance lease is the difference between the gross investment in the finance lease, less any unearned finance income, and the accumulated impairment losses.

	2017	2016
Gross investment in finance lease	1,705	1,325
Unearned finance income	(212)	(147)
Net minimum lease payments	**1,493**	**1,178**
Impairment loss	(458)	(474)
Net investment in finance lease	**1,035**	**704**

Allocation of net finance lease investment:

	2017	2016
Repayment not later than one year	41	185
Repayment later than one year and no later than five years	1,452	993
Net minimum lease payments	**1,493**	**1,178**
Impairment loss	(458)	(474)
Net investment in finance lease	**1,035**	**704**

The accrued and not yet matured interest as at the date of the financial statements amount to BGN 7 thousand (2016: BGN 5 thousand).

Movement in the allowance for impairment:

	2017	2016
Balance as of 01 January	**(474)**	**(308)**
Charge for the year	(11)	(208)
Reversed for the year	25	24
Written off	2	18
Balance as of 31 December	**(458)**	**(474)**

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	1,565	307	406	956	27,389
Additions	8,398	789	318	-	231	9,736
Disposals	-	(77)	(7)	(43)	-	(127)
As of 31 December 2016	**32,553**	**2,277**	**618**	**363**	**1,187**	**36,998**
Additions	-	196	181	-	133	510
Disposals	-	(347)	(221)	-	(5)	(573)
As of 31 December 2017	**32,553**	**2 126**	**578**	**363**	**1,315**	**36,935**
Accumulated depreciation						
As of 1 January 2016	549	963	241	121	856	2,730
Charge for the year	172	237	26	65	83	583
Disposals	-	(76)	(6)	(12)	-	(94)
As of 31 December 2016	**721**	**1,124**	**261**	**174**	**939**	**3,219**
Charge for the year	576	324	58	64	102	1,124
Disposals	-	(322)	(80)	-	(5)	(407)
As of 31 December 2017	**1,297**	**1,126**	**239**	**238**	**1,036**	**3,936**
Net book value						
As of 31 December 2017	**31,256**	**1,000**	**339**	**125**	**279**	**32,999**
As of 31 December 2016	**31,832**	**1,153**	**357**	**189**	**248**	**33,779**

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 parent company (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 925 thousand at cost (2016: BGN 550 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 Group 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 11A). The fair value at 31 December 2017 has been determined by an independent certified appraiser.

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

26. ASSETS HELD FOR SALE

Properties (land, buildings and fixtures and fittings) at 31 December 2017 amounting to BGN 10,100 thousand (2016: BGN 4,670 thousand – land and buildings) were acquired by the Group 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 Group'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	4,670	8,720
Acquired from collateral foreclosure	9,582	4,706
Sold	(2)	(1,392)
Reclassified to assets acquired from collateral foreclosure	(4,150)	(7,113)
Reclassified to investment property	-	(251)
	10,100	4,670

26. OTHER ASSETS И ASSETS, ACQUIRED FROM COLLATERAL FORECLOSURE

	2017	2016
Assets acquired from collateral foreclosure	15,875	11,372
Other receivables	727	499
VAT refundable	439	-
Corporate income tax refunded	1,596	-
Prepayments and advances	224	116
	18,861	11,987

Assets acquired from collateral foreclosure include assets acquired by the Group as a result of non-performing loans. These assets are valued at the lower of cost and net realisable value. The net realisable value is determined based on evaluations made by licensed independent valuers; management considers these evaluations reasonable and adequate for the Group.

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 assets held for sale	4,150	7,113
Reclassified to investment property	-	-
Expenses on construction	1,341	-
Sold	(793)	(36)
Impairment	(195)	(419)
Carrying amount at the end of period	**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	4,654
Companies and sole traders	651,579	572,479
	659,847	**577,133**

The amounts due to individuals represent deposits of employees of the Group.

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

	2017	**2016**
Term deposits	75,309	467,807
Demand deposits	584,538	109,326
	659,847	**577,133**

29. BORROWINGS FROM INTERNATIONAL INSTITUTIONS (IDENTICAL WITH SEPARATE FINANCIAL STATEMENTS)

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

	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 usedniko 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.

29. BORROWINGS FROM INTERNATIONAL INSTITUTIONS (CONTINUED)

Council of Europe Development Bank (continued)

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.

Kreditanstalt für Wiederaufbau

On 27 July 2010, Bulgarian Development Bank AD signed a direct loan agreement for EUR 25,000 thousand with the German Development Bank Kreditanstalt für Wiederaufbau. The financial resource is intended for direct lending to small and medium sized enterprises and/or for providing credit lines to commercial banks for special-purpose financing for the business. The loan is unsecured. At 31 December 2017, the loan was fully utilised, and the outstanding principal under the facility amounted to EUR 8,824 thousand equivalent to BGN 17,257 thousand (at 31 December 2016: 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 National Energy Efficiency Programme. The loan is secured by a State guarantee, in accordance with the Public Debt Act and a Guarantee Agreement signed between KfW and the Ministry of Finance. The Guarantee Agreement between KfW and the Ministry of Finance was ratified by the National Assembly. The Guarantee Agreement Ratification Act was promulgated in State Gazette on 30 December 2016. The interest rate is floating, based on the 6M Euribor plus margin. The term of repayment of the loan is up to 7 years, with a grace period of 2 years. At 31 December 2017, the loan facility 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.

European Investment Bank

On 18 November 2016 BDB signed a third contract with European Investment Bank for the amount of EUR 150,000 thousand for financing projects of small and medium-sized enterprises. The funds are provided with the support of EU through a guarantee issued by EFSI (European Fund for Strategic Investment), part of the Investment Plan for Europe – the Juncker Plan. This is the first contract signed under the Plan, which is provided by the EIB in Bulgaria. The loan term, including a grace period, is set for each individual tranche. The funds will be used to finance SMEs, including innovative projects, to support regions with high unemployment rates, as well as a part of the youth employment initiative or for start-up company projects. The loan will be allocated through partner banks, other financial intermediaries or directly. The loan is unsecured.

At 31 December 2017, the principal due on the loan amounted to EUR 75,000 thousand equivalent of BGN 146,687 thousand (at 31 December 2016: EUR 75,000 thousand equivalent of BGN 146,687 thousand). The interest rate is floating, based on the 6M EURIBOR plus margin..

29. BORROWINGS FROM INTERNATIONAL INSTITUTIONS (CONTINUED)

Nordic Investment Bank

On 16 November 2004 a Loan Agreement was signed with the Nordic Investment Bank for a credit facility amounting to EUR 10,000 thousand for financing of projects of small and medium-sized enterprises, which are of mutual interest for Bulgaria and the Nordic Investment Bank member states. The Loan is secured by a Letter of Intent. At 31 December 2017 the loan was fully utilised (31 December 2016: EUR 10,471 thousand equivalent to BGN 0,920 thousand).

As of 31 December 2017, the loan was fully repaid (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 2017, the loan was fully utilised, and 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.

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).

29. BORROWINGS FROM INTERNATIONAL INSTITUTIONS (CONTINUED)

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 2016, the credit line facility was not utilised and the loan was finalised.

Progress Program of the European Investment Fund

On 24 July 2015, a loan agreement was signed between Bulgarian Development Bank AD and the Progress Program of EIF for EUR 5,000 thousand (BGN 9,779 thousand). The 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 mey be 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 (At 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. 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. The loan is unsecured.

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.

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

29. BORROWINGS FROM INTERNATIONAL INSTITUTIONS (CONTINUED)

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.

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
Special-purpose deposits	93,914	95,185
	111,406	**112,864**

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 parent company (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.

30. OTHER BORROWINGS (CONTINUED)

Long-term agreement with the Executive Agency on Fisheries and Aquaculture

On 07 December 2010 a financing agreement for provision of funds for the issuance of guarantees under the Operational programme for development of fisheries sector 2007-2013 was signed between the National Guarantee Fund (NGF) and the Executive Agency on Fisheries and Aquaculture (NAFA) of the Ministry of Agriculture and Food of the Republic of Bulgaria. The aim of the program is to provide easier access to financing by the sector, with lower interest rates, lower collateral requirements and lower own financing.

The guarantee program is fulfilled within the Measure 2.7 of the Rural Development (RDP) Programme. Following consultations, the Executive Agency on Fisheries and Aquaculture (NAFA) and NGF EAD have chosen the financial engineering instrument, provided for under Commission Regulation (EC) No.498/2007 (OB, 10.05.2007, L 120) laying down detailed rules for the implementation of Council Regulation (EC) No.1198/2006, to be realised through a fund (accounts) in an account and under the governance of NGF.

In accordance with Commission Regulation (EC) No.498/2007 (Article 35), the financial engineering instrument is established in the form of a separate financial pool within NGF EAD.

In 2010, NAFA provided to NGF the amount of BGN 6,000 thousand under Article 1 of the Financing Agreement. On 28 December 2011 pursuant to Annex 2 an additional contribution of BGN 9,168 thousand was made. On 19 December 2012 Annex 4 of the Financing Agreement for provision of funds for the issuance of guarantees under the Operational programme for development of fisheries sector 2007-2013 was signed between NGF and NAFA. Pursuant to Annex 4, NAFA shall transfer to NGF additional contribution amounting to BGN 15,050 thousand for the realisation of the guarantee scheme. In accordance with Annex 5 signed between NGF EAD and NAFA on 16 January 2014, the Agency has withdrawn the last contribution of BGN 15,050 thousand. By Annex No. 7 dated 06 October 2015 between the parties, the Fund refunded to the Agency the amount of BGN 3,000 thousand from the additionally transferred financial resources.

In 2015, aiming at achieving a better yield, the program funds were invested in a current account bearing a preference interest rate with Bulgarian Development Bank AD. In 2016, the funds were deposited in a two-year deposit with the same bank. In 2017, the despot agreement was annexed for three more years.

The guarantee program is free of charge for businesses that benefit from it, while the cost for NGF EAD for its realisation are determined and paid under Article 35 of Commission Regulation (EC) No.498/2007.

As of 31 December 2017, within the OPRDP, NGF EAD has signed agreements with the following banks: Raiffeisenbank (Bulgaria) EAD, First Investment Bank AD, Cibank EAD, UniCredit Bulbank AD, Central Cooperative Bank AD, DSK Bank EAD, TBI Bank EAD, International Asset Bank AD, Bulgarian American Credit Bank AD, and Bulgarian Development Bank AD.

The term for inclusion of new loans and bank guarantees (which are scheduled within the Program) was 31 December 2015.

Long-term agreement with the Ministry of Agriculture and Food

On 20 December 2011, the National Guarantee Fund EAD and the Ministry of Agriculture and Food (MAF) signed a financial agreement to provide funds for the implementation of guarantees on guarantee schemes under the Rural Development Programme 2007 - 2013. The Guarantee Scheme was established on the grounds of Articles 51 – 52 of Commission Regulation (EC) No. 1974/2006 dated 15 December 2006 laying down detailed rules for the implementation of Council Regulation (EC) No. 1698/2005 dated 20 September 2005 regarding the support for rural development under EAFRD to facilitate access to financing of beneficiaries and the realisation of the projects under OPRDP.

MAF provides funding to NGF in BGN amount equivalent to EUR 121,100 thousand (BGN 242,000 thousand), in order to enhance the access to financing, support competitiveness, accelerate the completion of investments, which will be co-finance with funds under the Rural Development Programme (2007-2013) and which are used by the Fund for the issuance of guarantees and counter-guarantees. By Annex No.2 dated 14 October 2015 signed between the parties, the Fund refunded to the Ministry the amount of BGN 154,586 thousand from the financial resources provided. By Annex No. 3 dated 01 December 2015, signed between the parties, the term of the Agreement was extended until 01 April 2016.

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

30. OTHER BORROWINGS (CONTINUED)

Long-term agreement with the Ministry of Agriculture and Food (continued)

Pursuant to Annex No. 4 dated 29 March 2016 the parties declared that the funds provided under the Agreement should be re-used by the Guaranteed Activity Fund with the aim to facilitate access to financing for entities approved for aid under the Rural development programme of the Republic of Bulgaria (2014-2020 r.), as also for entities from Livestock breeding sector and Plant production sector. The funds are provided for carrying out guaranteed activities for a term of ten years.

In 2016 the funds were placed in a two-year deposit with the parent company. In 2017, the despot agreement was annexed for three more years.

As of 31 December 2017, within the Guarantee Scheme under OPRDP 2007 - 2013, NGF EAD has signed agreements with the following banks: Bulgarian American Credit Bank AD, DSK Bank EAD, United Bulgarian Bank AD, Piraeus Bank Bulgaria AD, First Investment Bank AD, Raiffeisenbank (Bulgaria) EAD, Cibank EAD, Central Cooperative Bank AD and Eurobank Bulgaria AD, UniCredit Bulbank AD, TBI Bank EAD, and Allianz Bank Bulgaria AD.

In 2017, the Guarantee Scheme 2014 -2020, a joint activity with MAF, was implemented by using funds amounting to BGN 50,000 thousand, released from the Guarantee Scheme under OPRDP 2007 – 2013. New agreements under the Guarantee Scheme was signed with 17 commercial banks: United Bulgarian Bank AD, Texim Bank AD, DSK Bank EAD, Piraeus Bank Bulgaria AD, Cibank EAD, Bulgarian American Credit Bank AD, Municipal Bank AD, Investment Bank AD, Allianz Bank Bulgaria AD, International Asset Bank AD, Eurobank Bulgaria AD, D Commercial Bank AD, TBI Bank EAD, First Investment Bank AD, UniCredit Bulbank AD, Bulgarian Development Bank AD, Raiffeisenbank (Bulgaria) EAD, and MFI Jobs EAD.

31. PROVISIONS

	2017	**2016**
Guarantee provisions	5,759	7,509
Litigation provisions	97	174
	5,856	**7,683**

Guarantee provisions consist of the amount the Group estimates as highly probable to be required to be actually paid to third parties under guarantees issued by the Group.

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	**7,509**	**6,153**
Charged over the year	1,982	4,273
Utilised over the year	198	135
Reversed over the year	(3,930)	(3,052)
Balance at 31 December	**5,759**	**7,509**

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

32. OTHER LIABILITIES

	2017	2016
Charges on debenture loans and portfolio guarantees	196	509
Payables to personnel and for social security	454	304
Retirement benefit liabilities	366	229
Accruals for expenses	777	177
Tax payables	281	131
Payables to EIF	148	-
Other creditors	617	70
	2,839	**1,420**

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 Group 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 parent company (the "Bank") – to six gross monthly salaries at the time of retirement. The parent company (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 336 thousand was included in the consolidated statement of financial position at 31 December 2017 (31 December 2016: BGN 229 thousand).

	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 (loss)/ gain recognized in other comprehensive income for the period	(63)	23	-	-	(63)	23
Actuarial (loss)/gain at 31 December	**(41)**	**22**	**-**	**-**	**(41)**	**22**

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

32. OTHER LIABILITIES (CONTINUED)

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 parent company (the Bank) are based on the Group'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:

	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:

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)	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

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 parent company (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)

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

34. RESERVES

In accordance with the general provisions of the Commercial Act, the parent company (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 Group 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 71,989 thousand. (31 December 2016: BGN 66,151 thousand).

As of 31 December 2017, the Additional Reserves of the Bank amounted to BGN 68,063 thousand (31 December 2016: BGN 48,751 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 parent company (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 at the end of each reporting period are recognised in equity, in a special components thereof formed by the Group 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 11,003 thousand (31 December 2016: BGN 6,534 thousand – a positive value).

35. CONTINGENCIES AND COMMITMENTS

	2017	2016
Contingent liabilities		
Guarantees and letters of credit	407,746	323,869
incl. with cash collateral	(9,472)	(3,853)
Letters of credit with borrowed funds, accounted as loan commitment	21	-
Guarantee provisions (Note 31)	(5,829)	(7,509)
	392,466	**312,507**
Risk free counter guarantees issued	63,696	50,851

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

35. CONTINGENCIES AND COMMITMENTS (CONTINUED)

Irrevocable commitments		
Unutilised amount of approved loans	446,223	531,646
incl. letters of credit with borrowed funds	*(21)*	-
Unclaimed portion of par value of EIF shares	4,694	4,694
Participation in the SIA investment program	1,603	1,724
	452,499	**538,064**
	844 965	**850,571**

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 parent company (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 (the parent company) 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 20).

In 2015, the parent company (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).

In 2017, there were active agreements for portfolio guarantees with 11 banks, under the 2009-2013 guarantee scheme, to which the National Guarantee Fund (a subsidiary of BDB AD) is a party. The maximum term of these guarantees is up to 10 years. The total limit of funds provided to the banks for including loans in the portfolio amounts to BGN 146,500 thousand (2015: BGN 146,500 thousand). As of 31 December 2017, the approved amount of guarantees included in the portfolio of the partner banks amounted to BGN 11,078 thousand (2016: BGN 17,778 thousand), and the guaranteed debt amounted to BGN 4,983 thousand (2016: BGN 7,724 thousand).

In 2014, the National Guarantee Fund launched a new guarantee scheme. There are 13 active signed agreements with banks for portfolio guarantees under this scheme. Unlike the previous one, banks under the new scheme have the opportunity to include loans in the guaranteed by the NGF portfolio themselves, complying with the requirements of the scheme. The term for inclusion of loans into the guaranteed portfolio ends in September 2015 and the NGF guarantee is valid by September 2018. Only new loans to small and medium-sized enterprises with a maximum guarantee by the National Guarantee Fund of up to 50 per cent from the amount of the loan and no more than BGN 500 thousand are included in the guaranteed portfolio. There is a payment cap for each guarantee scheme under the 2014 guarantee scheme. The banks pay a guarantee fee based on the volume achieved, as the borrowers are exempt from fees on the guarantees provided by the NGF. The total limit granted to banks for the inclusion of loans in the portfolios amounts to BGN 192,000 thousand (2016: BGN 192,000 thousand).

35. CONTINGENCIES AND COMMITMENTS (CONTINUED)

As of 31 December 2017, the approved limit of the guarantees included in the partner banks' portfolios amounted to BGN 49,047 thousand (2016: BGN 64,323 thousand) and the guaranteed debt amounted to BGN 39,009 thousand (2016: BGN 55,662 thousand).

In 2015, a procedure for selecting partner banks of NGF under a new guarantee scheme was initiated. After performing the selecting procedures and conducting an analysis of the commercial banks, guarantee agreements were signed with 10 commercial banks for the total amount of BGN 326,000 thousand from the beginning of October 2015 to the beginning of January 2016. In 2016, at request of two the banks having signed the agreement, the total guarantee limit was increased to BGN 379,000 thousand. Similar to the previous scheme, eligible for inclusion are only new loans for investment needs and working capital. According to the scheme, NGF guarantees up to 50 per cent of the loan amount, but not more than BGN 1 million at a related party level. The term for inclusion of loans into the guaranteed portfolio ends on 31 March 2017. A maximum limit of payments per guaranteed portfolio of up to 25 per cent is approved under the guarantee scheme, where in case of non-compliance with the terms and conditions of the scheme NGF has the right to exclude loans from the guaranteed portfolio. The banks pay a guarantee fee based on the volume achieved, while the borrowers are exempt from fees on the guarantees provided by the NGF. Since the start of the guarantee scheme, 2,024 SMEs have been supported. The total limit granted to banks for the inclusion of loans in the portfolios amounts to BGN 379,000 thousand (2016: BGN 379,000 thousand). At 31 December 2017, the approved limit of the guarantees included in the partner banks' portfolios amounted to BGN 209,598 thousand (2016: BGN 201,205 thousand) and the guaranteed debt amounted to BGN 169,038 thousand (2016: BGN 180,118 thousand).

In the beginning of 2017, NGF commenced a procedure for extending the term of the guarantee scheme NGF 2015-2017 for a new term for inclusion. All banks had expressed an interest and new agreements were signed for the amount of BGN 328,000 thousand. As in the previous scheme, only new investment loans and loans for working capital are eligible for inclusion.according to the scheme, NGF guarantees up to 50% of the loan amount, but not more than BGN 1 million at the level of related parties. The term for inclusion of loans into the guaranteed portfolio ends in September 2018. There is a payment cap for each guaranteed portfolio of up to 25%, while NGF has the right to exclude credits from the guaranteed portfolio in case of non-compliance with the terms and conditions of the scheme. Banks pay a guarantee fee based on the volumes achieved and the borrowers are exempt from guarantee fees by the NGF.

The total amount of funds provided to banks for inlusion in the portfolio is BGN 328,000 thousand. At 31 December 2017, the approved limit of the guarantees included in the partner banks' portfolios amounted to BGN 126,493 thousand and the guaranteed debt amounted to BGN 123,907 thousand. 1,266 SMEs have been supported.

In December 2016, an Agreement was signed between the European Investment Fund (EIF) and National Guarantee Fund EAD (NGF EAD), by virtue of which new EUR 40 million was ensured for financing of small and medium-sized enterprises in Bulgaria under the EC COSME Programme. The funds are ensured with the support of the European Fund for Strategic Investment (EFSI) underpinning the Investment Plan of Europe (the Juncker Plan). EIF provides a guarantee line of EUR 20 million, through which NGF will support a financing of EUR 40 million to SMEs in Bulgaria experiencing difficulties in ensuring the required collateral. Five applications were submitted within the deadline for submission of applications for interest, which ended on 21 December 2017, as follows: 4 – BACB, TBI Bank, MFI Jobs and First Investment Bank already signed guarantee agreements with a cap of BGN 23,780 thousand, and the application of Post Bank is undergoing processing.

At 31 December 2017, guarantees of BGN 3,574 thousand were issued on 63 loans for the total amount of BGN 7,147 thousand. The current guaranteed debt at 31 December 2017 amounts to BGN 2,992 thousand. 49 SMEs have been supported.

Based on a Financing Agreement signed with EAFA in 2011, NGF implements a guarantee scheme in the Fisheries sector. The guarantees issued by NGF pursuant to the Programme are risk-free as the claims are paid on account of the funds provided by OPDFS. Agreements with 15 commercial banks were signed under the NGF Programme. Thanks to the support of the scheme, projects amounting to BGN 46,000 thousand were implemented, of which BGN 33,000 thousand were for projects under Measure 2.1 (79 per cent of the measure's budget); the projects supported under Measure 2.6 amounted to BGN 12,000 thousand (77 per cent of the measure's budget). Projects under Measure 4.1 amounting to BGN 500 thousand were supported as well.

35. CONTINGENCIES AND COMMITMENTS (CONTINUED)

As of 31 December 2017, when applying the maximum amount of guarantee coverage of 80 per cent, NGF EAD had issued risk-free guarantees/counter guarantees for loans issued by partner banks for financing of approved projects under the Operational Programme "Fisheries Sector Development" 2007-2013 amounting to BGN 13,874 thousand with total amount of loans/bank guarantees – BGN 20,780 thousand (2016: guarantees BGN 15,110 thousand with total amount of loans/bank guarantees – BGN 20,780 thousand).

The carrying amount of the guaranteed debt as of 31 December 2017 was BGN 4,959 thousand (2016: BGN 7,775 thousand).

Based on a Financing Agreement signed with MAF in 2012, NGF performs guarantee activities in support of beneficiaries of OPRD 2007-2013. The guarantees issued by NGF under the Programme are risk-free for the Company as the claims are paid on account of the funds provided by OPRD. 544 beneficiaries of the Programme were supported for projects implementation under the scheme, whereas 84 per cent of the entities are classified as micro-, 14 per cent as small- and 3 per cent as medium-sized enterprises.

As of 31 December 2017, when applying the maximum amount of guarantee coverage of 80 per cent, NGF EAD had issued risk-free for the issuer guarantees/counter guarantees for loans issued by partner banks for financing of approved projects under the Operational Programme for Rural Development of Republic Bulgaria 2007-2013 amounting to BGN 185,606 thousand (2016: BGN 185,606 thousand) with total amount of loans of BGN 238,112 thousand (2016: BGN 238,112 thousand). The total guarantee limit under this program at 31 December 2017 amounts to BGN 24,254 thousand (2016: BGN 36,891 thousand).

The guarantee scheme is a scheme implemented jointly with MAF, which is realized by funds amounting to BGN 50 million released under the guarantee scheme of OPRD 2007-2013 for financing projects approved under the Operational Programme for Rural Development of Republic Bulgaria 2014 - 2020. The guarantees issued by NGF EAD under the Programme are risk-free for the Company as the claims are paid on account of the funds provided by OPRD.

At 31 December 2017, by applying the maximum guarantee cover amount of 50 per cent, NGF EAD issued risk-free guarantees and counter-guarantees for the Company on loans extended to partner banks for the purpose of financing projects approved under the Operational Programme for Rural Development of Republic Bulgaria 2014 - 2020 amounting to BGN 12,227 thousand with the total amount of loans being BGN 45,750 thousand (2016: BGN 24,486 thousand). The total guarantee limit of the Programme is BGN 50,000 thousand. At 31 December 2017, the loans guaranteed were 141 for the total amount of BGN 92,000 thousand. 112 small and medium-sized enterprises were supported. The book value of debt guarantees at 31 December 2017 is BGN 34,483 thousand (2016: BGN 6,185 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.

The guarantees of the parent company (the "Bank"), issued under the Micro-credits Guarantee Fund Project of MLSP, and the guarantees issued at own risk of NGF (subsidiary of BDB) are not secured. In case of activation of a component of a guarantee issued by the Group, 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 the Group.

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.

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

36. CASH AND CASH EQUIVALENTS

In BGN'000	**2017**	**2016**
Cash in hand (Note 16)	244	120
Current account with the Central Bank (Note 16)	447,404	78,401
Receivables from banks with original maturity up to 3 months	74,652	115,203
	522,300	**193,724**

	January 1, 2017	Cash inflow	Cash outflows	Effect of changes in exchange rates	Accruals under the effective interest rate method*	Other	31 December 2017	31 December 2017.
Dividends payable	-	19,313	-	(19,313)	-	-	-	-
Current borrowings from international institutions	379,998	-	556,939	(67,837)	-	-	721	869,821
Current liabilities on other borrowings	112,864	-	678	(2,136)	-	-	-	111,406
Total liabilities from financing activity	**492,862**	**-**	**557,617**	**(69,973)**	**-**	**-**	**721**	**981,227**

*The interest accruals of BGN 4,592 thousand are included in the operating cash flows of the Bank.

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

Related parties:

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
Ministry of Agriculture and Food	Company under common control with the State
Executive Agency on Fisheries and Aquaculture	Company under common control with the State
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
Executive Agency Fisheries and Aquacultures	Company under common control with the State
Ministry of Agriculture and Food	Company under common control with the State

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)

The table above shows the companies with which the Group had transactions during the reporting period.

Related party balances in the statement of financial position :

Assets

Entity/person	***Type of balance***	**2017**	**2016**
Ministry of Finance	Available-for-sale securities	288,881	248,634
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

Liabilities

Entity/person	***Type of balance***	**2017**	**2016**
Ministry of Finance	Available-for-sale securities	17,492	17,679
Company under common control with the State	Loans and advances to customers	604,596	535,577

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)
Company under common control with the State	Interest income	7,830	6,705
	Fee and commission income	498	355
	Interest expense	(977)	(642)
	Other operating income	210	-

Commitments and contingencies with related parties:

Entity/person	***Type***	**2017**	**2016**
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

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	371	429
Remuneration payable	68	38
Loans and advances to customers	405	561

Transactions with key management personnel	**2017**	**2016**
Remuneration and social security contributions	(2,075)	1,557
Interest expense	(1)	(1)
Interest income	4	11

38. EVENTS AFTER THE DATE OF THE FINANCIAL STATEMENTS

On 07 February 2018, Kostadin Bozhikov Munev was discharged from the Board of Directors of MFI JOBS and Angel Atanasov Dzhalazov was registered in his place. An amendment to the Articles of Association was registered on 22 March 2018, by virtue of which the composition of the Board of Directors was changed from three to five members.

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

In February 2018, the lawyer, Angel Dzhalazov was appointed as Executive Director of National Guarantee Fund EAD. The change was effected in pursuance with a decision of the sole owner of the capital in compliance with the legal provisions.

Angel Dzhalazov has long-standing experience in international investment banking, assets management, capital markets, project finance, investment products, supervision and financial instruments management.