BULGARIAN DEVELOPMENT BANK AD

ANNUAL MANAGEMENT REPORT

INDEPENDENT AUDITORS' REPORT AND

ANNUAL SEPARATE FINANCIAL STATEMENTS

31 December 2018

BULGARIAN
DEVELOPMENT BANK

SEPARATE ANNUAL ACTIVITY REPORT
OF BULGARIAN DEVELOPMENT BANK AD
FOR 2018

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GENERAL INFORMATION

Bulgarian Development Bank AD

Shareholding structure as at 31 December 2018

The State through the Minister of Economy – 99.9999% and DSK Bank - 0.0001%.

Supervisory Board:

- Luchezar Borisov – Chairman of the Supervisory Board;
- Mitko Simeonov – Vice Chairman of the Supervisory Board;
- Velina Burska – Member of the Supervisory Board.

Management Board:

- Stoyan Mavrodiev – Chairman of the Management Board and Chief Executive Director;
- Rumen Mitrov – Vice Chairman of the Management Board and Executive Director;
- Nikolay Dimitrov – Member of the Management Board and Executive Director.

Head office and registered address:

1000 Sofia, Sredets area, 1 Dyakon Ignatii Street

Registration Number – UIC 121856059

Join auditors of Bulgarian Development Bank AD:

Ernst & Young Audit OOD
Polygraphia Office Centre
47A Tsarigradsko Shose Blvd., floor 4
Sofia 1124
office.sofia@bg.ey.com

Zaharinova Nexia OOD

157-159 Konstantin Velichkov Boulevard
Floor 1, Office 3
Sofia 1309
office@zaharinovanexia.com

INFORMATION ABOUT THE BANK

The Group

At the end of 2018, the Financial Group Bulgarian Development Bank (the „Group"[1] of the Financial Group) comprise Bulgarian Development Bank AD („BDB", the „Bank") and its subsidiaries – National Guarantee Fund EAD (NGF), Micro Financing Institution Jobs EAD (MFI Jobs) and Capital Investments Fund AD (CIF).

At the beginning of 2019, the Bank incorporated two new subsidiaries – BDB Leasing EAD and BDB Factoring EAD, which will become members of the Financial Group of BDB as well.

Bulgarian Development Bank AD

Bulgarian Development Bank AD was established on 11 March 1999 as a joint-stock company under the name of Encouragement Bank AD. By means of the Bulgarian Development Bank Act (BDBA), on 23 April 2008 the name and scope of activity of the Bank were changed, so as to be able to apply schemes and instruments to finance public investments and projects of priority for the country's economy.

Being the only state-owned bank in the country, BDB provides funding for programmes specifically entrusted to it specifically by the government of the Republic of Bulgaria. The exposure to a customer or group of related clients, other than credit institutions, central governments and central banks, complies with the requirements and limits of Regulation 575/201H/EU taking into account the effect of credit risk mitigation under a procedure laid down by the Management Board.

Bulgarian Development Bank AD holds a license for an investment intermediary according to which it may provide investment services and perform investment activities[2] under Article 6, paragraph 2 of the Markets in Financial Instruments Act (MFIsA), as well as additional services under Art. 6, paragraph 3 of the MFIsA.

The Bank does not provide investments services, nor it performs investment activities under Article 6, paragraph 2, items 8 and 9 of the MFIsA – organisation of a multilateral trading facility and an organised trading facility.

As of 31 December 2017, the paid-in capital was BGN 601,774 thousand (31 December 2017: BGN 601,774 thousand). The capital consists of 6,017,735 ordinary registered voting shares of par value BGN 100. As of the date of preparation of this report, the ownership of the capital is distributed as follows: 99.9999% of it is held by the Republic of Bulgaria, represented by the Ministry of the Economy, 0.0001% is held by DSK Bank.

BDB is governed in accordance with Article 5 of BDBA, according to which the Bank has a two-tier management system with the Minister of Economy exercising the state's rights at the General Assembly of Shareholders of the Bank.

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[1] At the end of 2018, the Bank was a sole owner of the capital of TP Maritsa EOOD (TPM); however, the company was not a part of the strategic business model of the Financial Group of BDB.

[2] Investment services are provided and investment activities are performed in accordance with the requirements of MFIsA, Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (Directive 2014/65/EU or MIFID II), Regulation (EU) 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (Regulation (EU) 600/2014), Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (Delegated Regulation (EU) 2017/565) and the acts on their implementation.

Members of the BDB's management bodies are appointed in compliance with BDBA, Credit Institutions Act, Commercial Act, and the Regulations on their implementation, adopted by Bulgarian National Bank.

Bulgarian Development Bank AD has not acquired treasury shares pursuant to Article 187e.

The entity is not a party to transactions falling within the scope of Article 240b of the Commercial Act with reference to Article 247 of the same Act.

There are no shares of the entity acquired, held or assigned during the reporting year by the members of the management bodies. Pursuant to Article 6, paragraph 4 of the BDBA, the members of the Management and controlling bodies, the procurators and the senior management cannot hold shares and cannot be provided with options for shares of BDB, and in subsequent accounting periods no agreements may be concluded as a result of which in any future period changes may occur the relative volume of shares held by current shareholders.

As of 31 December 2018, BDB had not liabilities under existing or new issues of securities.

As of 31 December 2018, there were no pending court, administrative or arbitration proceedings related to liabilities or receivables of the Bank, amounting to 10 per cent or more of its equity. The average number of staff of the Bank is 191 employees (as of 31 December 2017: 171 employees).

Bulgarian Development Bank AD has no branches. The head office and registered address of BDB is at 1 Dyakon Ignatii Street, Sofia City.

BDB complies with the applicable Bulgarian and European environmental protection legislation. The Bank conducts an environmental impact analysis of all projects for which such an analysis is required under the applicable legal framework. In the project implementation process, BDB requires the submission of the necessary permits and documents, and strictly monitors the precise implementation of the projects. Subject to stricter environmental requirements set out in the loan agreements with external creditors, BDB requires compliance with these higher standards by its clients and monitors their performance.

In the field of human resource development, BDB focuses on continuing support for development and training of staff, creating prerequisites for professional growth of their highly qualified professionals.

BDB has no a dedicated R&D unit and Bank is currently not planning actions in this area, but staff training.

The Bank's financial performance and ratios are stable. There are no non-financial indicators, the value of which would affect the results of its principal activity.

MAIN FOCUS ACTIVITIES AND PROJECTS IN 2018

Key events

In 2018, Bulgarian Development Bank established Capital Investments Fund, and the process on incorporating two new subsidiaries - BDB Leasing and BDB Factoring, began. These two, newly incorporated entities, together with National Guarantee Fund, Micro Financing Institution Jobs and Capital Investments Fund supplement the BDB Group providing new opportunities for providing the Bulgarian businesses with financing. The Capital Investments Fund was not operational in 2018.

In 2018, the Bank prepared itself for the implementation of the new requirements of MFISA, Directive 2014/65/EU, Regulation 600/2014, Regulation 2016/679 on the protection of personal data (GDPR), the new Payment Services and Payment Systems Act (PSPSA), and Ordinance NO. 3 on payments of BNB and Directive 2015/2366 (PSD 2) on payment services, so that they are successfully implemented in 2018. The Bank has established and is applying organization related to the execution and performance of contracts with customers, to the client information requirement, to keeping accountability and the safekeeping of client assets, pursuant to the requirements of the above mentioned national and European legislative acts. The Bank has built a system of internal rules and procedures for internal control, which ensure full compliance with the legislative provisions specified above.

In 2018, the main IT activities were directed in two directions - in implementation of regulatory projects, improvement of the day-to-day operational IT activities, and updating the working procedures. The most significant projects were as follows: preparation of the bank and making its information systems compliant with GDPR requirements; achieving compliance with the reporting requirements and enlarging the system's functionalities in line with the requirements of MIFID II, preparation for and implementation of the latest SWIFT standards, and preparation for full outsourcing of the SWIFT service to BORIKA aiming at improving its reliability, as also in line with the latest SWIFT security requirements. A modern anti money laundering system was selected in accordance with the most recent regulatory requirements and the bank started preparing itself for the launch of the implementation project in 2019.

In 2018, the international rating agency Fitch Ratings carried out its regular annual review and confirmed the credit rating of the Bulgarian Development Bank AD. In April 2019, Fitch Ratings Agency upgraded the outlook of the long-term credit rating of BDB from BBB Stable Outlook to BBB, Positive Outlook. This is the highest credit rating assigned to a Bulgarian financial institution, and for BDB it is limited by the rating of the sovereign – the Bulgarian State.

Rating effective as of	As of 31 December 2017	As of 31 December 2018	As of the date of preparation of the Management Report
Date of preparation of the rating:	13.12.2017	06.12.2018	01.04.2019
Long-term Rating (IDR, SRF)	„BBB"	„BBB"	„BBB"
Outlook	Stable	Stable	Positive

The rating agency's assessment is based on the reliable support of the sovereign – the Bulgarian State, the BDB's good financial performance, its good capitalisation, and its role in supporting the government's economic policy. The positive outlook shows the existence of a balance in risks associated with credit rating assessments. The agency's notification states that, in the event of a subsequent increase in Bulgaria's rating, the BDB's rating will most likely be increased.

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

The General Assembly of Shareholders of BDB held in July 2018 approved the audited financial statements of the institution for 2017, certified by the joint auditors, Ernst & Young Audit OOD and Zaharinova and Partners OOD (the latter company with a current name Zaharinova Nexia OOD). Bulgarian Development Bank reported a profit for distribution for 2017 amounting to BGN 8,858 thousand (after considering the effect of the application of IFRS 9). The General Assembly took a decision to distribute the 2017 profit of the Bank as follows:

- contributions to the Reserve Fund amounting to 10 percent, or BGN 885 thousand;
- the remaining balance of the profit of Bulgarian Development Bank AD for 2017, net of contributions to the Reserve Fund, to be taken to Additional Reserves heading. Following this resolution, the capital adequacy of Bulgarian Development Bank continues to be the highest one in the Bulgarian banking system.

In 2018, the product and credit portfolio of the Bank continued to develop, as also the diversification of the sources of financing.

In May 2018, the last amount on the principal of the loan with the Japan Bank for International Cooperation was repaid and thus, the loan was fully repaid.

BDB was the first President by rotation and took the host's role at the First International Meeting of the China-CEEC Interbank Association of China and the Central and Eastern European countries.

In the framework of the meeting, at the beginning of July 2018, on a bilateral basis, BDB and the Chinese Development Bank (CDB), as part of the official agenda of the Seventh Annual Meeting of China's and CEE's Heads of Government, signed a financial cooperation agreement under the One Road, One Belt initiative. The agreement envisages a financing of EUR 1,500 million for the upcoming 5 years, as follows:

- Up to one billion Euro will be allocated for joint financing, project financing, joint equity investment funds, syndicated loans and other projects of mutual interest agreed between BDB and CDB within the One Road, One Belt initiative.
- At least EUR 500 million will be the amount of bilateral co-financing for BDB, which will be available for projects under the One Road, One Belt initiative and / or in accordance with the BDB's strategy; these projects may include, but are not limited to: support to SMEs, energy, communication, transport, agriculture in Bulgaria, or for other purposes as might be approved by BDB.
- The total amount under the agreement is 75% of the financial initiative of the Chinese Development Bank within the China-CEEC Interbank Association of China and the Central and Eastern European countries of EUR 2 billion.
- On the grounds of the a financial cooperation agreement under the One Road, One Belt initiative, on 13 December 2018 BDB signed a third Loan contract with the Chinese Development Bank EUR 300 million and a 10-year term; the purpose of the loan is to support the Bulgarian business. The first tranche of the new loan of EUR 30 million was utilised as of 31 December 2018.

In August 2018, the loan from Industrial and Commercial Bank of China was fully repaid in accordance with the repayment schedule.

In 2018, the entire agreed amount EUR 50 million under the agreement signed on 28 September 2017 with the Chinese Exim Bank was utilised.

A financing contract amounting to EUR 5,745 thousand was signed with a Bulgarian commercial bank for the purpose of promoting micro-, small- and medium-sized enterprises. BDB is a borrower under a Loan contract with the

Government of the Republic of Bulgaria. The contract was signed on the grounds of a Treaty between the Government of the Federal Republic of Germany and the Government of the Republic of Bulgaria for financial cooperation.

Bulgarian Development Bank concluded the first contract for on-lending financing with a commercial bank within the framework of the Investment Plan for Europe. The funds under the programme have been ensured by Bulgarian Development Bank and European Investment Bank and are part of the Investment Plan for Europe – one of the priority projects of the President of the European Commission Jean-Claude Juncker. The focus of the Plan is to promote investments in order to create jobs and achieve growth through a smarter use of new and existing financial resources, by removing barriers to investment and providing visibility and technical assistance to projects.

At the end of 2018, BDB concluded agreements with two commercial banks under the COSME+ Programme in support of small and medium-sized businesses, and launched lending for SMEs under preferential terms and conditions. The COSME+ Programme is implemented with support from the European Fund for Strategic Investments for indirect financing of small and medium -sized enterprises with guarantee facility and counter-guarantee. The COSME Programme builds upon the Entrepreneurship and Innovation Programme (EIP) launched in the period 2007-2013. The Programme's total budget amounts to EUR 2,300,000 thousand and covers the period 2014-2020. Four areas of support are included in its scope – improving access to finance for SMEs in the form of equity and debt instruments; improving access to SME markets worldwide; improving framework conditions for business competitiveness and promoting entrepreneurship.

The implementation of the Leasing Line Programme directed towards partners – non-banking financial institutions – lessors registered with BNB and carrying our finance lease activities continued in 2018 as well.

At the end of 2018, BDB launched a new programme for indirect support for SMEs through commercial banks and non-banking financial institutions. The programme is for indirect financing of farmers who are members of mutual credit cooperatives of private farmers. Its budget amounts to BGN 15 million. The loans are limited up to BGN 1,500 thousand and mature within 5 years.

The Chairman of the Board of Directors and Chief Executive Director of the Bulgarian Development Bank, Stoyan Mavrodiev is the winner in the category "Finance and Insurance" at the Mr. and Mrs. Economics 2018 competition. This is the second award for Stoyan Mavrodiev from the prestigious contest, which is organized by the Confederation of Employers and Industrialists in Bulgaria (KRIB) and "Economics" magazine.

In 2018, the process of rebranding the Financial BDB Group began – election of new logo for the bank and its subsidiaries, including elaboration of a brand book. The upgrading of the corporate vision coincides with the 20th anniversary of the Bank. The creation of a new, unified vision of the Bulgarian Development Bank Group corresponds with the pace of development of the financial institution in fulfilment of its mission to be a partner of business in its growth, to contribute to its competitiveness in the future, and to facility the building of an ecosystem, which favours entrepreneurship.

Successfully implemented programs and projects

In 2018 as well, the implementation of the **Energy Efficiency of Multi-Family Buildings National Programme** continued – Bulgarian Development Bank AD provides financing under the Energy Efficiency of Multi-Family Buildings National Programme (EEMFBNP) approved by Decree No 18 of 2 February 2015 of the Council of Ministers of the Republic of Bulgaria (the Program). The Programme has been oriented to the renovation of multi-family residential buildings with a main objective to secure better living conditions for the residents in the multi-family residential buildings, heat comfort and higher quality of living environment. The implementation of energy efficiency measures in multi-family residential buildings will contribute to higher level of the energy efficiency of multi-family residential buildings and energy costs decrease; improving the exploitation features for extending the life cycle of the buildings; and providing conditions of living environment in line with the sustainable development criteria.

The expected results and effects from the Programme are heat costs reduction for the households; improved residential infrastructure and change of the urban appearance; cleaner environment – saved green gas emissions (CO_2, etc.); and extending the life of the building that will have a higher price. The economic effect consists of giving more opportunities to business for Economic activity – designers, construction industry, companies for technical audits, companies for energy efficiency audits, materials' producers, etc., as also participation in the implementation of the Programme of small and medium-sized companies from all over the country. The Programme achieves also social effects by providing additional employment; establishing traditions in the management of multi-family residential buildings; and increasing public awareness of the ways for energy efficiency enhancement. The program activities cover the entire territory of Republic of Bulgaria, within 265 municipalities. The financial resource set aside by the State budget for the Programme amounts to BGN 2 billion.

Examples of projects financed by the bank:

- **Construction company** with main scope of activity the development, construction and reconstruction of industrial and commercial buildings, production halls, factories, auto-repair shops, corporate buildings, store of large commercial chains, etc. The company has manufacturing facilities, specialist equipment and technical staff. It offers, together with other Group companies, „complete engineering" and „design and construction in one". The completed projects are characterised by different design and operation conditions, high construction quality and are widely distributed and recognisable around the country – hypermarkets Billa, Metro, Hit, Praktiker, sports halls, Sofia Airport, etc. The company participates in joint projects with foreign investors – the German manufacturer Leoni, the Japanese corporation Yazaki.
- Licensed **air carrier** with basic products and services in the field of transport and charter services, wet lease (ACMI), damp lease, etc. The Borrower plans to expand business by purchasing aircrafts instead of leasing such.
- **A company operating the biggest mussels farm in Bulgaria.** The company is specialized in cultivation and production of environmentally clean Black Sea mussels, which it cultivates in its own plantation, which is the largest mussels plantation in the Black Sea. Its construction has gone through three main stages financed under the SAPARD Programme, the Operational Programme for Development of the Fisheries Sector (OPDFS) /2007-2013/ and Maritime and Fisheries Programme /2014-2020/. BDB has extended an investment loan to the company for the construction of the processing plant with technological equipment for processing, packaging, cooling and freezing of cultivated mussels.
- **A company registered as a farmer**, holding 300 dca of agricultural land on the land of the Malko Gradiste village, with fully developed and operational pear garden on 170 dca with 19,809 pear trees, equipped with an anti-hail system, a droplet irrigation system, bored well, and a water-main. The object of financing is the upcoming construction of warehouses for storage of plant production, agricultural equipment and machinery, office and household premises, which is the last stage of

development of the whole farm. The project is supported by grants under Sub-measure 4.1 Investment in Agricultural Holdings by the Rural Development Programme (RDP) 2014-2020 on the basis of a contract signed with the State Fund Agriculture. The implementation of the project aims at reducing direct operating costs, achieving higher quantitative and qualitative production results, making better use of production factors, and in the end, achieving a cost-effective and competitive production of pears.

- **A company operating in the area of the Bulgarian printing industry**, which provides to its customers printing services of high quality, combining traditions and high quality. Investments in the company have been made also with the support of the European Regional Development Funds (the company implements two Phase projects under the under the pre-accession programmes - Leonardo da Vinci programme, the Innovation and Competitiveness Operational Programme). The overall objective of the projects implemented so far and the financial support rendered by the bank is to improve competitiveness and achieve sustainable growth by improving energy efficiency and expanding the production capacity of the company.
- **A factory for producing various types of paper, including tissue paper**, for industrial customers in Bulgaria and abroad. The company's corporate vision is to continuously invest in modernizing existing equipment and acquiring new production facilities. Over the last two years, the company has been implementing an investment program to reduce the specific consumption of resources per tonne of product manufactured, as well as acquiring various peripherals to existing machines, allowing automation and computer assurance of the production process and thus, increasing quality control.
- **A holding group of companies in the IT sector.** In recent years, the company has been gradually acquiring various companies, including such with over 17 years of experience and start-ups. In 2016, the holding established a subsidiary in Nish, Serbia. The holding has, through its network of companies, 8 offices situated in 7 cities – Plovdiv, Sofia, Veliko Tarnovo, Varna, Blagoevgrad, Svishtov, and Nish. The main groups of services are in the IT area: trade, consulting activity, software implementation and maintenance, advertising activities, business agency, patent acquisition, granting of licences, and others. A project of a group company for obtaining a grant under the Innovation and Competitiveness Operational Programme has been approved. BDB has extended a loan for working capital to finance marketing activities for restoring a client database. The expected effect is the continuing growth of new customers, adding to those already attracted in 2017 and the beginning of 2018 from Switzerland, USA, United Kingdom, and increasing the volumes being offered to traditional customers of the group companies. The group expects a serious increase in revenue from its internally-developed human resource management product over the period of the loan agreement.

OVERVIEW OF THE ECONOMIC ENVIRONMENT AND BANKING SYSTEM IN 2018

In 2018, the Bulgarian economy reported record low unemployment and a reduction in external debt. Bulgaria's GDP marks a peculiar record – the expectations are for BGN 108 billion, and for the first time in Bulgaria's new history, it exceeds BGN 100 billion. GDP growth during the year remains sustainable and outstripping that of the Euro area and the EU average values – at a level of over 3%. The main driver of GDP growth remains domestic consumption and the level and growth of average income is also high. If combined with the growth of energy prices on global markets and food prices during the first three quarters of the year, this justifies the inflation rate that is higher than that in the Euro area, the growth of which remains lower than the growth of average income.

By sectors, what mostly contributed for the growth of the Bulgarian economy during 2018 was the Real estate transactions sector – an increase by 9.3% compared to the end of 2017. The low interest rates on residential loans and the improving environment on the labour market are the instruments to the record-high growth in real estate transactions; however, the growth in construction has slowed down to 4.0% per year, indicating the cooling of the real estate market over the next few years. The services sector continues to report a serious growth, establishing itself as the most important sector of the economy for the country during the last years. The relative share of value added realised as a result of the activities in the services sector has grown to 73.5% vs. 70.7% in the same period of the previous year. The industry also registers growth both of the Gross Added Value (GAV) produced in the sector, and in sales, and is also one of the sectors, the main driver of the economic growth during the year. The agricultural sector is weaker 2018, after its record-high growth in 2017.

The maintenance of a relatively high economic growth for a second year in a row lead to further improvement of the situation on the labour market. According to data of NSI, during the fourth quarter of 2018 the level of unemployment dropped to 4.7%, i.e. it was by 1.0% lower as compared to the same quarter of 2017, and the employment ratio increased to 71.1% for population between 20 and 64 years of age or by 0.2 p.p. on an annual basis. The low increase in employment rate shows that the peak of economic activity of the population is very close to its maximum and the economy is beginning to suffer from a lack of staff. This poses challenges to competitiveness and requires measures to intensify growth. The average working salary for the country in December was BGN 1,205, or a nominal increase by 7,3%. The increase in the public sector is by 7.5% YoY, while in the private sector the growth is by 7.1%. The factors underlying the increase in salaries are the developing economy and intensive competition for experts on the labour market; these factors will continue to support a growth of salaries ahead of the inflation, and especially, the compensation for qualified experts. With respect to the above, the Government undertook measures in order to regulate state administration, 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.

In 2018, the trade deficit increased to BGN 6.7 billion, net exports by about 0.7%, including the export to EU member states by 10.1%. The reason for the export stagnation was the decrease of export volumes to third countries by 12.3%. The main reasons for the significant reduction in exports to third countries were the economic situation in Turkey, the reduction in exports to Russia by more than 50%, low sales volumes of fuel and a variety of finished products. Together with the increase in consumption, imports increased by 7.4%. The trade balance deficit has a negative contribution to the growth of the economy. The trend of increase in imports over the export of goods is likely to continue until the end of the projection horizon, which will lead to a smooth increase in the trade deficit until 2020.

In 2017, the process of reduction of the external debt of the country continues. As compared to 2017, the total gross external debt of the private sector had decreased by 0.8% to 52,8% of GDP, while the external debt of the public sector decreased by 1.0% to 11,6% of GDP. The amount of direct foreign investments in Bulgaria reached EUR 1.744 billion in 2018, being the highest level for the last four years.

The average annual inflation for the period January-December 2018 as compared to the period January - December 2017 was 2.8%. The main groups of goods, which contributed the most for increasing the overall price index during the period were fuels and foods. The biggest increase in prices was reported by the transport sector – about a 4.7% annual increase. It is expected that the inflation rate for 2019 will be about 3.0%.

Banking sector

The past 2018 was a success for the banking sector in Bulgaria, marked with record-high profits, growth and improvement of the quality of bank portfolios, as well as continuing consolidation in the sector.

DSK Bank EAD began a process of acquisition of 99.74% shareholding in Societe Generale Expressbank AD (SGEB), which was finalised in January 2019. The new bank will be a leader in terms of assets and deposits together with UniCredit. The full integration of both institutions is expected to end in 2020.

Eurobank Ergasias S.A. ("Eurobank") announces the completion of the transaction in which its subsidiary bank Eurobank Bulgaria (Post Bank) acquired Piraeus Bank, a subsidiary of Piraeus Bank S.A. ("Piraeus Bank"). Thus, the estimated market share of Post Bank will reach more than 10% and therefore, the bank will rank the third in terms of credit portfolio. It is expected that the transaction will be finalised in 2019.

At the end of December 2018, the assets of the banking system amounted to BGN 105.56 billion, which represented a year-to-year increase of BGN 7.75 billion. Increases were observed in all groups of assets, except for financial assets, where there was a decrease by BGN 189 million. The greatest dynamics belonged to the loans and receivables – a growth by BGN 7.11 billion, and cash by BGN 826 million. The banking system's profit after taxes was record-high at the year-end, reaching BGN 1,68 billion. The high profit was due to growth in fees and commissions (increase by BGN 70 million compared to 2017), interest income (increase by BGN 66 million), and of the decrease in impairment expenses by BGN 266 million compared to 2017. The decrease in loans past due reduced the impairment expenses and contributed to the stability of the financial system.

Despite record-low interest rates on deposits, the level of attracted funds increased by BGN 6.0 billion in 2018, reaching BGN 89.7 billion. Deposit dynamics was mainly due to growth in household deposits by BGN 3.9 billion, as also in those from non-financial entities by BGN 1.1 billion. There was also an increase in deposits from other financial entities and general government. The reduction in unemployment rates and salary increases result in a growth in deposits, real estate transactions and domestic consumption.

In 2018, interest rates on deposits dropped reaching 0.13% for BGN deposits and 0.14% for EUR deposits. It was noted that banks did not demonstrate appetite for more deposit funds than existing customers and offered better conditions for new customers with short-term deposits. The reason for that situation is that the fee income is significant, which motivates the banks to attract new customers as a matter of priority. At the end of December, the deposit interest rates of the banking system for new businesses are lower for deposits with a term of over 1 year than for fixed-term deposits maturing from 3 to 6 months and from 6 months to 1 year.

In 2018, total loans and advances grew by BGN 7.5 billion, with increases being observed in all types of loans. The highest growth was reported by real estate loans - by 15.28% YoY. BNB warned of the risk of cyclical risks in case of future increases in interest rates or a weakening of economic activity. It is expected that increases in interest rates on loans will increase the costs of servicing these loans, which could potentially result in an increase in loans past due for over 90 days.

Interest rates on loans for new businesses, original maturity for non-financial entities, dropped by 0,22 p.p. to 3.48% for BGN loans and by 0.47 p.p. to 2.91% for EUR loans. There is a tendency that interest rates on BGN loans exceed those charged on EUR loans.

BDB compared with the banks operating in the country

As a result of the growth and the merger of UBB and CIBank in 2018, BDB climbed from 12 to 9 position in the Bulgarian banking system in terms of assets. The Bank marked a significant growth in 2018, while maintaining its stable capitalisation and key ratios.

Management of BDB expects that the key ratios of liquidity and capital adequacy will continue to exceed considerably the average ratios reported by the Bulgarian banking system, and the yield to remain around its current levels over 2019.

OVERVIEW OF THE ACTIVITY AND SELECTED FINANCIAL INFORMATION

Operating results

Bulgarian Development Bank AD continues to work actively towards the objectives set, while maintaining high levels of liquidity and capitalization. The process of modernisation and updating the BDB's operations continued throughout 2018 as well, while the Bank continued to increase the volume of its activity.

Key financial ratios as of 31 December 2018:

Comprehensive income	**2018**	**2017**	**Difference**
Net interest income	53,791	54,994	(-2%)
Net fee and commission income	2,027	2,181	(-7%)
Net gain on foreign currency transactions	379	409	(-7%)
Net income from financial assets measured at fair value through other comprehensive income	738	188	292%
General and administrative expenses	(22,948)	(16,430)	40%
Other operating income / (expenses)	1,547	1,698	(-9%)
Income before impairment	**35,534**	**43,040**	**(-17%)**
Income from reversed / (expenses on) impairment and provisions	(8,781)	(20,774)	(-58%)
Profit before taxes	**26,753**	**22,266**	**20%**
Income tax expense	(1,623)	(2,121)	(-23%)
Net profit for the period	**25,130**	**20,145**	**25%**
Actuarial gains / (losses) on defined benefit plans, net of taxes	33	(63)	(-152%)
Net change in the fair value of financial assets measured at fair value	1,108	1,466	(-24%)
Total comprehensive income	**26,271**	**21,548**	**22%**

The 2018 net interest income marked a minimal drop by 2% less versus 2017 amounting to BGN 53,791 thousand (as of 31 December 2017: BGN 54,994 thousand). The main reason underlying this result was the faster growth in interest expenses as compared to growth in interest income due to the increase of interest-bearing liabilities using borrowed funds only.

The net fee and commission income dropped 7%, or BGN 154 thousand.

Administrative expenses grew from BGN 16,430 thousand to BGN 22,948 thousand, with the main reason being the higher contribution to the Fund for Orderly Bank Restructuring. Its amount was increased more than twice reaching BGN 6,913 thousand (2017: BGN 3,180 thousand).

The ratio of operating expenses (including personnel expenses) to operating income grew to 39% in 2018 as compared to the previous year (2017: the ratio amounted to 28%).

The financial result after taxes of Bulgarian Development Bank as of 31 December 2018 was a profit of BGN 25,130 thousand compared to BGN 20,145 thousand in the previous year, or a growth by 25% for 2018.

Financial performance	**2018**	**2017**	**Difference**
Assets			
Cash in hand and balances in current account with the Central Bank	297,622	447,648	(-34%)
Receivables from banks	429,548	198,379	117%
Financial assets at amortised cost	1,511,079	1,437,196	5%
Financial assets at fair value through other comprehensive income	594,249	230,903	157%
Investments in subsidiaries	105,625	87,643	21%
Fixed assets	32,818	32,949	(-0%)
Other assets	41,820	37,525	11%
Total assets	**3,012,761**	**2,472,243**	**22%**
Liabilities			
Deposits from credit institutions	5,759	33,909	(-83%)
Borrowings from international institutions	904,782	869,822	4%
Deposits from other customers	1,307,522	790,590	65%
Other borrowings	17,306	17,492	(-1%)
Other liabilities	5,406	3,429	58%
Total liabilities	**2,240,775**	**1,715,242**	**31%**
Equity			
Issued capital	601,774	601,774	(-0%)
Retained earnings	25,130	20,145	25%
Revaluation reserves	6,055	4,947	22%
Other reserves	139,027	130,135	7%
Total equity	**771,986**	**757,001**	**2%**
Total liabilities and equity	**3,012,761**	**2,472,243**	**22%**

As of 31 December 2018, Bank's assets amounted to BGN 3,012,761 thousand, a 22% growth compared to the previous year. The main driver of the asset growth was:

- The increased direct lending, which reached BGN 1,039,080 thousand as of 31 December 2018 (compared to BGN 699,680 thousand as of 31 December 2017), or a growth of 49%,

- The investments in securities that have grown to BGN 594 249 thousand as of 31 December 2018, or a growth of 157%
- The growth in exposures to banks relating to both on-line lending programmes and nostro accounts thanks to the increased number of payment transactions.

These movements were partially offset by the drop in assets under the Energy Efficiency of Multi-Family Buildings National Programme (EEMFBNP) (a balance of BGN 471,999 thousand at the end of 2018 vs. BGN 728,010 thousand at the end of 2017) and the reduction in over-reserves deposited with BNB; the remaining part of this growth is financed by the higher amount of deposits from other customers and international institutions.

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

In 2018, the Bank continued to actively develop its business, supporting Bulgarian businesses, continuing to maintain a diversification of the industry structure of its loan portfolio. Greater dynamics are observed in the relative shares in the credit portfolio of the following sectors: Industry (increase by 45%), Tourist services (growth of 564%), Financial services, and General government enterprises. (Note 18B to the annual financial statements).

Development strategy

BDB – together with the Group companies –is a key instrument and a channel for conducting government economic policies, including in specific areas, regions, industries and social groups. The Bank and the Group companies actively collaborate with all government state structures in order to ensure maximum impact of the public funds targeted on support of the economic development. The focus of the activity is pre-export, export and bridge financing.

BDB and its subsidiaries operate in full transparency and apply the best banking and management practices. A core objective of the Bank is to reach the sectors of the economy and borrowers experiencing difficulties in accessing and obtaining financing, by providing financial solutions and products to overcome market imperfections.

In pursuing its mission, BDB 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.

The main principle underlying the BDB's activity is not to allow distortion of competition and displacement of the traditional commercial banks from the market. By compensating any existing market shortages in financing certain segments and clients, BDB contributes to adjusting their risk profile and further facilitates the increase of bank mediation and growth in credit volumes in the economy.

The strategic goals of BDB are :

- To facilitate the economic growth by supporting regions and sectors of the economy with established market shortage and potential for growth;
- To stimulate the economic activity of the investors for the modernization of the material and technological basis and for boosting the competitiveness of the economy;

- To facilitate the economic growth of the regions through financing, including syndicated, of sizable, strategic and infrastructural, by their nature, projects and investments;
- To support the development of competitive production initiatives and sectors of the economy of proven export potential;
- To facilitate, jointly with the other institutions in the country, the access to financing of innovative and newly established companies (start-ups);
- To facilitate and support the direction of capital flows to the Bulgarian economy.

In planning and carrying out its operational objectives, BDB will maintain the two approaches to support SMEs in the country – through direct lending and through indirect programmes through commercial banks. BDB follows the principles of prudent risk assessment and adequate management of these risks.

With regard to direct lending, the Bank will further develop focused product lines related to SME support. To fulfil the objectives, priorities will be pre-export, export and bridge financing. Traditionally, the Bank will continue to provide financing for small and medium-sized businesses with a longer loan period and relieved legal requirements for loan collateral.

The Bank considers that, in a context of high liquidity in the banking sector, the absorbing of part of the risk, namely additional risk that discourages commercial banks from financing, would be a key factor in the success of indirect programmes.

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

BDB will continue to support initiatives of the Bulgarian state in support of the economic and social development of the country. In 2019, BDB will continue in implementing the Energy Efficiency of Multi-Family Buildings National Programme (EEMFBNP).

In 2018 and early 2019, BDB incorporated new subsidiaries with objects of activity: equity investments in shares of other companies, leasing and factoring. The aim is to expand the financial services and solutions offered, and to meet the demand for these products on the main market segments.

Key strategic goals and policies of the Bank within the 2019-2020 horizon will be as follows:

- Reallocation of the asset in such a manner that indirect SMEs financing obtains a major contribution. The target ratio between indirect and direct financing should be 60:40, where the calculation of this ratio does not include the participation of the Bank in public and public-private projects or partnerships of strategic, national or regional importance
- Realization of a sustainable process in the creation and development of targeted product lines under the two main approaches for SME financing;
- Conservative assessment of risks and maintenance of high level of coverage of problem loans by provisions.

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

INTERNAL CONTROL

The internal control processes within the Bank and Group companies include the following components:

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

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

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

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

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

RISK MANAGEMENT

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

Credit risk

The credit risk is the key risk to which Bulgarian Development Bank is exposed, and therefore, its management is a key priority of the Bank's activity. The credit risk management takes place in compliance with the BDB Act, and the effective statutory laws and regulations of the Republic of Bulgaria, regulating the credit activity, the established international norms and best banking practices.

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

Market risk

In managing the currency risk, BDB follows the principle of maintaining minimum open FX positions through the observing of established limits. The positions of the Bank in various currencies, as well as the general FX position are monitored on a daily basis. The FX positions are not formed for speculative purposes, but are the consequence of the currency transactions, occurring in the course of the ordinary bank activity. In managing its assets and liabilities, due to the specifics of its financing, BDB seeks to maintain these assets and liabilities in EUR or BGN. The Bank's open FX position takes into account the terms and possibilities for netting the EUR and BGN positions in accordance with the applicable regulatory framework.

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

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

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

Operational risk

The operational risk is managed by strictly monitoring and registering all operational events occurring in the activity of the various units as a result of the processes within the Bank. Operational events, which are more frequent, and the ones having great potential or real impact on the BDB's financial result, are subject to strict investigation and monitoring. They serve as the basis for the analysis of the operational risk in various scenarios, including operational risk stress tests. The operational risk is measurable and controllable, while a registry of the operational events is maintained and used as basis for analysis and improvement of the bank's working processes and for minimizing the conditions, which could potentially lead to operational events and loss for the Bank. The necessary capital for operational risk is calculated by using the basis indicator approach pursuant to the applicable regulatory framework.

Recovery Plan (Directive 59/15.05.2014/EU)

BDB has developed a Recovery Plan of the BDB Group. Its latest update, approved by decision of the MB No. 67 of 26 October and decision of the SB No. 39 of 30 October 2018, was timely submitted to BNB. The Plan complies with the requirements laid down in the Law on the Recovery and Resolution of Credit Institutions and Investment Firms Guidelines on recovery plan indicators, and Technical advice on critical functions and core business lines of the European Banking Authority.

The Recovery Plan addresses the systemically important/critical functions of the BDB Group and sets out the recovery indicators – a system of indicators that Bank observes with the aim of early identification of potential situations which could jeopardise the financial performance of the institution. The prerequisites for the implementation of the recovery measures set out in the Recovery Plan are described. Scenarios and recovery options are considered which, in the event of activation of the Recovery Plan, can be taken, as well as the internal communication and decision-making process. A communication action plan has been elaborated in case of activation of the Recovery Plan.

The recovery plan is updated once a year and proposed for validation by the MB and SB of BDB. Furthermore, the Recovery Plan is updated in the event of a material change in the legal or organisational structure, activity or financial position of the Bank, or in the financial system in Bulgaria, which may have a significant impact on its effectiveness.

CONTROL ENVIRONMENT

Bulgarian Development Bank follows management philosophy and operating style, subject to the principles of conservatism when performing the strategic goals of the Bank set forth by the BDB Act.

The Bank applies the model of the three lines of defence within the risk management:

The first line of defence is the management control that the leaders of the operational units are exercising. The operational management identifies, evaluates, controls and mitigates risks, ensuring that they operate in accordance with the objectives set out in advance.

The second line of defence is the risk management and compliance function carried out by the Risk Management, Compliance and the Classified Information Departments with regard to the prevention of money laundering and terrorist financing. In their activities, these departments are supported by Management, Analysis and Regulation and Legal Departments. The second line of defence is independent from the first one in terms of organisation, and carries out preventive and ongoing control.

The third line of defence is the internal control function. Internal Audit of the Group Department carries out ex-post control and provides assurance to senior management with respect to the effectiveness of risk management, internal control and corporate governance, as well as the way in which the first and second lines achieve the risk management and control objectives. Internal Audit of the Group Department provides comprehensive assurance from the position of the highest level of independence in the organisation, through a direct subordination to the Supervisory Board (SB).

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

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

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

The Bank's audit committee monitors the financial reporting processes, the effectiveness of internal control systems and the effectiveness of risk management systems; moreover, it monitors the independent financial audit, conducts a review of the independence of the registered auditor, and makes recommendations for selecting a registered auditor.

BANK SUPERVISION AUTHORITIES PURSUANT TO THE BULGARIAN LEGISLATION

In compliance with the requirements of the framework of the laws and by-laws, regulating the banking activity in the country, BDB must follow limitations, related to certain ratios. As of 31 December 2018, the Bank has observed all regulatory requirements of BNB and the Bulgarian legislation.

The Bank's capital adequacy ratio on an individual basis as of 31 December 2018 was 35.96 % (31 December 2017: 55.30%). The coverage of assets with capital buffers exceeds by many times the statutory requirements. BDB continues to maintain a good liquidity level. The liquidity coverage ratio (according to the definition of Regulation 575 /2013/EU, LCR) of the Bank increased to 1,331% as of 31 December 2018 (compared to 301% at the end of 2017).

INTERNATIONAL COOPERATION

BDB continues to develop successful partnerships with leading European and international financial institutions, including through participating in renown 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 2018, 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 2018, BDB was the first President by rotation and took the host's role at the First International Meeting of the China-CEEC Interbank Association of China and the Central and Eastern European countries. In the framework of the meeting, at the beginning of July 2018, on a bilateral basis, BDB and the Chinese Development Bank (CDB) signed a financial cooperation agreement under the One Road, One Belt initiative. BDB is a co-founder of the China-CEEC Interbank Association of China and the Central and Eastern European countries.
- BDB is a shareholder of the European Investment Fund (EIF) 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 matters.

BANK GOVERNANCE

There were no charges in the main BDB corporate governance principles in 2018.

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

Supervisory Board (SB) of BDB:

Luchezar Borisov *– Chairman of the SB*

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

Mitko Simeonov *- Deputy Chairman of the SB*

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

Velina Burska - Member of the SB

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

Management Board of BDB:

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

Stoyan Mavrodiev holds a Master degree in Law from Sofia University "St. Kliment Ohridski" and a Master degree 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 PricewaterhouseCoopers. 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 of 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 over the period 2010 – 2017.

Until 06 March 2018, Ilia Vasilev Kirchev was also a member of the Management Board of BDB.

Bulgarian Development Bank AD is represented by either two of the Chief Executive Director, Executive Directors and the Procurator, jointly.

Contracts signed with related parties involved in the management and participation of the Bank's MB and SB members in other companies

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

In 2018, there were no concluded deals between BDB and its related parties, or offers for signing such deals, which fall outside the scope of the ordinary activity, or which significantly deviate from the market conditions, to which BDB or its subsidiary is a party.

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

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

A participation, pursuant to Art.247, Para.2, item 4 of the Commercial Act, of members of the SB and MB in commercial companies as general partners holding more than 25 per cent of the capital of another company, as well as their participation in the management of other business companies or cooperatives as procurators, managers or members of boards, is as follows (as of 31 December 2018):

With respect to members of the SB of the Bank:

- Luchezar Dimitrov Borisov – Chairman of the SB – he participates in the management of Energy Efficiency and Renewable Sources Fund, UIC: 131330278, member of the MB of the company
- Mitko Emilov Simeonov - he has no participations in the capital and management of other companies
- Velina Ilieva Burska - she has no participations in the capital and management of other companies
-

With respect to members of the Management Board (MB):

Stoyan Todorov Mavrodiev – Chief Executive Director, Chairman of the MB; he participates in the management of the following commercial companies:

- Capital Investments Fund AD, UIC: 205322014, a subsidiary of the Bank, as Chairman of the Board of Directors and Executive Director;
- NATIONAL GUARANTEE FUND EAD, UIC: 200321435, a subsidiary of the Bank, as Chairman of the Board of Directors;
- REAL ESTATE VENTURES EOOD, UIC: 131160908, a sole equity owner.

Rumen Dimitrov Mitrov - Executive Director, Vice Chairman of the MB, he participates in the management of the following commercial companies:

- Micro Financing Institution Jobs EAD, UIC: 201390740, a subsidiary of the Bank, as Vice Chairman of the Board of Directors;
- Capital Investments Fund AD, UIC: 205322014, a subsidiary of the Bank, as Vice Chairman of the Board of Directors;

Nikolay Dimitrov Dimitrov - Executive Director, member of the MB; he participates in the management of the following commercial companies:

- Micro Financing Institution Jobs EAD, UIC: 201390740, a subsidiary of the Bank, as a member of the Board of Directors;
- Capital Investments Fund AD, UIC: 205322014, a subsidiary of the Bank, as a member of the Board of Directors;

Remuneration to the MB and SB members

The amount of BGN 1,445 thousand was paid to persons managing the Bank in 2018.

Details about the full amount of the remuneration, rewards and/or benefits paid by the issuer and its subsidiaries to each one of the members of the management and control bodies for the reporting financial year are disclosed in Note 37 to the financial statements.

TRANSACTIONS WITH COMPANIES UNDER JOINT CONTROL OF THE STATE

The owner of BDB is the Bulgarian state. Transactions with related parties and companies under the common control with the state are disclosed in Note 38 to the separate financial statements of BDB for 2018.

EVENTS AFTER THE DATE OF THE FINANCIAL STATEMENTS

In pursuance of its strategy and designation of specific and new activities in separate companies, BDB incorporated two new subsidiaries – both with one single shareholder and 100 percent owned by the Bank - BDB Leasing EAD and BDB Factoring EAD,. The companies were incorporated by decision of the MB dated 06 March 2019.

In April 2019, Fitch Ratings Agency upgraded the outlook of the long-term credit rating of Bulgarian Development Bank from BBB Stable Outlook to BBB, Positive Outlook.

MANAGEMENT'S REPRESENTATIONS

Management of BDB declares that the enclosed annual separate financial statements give true and fair view of the property and financial position of the Bank at the end of 2018, and the determination of the financial result for the year in compliance with the applicable legislation. Suitable accounting policies have been used and applied consistently. In the preparation of the annual financial statements, judgments have been made, as necessary, in accordance with the prudence concept. Management applies consistently the applicable accounting standards and the annual financial statements have been prepared on a going concern basis.

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

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

The current Activity Report was approved on 12 June 2019 by MB of the Bulgarian Development Bank, and it was signed by:

EXECUTIVE DIRECTORS:

RUMEN MITROV **NIKOLAY DIMITROV**

BULGARIAN DEVELOPMENT BANK
BULGARIAN DEVELOPMENT BANK
SOFIA

APPENDIX 1: CORPORATE GOVERNANCE STATEMENT OF BDB GROUP

This Corporate Governance Statement has been prepared on the grounds of Article 40, paragraph 1 of the Accountancy Act. The information provided takes into account the fact that Bulgarian Development Bank AD has not issued securities admitted to trading on a regulated market or shares traded on a multilateral trading facility.

BDB Group

At the end of 2018, the Financial Group Bulgarian Development Bank (the „Group"[3] of the Financial Group) comprise Bulgarian Development Bank AD („BDB", the „Bank") and its subsidiaries – National Guarantee Fund EAD (NGF), Micro Financing Institution Jobs EAD (MFI Jobs) and Capital Investments Fund AD (CIF).

At the beginning of 2019, the Bank incorporated two new subsidiaries – BDB Leasing EAD and BDB Factoring EAD, which will become members of the Financial Group of BDB as well.

Being a financial institution established pursuant to a special act – the BDB Act („BDBA") - and at the same time, applying all regulatory requirements of BNB and the European legislation, and in performing its mission of being a sustainable instrument of the government policy for promoting the development of the small and medium-sized businesses in Bulgaria, Bulgarian Development Bank AD has set as its goal to be a benchmark for good corporate governance and corporate responsibility while consistently and strictly observing the National Corporate Governance Code of 2016, The Code of Professional Conduct of 2017 adopted by the bank, the Code of Ethics of the Internal Audit of the BDB Group of 2015, as well as good corporate and banking practices.

Bulgarian Development Bank AD holds a license for an investment intermediary according to which it may provide investment services and perform investment activities under Article 6, paragraph 2 of the Markets in Financial Instruments Act (MFIsA), as well as additional services under Art. 6, paragraph 3 of the MFIsA.

Bulgarian Development Bank AD holds a license for an investment intermediary according to which it may provide investment services and perform investment activities under Article 6, paragraph 2 of the Markets in Financial Instruments Act (MFIsA), as well as additional services under Art. 6, paragraph 3 of the MFIsA. Investment services are provided and investment activities are performed in accordance with the requirements of MFIsA, Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (Directive 2014/65/EU or MIFID II), Regulation (EU) 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (Regulation (EU) 600/2014), Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (Delegated Regulation (EU) 2017/565) and the acts on their implementation.

The Bank does not provide investments services, nor it performs investment activities under Article 6, paragraph 2, items 8 and 9 of the MFIsA – organisation of a multilateral trading facility and an organised trading facility.

[3]At the end of 2018, the Bank was a sole owner of the capital of TP Maritsa EOOD (TPM); however, the company was not a part of the strategic business model of the Financial Group of BDB.

Bulgarian Development Bank AD applies and maintains systems and producers that guarantee the security, completeness and confidentiality of its operations as an investment broker.

In view of the above, the Bank has adopted and updated its internal regulations in accordance with the applicable legislation.

Bulgarian Development Bank AD

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

On 23 April 2018, the Bulgarian Development Bank Act (BDBA) was adopted. It arranges the scope of activity of the Bank and its subsidiaries that may be established.

The seat of Bulgarian Development Bank AD is Sofia 1000, Sredets area, 1 Dyakon Ignatii St.

As of 31 December 2018, Bulgarian Development Bank AD had no branches.

The Bank has fulfilled the requirements of BNB of minimum statutory shareholding capital for exercising bank activity, as well as the capital requirements of BDBA. Since its establishment and until August 2017, the government shareholding in BDB is controlled by the Ministry of Finance of the Republic of Bulgaria. On 04 August 2017, by amendment of the BDB Act pursuant to SG, issue 63 of 2017, the government shareholding went under the control of the Minister of the Economy of the Republic of Bulgaria. As of the date of preparation of this Statement, the ownership of the capital is allocated as follows: 99.9999% is owned by the Republic of Bulgaria, represented by the Ministry of the Economy, 0.0001% is owned by DSK Bank.

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

The Bulgarian Development Bank Act sets forth that a package of at least 51% of the shares of the capital of the Bank shall be state owned, where the shares of the State in the amount of no less than 51% of the subscribed shareholding capital shall be non-transferable. Furthermore, a specific restriction was established regarding the composition of the remaining shareholders, other than the Bulgarian state. The shares of the Bank cannot be pledged, and the rights attached thereto cannot be subject to transfer agreements.

Regarding the acquisition of its own shares, pursuant to Arts. 187e and 247 of the Companies Act, BDB declares that such an acquisition has not taken place, as well as that there are no shares or bonds of the company acquired, held or assigned by the Board Members of the during the reported year.

Pursuant to Art. 6 Par. 4 of the BDB Act the shares in the capital of the Bank, besides the Bulgarian state, may be acquired and owned by the Council of Europe Development Bank, the European Investment Bank and the European Investment Fund, by development banks of Member States of European Union . In these cases art. 31 of the Credit Institutions Act does not apply.

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

The management of BDB is carried out in compliance with Art. 5 of the BDB Act, pursuant to which the Bank has a two-tier system of governance and the rights of the state during the General assembly of shareholders of the

Bank are exercised by the Minister of the Economy. Outside the powers of the Minister of the Economy, any amendment to the BDB Act and the right to issue or buy back shares are only possible by voting a new act or by amending the current act by the National Assembly. Under this article, only the Minister of the Economy, acting as representative of the majority shareholder in BDB, may decide to reduce the share capital through the redemption of shares.

At the end of 2018, BDB had not liabilities under existing or new issues of securities.

As of 31 December 2018, there is no pending court, administrative or arbitration proceeding related to liabilities or receivables of the BDB Group, amounting to 10 percent or more from its equity.

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

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

The Bank extends also other types of loans according to a procedure set by the Management Board, whereas the amount of the exposure to one customer or a group of related customers is subject to the requirements and limitations laid down in Regulation 575/2013/EU.

The Bank shall not lend funds to:

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

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

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

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

In view with its specific function related to carrying out state policy on promoting the business, BDB prioritizes its activity programs and products to promote SMEs, on-lending programs, export financing and financing under assigned mandates. The biggest credit exposure of the Bank, provided to a group of related parties /other than bank institutions/, amounts to BGN 150,129 thousand according at amortized cost (2017: BGN 69 259 thousand.), which represents 23.22% of the Bank's equity (2017: 10.88%) (the eligible capital of the Bank calculated in accordance with Regulation 575 /2013/EU as equal to BGN 646,679 thousand (2017: BGN 636,570 thousand)). Analysis of the structure of the credit portfolio by segments is provided in the individual financial statements.

Bearing in mind the specific activity of the Bank, as of 31 December 2018, the funds attracted from 20 largest non-bank depositors represent 95.26% of the total amount of liabilities to other clients (31 December 2017: 97.13%).

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

National Guarantee Fund EAD (NGF)

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

- Issuing guarantees for supplementing the collateral under loans to small and medium-sized enterprises;
- Offering other products to small and medium-sized enterprises, like: guarantee for participation in a tender; performance guarantee; advance payment guarantee; guarantee for payment of a loan of an exporter, etc;
- Issuing guarantees for supplementing collateral under loans to small and medium-sized enterprises, carrying out research and development and for implementing these products and scientific developments into the industry;
- The guarantees issued by NGF at its own risk may cover not more than 50 percent of the liability. By an amendment to the BDB Act, promulgated in the State Gazette, issue 102 of 21 December 2012, the guarantees issued by NGF EAD in connection with guarantee schemes under the Rural Development Programme for 2007 - 2013 and Development of the Fisheries Sector Operational Programme for 2007 - 2013 may cover up to 80 percent of the liability;
- Other activities, not particularly prohibited by law.

The registered capital of the company as of 31 December 2018 amounted to BGN 80,000,000 split into 800,000 shares with nominal amount of BGN 100 each, the shares are ordinary, materialised, registered and indivisible, and each share give the right to one vote. The company's capital is fully paid-in.

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

As of 31 December 2018, NGF had no branches.

Micro Financing Institution Jobs EAD (MFI Jobs)

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

The registered capital of MFI Jobs as of 31 December 2018 amounted to BGN 7,643,000 split into 76,430 shares with nominal amount of BGN 100 each, the shares are ordinary, materialised, registered and indivisible, and each share give the right to one vote. The company's capital is fully paid-in.

The seat and registered address of Micro Financing Institution Jobs EAD is Sofia, 1 Dyakon Ignatii St.

As of 31 December 2018, MFI JOBS had no registered branches.

Capital Investments Fund AD (CIF AD)

Capital Investments Fund EAD (CIF) was incorporated on 24 August 2018 and registered on 04 October 2018 as a joint-stock company with 100 percent of ultimate participation of BDB (84.62% of direct participation of BDB, or 550,000 shares, and indirect participation through NGF – 15.38%, the owner of the remaining 100,000 shares). The registered address of MFI is at 1 Dyakon Ignatii St., Sofia. The registered capital of as of 31 December 2018 consisted of 650,000 registered shares with nominal amount of BGN 100, including paid-in capital as of 31 December 2018 of BGN 16,250,000.

The object of activity of CIF includes:

- Participation in the capital of small and medium-sized enterprises;
- Provision of consulting services regarding the capital structure of small and medium-sized enterprises; advice and services on incorporation of entities under Article 261 of the Commercial Act;
- Investment consultancy;
- Consulting services on the management of pools of securities of small and medium-sized enterprises;
- Other activities, not particularly prohibited by law.

As of 31 December 2018, CIF had no registered branches and did not carry out operating activities.

Risk management within the Group of BDB

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

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

Credit risk of the BDB Group

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

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

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

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

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

In 2018, the subsidiary of the Bank – Capital Investments Fund AD, was not operational.

Market risks to which BDB Group is exposed

In managing the currency risk, BDB and the Group follow the principle of maintaining minimum open FX positions through the observing of established limits. The positions in various currencies, as well as the general FX position, are monitored on a daily basis. The FX positions are not formed for speculative purposes, but are the consequence of the currency transactions, occurring in the course of the ordinary bank activity. In managing its assets and liabilities, due to the specifics of its financing, BDB seeks to maintain these assets and liabilities in EUR or BGN. The Bank's open FX position takes into account the terms and possibilities for netting the EUR and BGN positions in accordance with the applicable regulatory framework.

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

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

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

<u>*Operational risk to which BDB Group is exposed*</u>

The operational risk is managed by strictly monitoring and registering all operational events occurring in the activity of the various units as a result of the processes within the Group. Operational events, which are more frequent, and the ones having great potential or real impact on the financial result of BDB and the Group companies, are subject to strict investigation and monitoring. They serve as the basis for the analysis of the operational risk in various scenarios, including operational risk stress tests. The operational risk is measurable and controllable, while a registry of the operational events is maintained and used as basis for analysis and improvement of the bank's working processes and for minimizing the conditions, which could potentially lead to operational events and loss for the Group. The necessary capital for operational risk is calculated by using the basis indicator approach pursuant to the applicable regulatory framework.

Structure of risk management

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

- ***For the Parent Company (the Bank):***

  - Supervisory Board – performs overall supervision on risk management;
  - Audit committee to the Supervisory Board – implements best practices of independent audit control and the establishment of system of the three pillars for control in the financial sectors according to the recommendations from Basel III;
  - Internal audit – provides assurance to the Bank's top management on risk management effectiveness, internal control and management;
  - Management Board – it is responsible for overall risk management approach and for approval of risk strategies, principles and the specific methods, techniques and procedures;
  - Risk Committee – it is responsible for the control on the implementation of the management policies of various types of risk and the adequacy of the risk profile of the Bank to the assigned tasks to it;
  - Committee of Assets and Liabilities Management (ALCO) – it is responsible for the strategic management of the assets and liabilities, and for the management of the market risks, incl. liquidity risk, related to assets and liabilities;
  - Committee on Remunerations and Committee on Recruitment– responsible for the management of activities in the field of human resources.
  - Executive Directors and Members of the MB – exercise current operating control on maintaining and observing the specified limits for the particular types of risk and the application of the established procedures;
  - Risk Management Department – develops and implements the risk management system. The Department prepares and submits periodic reports to the Board of Directors in order to evaluate the risks in the business activity, incl. the keeping within the limits, and it regularly reports to the operational management of the Company. It performs initial and ongoing inspection of the risk assessment methods. It controls the input data necessary for evaluating the risk according to an applicable method of reliability and sufficiency.
  - Compliance Department – monitors and ensures compliance with policies, processes and procedures within the Bank. The Department reports to the MB, on a regular basis, on all compliance matters – establishment and taking measures for remedy of any inconsistencies that might have been found;
  - Planning, Analysis and Regulations Department –submits reports to the MB and BNB, reports on key indicators, business plans and their performance, and identifies any risks at operational,

business, reporting and strategic level, and interacts with the other units of the Bank for the purpose of their management;

- 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 particular risks.

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For the subsidiary National Guarantee Fund (the Fund):

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

- Management Board of BDB AD (the parent company) – performs overall supervision on risk management;
- Board of Directors – carries out overall risk management supervision; responsible for overall risk management approach and for approval of risk management strategies, principles and the specific methods, techniques and procedures;
- Committee on Provisions – analyses the guaranteed portfolios in terms of overall credit risk management for the total guaranteed portfolio, as well as of each guarantee deal and beneficiary of the guarantee itself.
- Risk and Monitoring Department – performs general monitoring with respect to the guaranteed portfolios by carrying out inspections (current and after a claim for payment has been filed) of the commercial banks regarding the fulfilment of the terms and conditions of their guarantee agreements at the level of both the separate client and individual portfolio. The Department also identifies, assesses, monitors and applies measures for limiting the impact of the major risks.

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

The main units directly responsible for risk management are:

- Board of Directors – adopts rules and procedures for risk management. Controls risk factors for the activity of the Company and adopts resolutions within its powers. It also analyses the credit transactions amounting to above BGN 100,000 in terms credit risk management;
- Credit Committee – it continuously monitors and analyses the credit and lease portfolio of the Company from the point of view of the credit risk, incl. on the level of individual transaction;
- Credit Council – analyses the credit and lease deals from the point of view of credit risk management during their authorization and/or renegotiation;
- Operational management (Executive Director and Procurator) – organizes the activities for implementation of the Rules on Risk Management adopted by the Board of Directors. Creates a work organization, which ensures the observation of the specified limits and levels of risk. Exercises control over the compliance of the analysis, risk estimation and evaluation

procedures used by the relevant employees with the internal legislative documents adopted by the Board of Directors;

- Risk Management Department – develops and implements the risk management system. Prepares and submits periodic reports to the Board of Directors in order to evaluate the risks in the business activity, incl. the keeping within the limits, and it regularly reports to the operational management of the Company. It performs initial and ongoing inspection of the risk assessment methods. It controls the input data necessary for evaluating the risk according to an applicable method of reliability and sufficiency.

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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 in its separate and consolidated financial statements. As of 31 December 2018, BDB has observed all regulatory requirements of BNB and the Bulgarian legislation. The amounts of key ratios – capital adequacy and asset coverage ratio – are among the highest within the Bulgarian banking system.

Control environment

BDB follows a management philosophy and operating style subordinate to the principles of conservatism when performing the strategic goals of the Bank assigned pursuant to the BDB Act.

The Bank applies the model of the three lines of defence within the risk management:

The first line of defence is the management control that the leaders of the operational units are exercising. The operational management identifies, evaluates, controls and mitigates risks, ensuring that they operate in accordance with the objectives set out in advance.

The second line of defence is the risk management and compliance function carried out by the Risk Management, Compliance and the Classified Information Departments with regard to the prevention of money laundering and terrorist financing. In their activities, these departments are supported by Management, Analysis and Regulation and Legal Departments. The second line of defence is independent from the first one in terms of organisation, and carries out preventive and ongoing control.

The third line of defence is the internal control function. Internal Audit of the Group Department carries out ex-post control and provides assurance to senior management with respect to the effectiveness of risk management, internal control and corporate governance, as well as the way in which the first and second lines achieve the risk management and control objectives. Internal Audit of the Group Department provides comprehensive assurance from the position of the highest level of independence in the organisation, through a direct subordination to the Supervisory Board (SB).

Management assigns powers and responsibilities for the operating activity in line with a detailed internal normative set of documents, which are in conformity with the current national and European legislations, where in order to guarantee the relationships in accountancy and reporting, and various specialized committees, by hierarchy of authorities, were formed to the MB and SB of BDB.

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

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

The Bank's audit committee monitors the financial reporting processes, the effectiveness of internal control systems and the effectiveness of risk management systems; moreover, it monitors the independent financial audit, conducts a review of the independence of the registered auditor, and makes recommendations for selecting a registered auditor.

Corporate governance of Bulgarian Development Bank

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

As of 31 December 2018, the structure of the management bodies has the following components:

Supervisory Board of BDB:

***Luchezar Borisov** – Chairman of the SB*

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

***Mitko Simeonov** - Deputy Chairman of the SB*

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

***Velina Burska** - Member of the SB*

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

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

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

Audit Committee:

***Mrs Svetla Lambreva** – Chair of the Audit Committee*

***Mrs Rositsa Grigorova** – Member of the Audit Committee;*

***Mrs Kalina Mavrova** – Member of the Audit Committee.*

Management Board of BDB:

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

Stoyan Mavrodiev holds a Master degree in Law from Sofia University "St. Kliment Ohridski" and a Master degree 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 PriceWaterhouseCoopers. 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 of 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 over the period 2010 – 2017.

Until 06 March 2018, Ilia Vasilev Kirchev was also a member of the Management Board of BDB.

Bulgarian Development Bank AD is represented by either two of the Chief Executive Directors, Executive Directors and the Procurator, jointly.

There were no charges in the main corporate governance principles of the BDB Group in 2018.

Committees of the Management Board

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

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

	Committee on Assets and Liabilities Management (ALCO)	**Commission on Complaints and Signals***
Stoyan Mavrodiev	Member	
Rumen Mitrov	Member	
Nikolay Dimitrov	Chairman	
Head of Risk Department	Member	Member
Head of Legal Department		Member
Head of Security Department		Member
Head of the Planning, Analysis and Regulations Department	Member	Member
Head of the Group Internal Audit Department		Member
Deputy Head of Treasury Department	Member	
Head of the Compliance Department		Chairman
Head of the International Financial Institutions and EU Funds Department	Member	

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

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

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

In 2018, there were no concluded deals between BDB and its related parties, or offers for signing such deals, which fall outside the scope of the ordinary activity, or which significantly deviate from the market conditions, to which BDB or its subsidiary is a party.

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

There is no practice of concluding agreements among the BDB Group companies and their management bodies and/or employees for the payment of compensation upon resignation or dismissal without legal grounds thereof, or upon terminating the legal employment relationships by reasons related to tender offers.

The participations, pursuant to Art.247, Para.2, item 4 of the Companies Act, of members of the SB and MB in commercial companies as general partners holding more than 25 per cent of the capital of another company, as well as their participation in the management of other business companies or cooperatives as procurators, managers or members of boards, is as follows (as of 31 December 2018):

With respect to members of the SB of the Bank:

- Luchezar Dimitrov Borisov – Chairman of the SB – he participates in the management of Energy Efficiency and Renewable Sources Fund, UIC: 131330278, member of the MB of the company
- Mitko Emilov Simeonov - he has no participations in the capital and management of other companies
- Velina Ilieva Burska - she has no participations in the capital and management of other companies
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With respect to members of the Management Board (MB):

Stoyan Todorov Mavrodiev – Chief Executive Director, Chairman of the MB; he participates in the management of the following commercial companies:

- Capital Investments Fund AD, UIC: 205322014, a subsidiary of the Bank, as Chairman of the Board of Directors and Executive Director;
- NATIONAL GUARANTEE FUND EAD, UIC: 200321435, a subsidiary of the Bank, as Chairman of the Board of Directors;
- REAL ESTATE VENTURES EOOD, UIC: 131160908, a sole equity owner.

Rumen Dimitrov Mitrov - Executive Director, Vice Chairman of the MB, he participates in the management of the following commercial companies:

- Micro Financing Institution Jobs EAD, UIC 201390740, a subsidiary of the Bank, as Vice Chairman of the Board of Directors;
- Capital Investments Fund AD, UIC: 205322014, a subsidiary of the Bank, as Vice Chairman of the Board of Directors;

Nikolay Dimitrov Dimitrov - Executive Director, member of the MB; he participates in the management of the following commercial companies:

- Micro Financing Institution Jobs EAD, UIC 201390740, a subsidiary of the Bank, as a member of the Board of Directors;
- Capital Investments Fund AD, UIC: 205322014, a subsidiary of the Bank, as a member of the Board of Directors;

Information about the full amount of the compensations, rewards and/or benefits for the members of the Management and control bodies for the fiscal accounting year, paid by the issuer and its subsidiaries is disclosed in the notes to the financial statements.

Management of the subsidiaries

As of 31 December 2018, BDB is the equity owner of the following subsidiaries:

- The sole owner of:
    - National Guarantee Fund EAD, UIC: 200321435;
    - Micro Financing Institution Jobs EAD, UIC: 201390740;
    - Trade Centre Maritsa EOOD, UIC: 115619162
- Co-owner jointly with NGF of Capital Investments Fund AD, UIC: 205322014, with the following distribution of the subscribed (84.62% for BDB and the remaining 15.38% for NGF).

National Guarantee Fund

NGF EAD has a one-tier management system – Board of Directors, comprising three members. As of 31 December 2018, the composition of BD was as follows:

Board of Directors of the company:

***Stoyan Mavrodiev** – Chairman of the Board of Directors*

***Angel Djalazov** – Vice Chairman of the Board of Directors and Executive Director*

Angel Djalazov has over 15 years of experience in international investment banking, asset management, capital markets, project finance, investment products, supervision and financial instruments management. He has occupied consequently the positions of an investment manager of TBD Fund, Director of Legal Department at JD & MG, Executive Director and Chairman of the Board of Directors of the Managing company KD Investments and the investment company KD Pelican, Executive Director of Capital Dynamics-Bulgaria and Euro-Phoenix Financial Advisors, and Vice Chairman of FSC. He has knowledge of English, German, Russian and Dutch language.

***Andon Georgiev Georgiev** – Member of the Board of Directors and Procurator*

In the calendar year 2018, part of management were also:

- Samuil Pavlov Shiderov – until 07 February 2018
- Alexander Angelov Georgiev – until 06 June 2018.

The company is represented by either two of the members of the Board of Directors, jointly, or by the Procurator and either one of the members of the Board of Directors, jointly.

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

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

The participations, pursuant to Art.247, Para.2, item 4 of the Companies Act, of members of the SB and MB in commercial companies as general partners holding more than 25 per cent of the capital of another company, as well as their participation in the management of other business companies or cooperatives as procurators, managers or members of boards, is as follows (as of 31 December 2018) :

Stoyan Todorov Mavrodiev – Chairman of the BD of NGF; he participates in the management of the following commercial companies:

- Chief Executive Director and Chairman of the MB of Bulgarian Development Bank AD, UIC 121856059
- Executive Director and Chairman of the Board of Directors Capital Investments Fund AD, UIC: 205322014, a subsidiary of the Bank;
- sole equity owner of REAL ESTATE VENTURES EOOD, UIC: 131160908.

Angel Atanasov Djalazov – Vice Chairman of BD and Executive Director of NG; he participates in the following commercial companies:

- Micro Financing Institution Jobs , UIC: 201390740, member of BD and Executive Director;
- BG LIFE OOD, UIC: 175273067 – a partner holding a 25% share

Andon Georgiev Georgiev has no participation in the management or capital of other commercial companies.

Micro Financing Institution Jobs (MFI) EAD

MFI Jobs EAD also has a one-tier management system - Board of Directors (BD), which comprises from three to five members. The composition of BD at the end of 2018 was as follows:

Board of Directors:

Rumen Mitrov *- Chairman of the Board of Directors*

Nikolay Dimitrov *– Vice Chairman of the Board of Directors*

Angel Djalazov *- Member of the Board of Directors and Executive Director*

Hristina Todorova *– Member of the Board of Directors and Procurator*

Hristina Todorova holds a Master degree in Law from the University of National and World Economy. She has long-standing experience in the financial sector. She participated in the elaboration of many draft laws, practices and administrative procedures in the area of non-banking sector. For 10 years she has worked in the Financial Supervision

Commission (FSC) at various expert and managerial positions. She occupied the positions of Head of the Judicial Protection Department and Director of the Legal Department of FSC. As Director of the Legal Directorate, Hristina Todorova leads both the activities of creating and developing the legal framework in the non-banking financial sector, the procedural representation of the FSC and its bodies, and the protection of the interests of financial service users. In 2016, Hristina Todorova was elected Chair of the newly established Sectoral Conciliation Commission on Consumer Disputes Hearing and Settlement in the area of insurance and insurance intermediation at the Commission for Consumer Protection, including upon provision of remote financial services to this sector. In 2017, Hristina Todorova was Director of the Legal Department at the Ministry of Health.

In the calendar year 2018, part of management was also:

Kostadin Bozhikov Munev - until 07 February 2018.

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

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

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

Rumen Mitrov – Chairman of the Board of Directors; he participates in the management of:

- Bulgarian Development Bank AD, UIC: 121856059, as Vice Chairman of the MB and Executive Director;
- Capital Investments Fund AD, UIC: 205322014, a subsidiary of the Bank, as Vice Chairman of the Board of Directors.

Nikolay Dimitrov – Vice Chairman of the Board of Directors; he participates in the management of:

- Bulgarian Development Bank AD, UIC: 121856059, member of the MB and Executive Director;
- Capital Investments Fund AD, UIC: 205322014, a subsidiary of the Bank, as a member of the Board of Directors

Angel Djalazov – Member of Board of Directors and Executive Director of the company; he participates in the management of:

- National Guarantee Fund, UIC: 200321435, Vice Chairman of the Board of Directors of the company and Executive Director.
- BG LIFE OOD, UIC: 175273067, a partner holding a 25% shareholding.

Hristina Todorova – member of the Board of Directors and Procurator; she does not participate in the management or capital of other commercial companies.

BDB holds a share of 84.62% of the capital of Capital Investments Fund AD, UIC: 205322014, with the remaining 15.38 % of the capital of the company being subscribed by National Guarantee Fund AD.

Capital Investments Fund (CIF) AD

CIF AD has a one-tier management system – Board of Directors, comprising three members. At the end of 2018, the composition of BD was as follows:

Board of Directors:

Stoyan Mavrodiev – *Chairman of the Board of Directors and Executive Director*

Rumen Mitrov – *Vice Chairman of the Board of Directors*

Nikolay Dimitrov – *Member of the Board of Directors*

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

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

The participations, pursuant to Art.247, Para.2, item 4 of the Companies Act, of members of the BD of Capital Investments Fund AD in commercial companies as general partners holding more than 25 per cent of the capital of another company, as well as their participation in the management of other business companies or cooperatives as procurators, managers or members of boards, is as follows (as of 31 December 2018) :

Stoyan Mavrodiev – Chairman of the Board of Directors and Executive Director of the company; he participates in the management of the following companies:

- Bulgarian Development Bank AD, UIC: 121856059, Chairman of the MB and Chief Executive Director;
- National Guarantee Fund, EAD, UIC: 200321435, a subsidiary of the Bank, as Chairman of the Board of Directors;
- REAL ESTATE VENTURES EOOD, UIC: 131160908 – a sole equity owner;

Rumen Mitrov – Vice Chairman of the Board of Directors, ; he participates in the management of:

- Bulgarian Development Bank AD, UIC: 121856059, as Vice Chairman of the MB and Executive Director;
- Micro Financing Institution Jobs EAD, UIC: 201390740, a subsidiary of the Bank, Chairman of the Board of Directors.

Nikolay Dimitrov – Member of Board of Directors of the company, he participates in the management of:

- Bulgarian Development Bank AD, as a member of the MB and Executive Director;
- Micro Financing Institution Jobs EAD, UIC: 201390740, a subsidiary of the Bank, as a member of Board of Directors.

In 2018, there were no material contracts concluded, which lead to action, are amended, or terminated, due to change in the control or as a result of performing a compulsory public procurement procedure, and no such contracts are expected to be concluded.

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Transactions with companies under the joint control of the State

Owner of BDB is the Bulgarian state. The consolidated and separate financial statements of the Bank present detailed information regarding the deals of the BDB Group and of BDB with companies under the joint control of the state.

STRATEGY FOR DEVELOPMENT AND BUSINESS GOALS

The strategic goals of BDB are:

- To facilitate the economic growth by increasing its exposure in support of regions and sectors of the economy with suppressed growth;
- To facilitate the economic growth of the regions through financing, including syndicated, of sizable, strategic and infrastructural, by their nature, projects and investments;
- To support the development of competitive production initiatives and sectors of the economy of proven export potential;
- To facilitate, jointly with the other institutions in the country, the access to financing of innovative and newly established companies (start-ups);
- To facilitate and support the direction of capital flows to the Bulgarian economy.

The BDB Group operates in full transparency and applies the best banking and management practices. A core objective of the Group is to identify and analyse sectors of the economy, in which there are market imperfections and that experience difficulties in accessing and obtaining financing, and to take measures to facilitate their access to funds. The Group supports the export potential and business competitiveness by compensating existing market deficiencies in the financing of certain segments, thereby changing their risk profile and encouraging commercial banks to develop their exposure to them.

These tasks the Bank's Group accomplishes by "completing" the market, while not allowing a "displacing" of commercial banks, and its goal is not to maximize profits.

The Bank adequately assesses the risks assumed and provides credit and warranty lines which, to the maximum extent, allow it to transfer an advantage to customers.

For the effective implementation of the above objectives and tasks, the BDB Group relies on its status as a development bank and the opportunities to attract a long-term and cheap resource, including from international markets.

In future, the BDB Group will continue to offer financing for working capital, capital investments and export finance for small and medium-sized businesses. The Group offers flexible and market-based financial solutions that meet the specificity of the borrower and the project being funded.

SOCIAL RESPONSIBILITY AND POLICY OF DIVERSITY

In 2018, Bulgarian Development Bank continues developing corporate social responsibility by concentrating its efforts most of all towards areas "Vulnerable social groups, "Culture and Art" and "Science and Education".

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

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

Vulnerable social groups

Among the initiatives in support of vulnerable social groups the Bank distinguishes the partnership of Bulgarian Development Bank with **Bulgarian Red Cross** in their *The Easter for Everyone National Charity* in support of elderly people, which is held under the auspices of the Ombudsman of the Republic of Bulgaria. The initiative includes provision of financial support to pensioners just before the holidays and is deemed to be very successful as there is a deficit of charity campaigns directed towards this part of the society.

In 2018, the BDB Group also established cooperation with **UNICEF Bulgaria** for the implementation of a pilot project on patrol care in the districts of Sliven and Shumen. It includes free medical examinations, consultations and practical guidelines for pregnant women and young mothers, with the main aim of preventing problems in early childhood development, neglecting and violence in the family. The Ministry of Health is about to introduce home-based care throughout Bulgaria using the experience of the pilot centres for maternal and child health, and UNICEF will support the process closely through providing technical and expert assistance and training.

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

Among the causes supported by BDB is the support for disadvantaged children or children at risk. In 2018, the Bank supported the **SOS Children's Villages** association in the establishment of a community of foster families and in conducting a summer charity campaign aimed at children and young people deprived of parental care placed in foster families or protected housing. The purpose of the initiative is to organise excursions and summer camps for children at risk, as well as joint activities for children and parents supported by SOS - Centres in Sofia, Pernik, Veliko Tarnovo and Gabrovo. The main task of the campaign is to help children adapt to the new environment and their integration, as well as to conduct targeted individual work with psychologists for deficits and injuries, while at the same time young people are creating positive emotions and experiences.

Traditionally, the **Bulgarian Christmas** is part of the corporate social responsibility of BDB. In 2018, the Bank continued its support to the charity initiative.

Culture and art

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

Among the BDB's campaigns in this direction in 2018, it could be distinguished the initiative with **a focus on cultural heritage "How Sofia has become a European city"** dedicated to the first city architect of the capital, Antonin Collar. It included an exhibition at the Sofia History Museum (September – October 2018), where there were collected all plans, buildings and public spaces, drawn up by the talented Czech, who 140 years ago committed to the mission to turn the post-Liberation Sofia into a modern European city, as well as the presentation of a documentary on life and work of architect Collar.

The Bank's Group has continued its efforts to support the preservation of cultural heritage by supporting **a scientific conference** organised by the Sofia History Museum, with the participation of well-established Bulgarian scientists – historians, archaeologists, architects, restaurateurs, whose activity is linked to the preservation of the rich cultural and historical heritage of Sofia and the region.

In this vein, BDB supports also the **International Easter Festival** in the town of Bossilegrad where every year, children from Bulgarian communities both in the country and from Bulgarian diasporas in Serbia, Macedonia, Ukraine, Moldova, and other, take part. Among the goals of the event is the preservation of the customs and traditions in the region.

Bulgarian Development Bank supported the most prestigious classical music ranking in Bulgaria **Musician of the Year 2018**, organised by the Bulgarian National Radio. Prize-winners are renown Bulgarian performers, such as Mincho Minchev, Gena Dimitrova, Rayna Kabaivanska, Krasimira Stoyanova, Vesko Panteleev-Eshkenazi, Yordan Kamdzhalov, Emil Tabakov, Teodosii Spasov. etc. A special prize of BDB – a poster and financial premium for young musicians was established.

In pursuance of its policy to support Bulgarian art, the BDB building is traditionally a host of **temporary exhibitions of paintings and sculptures** of both young and well-established Bulgarian artists.

Education

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

Traditionally, BDB Group supports the largest start-up training program in Bulgaria - The Founder Institute-Sofia. The initiative focuses on young entrepreneurs who learn how to develop their ideas into real profitable businesses. In the training process, the most impressive projects reach the successful finals and are formally presented to investors, entrepreneurs and mentors.

In 2018, BDB also helped to implement **the annual study of the Bulgarian digital economy**, which is being prepared by the MOZE.BG Foundation. It aims to map innovative digital start-ups and to explore their history, current and targeted markets, specificities in recruitment, methods of financing, etc. The study covered over 350 companies that meet the criteria for modern digital business and the results provide information on the demography of the Bulgarian digital business and guidelines for the successful development of micro- and small-sized enterprises and start-ups in the sector.

Equal access to education is among the missions that BDB has embedded into its Corporate Social Responsibility Policy. In this respect, in 2018, in cooperation with Vivacom, Bulgarian Development Bank equipped **a computer room at the Center for Family-Type Accommodation** in Gavril Genovo village, where children from 7 to 18 years of age deprived of parental care live. Computer stations Internet, as well as an educational course on initial computer literacy are provided to young people.

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

EXECUTIVE DIRECTORS:

RUMEN MITROV **NIKOLAY DIMITROV**

BULGARIAN DEVELOPMENT BANK BULGARIAN DEVELOPMENT BANK SOFIA

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Independent auditors' report

To the shareholders of Bulgarian Development Bank AD

Report on the Audit of the Separate Financial Statements

Opinion

We have audited the accompanying separate financial statements of Bulgarian Development Bank AD (the Bank), which comprise the separate statement of financial position as at 31 December 2018, and the separate statement of comprehensive income, separate statement of changes in equity and separate statement of cash flows for the year then ended, and notes to the separate financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying separate financial statements give a true and fair view of the financial position of the Bank as at 31 December 2018, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU).

Basis for Opinion

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

Key Audit Matters

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

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

Key audit matter	How our audit addressed the key audit matter
Impairment of loans and advances to customers and related impact from adoption of IFRS 9 "Financial instruments" The Bank's disclosures about impairment of loans and advances to customers are included in Note 18 "Loans and advances to customers" and Note 4.1 "Credit risk" with information on the related impact from the adoption of IFRS 9 "Financial instruments" presented and disclosed in Note 2.1 "Changes in accounting policies and disclosures".	
Loans and advances to customers represent a significant part (34%) from the total assets of the Bank as at 31 December 2018 with aggregate gross value of BGN 1,197,889 thousand and accumulated loss allowance of BGN 158,809 thousand. The credit risk concentration of the loan and advances portfolio (excluding bank institutions) is disclosed in Note 4.1 "Credit risk". As a result of the adoption of IFRS 9 "Financial instruments", effective 1 January 2018 the Bank has implemented a new impairment model based on expected credit loss (ECL) estimation. The reported impact on the opening balance of equity as of 1 January 2018 is BGN 11,286 thousand of additional impairment loss, as disclosed in Note 2.1 "Changes in accounting policies and disclosures".	In this area, our audit procedures included, amongst others: • We gained understanding of the IFRS 9 implementation process of the Bank focusing on the ECL impact assessment at the date of initial application, the adopted methodology in the new impairment model and key changes in assumptions and judgements applied. • We evaluated whether the new Bank's impairment policy and estimation approaches are in line with the requirements of IFRS 9 and whether the adoption of the Standard is accounted for in accordance with the relevant transitional provisions. • We assessed the Bank's governance over the impairment model developed, including the model documentation and

The application of the new impairment model has led to increased complexity and degree of management judgment in the ECL estimations as disclosed in Note 4.1 "Credit risk". The key inputs in the model relate to developing significant increase of credit risk (SICR) criteria for staging of loans and advances to customers (Stage 1: Exposures with no SICR, Stage 2: Exposures with SICR but no objective evidence for impairment and Stage 3: Exposures with objective evidence for impairment), determining the probability of default (PD), the loss given default (LGD) and the exposure at default (EAD), applying also forward looking information (FLI) of macro-economic factors considering multiple scenarios in ECLs estimations. The higher degree of estimation uncertainty and management judgement is inherent to the estimation of ECLs for the portfolios of loans and advances to customers in Stage 1 and Stage 2 as it is linked to the internal historical data availability for back testing and calibrating the PD and LGD estimates. Further to this, significant management judgement is also required in calculating the ECLs for Stage 3 loans and advances due to inherent estimation uncertainty in determining the timing and amount of the expected cash flows, including the value of the respective collaterals. Due to the significance of the loans and advances to customers and the credit risk concentration, as well as the high estimation uncertainty, complexity and management judgement involved in ECL calculations under the new impairment model implemented as a	the reasonableness and frequency of overlays applied. • We obtained understanding and performed walk-throughs of the Bank's processes and controls related to monitoring and evaluating for impairment of loans and advances to customers focusing on any changes as a result of the adoption and post implementation of IFRS 9. We involved our internal IT specialists to assess and test the IT general controls over these processes. • We designed and performed tests of the operating effectiveness of the controls over the new impairment model underlying the process for evaluating for impairment of loans and advances to customers and ECL estimation. • We assessed the new impairment model applied as at both the date of initial application and the reporting date in view of IFRS 9 requirements, the specifics of Bank's loan portfolio and the availability of internal historical and forward-looking information. We evaluated the reasonability of SICR criteria and proper staging of loans and advances to customers for a risk-based sample. Further, we accessed for reasonableness the PD and LGD calculations by examining support for the key assumption used and data sources. • We also analysed whether the forward looking information have been correlated and considered in the impairment model. In addition, we tested the mathematical accuracy of the ECL calculations. • We performed analytical procedures on a disaggregated data to evaluate if the relationship in the trends in the recorded impairment expense follow the tendencies of development of the loan portfolios. • For a risk-based sample of loans and advances to customers from stage 3

result of IFRS 9 adoption, this is considered a key audit matter.	and focusing on those with the most significant potential impact on the separate financial statements, we specifically assessed the Bank's assumptions on the expected future cash flows, including the realizable value of collateral based on our own understanding and available market information. We involved internal experts to assist us in assessing the value of realizable collateral on a sample basis. • We performed subsequent events procedures focused on the development of the sampled loans as per the previous paragraph, post balance sheet date to assess the Bank's assumptions on the expected future cash flows. • We assessed the relevance and adequacy of the disclosures for the impairment of loans and advances to customers and related impact from adoption of IFRS 9.

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

Management is responsible for the other information. The other information, which we have obtained prior the date of our auditor's report, comprises the management report, including the corporate governance statement prepared by management in accordance with Chapter Seven of the Accountancy Act, but does not include the separate financial statements and our auditor's report thereon.

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

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

We have nothing to report in this regard.

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Responsibilities of Management and Those Charged with Governance for the Separate Financial Statements

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

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

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

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

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

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

- Identify and assess the risks of material misstatement of the separate financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the separate financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the separate financial statements, including the disclosures, and whether the separate financial statements represent the underlying transactions and events in a manner that achieves true and fair presentation.

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

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

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

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

Report on Other Legal and Regulatory Requirements

Additional Matters to be Reported under the Accountancy Act

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

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

Based on the procedures performed, our opinion is that:

a) The information included in the management report referring to the financial year for which the separate financial statements have been prepared is consistent with those separate financial statements.
b) The management report has been prepared in accordance with the requirements of Chapter Seven of the Accountancy Act.
c) The corporate governance statement referring to the financial year for which the separate financial statements have been prepared presents the information required under Chapter Seven of the Accountancy Act and Art. 100 (m), paragraph 8 of the Public Offering of Securities Act.

Reporting in accordance with Ordinance №38/2007 and №58/2018 of Financial Supervision Commission

Statement in accordance with article 33 of Ordinance №38/2007 of Financial Supervision Commission (FSC) on the requirements to the activities of the investment intermediaries and article 11 of Ordinance №58/2018 of FSC on the requirements for protection of the financial instruments and cash funds of clients, for management of goods and for providing or receipt of remuneration, commissions, other cash and non-cash benefits

On the basis of the performed audit procedures and the obtained understanding for the activity of the Bank and during the performance of our audit of the separate financial statements of the Bank, the created and applied organization in relation with the fiduciary assets is in accordance of the requirements of article 28-31 of Ordinance №38 and of article 3-10 of Ordinance №58 of FSC on the activity of the Bank in its role as investment intermediary.

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 Nexia OOD were appointed as statutory auditors of the separate financial statements of Bulgarian Development Bank AD (the Bank) for the year ended 31 December 2018 by the general meeting of shareholders held on 16 August 2018 for a period of one year.
- The audit of the separate financial statements of the Bank for the year ended 31 December 2018 represents fourth total uninterrupted statutory audit engagement for that entity carried out by Ernst & Young Audit OOD and second total uninterrupted statutory audit engagement for that entity carried by Zaharinova Nexia OOD.
- We hereby confirm that the audit opinion expressed by us is consistent with the additional report, provided to Bank's audit committee, in compliance with the requirements of Art. 60 of the Independent Financial Audit Act.
- We hereby confirm that we have not provided the prohibited non-audit services referred to in Art. 64 of the Independent Financial Audit Act.
- We hereby confirm that in conducting the audit we have remained independent of the Bank.

Audit Firm Ernst & Young Audit OOD:

Milka Natcheva-Ivanova

Legal Representative and

Registered Auditor in charge of the audit

Audit Firm Zaharinova Nexia OOD:

Dimitrina Zaharinova

Legal Representative and

Registered Auditor ~~in charge of~~ the audit

ОДИТОРСКО ДРУЖЕСТВО
София
Рег. № 138
ЗАХАРИНОВА НЕКСИА ООД

Sofia, Bulgaria

1 July 2019

BULGARIAN DEVELOPMENT BANK
SEPARATE STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2018
All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

	Note	As at 31.12.2018	As at 31.12.2017
Assets			
Cash in hand and balances in current account with the Central Bank	16	297,622	447,648
Receivables from banks	17	429,548	198,379
Financial assets at fair value through other comprehensive income	21A	594,249	-
Available-for-sale securities	21B	-	230,903
Loans and advances to customers	18	1,039,080	699,680
Assets held for sale	25	4,840	9,924
Current tax receivables	26	1,244	1,596
Securities held to maturity	20	-	594
Other assets	26	712	686
Receivables from the State budget	19	471,999	737,516
Assets, acquired from collateral foreclosure	26	27,128	15,875
Investment property	24	7,649	7,702
Investments in subsidiaries	22	105,625	87,643
Property, plant and equipment, intangible assets	23	32,818	32,949
Deferred tax assets	14	247	1,148
Total assets		**3,012,761**	**2,472,243**
Liabilities			
Deposits from credit institutions	27	5,759	33,909
Deposits from customers other than credit institutions	28	1,307,522	790,590
Other liabilities	32	2,221	2,499
Provisions	31	3,185	930
Borrowings from international institutions	29	904,782	869,822
Other borrowings	30	17,306	17,492
Total liabilities		**2,240,775**	**1,715,242**
Equity			
Share capital	33	601,774	601,774
Retained earnings		25,130	20,145
Revaluation reserve on financial assets at fair value through other comprehensive income	34	6,055	4,947
Reserves	34	139,027	130,135
Total equity		**771,986**	**757,001**
Total liabilities and equity		**3,012,761**	**2,472,243**

The accompanying notes from 1 to 38 are an integral part of these financial statements. The separate financial statements were approved by the Management Board of Bulgarian Development Bank AD on 12 June 2019.

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

BULGARIAN DEVELOPMENT BANK SOFIA

Financial statements on which our auditors' report was issued dated 01[st] of July 2019

"Ernst & Young Audit" OOD

„Zaharinova Nexia" OOD

ОДИТОРСКО ДРУЖЕСТВО София Рег. № 138 ЗАХАРИНОВА НЕКСИА ООД

BULGARIAN DEVELOPMENT BANK
SEPARATE STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2018
All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

	Note	2018	2017
Interest income	6	63,280	60,748
Interest expense	6	(9,489)	(5,754)
Net interest income	6	**53,791**	**54,994**
Fee and commission income	7	2,062	2,215
Fee and commission expense	7	(35)	(34)
Net fee and commission income	7	**2,027**	**2,181**
Net income on foreign exchange deals	8	379	409
Net gain/(loss) on financial assets at fair value through other comprehensive income	9	738	188
Other operating income	10	3,004	2,514
Other operating expenses	11	(1,457)	(816)
(Expenses)/income on / from reversed impairment and provisions	12	(8,781)	(20,774)
Operating income		**49,701**	**38,696**
Costs of personnel	13A	(11,690)	(9,932)
General and administrative expenses	13B	(10,120)	(5,407)
Depreciation / amortisation expenses	23	(1,138)	(1,091)
Profit before income tax		**26,753**	**22,266**
Income tax expense	14	(1,623)	(2,121)
Net profit for the year		**25,130**	**20,145**
Other comprehensive income			
Items not to be reclassified to profit or loss in subsequent periods			
Actuarial gains /(losses) on defined benefit plans, net of taxes	32	33	(63)
Items to be reclassified to profit or loss in subsequent periods			
Net change in fair value of financial assets at fair value through other comprehensive income	15	1,108	1,466
Total other comprehensive income for the year, net of tax		**1,141**	**1,403**
Total comprehensive income for the year		**26,271**	**21,548**

The accompanying notes from 1 to 38 are an integral part of these financial statements. The separate financial statements were approved by the Management Board of Bulgarian Development Bank AD on 12 June 2019.

Rumen Mitrov
Executive Director

Nikolay Dimitrov
Executive Director

Ivan Lichev
Chief Accountant and Preparer

BULGARIAN DEVELOPMENT BANK SOFIA

Financial statements on which ~~our auditors' report~~ was issued dated 01st of July 2019

"Ernst & Young Audit" OOD

„Zaharinova Nexia" OOD

ОДИТОРСКО ДРУЖЕСТВО София Рег. № 138 ЗАХАРИНОВА НЕКСИА ООД

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

	Share capital	Statutory reserves	Additional reserves	Revaluation reserve on financial assets at fair value through other comprehensive income	Retained earnings	Total
As of 1 January 2017	**601,774**	**58,705**	**47,887**	**3,481**	**42,920**	**754,767**
Total comprehensive income for the period						
Profit	-	-	-	-	20,145	20,145
Other comprehensive income, net of taxes	-	-	(63)	1,466	-	1,403
Total comprehensive income for the period	-	-	(63)	1,466	20,145	21,548
Transactions with owners, recognised in equity						
Dividends to equity holders	-	-	-	-	(19,314)	(19,314)
Transfer to Reserves based on shareholders' decision	-	4,292	19,314	-	(23,606)	-
Total transactions with owners	-	4,292	19,314	-	(42,920)	(19,314)
As of 31 December 2017	**601,774**	**62,997**	**67,138**	**4,947**	**20,145**	**757,001**
Total comprehensive income for the period						
Effect from the initial adoption of IFRS 9	-	-	-	-	(11,286)	(11,286)
As of 01 January 2018	601,774	62,997	67,138	4,947	8,859	745,715
Profit	-	-	-	-	25,130	25,130
Other comprehensive income	-	-	33	1,108	-	1,141
Total comprehensive income for the period	-	-	33	1,108	25,130	26,271
Transactions with owners, recognised in equity						
Dividends to equity holders						
Profit distribution	-	885	7,974	-	(8,859)	-
Total transactions with owners	-	885	7,974	-	(8,859)	-
As of 31 December 2018	**601,774**	**63,882**	**75,145**	**6,055**	**25,130**	**771,986**

The accompanying notes from 1 to 38 are an integral part of these financial statements. The separate financial statements were approved by the Management Board of Bulgarian Development Bank AD on 12 June 2019.

Rumen Mitrov — *Executive Director*

Nikolay Dimitrov — *Executive Director*

Ivan Lichev — *Chief Accountant and Preparer*

BULGARIAN DEVELOPMENT BANK SOFIA

Financial statements on which our auditors' report was issued dated 01st of July 2019

"Ernst & Young Audit" OOD

„Zaharinova Nexia" OOD

ОДИТОРСКО ДРУЖЕСТВО София Рег. № 138 ЗАХАРИНОВА НЕКСИА ООД

BULGARIAN DEVELOPMENT BANK
SEPARATE STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2018
All amounts are stated in thousands of Bulgarian leva, unless otherwise stated.

	Note	2018	2017
Cash flows from operating activities			
Profit for the year		25,130	20,145
Adjustments for:			
Dividend income	11	(909)	(1,393)
Expenses / (Income) on / from reversed loan impairment	12	5,694	23,091
Expenses / Income on/from guarantee provisions and unutilised credit commitments	12	1,152	(2,514)
Impairment losses on financial assets at fair value through other comprehensive income	9	1,703	-
Impairment loss and sale of other assets	12	232	194
Net gain on revaluation of foreign currency assets and liabilities	8	(7)	10
Depreciation / amortisation expenses	23	1,139	1,091
Gain on sale of assets, acquired from collateral foreclosure		(437)	(196)
Carrying amount of written-off assets	23	1	32
Income tax expense	14	1,623	2,121
		35,321	**42,581**
Changes in:			
Receivables from banks		14,542	35,020
Loans and receivables		(357,433)	(1,724)
Loans to the State budget		265,517	(312,350)
Financial assets at fair value through other comprehensive income		(365,508)	34,931
Assets held for sale	25	(3,879)	(9,417)
Other assets		(26)	(536)
Deposits from credit institutions		(28,150)	(9,828)
Deposits from customers other than credit institutions		516,932	81,030
Provisions		2,255	122
Other liabilities		(278)	1,376
Cash flows (used in) / from operating activities		**79,293**	**(138,795)**
Corporate income tax paid		(2,640)	(5,413)
Net cash flows used in operating activities		**76,653**	**(144,208)**

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

	Note	2018	2017
Cash flows from investing activities			
Cash payments for acquisition of property, plant and equipment, and intangible assets		(1,010)	(348)
Cash proceeds from sale of property, plant and equipment, and intangible assets		1	7
Cash proceeds from matured Securities held to maturity		593	791
Proceeds from sale and improvements of assets, acquired from collateral foreclosure		(2,521)	796
Proceeds from investment property		53	480
Dividends received from investments in subsidiaries		892	1,393
Acquisition of shares in subsidiaries		(13,750)	-
Net cash flows (used in) / from investing activities		**(15,742)**	**3,119**
Cash flows from financing activities			
Dividends paid to the equity owners		-	(19,313)
Cash paid on issued debenture loans		-	-
Cash paid on other borrowings		(202)	(186)
Cash received from other borrowings		16	-
Cash received from borrowings from international institutions		156,254	556,939
Cash paid on borrowings from international institutions		(121,294)	(67,837)
Net cash flows from financing activities		**34,774**	**469,603**
Net increase in cash and cash equivalents		95,685	328,514
Cash and cash equivalents at the beginning of period	**36**	**521,616**	**193,102**
Cash and cash equivalents at end of period	**36**	**617,301**	**521,616**
Operating interest-related cash flows			
Proceeds from interest		59,857	49,294
Interest paid		(8,019)	(5,290)

The accompanying notes from 1 to 38 are an integral part of these financial statements. The separate financial statements were approved by the Management Board of Bulgarian Development Bank AD on 12 June 2019.

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

Financial statements on which our auditors' report was issued dated 01st of July 2019

"Ernst & Young Audit" OOD „Zaharinova Nexia" OOD

BULGARIAN DEVELOPMENT BANK SOFIA BULGARIAN DEVELOPMENT BANK

ОДИТОРСКО ДРУЖЕСТВО София Рег. № 138 ЗАХАРИНОВА НЕКСИЯ ООД

1. ORGANISATION AND OPERATING POLICIES

The financial statements of Bulgarian Development Bank AD (the „Company") for the year ended 31 December 2018 were approved for issue by decision of the Management Board dated 12 June 2019.

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

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

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

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

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

The Bank's lending 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.

1. ORGANISATION AND OPERATING POLICIES (CONTINUED)

Bulgarian Development Bank AD has a two-tier system of governance, which comprises Supervisory Board (SB) and Management Board (MB). Changes in the structure of the management bodies were made in 2017. The Supervisory Board and the Audit Committee represent those charged with governance. As of 31 December 2018, the members of the Supervisory Board of BDB (SB) were: Luchezar Dimitrov Borisov – Chairman of SB, Mitko Emilov Simeonov – Vice Chariman and member of SB, Velina Ilieva Burska – member of SB.

The composition of the Management Board of BDB as of 31 December 2018 was as follows: Stoyan Todorov Mavrodiev - Chairman of MB and Chief Executive Officer; Rumen Dimitrov Mitrov - Vice Chairman / member of MB and Executive Director, Nikolay Dimitrov Dimitrov – member of MB and Executive Director.

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

As of 31 December 2018, the Bank's employees were 191 (31 December 2017: 171).

The Bulgarian Development Bank Act (2008) envisages the establishment of two Bank subsidiaries - the Capital Investment Fund and the National Guarantee Fund (Note 22).

The Capital Investment Fund was established as of 31 December 2018.

Bulgarian Development Bank AD had no branches as at 31 December 2018.

The Bank has begun the process of preparation of its consolidated financial statements for 2018 in accordance with International Financial Reporting Standards (IFRS); these separate financial statements will be included in the consolidated financial statements. According to the dates planned, management expects that the consolidated financial statements will be approved for issue not later than 30 June 2019 and then, the financial statements will be made publicly available to third parties.

2. BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

Applicable standards

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

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

Statement of compliance

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

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

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

Going concern

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

Order of liquidity and maturity structure

In general, the Bank presents its separate statement of financial position in order of liquidity. An analysis regarding recovery of assets or settlement of liabilities is presented in Note 4.3.

Comparability of data

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

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

Presentation currency

These Bulgarian lev is the reporting and functional currency. These financial statements are presented in thousands of Bulgarian leva (BGN'000).

Accounting estimates

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

Key estimates and assumptions of high uncertainty

a) Expected credit losses on assets carried at amortised cost

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

The main indicators for determining the risk groups are the debtor's financial condition and project implementation, funded by the loan, problems with servicing, including interest in arrears and maturing principal, sources of repayment and granted collateral, as a type and opportunity for realisation. Additionally, for loans, guaranteed by the EIF, the impairment loss is recognised after deduction of the portion borne by the Fund (Note № 4.1).

In determining the future cash flows pattern, the Bank's management uses estimates, judgments and assumptions based on its historical loss experience for assets with similar credit risk characteristics, as well as an objective evidence for impairment or expected impairment of the portfolio from unrealised 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 C).

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

Key estimates and assumptions of high uncertainty (continued)

b) Measurement of financial instruments at fair value through other comprehensive income

Equity and debt instruments not quoted on stock markets

The Bank classifies as Financial assets at fair value through other comprehensive income its investments held in the form of non-publicly traded companies' shares / entities (less than 20% of their capital), which have been acquired with the aim to establish and develop business relations of interest to the Bank. Management measures these financial assets at fair value using methods that are allowed under IFRS 13, except in cases where it has judged that the cost of acquisition (cost) better reflects their fair value, namely:

- When there is no sufficient and up-to-date information to enable it to measure the fair value; or
- When there is a large scope of eligible methods and/or resultant valuations of the fair value and the cost approximates most closely the fair value within a range of values calculated (Note 9, 21).

Equity and debt instruments quoted on stock markets

As of 31 December 2018, the Bank conducted a detailed comparative analysis of the movements on the national and foreign stock markets of the stock market prices of public companies' shares and bonds listed for dealing held by it.

For investments in securities that are listed for dealing at stock exchange markets, management has carried out research and analyses and deems that they may be subsequently carried at fair value determined directly on the basis of completed transactions in the stock market in the last month of the financial year (Level 1). In addition, the applied prices are analysed for trends in the behaviour of stock exchange prices of the respective securities at least for the last three months of the year and respectively, to the date of issuing of the separate financial statements. (Notes 9, 15, 21).

The Bank impairs its debt instruments in compliance with its Policy and Methodology for assessment of expected credit losses and calculation Procedure.

c) Provisions for bank guarantees issued

The Bank has formed provisions for a portfolio of contingent liabilities for payment in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.* The Bank reviews its contingent liabilities the purpose of establishing whether any events have occurred, that would confirm to a large extent the probability that a commitment will be paid to settle an obligation. If such events occur, the Bank provides its liability up to the amount of its future costs related to the outflows of economic benefits/payments. These costs/losses are determined on the basis of the present value of the future net cash flows, representing the difference between the payment obligation and the possible inflows of subsequent recourse to the guarantee user or third parties (Notes № 12, 35).

d) Actuarial calculations

In assessing the present value of the long-term liabilities to employees upon retirement, actuarial methods and calculations are used based on assumptions for mortality rate, staff turnover rate, future salary levels and a discount factor considered by management as reasonable and relevant to the Bank (Note № 32).

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

Key estimates and assumptions of high uncertainty (continued)

e) Valuation of investment property

The fair value of investment property, which management considers reasonable and adequate for the Bank, is determined by certified independent appraisers. The valuations are conducted by using various valuation techniques, such as the recoverable amount method, the method of income capitalisation, the method of market analogues, where for each method a weight is set for the purposes of achieving the final fair value of investment property at the end of the reporting period (Note № 24).

f) Assets acquired from collateral foreclosure

Assets acquired from collateral foreclosure include assets acquired by the bank as a result of non-performing loans. These assets are measured at the lower of at cost and net realisable value. The net realisable value, which management considers reasonable and adequate for the Bank, is determined by certified independent appraisers.

g) Fair value of financial instruments

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

2.1 Changes in accounting policies and disclosures

New and amended standards and interpretations

The accounting policies adopted are consistent with those of the previous financial year. The following amendments to IFRS have been adopted by the Bank as of 1 January 2018:

IFRS 15 Revenue from Contracts with Customers

IFRS 15 supersedes IAS 11 Construction Contracts, IAS 18 Revenue and related Interpretations and it applies, with limited exceptions, to all revenue arising from contracts with customers and not covered by the scope of:

- Lease contracts (IAS 17/IFRS 16 Leases);
- Insurance contracts (IFRS 4 Insurance contracts);
- Financial instruments and other contractual rights or obligations (IFRS 9 Financial Instruments, IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Ventures, IAS 27 Separate Financial Statements, and IAS 28 Investments in Associates and Joint Ventures;
- Non-monetary transactions among entities engaged in the same business to facilitate the sales to customers or potential customers.

The Bank has applied IFRS 15 effective for annual periods beginning on or after 1 January 2018.

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

2.1 Changes in accounting policies and disclosures (continued)

IFRS 15 Revenue from Contracts with Customers (continued)

IFRS 15 establishes a five-step model to account for revenue arising from contracts with customers, regardless of the type if transaction or industry, requiring the Bank (1) to identify the contracts with customers, (2) to identify the performance obligations in the contracts, (3) to determine the transaction price, (4) to allocate the transaction price to the performance obligations, and (5) to recognise revenue when each performance obligation is satisfied.

The Bank has identified the following 3 performance obligations under IFRS 15:

- Transaction-related services – revenue is recognised at a point in time because the customer simultaneously receives and consumes the benefits due to the short time period of performance of the service. The fees for these services are based on the Bank's tariff and represent a fixed amount per transaction corresponding to the customers' benefit transferred. Considering the above circumstances, the Bank applies the practical expedient under IFRS 15, paragraph B16, namely, to recognise revenue in an amount it has the right to withheld in accordance with the Tariff. Under IAS 18, the Bank used to recognise revenue by applying the accrual principle and thus, it recognised revenue in the same way.

Issuance of guarantees and letters of credit – revenue is recognized over time because the customer simultaneously receives and consumes the benefits. The transfer of the benefits to the customer is consistent over time and thus, the Bank uses a straight-line method for measuring the progress of the contract, which in turn results in a straight-line amortisation of the fees over the contracted period. The fees for these services are fixed, calculated depending on:

- The amount of the guarantee or the letter of credit. Under IAS 18, The Bank used to recognize revenue from the fixed fee over the term of the contract on a straight-line basis, which in substance is identical with the accounting policy under IFRS 15.

- Deposit maintenance – revenue is recognised at a point in time because the customer simultaneously receives and consumes the benefits. The fees for these services are based on the Bank's Tariff and represent a fixed monthly amount corresponding to the customers' benefit transferred. Considering the above circumstances, the Bank applies the practical expedient under IFRS 15, paragraph B16, namely, to recognise revenue in an amount it has the right to withheld in accordance with the Tariff. Under IAS 18, the Bank used to recognise revenue by applying the accrual principle and thus, it recognised revenue in the same way.

Brokerage operations for which the Bank receives agent's commissions - revenue is recognised at a point in time upon the provision of the brokerage service as the Bank operates as a broker. Considering the above circumstances, the Bank recognizes revenue that is equal to the amount of the commission fee for the performance of the brokerage service. The commission fee is the net amount to be withheld by the Bank after paying the portion due to the third party to which / whom the Bank has mediated to perform the services of that third party.

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

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

2.1 Changes in accounting policies and disclosures (continued)

IFRS 15 Revenue from Contracts with Customers (continued)

Fee and commission income of Bulgarian Development Bank for 2018 and 2017 are as follows:

Fee and commission income under IFRS 15	**2018**	**2017**
Transaction-related services	594	-
Issuance of guarantees and letters of credit	1,383	-
Account maintenance	69	-
Total fee and commission income from contract with customers	**2,046**	-
Other charges	16	-
Total fees and commissions 2018	**2,062**	-
Guarantees and letters of credit	-	1,329
Account maintenance, transfers and customers' treasury operations	-	570
Servicing of debenture issues	-	252
Management of special-purpose funds of the Ministry of Finance (Note 30)	-	64
Total fees and commissions 2017	**-**	**2,215**
Fee and commission expenses		
Agent's commissions	(2)	(1)
Servicing of accounts with other banks	(29)	(30)
Transfers and treasury operations in other banks	(4)	(3)
Total fee and commission expenses	**(35)**	**(34)**
Net fee and commission income	**2,027**	**2,181**

Servicing of debenture issues fees are fees for the Bank to perform the function of a trustee bank on a bond issue of a public interest entity. The fee is charged and paid periodically, in accordance with a contract.

Income from funds trusted in custody consists of fees for managing funds provided by the Ministry of Finance in relation to a loan from Kreditanstalt für Wiederaufbau extended to the Ministry of Finance. These fees are recognized when due under a contract.

The Bank – except for certain operations provided to its employees – earns no income from retail banking services: the amount of deposits accepted as at 31 December 2018 is immaterial (BGN 967 thousand), as also the amount of accounts opened. The Bank has not analysed in detail the potential effect of such services on revenue due to its limited exposure to retail customers and the absence of branch network.

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

2.1 Changes in accounting policies and disclosures (continued)

IFRS 9 Financial instruments: classification and measurement

The standard is effective for annual periods beginning on or after 1 January 2018. The Bank has decided not to apply it earlier. The Bank has elected not to restate items on the statement of financial position and income statement for previous periods in accordance with the new standard any differences arising until 31 December 2017 are included in Retained earnings/(losses).

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.

Initial adoption of IFRS 9

The bank applied for the first time IFRS 9 in 2018. In the months preceding 1 January 2018, the Bank's management approved a standard implementation program, including:

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

Asset recognition

The Bank recognizes a financial asset or financial liability in its statement of financial position when, and only when, it is a part of an existing contractual relationship regulating the instrument.

The Bank classifies financial assets as subsequently measured at amortised cost, at fair value in other comprehensive income or at fair value through profit or loss, as the case may be, on the grounds of:

a) a business model of the Bank for financial assets management (or a sub-portfolio of financial assets), and

b) the features of the contractual cash flow of the financial asset.

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

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

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

2.1 Changes in accounting policies and disclosures (continued)

IFRS 9 Financial instruments: classification and measurement (continued)

Asset recognition (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 (SPPI).

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

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

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

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

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

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

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

2.1 Changes in accounting policies and disclosures (continued)

IFRS 9 Financial instruments: classification and measurement (continued)

The effect of initial adoption of IFRS 9 as at 1 January 2018 compared to IAS 39 as of 31 December 2017 was, as follows:

	IAS 39		As of 01 January 2018	IFRS 9	
Financial assets	**Category**	**Amount**	**Effect of adoption of IFRS 9**	**Amount**	**Category**
Cash in hand and balances in accounts with the Central Bank	Loans and receivables	447,648	-	447,648	Amortised cost
Loans and advances to central banks and government	Loans and receivables	737,516	(1,432)	736,084	Amortised cost
Loans and advances to central banks and financial institutions	Loans and receivables	198,379	(3,594)	194,785	Amortised cost
Loans and advances to customers	Loans and receivables	699,680	(5,050)	694,630	Amortised cost
Financial assets available for sale	Available for sale/Held for trading	231,497	(460)	231,037	Fair value through OCI
Debt securities	Available for sale/Held for trading	227,917	(459)	227,458	Fair value through OCI
Equity securities	Available for sale/Held for trading	2,986	(1)	2,985	Fair value through OCI
Total financial assets		**2,314,720**	**(10,536)**	**2,304,184**	
Off-balance sheet exposures		519,634	(750)	518,884	

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

2.1 Changes in accounting policies and disclosures (continued)

IFRS 9 Financial instruments: classification and measurement (continued)

Reclassification of financial assets

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

Assessment and reporting

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

Determination of a business model

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

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

The Bank defines "other business models" as a business model that does not include the holding of financial assets for the purpose of collecting contractual cash flows or for the simultaneous collecting of contractual cash flows and selling financial assets. Typically, this process involves actively buying and selling financial assets. These assets are reported as financial assets at fair value through profit or loss.

In this respect, as of 1 January 2018 and 31 December 2018, the Bank has defined the following classification of the main financial assets:

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

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

2.1 Changes in accounting policies and disclosures (continued)

IFRS 9 Financial instruments: classification and measurement (continued)

Determination of a business model (continued)

The Bank derecognises financial asset when, and only when:

a) the contractual cash flows from the financial asset have expired, or
b) the financial asset has been transferred and this transfer meets the derecognition criteria.

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

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

The phases and their characteristics are described below:

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

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

2.1 Changes in accounting policies and disclosures (continued)

IFRS 9 Financial instruments: classification and measurement (continued)

Impairment of financial assets (continued)

The absolute threshold for the transfer of credits among the levels is linked to the internal credit rating determined by the Bank of the borrower concerned. The Bank has set a credit rating of 7 as a transition limit to move to Phase 2.

Hedge accounting

IFRS introduces a significant amendment to hedge accounting, requiring more extensive disclosures regarding the risk management activity. The Bank's business model does not provide taking of significant market or foreign currency positions. Insofar as the Bank is exposed to currency or interest rate risk, it takes appropriate measures to minimize that risk: matching the amount of active and passive exposures in the relevant currency, providing coverage of interest-bearing fixed-rate assets with similar interest-bearing fixed-rate liabilities.

The Bank fully assumes the market risk arising out of its securities regardless of whether they have been held to collect cash flows or to sell.

The Bank has no foreign subsidiaries to be consolidated.

The Bank does not report active financial instruments designated as hedging relationship and therefore, the requirements of IFRS 9, applicable to hedges, have no effect on the Bank's financial statements.

IFRS 2 Share-based Payment (Amendments): Classification and Measurement of Share based Payment Transactions

The amendments are effective for annual periods beginning on or after 1 January 2018 with earlier application permitted. The amendments provide requirements on the accounting for the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments, for share-based payment transactions with a net settlement feature for withholding tax obligations and for modifications to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. The amendments were endorsed by the EU in February 2018. The amendments are not relevant for the Bank.

IFRS 4 Insurance Contracts (Amendments): Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts

The amendments are effective for annual periods beginning on or after 1 January 2018. The objective of these amendments is to address issues arising from the different effective dates of IFRS 9 Financial Instruments and the upcoming new insurance contracts standard IFRS 17 Insurance Contract. Entities issuing insurance contracts will still be able to adopt IFRS 9 on 1 January 2018. The amendments introduce two alternative options for entities issuing contracts within the scope of IFRS 4, notably a temporary exemption and an overlay approach. The temporary exemption enables eligible entities to defer the implementation date of IFRS 9. The overlay approach allows an entity applying IFRS 9 from 2018 onwards to remove from profit or loss the effects of some of the accounting mismatches that may occur from applying IFRS 9 before IFRS 17 is applied. The standard had no significant impact on the financial performance and operating results of the Bank in 2018. The Bank does not expect that the standard will have a significant impact in the future as well.

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

2.1 Changes in accounting policies and disclosures (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. The interpretation was endorsed by the EU in April 2018. The interpretation had no significant impact on the financial performance and operating results of the Bank in 2018. The Bank does not expect that the interpretation will have a significant impact in the future as well.

IAS 40 Investment Property (Amendments): Transfers of Investment Property

The amendments are effective for annual periods beginning on or after 1 January 2018 with earlier application permitted. The amendments clarify transfers of property to, or from, investment property when there is a change in the use of such property which is supported by evidence. The amendments were endorsed by the EU in March 2018. The amendments had no significant impact on the financial performance and operating results of the Bank in 2018 and it is not expected that they will have a significant impact on its future financial statements.

Annual Improvements to IFRSs 2014-2016 Cycle

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

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

The annual improvements to IFRSs 2014 – 2016 Cycle were endorsed by the EU in February 2018. These amendments had no significant impact on the financial performance and operating results of the Bank in 2018.

2.2 Standards issued but not yet effective and not early adopted

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

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

2.2 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 Bank has analysed the potential impact of the adoption of this standard on its financial position or performance. Considering the minimum leased assets used by the Bank – with carrying amount of BGN 698 thousand as at 31 December 2018 – the Bank deems the effect of its adoption immaterial.

IFRS 17: Insurance Contracts

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

IFRIC 23 Uncertainty over Income Tax Treatments

The Interpretation is effective for annual periods beginning on or after 1 January 2019 with earlier application permitted. The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12. The Interpretation provides guidance on considering uncertain tax treatments separately or together, examination by tax authorities, the appropriate method to reflect uncertainty and accounting for changes in facts and circumstances. This interpretation was endorsed by the EU in October 2018. The Bank does not expect a significant impact of this interpretation on its financial statement and financial performance in future periods.

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.

IAS 19 Employee Benefits (Amendments): Plan Amendment, Curtailment or Settlement

The amendments are effective for annual periods beginning on or after 1 January 2019 with earlier application permitted. The amendments require entities to use updated actuarial assumptions to determine current service cost and net interest for the remainder of the annual reporting period after a plan amendment, curtailment or settlement has occurred. The amendments also clarify how the accounting for a plan amendment, curtailment or settlement affects applying the asset ceiling requirements. These amendments have not yet been endorsed by the EU. The Company will assess the impact of these amendments on its financial position or performance.

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

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

IFRS 3 Business combinations (Amendments): Definition of a business

The amendments are effective for annual periods beginning on or after 1 January 2020 with earlier application permitted. The amendments clarify the minimum requirements for a business and narrow the definition of a business. The amendments also remove the assessment of whether market participants are capable of replacing any missing elements, add guidance to help entities assess whether an acquired process is substantive and introduce an optional fair value concentration test. These amendments have not yet been endorsed by the EU.

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

The amendments are effective for annual periods beginning on or after 1 January 2020 with earlier application permitted. The amendments clarify the definition of material and how it should be applied by including in the definition guidance that until now has featured elsewhere in IFRS Standards. The amendments also specify that materiality will depend on the nature or magnitude of information. These amendments have not yet been endorsed by the EU.

The Conceptual Framework for Financial Reporting

The IASB issued the revised Conceptual Framework for Financial Reporting on 29 March 2018, which is effective for annual periods beginning on or after 1 January 2020. The Conceptual Framework sets out a comprehensive set of concepts for financial reporting, standard setting, guidance for preparers in developing consistent accounting policies and assistance to others in their efforts to understand and interpret the standards. The main amendments introduced in the revised Conceptual framework for financial reporting are related to measurement, including factors, which should be considered when choosing measurement basis, and to presentation and disclosure, including income and expenses which should be classified in other comprehensive income. The Conceptual framework also provides updated definitions for asset and liability and criteria for their recognition in the financial statements. The Conceptual framework for financial reporting has not yet been endorsed by the EU.

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 were endorsed by the EU in March 2019. The Bank is in the process of assessing the impact of the amendments on its future financial statements.

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

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

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.

3. SIGNIFICANT ACCOUNTING POLICIES

3.1 Financial instruments

Financial assets

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

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

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

The Bank has the following non-derivative financial assets:

- financial assets at fair value through profit or loss;
- financial assets at fair value through other comprehensive income;
- financial assets at amortised cost;

Financial assets at fair value through profit or loss
A financial asset is carried at fair value through profit or loss if it is held for trading or if it is designated as such upon initial recognition. Financial assets are designated at fair value through profit or loss when the Bank manages them and makes decisions for purchases and sales on a fair value basis, in accordance with a documented risk or investment management strategy of the Bank. Attributable transaction costs are recognised in profit or loss as incurred.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

3.1 Financial instruments (continued)

Financial assets (continued)

Financial assets at fair value through profit or loss(continued)

Financial assets at fair value through profit or loss are measured at fair value and any related changes, including dividend income, are recognised in profit or loss.

Upon initial acquisition, the Bank's management determines whether a financial assets will be held for trading. Usually, management designates derivatives as such instruments.

A derivative is a financial instrument:

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

When upon entering a specific derivative transaction, the Bank defines a position to be hedged and all the requirements of IFRS 9 have been met, the corresponding derivative is recognised as such hedging and it shall be specified whether it hedges:

- deviations in the fair value of a specific asset (fair value hedge),
- differences in the estimated future cash flows (cash flow hedge), or
- the effect of investments in foreign subsidiaries (net investment hedge).

Derivatives that do not meet the criteria for hedge accounting are measured at fair value through profit and loss.

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.

Financial assets measured at amortised cost

Financial assets measured at amortised cost are financial assets with fixed or determinable payments that are not quoted in an active market and that are 'solely payments of principal and interest (SPPI)'. The Bank holds such financial assets within a business model with the objective to hold financial assets in order to collect contractual cash flows within the life of the asset. 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.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

3.1 Financial instruments (continued)

Financial assets (continued)

Financial assets measured at amortised cost(continued)
When calculating the effective interest rate, the Bank estimates the cash flows by considering all contractual terms of the financial instrument, but not considering any future credit losses.

The calculation includes all charges and other fees paid to or received by the contractors that are an integral part of the effective interest rate.

The Bank assesses whether evidence of impairment of loans and receivables exists for each specific asset, except for receivables from employees (Note 3: Impairment of financial assets). After a thorough review of the quality and impairment testing of standard exposures, the Bank established that as at 31 December 2018, as also in 2017, the expected credit loss on receivables from employees was 0%, and that which had arisen from receivables having occurred in relation to Energy Efficiency of Multi-Family Buildings National Programme (EEMFBNP)amounted to BGN 804 thousand (as at 01 January 2018, after considering the effect of the adoption of IFRS 9: BGN 1,432 thousand, as at 31 December 2017: Nil).

Financial assets measured at amortised cost cash and cash equivalents, receivables from banks, loans and advances to customers, receivables from the State budget, and trade and other receivables.

Financial assets at fair value through other comprehensive income

Financial assets measured at fair value through other comprehensive income are assets acquired under a business model with the objective of both holding to collect contractual cash flows and selling; and that are not classified in any one of the previous categories. 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.

Financial assets measured at fair value through other comprehensive income include equity and debt securities, and certain cases of loans and advances.

Reclassification of financial assets

According to the treatment of IFRS 9, financial assets are reclassified only if the business model in which the assets are acquired and/or managed is changed. Upon such a change, the Bank reclassifies all affected assets from one category to the other.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

3.1 Financial instruments (continued)

Financial assets (continued)

Assets under trust management

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

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

Financial liabilities

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

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

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:
    - the Bank has transferred substantially all the risks and rewards of the financial asset, or
    - the Bank has neither transferred nor retained substantially all the risks and rewards of the financial asset, but has transferred control of the asset.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

3.1 Financial instruments (continued)

Financial liabilities (continued)

When the Bank has transferred its contractual rights to receive cash flows from a financial asset and has neither transferred nor retained substantially all of the risks and rewards of the financial asset nor transferred control of the asset, the transferred financial asset is recognised to the extent of the Bank's continuing involvement in the asset. In this case, the Bank recognises the related obligation. The transferred asset and the concomitant obligation are evaluated to reflect the rights and obligations, which the Bank has retained. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

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

Impairment of financial instruments

A financial asset classified in Phase 1 – Standard (Performing) – is impaired individually on the basis of the probability of default of the debtor during the next 12 months or less, if the life of the instrument or the residual term is less than one year.

A financial asset classified in Phase 2 – Watch – is an asset for which there has not been a significant increase in credit risk since initial recognition. The Bank considers that there has been a significant increase in credit risk when contractual payments are more than 30 days past due; the debtor has been reclassified as watch exposure; the debtor's credit rating has deteriorated as at the reporting date compared to its rating as at the date of recognition of the instrument, or the Bank expects that the credit will be restructured. In this case, the expected credit losses are calculated for the entire life of the asset.

A financial asset classified in Phase 3 – Non-performing - which is not recognised at fair value through profit and loss, is reviewed at each reporting date to assess whether there is objective evidence of its impairment. A financial asset is impaired when there is objective evidence that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows of the asset that can be estimated reliably.

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

Financial assets measured at amortised cost
The Bank impairs assets on individual and collective bases.

The Bank considers evidence for impairment of financial assets measured at amortised cost (loans and receivables) at both individual and collective level. Assets with similar risk characteristics are collectively assessed for impairment.

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

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

3.1 Financial instruments (continued)

Impairment of financial instruments (continued)

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.

Pursuant to the Policy and Rules for Calculation of Expected Credit Losses and Exposures Impairment, the understanding of the Bank of the impairment on a collective (portfolio) basis is as follows:

Financial assets measured at amortised cost (continued)
„Article 32. (1) Based on a motivated proposal by Risk Department, the bank may designate sub-portfolios of exposures with similar risk characteristics.

(2) The indicators underlying the establishment of a sub-portfolio are controlled and monitored at least once a year in order to identify potential unfavourable dynamics and changes in the risk profile of the portfolio.

Article 33. The amount of the collective impairment is determined in accordance with the methodology adopted by the Bank. It is also possible to develop additional methodologies that take into account specific risk factors for particular sub-portfolios.

Article 34. For groups of financial instruments the credit risk of which has increased significantly since initial recognition, a portfolio assessment can be made taking into account the information that shows a significant increase in credit risk at the level of a group or sub-group of financial instruments. Thus, the Bank recognizes expected credit losses over the entire life of financial instruments the credit risk of which has increased significantly, even when there is no such evidence at the level of an individual instrument.

Article 35. (1) When the Bank determines whether there has been a significant increase in credit risk and recognizes loss adjustments on a collective basis, financial instruments may be grouped on the basis of common credit risk characteristics with the aim to conduct an analysis to identify a significant increase in credit risk in a timely manner.

(2) By grouping its financial instruments, the Bank complies with the principle of not impairing the quality of information available by grouping financial instruments with different risk characteristics. Common characteristics of credit risk include, but are not limited to: a type of instrument; credit risk rating; type of collateral; date of initial recognition; residual term to maturity; industry; geographical location of the borrower; and the relative value of the collateral compared to the financial asset if it affects the probability of default (for example, non-recourse loans in some jurisdictions or loan / collateral ratios)."

Currently, the Bank has designated as a portfolio for collective impairment its receivables on Energy Efficiency of Multi-Family Buildings National Programme (EEMFBNP).

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

3.1 Financial instruments (continued)

Impairment of financial instruments (continued)

For the Bank, *impairment on an individual basis* means (again, as defined in the same Policy) an assessment of the expected credit losses based on the exposure's individual parameters.

1. When the exposure is in Phase 3, an individual matrix is applied to the expected future cash flows from collateral realisation.

2. When the exposure is in Phase 1 or 2, a tool is used to compare the exposure's individual characteristics (such as maturity, payment models, sectors, etc.) with probabilities of non-performance, which have been observed historically with respect to similar exposures, as well as macroeconomic parameters, sector specifics, etc.

Financial assets measured at fair value through other comprehensive income

Impairment losses on financial assets measured at fair value through other comprehensive income 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. An impairment is accrued for equity securities and every movement in the fair value is recognised in other comprehensive income until the security is sold or derecognised.

Fair value of financial assets and liabilities

Definitions

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Bank discloses information about the fair value of those assets and liabilities for which there is market information available and the fair value of which significantly differs from their carrying amount.

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

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

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

3.1 Financial instruments (continued)

Fair value of financial assets and liabilities (continued)

Fair Value Hierarchy

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

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

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

Cash and cash equivalents

For the purposes of the cash flow statement cash equivalents comprise cash in hand, cash in current accounts with other banks, deposits and placements with other banks – payable at sight and/or with original maturity of up to 3 months, including repo deals with original maturity of up to 3 months, as well as unrestricted (not blocked) balances with the Central Bank (BNB). The parent company (the Bank) maintains a minimum statutory reserve according to the requirements of BNB and for the purposes of cash flow statement it includes these funds included as a component of Cash and cash equivalents.

They are presented in the separate statement of financial position at amortised cost.

For the purposes of preparation of the separate cash flow statement, bank overdrafts payable on demand and forming an integral part of the Bank's cash management are included as a component of Cash and cash equivalents.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2 Other assets

Assets held for sale

Assets are classified as held for sale, if their carrying amount will be recovered through a sale and not through a continuing use in the Bank's operations. Assets held for sale are stated initially at cost, with the transaction costs being taken into account in the initial measurement. Usually, these assets have been initially accepted by the Bank as collateral and subsequently acquired as a result of a "debt against property" exchange by borrowers that do not perform their obligations in accordance with the agreed contractual terms.

Assets classified in this group are available for immediate sale in their present condition. Management is usually engaged actively and performs actions to realise a sale transaction within at least one year after the date of classification of the asset in this group.

Assets classified as held for sale are presented in the separate statement of financial position separately and measured at the lower of their carrying amount and their fair value less the estimated direct costs to sell.

The assets within this classification group are not depreciated.

Investments in subsidiaries

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

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

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

Taxes

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

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

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

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2 Other assets (continued)

Taxes (continued)

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 separate financial statements at historical cost of acquisition, less any accumulated depreciation and impairment losses.

Initial recognition

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

Subsequent measurement

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

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

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

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

The useful life by groups was not changed compared to 2017.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2 Other assets (continued)

Property, plant and equipment (continued)

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 separate financial statements at cost less accumulated amortisation and any accumulated impairment losses. They include software products and software licences.

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

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

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

Investment property

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

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

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2 Other assets (continued)

Assets acquired from collateral foreclosure

Assets acquired from collateral foreclosure are measured at the lower of cost and net realisable value in compliance with the requirements of IAS 2 Inventories.

Cost of the assets acquired from collateral foreclosure is the sum of all direct costs incurred on the acquisition of the assets and other expenses incurred on bringing them to their current location and condition. The net realisable value is the estimated selling price in the ordinary course of business less estimated costs to complete the trade cycle and costs to sell.

The impairment of these assets is calculated in accordance with the Bank's accounting policy based on the expected realisation of the assets acquired from collateral foreclosure. The impairment of the assets acquired from collateral foreclosure is recognised in the statement of profit or loss. The Bank's management is of the opinion that the carrying amount of the assets acquired from collateral foreclosure is the best estimate of their net realisable value at the date of the statement of financial position. The impairment of these assets as of 31 December 2018 amounts to BGN 0 (2017: BGN 0). Further details are provided in Note 21.

Impairment of non-financial assets

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

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

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

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

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

3.3. Liabilities

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

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

Short-term employee benefits

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

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

Long-term retirement benefits

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

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

Past service, costs are recognised immediately in the separate statement of comprehensive income in the period in which they were incurred.

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

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

3.3. Liabilities (continued)

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

Long-term retirement benefits (continued)

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

Termination benefits

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

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

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

Provisions and contingent liabilities

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

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

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

3.3 Liabilities (continued)

Financial guarantee contracts

Financial guarantee contracts are contracts that require the issuer of the guarantee to make specified payments to reimburse the holder as a result of the failure of a third party - debtor to comply with commitments made that have been guaranteed. Financial guarantee contracts are initially measured at fair value, whereas it is accepted that the guarantee's fair value on the date of its issuance is the premium received at inception. No receivables for the future premiums are recognized. Commission fee income is deferred on a straight-line basis over the period, to which such fees refer. Subsequently, the Bank's liabilities under financial guarantee contracts are measured at the higher of the amount initially recognized less amortization and the provision that should have been accrued for the Bank to meet its contractual obligations arising at the date of the financial statements. The expected credit losses, related to the financial guarantees issued, are recognised in the statement of comprehensive income, under the heading Impairment of financial assets. The likelihood of an obligation for payment by the Bank under such contracts is estimated based on historical experience with similar instruments.

3.4 Capital

Share capital

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

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

Dividends

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

3.5 Income and expenses

Interest income and interest expenses

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

Interest income includes interest income on debt securities measured at fair value through other comprehensive income and through profits and losses, 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.

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

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

3.5 Income and expenses (continued)

Interest income and interest expenses (continued)

For loans past due for more than 90 days, the balance sheet reporting of interest income, fee and commission income and other loan-related income is ceased. For exposures classified in Phases 1 and 2, the Bank recognizes interest income and other EIR -forming income accrued on their amortised cost before the impairment for expected credit losses. For exposures classified in Phase 3, the Bank recognizes interest income and other EIR-forming income accrued on their amortised cost less any impairment for expected credit losses.

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

Fees and commissions

Pursuant to IFRS 15 Revenue from Contract with Customers and the classification adopted, described in note 2.1, fee and commission income is recognized on a one-off or periodical basis over the life of the exposure, while ensuring comparability with the costs of providing the service, as well as consuming the benefits of the services provided by the customer.

Fee and commission expenses are recognised when the service, to which they relate, is provided or when the result thereof has been achieved.

Foreign currency transactions

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

Foreign currency	31 December 2018	31 December 2017
USD	1.70815	1.63081
Euro	1.95583	1.95583

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

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

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

3.5 Income and expenses (continued)

Segment reporting

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

4. FINANCIAL RISK MANAGEMENT

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

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

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

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

4.1. Credit risk

Credit risk is the risk of potential losses due to a failure of the Group's customers to discharge their contractual obligations in connection with receivables and financial instruments held by the Bank, incl. country (sovereign) risk, contractor's risk and settlement risk, and credit risk of concentration.

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

In assessing and managing credit risks (including the counterparty risk) of its exposures, the Bank applies internal rating generation models. These internal rating models depend on the specifics of the object being rated. The so-developed rating models for credit risk assessment of corporate clients of the Bank are based on an analysis of historical data and the counterparty's and its relating parties' current financial position; their history and behaviour in servicing their liabilities to other contractors; future cash flow analyses; sources of servicing the existing and any potential future liabilities to the Bank, and other parameters specific to a particular transaction. Credit portfolio quality monitoring, control and assessment units are established and function within BDB. Credit portfolio current monitoring, reporting and management procedures and mechanisms are implemented, which require periodical, and if necessary, extraordinary, reports on the financial and credit status of each borrower and other liable persons. There is an „Early Warning Procedure for Corporate Credit Clients", which includes an early warning system of signals and actions.

In managing its credit risk, the Bank applies an intra-bank system of limits that is subject to periodic review and updating.

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

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

The exposures in the Bank's corporate credit portfolio are classified mainly in three categories depending on the existence of indications of impairment – changes in the objective indicators on the basis of which the initial measurement and subsequent monitoring of exposure / customer are carried out, which would result in changes in cash flows from financial assets, including default in payment due by the borrower: Phase 1: „Standard" (with assigned internal credit ratings from 1 to 6, incl.; Phase 2 "Watch" or "Forborne" (with assigned internal credit ratings of 7 or 8) and Phase 3 „Problematic/Non-preforming" (with assigned internal credit ratings of 8, 9 or 10).

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

In the case of customers, for which there are currently no indications of increased risk, the Bank periodically (at least once a year) reviews the financial and legal status, including the collateral accepted, in order to establish the need for a change in the percentage of impairment for loss risk and / or change in the assessment of the degree of credit risk. Clients with a higher credit risk are subject to a review in every 6 months and those classified as „problematic/non-preforming", in every three months. In follow-up of the recommendations of the Basel Committee and their transposition into regulations within the European Union and in particular, Regulation 575/2013/EC and Directive 2013/36/EC, the commercial banks are required to implement in their internal regulations an in-house rating system that allows them to achieve comparability with the borrowers' official crediting rating assigned by recognized external credit rating institutions, which adopts the scale, used worldwide, of ten credit rating categories, including two categories for non-performing loans. The Bank has developed a detailed internal normative base, comprising Policy and rules for determining the impairment due to uncollectability of risk exposures, Methodology for credit risk analysis and assessment of Bulgarian Development Bank AD, and Credit activity manual of BDB, ensuring full compliance of the policy and procedures for determining internal credit ratings with the above EU regulations. The amount of the impairment is calculated as the difference between the current amount of the amortised cost of the customer's exposure to the Bank and its recoverable amount.

The Bank accrues impairment on a portfolio basis for its receivables on Energy Efficiency of Multi-Family Buildings National Programme (EEMFBNP).

Aiming at minimizing and reducing the credit risk, the Bank accepts collateral in accordance with its in-house rules. It is a common practice of the Bank to require collateral from the borrowers that is equal to at least 100 per cent of the agreed loan amount, and valuations from accredited independent valuers are required.

Based on a Guarantee letter from year 2003 and the subsequent annexes signed with the European Investment Fund (EIF), the Bank participates in the EU SME Guarantee Facility under conditions determined by the long-term EU Program on SMEs. EIF is committed to provide a direct guarantee covering 50 per cent of the remaining loss on the principal and interest of each loan, included in the sub-portfolio of the Bank, formed on the basis of the conditions of the agreement, but not exceeding EUR 2,520 thousand (BGN 4,929 thousand). The Bank has applied reduced requirements in ,accepting collaterals for the EIF-guaranteed portfolio of loans. As of 31 December 2018, the total exposure on EIF-guaranteed loans amounted to BGN 5,286 thousand (31 December 2017: BGN 5,659 thousand). This amount includes the utilised but not yet repaid portion of the loans, as well as the Bank's commitments on unutilised loans. The payment engagement of EIF to date amounts to BGN 3,563 thousand (31 December 2017: BGN 3,563 thousand), whereas the losses covered by EIF amount to BGN 2,617 thousand (31 December 2017: BGN 2,773 thousand).

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

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

As at 31 December 2018, there was no commitment on the counter-guarantee agreement.

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

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 Energy Efficiency of Multi-Family Buildings National Programme (EEMFBNP) in compliance with Decree No18 of Council of Ministers (CMD18).

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

- portfolio of financial instruments, other than loans, formed in connection with the Bank's free cash management, which comprises mainly government securities issued by the Republic of Bulgaria, classified as „ Financial assets at fair value through other comprehensive income ";

- to banks in connection with money market transactions, placed term deposits and available balances in Nostro accounts;

- exposure to receivables relating to the State budget.

The Bank applies a system of limits relating to credit risk and concentration risk with respect to the different sub-portfolios, and currently monitors the credit risk of concentration of financial assets on the basis of industry criteria, and also by individual counterparty and insurance companies ensuring coverage. Regarding the Bank's direct lending activities, 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 separate statement of financial position is as follows:

	2018		2017	
Financial asset	maximum	net	maximum	net
Receivables from banks	430,660	429,548	198,379	198,379
Loans and advances to customers	1,197,889	1,039,080	854,853	699,680
Receivables from the State budget	472,803	471,999	737,516	737,516
Financial assets at fair value through other comprehensive income / (2017: Available-for-sale securities)	594,249	594,249	230,903	230,903
Securities, held to maturity	-	-	594	594
Other financial assets	12	12	36	36
	2,695, 613	**2,534, 888**	**2,022,281**	**1,867,108**

Cash in current accounts and balances with the Central Bank expose the Bank to a minimum credit risk and are not included in the above table.

The heading *Receivables from the State Budget* comprise loans on the Energy Efficiency of Multi-Family Buildings National Programme (EEMFBNP) amounting to BGN 471,999 thousand (2017: BGN 728,010 thousand).

The exposure to credit risk arising out of off-balance sheet commitments is as follows:

	2018		2017	
	maximum	net	maximum	net
Bank guarantees and letters of credit	56,073	37,536	71,531	61,226
Unutilised amount of authorized loans	348,377	348,377	447,976	447,976
Participation in the SIA investment program	1,410	1,410	1,603	1,603
	405,860	**387,323**	**521,110**	**510,805**
Maximum exposure to credit risk	**3,101,473**	**2,922,211**	**2,543,391**	**2,377,913**

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.

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

Credit risk - concentration

The financial assets of the Bank (cash in current accounts and balances with the Central Bank, financial assets at fair value through other comprehensive income, loans and advances to customers, receivables from the State budget and other financial assets), classified by industry sectors (at gross amount before impairment), are presented in the table below:

	2018	%	2017	%
Sectors				
Government	1,090,620	36.44	997,809	40.40
Financial services	850,817	28.42	726,911	29.43
Industry, total	480,750	16.06	300,669	12.17
Industry – energy generation and distribution	*119,752*	*4.00*	*85,046*	*3.44*
Industry – other industries	*92,866*	*3.10*	*44,076*	*1.78*
Industry – manufacture of foodstuffs	*51,392*	*1.72*	*50,032*	*2.03*
Industry – manufacture of tobacco products	*149,129*	*4.98*	*58,773*	*2.38*
Industry – manufacture of plant and equipment	*67,611*	*2.26*	*62,742*	*2.54*
Construction	162,402	5.43	146,346	5.93
Transport	130,765	4.37	105,615	4.28
Real estate transactions	49,552	1.66	49,286	2.00
Administrative and office activities	-	-	48,815	1.98
Trade	32,165	1.07	35,848	1.45
Agriculture	29,159	0.97	26,984	1.09
Tourist services	108,148	3.61	16,282	0.66
Collection and disposal of garbage	4,190	0.14	8,399	0.34
Other industries	54,667	1.83	6,965	0.28
	2 ,993,235	**100**	**2,469,929**	**100**

The largest credit exposure of the Bank to a group of related parties /other than bank institutions/ amounts to BGN 150,129 thousand (including balance sheet commitments of BGN 149,129 thousand and off-balance sheet commitment of BGN 1,000 thousand) (2017: BGN 69,239 thousand) at amortised cost, which represents 23.22 per cent of Bank's equity/eligible capital ratio according to Regulation 575/2013/EU (2017: 10.88 per cent). The concentration of client's portfolio (other than bank institutions) is presented in the following table:

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

Credit risk – concentration (continued)

	2018 Net exposure* (BGN'000)	% of Equity/Eligible capital	2017 Net exposure* (BGN'000)	% of Equity
The biggest total exposure to a customer group	149,182	23,07%	60,438	9.49%
Total amount of the ten biggest exposures	706,117	109.19%	395,365	62.11%
Total amount of the twenty biggest exposures	1,003,205	155.13%	564,118	88.62%

There is no exposure to a customer or a group of related customers as at 31 December 2018, exceeding 25 per cent of Bank's capital base.

*Net exposure – the amount of the exposure net of provisions and highly liquid collateral.

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

As of 31 December 2018	Standard (Phase 1)	Watch (Phase 2)	Non-performing (Phase 3)	Total
Cash in hand and balances in current account with the Central Bank	297,622	-	-	297,622
Receivables from banks	430,660	-	-	430,660
Receivables from the State budget	472,803	-	-	472,803
Loans for commercial property and construction	247,402	77,079	70,011	394,494
Trade loans	220,607	104,773	116,642	442,022
Agricultural loans	-	-	2,040	2,040
Consumer loans	778	-	19	797
Residential mortgage loans to individuals	1,436	-	-	1,436
Loans to other financial institutions	69,281	-	44,661	113,942
Other loans and receivables	119,792	90,901	32,467	243,160
Financial assets at fair value through other comprehensive income	594,249	-	-	594,249
Securities, held to maturity	-	-	-	-
Other financial assets	12	-	-	12
Total financial assets	**2,454,642**	**272,753**	**265,840**	**2,993,237**

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 2017	Standard (Phase 1)	Watch (Phase 2)	Non-performing (Phase 3)	Total
Cash in hand and balances in current account with the Central Bank	447,648	-	-	447,648
Receivables from banks	198,379	-	-	198,379
Receivables from the State budget	737,516	-	-	737,516
Loans for commercial property and construction	267,005	84,936	54,680	406,621
Trade loans	217,368	52,873	71,868	342,109
Agricultural loans	-	-	2,103	2,103
Consumer loans	900	28	-	928
Residential mortgage loans to individuals	1,972	-	-	1,972
Loans to other financial institutions	32,915	-	44,541	77,456
Other loans and receivables	6,805	16,769	90	23,664
Available-for-sale securities	230,903	-	-	230,903
Securities, held to maturity	594	-	-	594
Other financial assets	36	-	-	36
Total financial assets	**2,142,041**	**154,606**	**173,282**	**2,469,929**

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:

	2018		2017	
Type of collateral	Fair value	%	Fair value	%
Mortgages	514,012	52.31	252,215	42.18
Mortgages on ships	148,321	15.09	111,711	18.68
Pledge of plant, machinery, equipment, and inventories	273,290	27.81	213,538	35.71
Securities quoted on a stock market	20,536	2.09	-	-
Credit risk insurance	18,482	1.88	16,237	2.72
Bank guarantees	3,863	0.39	1,064	0.18
Restricted deposits	4,164	0.42	3,176	0.53
Total collateral	**982,668**	**100**	**597,941**	**100**

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

Credit exposures could have more than one collateral, i.e. it could be included in more than one position. The amount of the collateral could exceed 100 per cent, as more than one collateral could be provided to secure one loan.

At the request of the contractors, the Bank is able to re-negotiate the initial terms and conditions on the contract. Usually, these are the terms of loan utilization, loan amount, interest rates and/or repayment schedules from the point of view of the amount of a particular repayment instalment. Most of all, these are cases of changes in the initial parameters, purpose and scope, and respectively, the time schedule of projects. Upon renegotiation, the changes in preliminary terms and conditions are analysed in order to establish whether these changes represent a concession (discount) in favour of the debtor and the exposure should be accepted as restructured and therefore, to be reclassified to Phase 2 or Phase 3 pursuant to the Policy and Rules for Calculation of Expected Credit Losses and Exposures Impairment of BDB, as follows:

„Article 11. Indicators of impairment :

(1) Significant increase in credit risk, which results in recognition of a lifetime expected credit loss for the instrument (i.e. transition from a 12-month expected credit loss) and respectively, classification in Phase 2 (Watch) would be a consequence of the following circumstances:

1. significant changes in internal credit risk indicators as a result of a change in credit risk relative to the beginning of the life of the asset;

2. other changes in interest rates or the conditions of an existing financial instrument that would be materially different if the instrument was newly granted or issued at the date of the financial statements (for example, more stringent terms and conditions, increased collateral or warranty requirements) due to changes in the credit risk of the financial instrument compared to that of its initial recognition;

3. significant changes in the external market indicators of credit risk for a particular financial instrument or similar financial instruments with the same life expectancy. Changes in credit risk margins include, but are not limited to:

a) credit spread;

b) the credit default swap price for the borrower;

c) duration of the period or the extent to which the fair value of a financial asset is lower than its amortized cost; and

d) changes in the price of borrower's debt and equity instruments;

e) any other market information about the borrower.

4. actual or expected significant change in the financial instrument's external credit rating (or of the debtor);

5. actual or expected downgrade of the borrower's external credit rating or a downgrade in the scoring rating used to measure credit risk;

6. existing or expected adverse changes in business, financial or economic conditions, for which it is expected to result in a significant change in the borrower's ability to perform its obligations.

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

7. actual or expected significant change in the borrower's operating results, such as actual or expected decreasing revenue or margins, increase in operating risks, working capital shortage, asset quality deterioration, increased leverage, low liquidity, management problems or changes within the scope of business or organisational structure that results in a significant change in the borrower's ability to perform its obligations on the debt;

8. significant increases in credit risk for other financial instruments of the same borrower;

9. actual or expected significant adverse change in the borrower's regulatory, economic or technological environment, which has resulted in a significant change in the borrower's ability to perform its obligations;

10. significant changes in the value of the debt collateral or in the quality of guarantees and additional credit protection provided by a third party that are expected to reduce the economic incentive of the borrower to make scheduled contractual payments or to otherwise impact on the probability of default on the loan;

11. significant change in the quality of a guarantee provided by a shareholder (or by the owner of an entity) if the shareholder (owners) have an incentive and financial opportunity to prevent default through an increase in capital and / or cash;

12. significant changes, such as a reduction in financial support from a parent company or other subsidiary, or actual or expected significant change in the quality of credit protection that is expected to reduce the economic incentive for the borrower to make contractual payments.

13. expected changes in the loan documentation, including an expected breach of the contract, which may lead to the debtor being released from the obligation to comply with contractual commitments or amendments to the contract, interest rates, interest rate increases, requirements for additional collateral or guarantees, or other changes in the contractual framework of the instrument;

14. significant changes in the expected results and behaviour of the borrower, including changes in the creditworthiness of the borrowers within the group;

15. specific changes in the Bank's approach for managing the loan in relation to the financial instrument; for example on the basis of newly emerging indicators of a change in financial instrument's credit risk, it is expected that the Bank's credit risk management practice will become more active or focused on instrument management, including more prudent or stringent monitoring, or active intervention in the relationships with the borrower;

16. information on arrears, including cases of amounts past due by more than 30 days (if there is evidence that a significant number of defaulting debtors for more than 30 days have not reached the stage of significant deterioration, this threshold may be increased; however, extensive supporting data will be required in accordance with the provision of paragraph B5.5.19 of IFRS 9);

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

17. initiation of court proceedings; claiming of bank guarantees or other circumstances that are expected to result in significant costs for the borrower;

18. considerable delay in the provision by the borrower of financial and other necessary information;

19. undertaking of significant obligations of the borrower towards third parties, incl. off balance sheet, which would result in difficulties or inability to properly service the Bank's credit exposure.

(2) Events related to a classification where a financial instrument is classified in Phase 3, i.e. it is considered to be an asset with deteriorated credit quality and which, in most cases, correspond to the definition of default on the instrument, include:

1. significant financial difficulties of the debtor;

2. past due or unpaid liabilities to the Bank for more than 90 days;

3. priovision of a concession to the debtor in view of its financial difficulties, which would otherwise not have been provided by the Bank;

a) if, as a result of the re-negotiation and priovision of a concession to the debtor resulting in changes of cash flows the asset is derecognised and a new one is created (initially recognised), the Bank estimates only the 12-month expected loss. Further analysis of the expected credit loss is carried out if an increased credit risk exists.

b) if, a result of the re-negotiation and priovision of a concession to the debtor resulting in changes of cash flows the asset is derecognised and a new one is created (initially recognised), but as a consequence the latter is reported as an impaired asset acquired / occurred, the Bank recognises the cumulative changes in the expected credit losses over its entire life.

c) if, a result of the re-negotiation and priovision of a concession to the debtor, the financial asset is not derecognised, the Bank analyses whether there is a significant increase in credit risk, comparing:

(aa) the risk of default assessed at the reporting date (based on changed contractual terms); and

(bb) the risk of default assessed at initial recognition (on the basis of the original unchanged contractual terms);

in order to establish whether it should recognise lifetime expected credit losses or 12-month expected credit losses;

4. high probability of insolvency of the debtor or other financial reorganization of the debtor;

5. other evidence of deterioration in the debtor's creditworthiness."

Regarding the loans extended under the Energy Efficiency of Multi-Family Buildings National Programme (EEMFBNP), it should be noted that according to the programme's parameters the amount of the loan approved is subject to regular updating in order to ensure expenditure control. The signature of annexes to the loan contracts, by means of which the financial parameters are updated, is a result of those controls.

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

The table below presents data on the portfolio amount of the Bank's financial assets by type of instrument after the impairment made:

	Loans and receivables from non-financial institutions		Receivables from the State budget		Loans and receivables from financial institutions		Loans and receivables from individuals		Cash in hand and balances in current account with the Central Bank		Financial assets carried at fair value through other comprehensive income/ 2017: Securities available for sale		Securities, held for trading	
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
Impaired on an individual basis														
----standard (Phase 1)	656,220	-		-	98,971	-	2,214	-	-	-	514,691	-		
----watch (Phase 2)	272,227	111,503	-	-	1,467	-	-	28	-	-	-	-	-	-
----non-performing (Phase 3)	261,872	174,112	-	-	-	-	19	-	-	-	-	-	-	-
Gross amount	**1,190,319**	**285,615**		-	**100,438**	-	**2,233**	**28**	-	-	**514,691**	-	-	-
Incl. renegotiated	890,545	177,625	-	-	48,290	-	370	-	-	-	-	-	-	-
Past due but not impaired	-													
---standard (Phase 1)		46,280	-	-	-	-	-	-	-	-	-	-	-	-
---watch (Phase 2)			-	-	-	-	-	-	-	-	-	-	-	-
---non-performing (Phase 3)			-	-	-	-	-	-	-	-	-	-	-	-
Gross amount		**46,280**	-	-	-	-	-	-	-	-	-	-	-	-
Incl. renegotiated		46,280	-	-	-	-	-	-	-	-	-	-	-	-
Within 30 days			-	-	-	-	-	-	-	-	-	-	-	-
From 30- 90 days			-	-	-	-	-	-	-	-	-	-	-	-
Over 90 days			-	-	-	-	-	-	-	-	-	-	-	-

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

	Loans and receivables from non-financial institutions		Receivables from the State budget		Loans and receivables from financial institutions		Loans and receivables from individuals		Cash in hand and balances in current account with the Central Bank		Financial assets carried at fair value through other comprehensive income/ 2017: Securities available for sale		Securities, held for trading	
Impaired on a portfolio basis														
-------standard	-	-	472,803	-	-	-	-	-	-	-	-	-	-	-
Gross amount	-	-	472,803	-	-	-	-	-	-	-	-	-	-	-
Incl. renegotiated	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Not past due and not impaired														
-------Phase 1	874	414,487	-	737,516	330,222	198,379	-	2,872	297,622	447,648	79,558	230,903	-	594
-------Phase 2	526	101,091	-	-	-	-	-	-	-	-	-	-	-	-
-------Phase 3	3,949	4,509	-	-	-	-	-	-	-	-	-	-	-	-
Gross amount	**5,349**	**520,087**	-	**737,516**	330,222	**198,379**	-	**2,872**	297,622	**447,648**	79,558	**230,903**	-	**594**
Incl. renegotiated	5,337	360,961	-		48,290	66,269	-	494	-	-	-	-	-	-
Gross amount	**1,195,668**	**851,982**	**472,803**	**737,516**	**430,660**	**198,379**	**2,233**	**2,900**	**297,622**	**447,648**	**594,249**	**230,903**	-	**594**
Incl. renegotiated	**905,971**	**603,876**	-	-	48,290	66,269	370	494	-	-	-	-	-	-

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

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

- high class – credit rating from 1 to 3 – Phase 1
- standard class – credit rating from 4 to 5 – Phase 1
- low class – credit rating from 6 to 7 – Phase 1 (rating 6) or Phase 2 (rating 7)
- non-performing – Phase 3 (rating 8, 9 and 10)

The Bank assesses the credit quality of provided contingent commitments by applying a methodology, which estimates whether events indicating with a high probability that outflow of Bank's resources might take place have occurred. These costs (losses) are determined on the basis of the Policy and Methodology for assessment of expected credit losses, and a Calculation Procedure of BDB based on a Conversion Factor (CCF) that is applied in the case of off-balance sheet exposures that are likely to turn into balance sheet exposures (payments on guarantees, utilisation of part of the allowed amount of the loan, etc.). At the date of the financial statements, the Bank identified commitments amounting to BGN 56,073 thousand (2017 : BGN 71,510 thousand), which were provided by BGN 2,998 thousand (2017: BGN 833 thousand) (Note 31).

Watch loans and receivables (Phase 2), presented at amortised cost, are as follows:

	2018	2017
Loans for commercial property and construction	77,079	84,936
Trade loans	104,773	52,873
Loans to banks	1,467	-
Consumer loans	-	28
Other loans and receivables	90,901	16,768
	274,220	**154,605**

When the initial terms of the agreement have been modified by the Bank by granting a concession (discounts) to a debtor experiencing difficulties in performing its financial obligations a loan is classified as "restructured" (Phase 2 or 3 pursuant to the Policy and Rules for Calculation of Expected Credit Losses and Exposures Impairment of BDB).

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

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

In BGN'000	**2018**	**2017**
Loans for commercial property and construction	**47,387**	**56,955**
incl. Standard (Phase 1)	*966*	*5,443*
Watch (Phase 2)	*9,412*	*14,068*
Non-performing (Phase 3)	*37,009*	*37,444*
Other loans and receivables	**67,315**	**67,867**
incl. Standard (Phase 1)	-	*53,330*
Watch (Phase 2)	*52,971*	*1,548*
Non-performing (Phase 3)	*14,344*	*12,989*
	114,702	**124,822**

Expected credit losses (ECL) reporting

For instruments measured at amortised cost, ECLs reduce the carrying amount in the statement of financial position.

For debt instruments measured at fair value through other comprehensive income, ECLs are part of the negative change in the fair value due to an increased credit risk. They continue to be presented at the fair value in the statement of financial position, and the accumulated adjustment for losses is recognized in the statement of comprehensive income. Upon subsequent derecognition of the instrument, the accumulated adjustment is recognized in the profit or loss for the period.

Probability of default (PD)

PD is the probability of a counterparty not complying with contract clauses related to debt repayment. For each individual exposure or a portfolio of collectively assessed exposures, the Bank maintains historical information on the migration of exposures between different phases.

The value of 12M PD is determined on the basis of observed deterioration rates and is calculated as a moving average over a period of at least 2 years. For exposures that are individually measured, the value of the 12m PD is determined depending on the assigned credit rating according to an internal model. Data on the changes in the borrowers' rating over a one-year horizon is aggregated into transaction matrices, and a 12-m PD is calculated for each rating scale depending on the number of default cases found. The Bank adjusts the values of 12m PD to reflect the current or expected economic conditions that may differ from those during the historical periods analysed.

Exposure at default (EAD)

EAD is potential exposure at the time of default. The level of exposure at default is determined individually for each loan depending the type of loan, taking into account both the amount of utilized amounts and the agreed undrawn amounts according to the expectation of future drawdowns.

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

ECL reporting (continued)

Loss Given Default (LGD)

LGD is the ratio of the exposure loss due to default to the amount of exposure at default. The Bank calculates the potential loss that would have arisen if an exposure goes into default and the only source for collecting the receivable is the realization of the collateral. The loss is measured as a percentage of Exposure at Default (EAD).

The Bank has determined relative thresholds that are used also for the exposures for which the absolute thresholds are applied and for those, for which no such thresholds have been determined. They are based on matrixes covering the overall credit cycle (through-the-cycle, TTC) and the change in the probability of default on the respective exposures from the external aggregated data of Moody's (the Bank has developed preliminary a methodology for equalizing the internal credit ratings to those assigned by the rating agency).

Main groups of assets subject to impairment

The following tables present the movements in the main groups of assets subject to impairment between the different phases for the period 01 January – 31 December 2018:

Assets measured at amortised cost (except for General Government and Receivables from Banks)	**Phase 1**	**Phase 2**	**Phase 3**	**Total**
Balance as of 01.01.2018	**462,814**	**128,350**	**263,689**	**854,853**
Transfers:				
Transfer from Phase 1 to Phase 2	(35,079)	35,079	-	-
Transfer from Phase 1 to Phase 3	(1,670)	-	1,670	-
Transfer from Phase 2 to Phase 3		(8,037)	8,037	-
Transfer from Phase 2 to Phase 1	1,233	(1,233)	-	-
Newly occurred and newly acquired exposures	103,573	31,021	14,631	**149,225**
Paid or transferred	(113,927)	(21,355)	(103,711)	**(238,993)**
Increased	241,087	108,931	82,786	**432,804**
Balance as of 31.12.2018	**658,031**	**272,756**	**267,102**	**1,197,889**

All assets measured at amortised cost – non-financial entities, including with state participation, individuals and non-banking financial institutions are included in the above table.

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

Main risk parameters affecting the amount of ECLs (continued)

Main groups of assets subject to impairment (continued)

Assets measured at amortised cost - General Government	Phase 1	Phase 2	Phase 3	Total
Balance as of 01.01.2018	**737,516**	-	-	**737,516**
Newly occurred and newly acquired exposures	8,179	-	-	**8,179**
Paid or transferred	(549,510)	-	-	**(549,510)**
Increased	276,618	-	-	**276,618**
Balance as of 31.12.2018	**472,803**	-	-	**472,803**

The Bank presents under the heading of General Government assets measured at amortised cost relating mainly to the Energy Efficiency of Multi-Family Buildings National Programme (EEMFBNP). The loans for Military Medical Academy (MMA), acquired through a cession contract, were paid fully in 2018.

Assets measured at amortised cost - Banks and financial institutions	Phase 1	Phase 2	Phase 3	Total
Balance as of 01.01.2018	**198,379**	-	-	**198,379**
Newly occurred and newly acquired exposures	343,245	-	-	**343,245**
Paid or transferred	(113,513)	-	-	**(113,513)**
Increased	2,549	-	-	**2,549**
Balance as of 31.12.2018	**430,660**	-	-	**430,660**

Loans to banks and financial institutions include both transactions on an interbank market and deposits of different maturity.

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

Main risk parameters affecting the amount of ECLs (continued)

Main groups of assets subject to impairment (continued)

Assets measured at fair value through other comprehensive income	**Phase 1**	**Phase 2**	**Phase 3**	**Total**
Balance as of 01.01.2018	**231,497**	-	-	**231,497**
Newly occurred and newly acquired exposures	315,141	-	-	**315,141**
Paid or transferred	(80,015)	-	-	**(80,015)**
Increased	127,626	-	-	**127,626**
Balance as of 31.12.2018	**594,249**	-	-	**594,249**

Portfolio of securities consists mainly of bonds of the Republic of Bulgaria, other European sovereign issuers and bonds of large corporate clients.

Movement in the impairment of main groups of assets subject to impairment in 2018

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.

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

Main risk parameters affecting the amount of ECLs (continued)

Movement in the impairment of main groups of assets subject to impairment in 2018 (continued)

Movement in impairment in 2018:

Assets measured at amortised cost (except for General Government)	**Phase 1**	**Phase 2**	**Phase 3**	**Total**
Balance of impairment as of 01.01.2018	**4,211**	**902**	**155,109**	**160,222**
Transfers:				
Transfer from Phase 1 to Phase 2	(915)	915	-	-
Transfer from Phase 1 to Phase 3	(406)	-	406	-
Transfer from Phase 2 to Phase 3	-	(2,048)	2,048	-
Transfer from Phase 2 to Phase 1	2	(2)	-	-
New exposures	2,519	185	-	**2,704**
Paid or transferred	(4,211)	(902)	(60,340)	**(65,453)**
Increase in impairment on existing exposures	3,610	3,106	54,620	**61,336**
Balance of impairment as of 31.12.2018	**4,810**	**2,156**	**151,843**	**158,809**

Assets measured at amortised cost - General Government	**Phase 1**	**Phase 2**	**Phase 3**	**Total**
Balance of impairment as of 01.01.2018	**1,432**	-	-	**1,432**
Net movement in impairment on Energy Efficiency of Multi-Family Buildings National Programme (EEMFBNP)	(824)	-	-	**(824)**
Repayment of cessions Military Medical Academy (MMA)	196	-	-	**196**
Balance of impairment as of 31.12.2018	**804**	-	-	**804**

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

Main risk parameters affecting the amount of ECLs (continued)

Movement in the impairment of main groups of assets subject to impairment in 2018 (continued)

Assets measured at amortised cost - Banks and financial institutions	Phase 1	Phase 2	Phase 3	Total
Balance of impairment as of 01.01.2018	**3,594**	-	-	**3,594**
Paid or transferred	(2,482)	-	-	**(2,482)**
Balance of impairment as of 31.12.2018	**1,112**	-	-	**1,112**

Assets measured at fair value through other comprehensive income	Phase 1	Phase 2	Phase 3	Total
Balance of impairment as of 01.01.2018	**459**	-	-	**459**
New exposures	7,249	-	-	**7,249**
Paid or transferred	(4,926)	-	-	**(4,926)**
Other movements	(622)	-	-	**(622)**
Balance of impairment as of 31.12.2018	**2,160**	-	-	**2,160**

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.1. Credit risk (continued)

Main risk parameters affecting the amount of ECLs (continued)

Amount of the collateral as of 31.12.2018

The amount of the collateral on secured assets is presented in the following table:

Type of collateral	Carrying amount of the loan, BGN'000	Amount of the collateral, BGN'000
Mortgages	569,590	516,035
Pledge of plant, equipment and inventories	375,483	277,314
Restricted deposits	200,600	4,164
Mortgage on a ship	58,102	148,321
Insurances	27,343	18,482
Bank guarantees	22,631	3,863
Securities	14,718	20,536
Total	**1,268,467**	**988,715**

Country (sovereign) risk

The Bank has formed a portfolio of securities classified as financial assets at fair value through other comprehensive income, comprising only government securities issued by the Republic of Bulgaria. The Bank's exposure to sovereign was BGN 540,158 thousand as of 31 December 2018 and BGN 227,917 thousand as of 31 December 2017.

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 (23 March2019). Moody's credit rating for Republic of Bulgaria was last set at Baa2 with stable outlook (26 May 2017).

According to Fitch Ratings, BBB credit rating means that insolvency expectations are low, and the capacity to service financial liabilities is adequate, but a deterioration in economic conditions or business environment is likely to lessen this capacity. The definitions of Moody's and Standard&Poor's of the rating assigned to the sovereign are similar.

4.2. Market risk

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

Interest rate risk

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

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

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.2. Market risk (continued)

Interest rate risk (continued)

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

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

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

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

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

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

31 December 2018	*With floating interest rate*	*With fixed interest rate*	*Interest free*	*Total*
Financial assets				
Receivables from banks	4,506	414,499	10,543	**429,548**
Loans and advances to customers	991,442	47,638	-	**1,039,080**
Receivables from the State budget	471,999	-	-	**471,999**
Securities held to maturity	-	-	-	**-**
Financial assets at fair value through other comprehensive income	-	590,966	3,283	**594,249**
Other financial assets	-	-	12	**12**
Total financial assets	**1,467,947**	**1,053,103**	**13,838**	**2,534,888**

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

31 December 2018	*With floating interest rate*	*With fixed interest rate*	*Interest free*	*Total*
Financial liabilities				
Deposits from credit institutions	5,759	-	-	**5,759**
Deposits from customers other than credit institutions	702,074	578,747	26,701	**1,307,522**
Borrowings from international institutions	727,017	177,765	-	**904,782**
Other borrowings	11,236	6,070	-	**17,306**
Total financial liabilities	**1,446,086**	**762,582**	**26,701**	**2,235,369**
Total balance sheet interest exposure	**21,861**	**290,521**	**(12,863)**	**299,519**
Contingencies and commitments	328,077	20,300	98,733	447,110

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

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.2. Market risk (continued)

Interest rate sensitivity analysis

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

31 December 2018	*within 1 month*	*1-3 months*	*3-6 months*	*1-5 years*	*over 5 years*	*With fixed interest rate*	*Interest-free*	*Total*
Financial assets								
Receivables from banks	4,506	-	-	-	-	414,499	10,543	429,548
Loans and advances to customers	64,794	926,648	-	-	-	47,638	-	1,039,080
Receivables from the State budget	471,999	-	-	-	-	-	-	471,999
Securities held to maturity	-	-	-	-	-	-	-	-
Financial assets at fair value through other comprehensive income	76,821	8,635	8,961	268,445	228,104	-	3,283	594,249
Other financial assets	-	-	-	-	-	-	12	12
Total financial assets	**618,120**	**935,283**	**8,961**	**268,445**	**228,104**	**462,137**	**13,838**	**2,534,888**

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

31 December 2018	*within 1 month*	*1-3 months*	*3-6 months*	*1-5 years*	*over 5 years*	*With fixed interest rate*	*Interest-free*	*Total*
Financial liabilities								
Deposits from credit institutions	5,759	-	-	-	-	-	-	5,759
Deposits from customers other than credit institutions	781,267	4,074	24,860	92,537	-	-	26,701	1,307,522
Borrowings from international institutions	101,397	251,770	-	-	-	177,765	-	904,782
Other borrowings	-	11,236	-	-	6,070	-	-	17,306
Total financial liabilities	**888,423**	**267,080**	**24,860**	**92,537**	**6,070**	**177,765**	**26,701**	**2,235,369**
Total exposure to interest rate sensitivity	**(270,303)**	**668,203**	**(15,899)**	**175,908**	**222,034**	**284,372**	**(12,863)**	**299,519**
Contingencies and commitments	**54,295**	**43,477**	**79,578**	**142,938**	**-**	**20,300**	**98,733**	**447,110**

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

31 December 2017	*within 1 month*	*1-3 months*	*3-6 months*	*6-12 months*	*1-5 years*	*Over 5 years*	*With fixed interest rate*	*Interest-free*	*Total*
Financial assets									
Receivables from banks	2,182	3,483	-	-	-	-	182,172	10,542	198,379
Loans and advances to customers	82,352	567,265	-	-	-	-	50,063	-	699,680
Receivables from the State budget	728,010	-	-	-	-	-	9,506	-	737,516
Securities held to maturity	594	-	-	-	-	-	-	-	594
Available-for-sale securities	67,346	-	-	-	133,797	26,774	-	2,986	230,903
Other financial assets	-	-	-	-	-	-	-	36	36
Total financial assets	**880,484**	**570,748**	**-**	**-**	**133,797**	**26,774**	**241,741**	**13,564**	**1,867,108**
Financial liabilities									
Deposits from credit institutions	3,897	30,012	-	-	-	-	-	-	33,909
Deposits from customers other than credit institutions	638,862	1,406	436	16,330	111,382	-	-	22,174	790,590
Borrowings from international institutions	1,838	23,255	4,053	48,519	293,848	291,977	206,332	-	869,822
Other borrowings	-	11,236	-	-	-	6,256	-	-	17,492
Total financial liabilities	**644,597**	**65,909**	**4,489**	**64,849**	**405,230**	**298,233**	**206,332**	**22,174**	**1,711,813**
Total exposure to interest rate sensitivity	**235,887**	**504,839**	**(4,489)**	**(64,849)**	**(271,433)**	**(271,459)**	**35,409**	**(8,610)**	**155,295**
Contingencies and commitments	1,355	12	9,274	31,413	405,922	-	-	73,134	521,110

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.2. Market risk (continued)

Sensitivity of the floating rate interest assets and liabilities

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

	2018			2017		
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%	819	(2,350)	0.50%	1,981	(689)
EUR	0.50%	(454)	(9,103)	0.50%	(1,291)	(1,551)
USD	0.50%	(237)	(32)	0.50%	(153)	-
BGN	-0.50%	(819)	2,350	-0.50%	(1,981)	689
EUR	-0.50%	454	9,103	-0.50%	1,291	1,551
USD	-0.50%	237	32	-0.50%	153	-

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

	31.12.2018	**31.12.2017**
Financial assets	2,66%	2,35%
Financial liabilities	0,37%	0,43%

Currency risk

The currency risk is the risk that the financial position and cash flows of the Bank might be affected adversely by changes in exchange rates due to open currency positions. In managing the foreign currency risk, the Bank follows the principle of maintaining minimum open currency positions within the specified limits. Foreign currency positions are not formed with speculative purposes, but arise out of foreign currency transactions in the ordinary course of business of the Bank.

4. FINANCIAL RISK MANAGEMENT (continued)

4.2. Market risk (continued)

Currency risk (continued)

The policy of the parent company (the "Bank") is that the main portion of the assets and liabilities, and respectively the bank transactions, shall be denominated in EUR or BGN. The Bank does not carry out significant transactions and does not hold significant open positions in currencies other than EUR and BGN. As the exchange rate of the Bulgarian lev is pegged to that of the Euro, there is no significant open currency risk for the Bank's cash flows and financial performance.

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

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

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

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

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

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 2018	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	28	4,178	-	293,416	297,622
Receivables from banks	114,399	122,448	57	192,644	429,548
Loans and advances to customers	-	735,825	-	303,255	1,039,080
Receivables from the State budget	-	-	-	471,999	471,999
Securities held to maturity	-	-	-	-	-
Financial assets at fair value through other comprehensive income	17,597	460,260	-	116,392	594,249
Other financial assets	-	-	-	12	12
Total financial assets	**132,024**	**1,322,711**	**57**	**1,377,718**	**2,832,510**
Financial liabilities					
Deposits from credit institutions	-	1,465	-	4,294	5,759
Deposits from customers other than credit institutions	131,979	97,012	40	1,078,491	1,307,522
Borrowings from international institutions	-	904,782	-	-	904,782
Other borrowings	-	17,306	-	-	17,306
Total financial liabilities	**131,979**	**1,020,565**	**40**	**1,082,785**	**2,235,369**
Net balance sheet currency position	**45**	**302,146**	**17**	**294,933**	**597,141**
Contingencies and commitments	**1,025**	**206,657**	**-**	**239,428**	**447,110**

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

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.2. Market risk (continued)

Currency risk (continued)

The following table presents the Bank's sensitivity to possible changes in exchange rates based on the structure of the assets and liabilities at 31 December 2018.

2018

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	1.7082	+1,201	-1,337	-28	31	-
JPY	0.0155	+17	-16	-	-	-
GBP	2.1864	-2,504	1,005	-2	1	-
Total effect				**-30**	**32**	-

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)**	-

The open FX position and the market volatility of the respective foreign currencies as at 31 December 2018 would have an immaterial effect on the Bank's financial result assessed as equal to minus BGN 30 thousand if the hypothesis of unfavourable change in exchange rates occurs compared to the open positions of the Bank by separate currencies with the reported basis points (BPS: 1 b.p. = 0.0001 in decimal form).

4. FINANCIAL RISK MANAGEMENT (continued)

4.2. Market risk (continued)

Price risk of shares quoted on the Stock Exchange

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

4.3. Liquidity risk

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

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

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

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

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 amounts in percentage of the liquidity coverage ratio (LCR) of the Bank:

	2018	2017
As of 31 December	1,331.20%	301.05%
Average for the period	1,053.40%	216.71%
Highest for the period	1,785.50%	457.21%
Lowest for the period	424.26%	91.61%
Cash and cash balances with BNB	297,622	447,648
Balances in current accounts with other banks and international deposits of up to 7 days	319,679	73,968
Government securities	540,158	227,917
Liquid assets	**1,157,459**	**749,533**
Financial liabilities measured at amortised cost	2,235,369	1,711,813
Provisions	3,185	930
Employee retirement benefits	400	366
Liabilities	**2,238,954**	**1,713,109**
Liquidity assets ratio (LAR)	**51,70%**	**43,75%**

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.3. Liquidity risk (continued)

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

As of 31 December 2018	Within 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite maturity	Total
Financial assets							
Cash in hand and balances in current account with the Central Bank	297,622	-	-	-	-	-	297,622
Receivables from banks	218,627	102,757	10,317	1,644	96,203	-	429,548
Loans and advances to customers	51,917	36,001	141,342	445,922	363,898	-	1,039,080
Receivables from the State budget	23,756	143,647	304,596	-	-	-	471,999
Financial assets at fair value through other comprehensive income	78,151	10,849	11,606	210,595	279,765	3,283	594,249
Assets held for sale	-	-	4,840	-	-	-	4,840
Current tax receivables	-	-	1,244	-	-	-	1,244
Securities held to maturity	-	-	-	-	-	-	-
Other assets	-	-	712	-	-		712
Assets acquired from collateral foreclosure	-	-	-	27 ,128	-	-	27 ,128
Investment property	-	-	-	-	-	7,649	7,649
Investments in subsidiaries	-	-	-	-	-	105,625	105,625
Property, plant and equipment, intangible assets	-	-	-	-	-	32,818	32,818
Deferred tax assets	-	-	247	-	-	-	247
Total financial assets	**670,073**	**293,254**	**474,904**	**685,289**	**739,866**	**149,375**	**3,012,761**

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

Financial liabilities							
Deposits from credit institutions	5,759	-	-	-	-	-	5,759
Current tax liabilities	-	-	-	-	-	-	-
Deposits from customers other than credit institutions	782,564	4,330	415,628	103,979	1,021	-	1,307,522
Provisions	-	-	-	-	-	3,185	3,185
Other liabilities	1,067	-	-	118	-	1,036	2,221
Borrowings from international institutions	1,837	21,992	597,177	-	283,776	-	904,782
Other borrowings	-	-	213	960	16,133	-	17,306
Total financial liabilities	**791,227**	**26,322**	**1,013,018**	**105,057**	**300,930**	**4,221**	**2,240,775**
Gap in maturity thresholds of assets and liabilities	**(121,154)**	**266,932**	**(538,114)**	**580,232**	**438,936**	**145,154**	**771,986**
Contingencies and commitments	58,248	51,252	97,015	157,552	23,256	45,944	433,267

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 2017	Within 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite maturity	Total
Financial assets							
Cash in hand and balances in current account with the Central Bank	447,648	-	-	-	-	-	447,648
Receivables from banks	75,286	122	19,377	10,947	92,647	-	198,379
Loans and advances to customers	8,428	13,820	132,400	326,628	218,404		699,680
Receivables from the State budget	-	-	-	737,516	-	-	737,516
Securities available for sale	67,346	-	-	133,797	26,774	2,986	230,903
Assets held for sale	-	-	9,924	-	-	-	9,924
Current tax receivables	-	-	1,596	-	-	-	1,596
Securities held to maturity	7	-	587	-	-	-	594
Other assets	-	-	686	-	-	-	686
Assets acquired from collateral foreclosure	-	-	-	15,875	-	-	15,875
Investment property	-	-	-	-	-	7,702	7,702
Investments in subsidiaries	-	-	-	-	-	87,643	87,643
Property, plant and equipment, intangible assets	-	-	-	-	-	32,949	32,949
Deferred tax assets	-	-	1,148	-	-	-	1,148
Total financial assets	**598,715**	**13,942**	**165,718**	**1,224,763**	**337,825**	**131,280**	**2,472,243**
Financial liabilities							
Deposits from credit institutions	3,897	30,012	-	-	-	-	33,909
Current tax liabilities	-	-	-	-	-	-	-
Deposits from customers other than credit institutions	641,390	1,406	24,016	123,778	-	-	790,590
Provisions	-	-	-	-	-	930	930
Other liabilities	1,562	-	-	510	-	427	2,499
Borrowings from international institutions	1,838	23,255	94,613	458,138	291,978	-	869,822
Other borrowings	-	-	213	853	16,426	-	17,492
Total financial liabilities	**648,687**	**54,673**	**118,842**	**583,279**	**308,404**	**1,357**	**1,715,242**
Gap in maturity thresholds of assets and liabilities	(49,972)	(40,021)	46,876	641,484	29,131	(26,276)	757,001

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.3. Liquidity risk (continued)

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

As of 31 December 2018	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	5,759	5,759	5,759	-	-	-	-
Deposits from customers other than credit institutions	1,307,522	1,308,132	782,566	4,332	415,776	104,436	1,022
Financial liabilities held for trading	-	-	-	-	-	-	-
Borrowings from international institutions	904,782	954,593	1,837	22,086	611,195	-	319,475
Other borrowings	17,306	18,909	-	30	303	1,473	17,103
	2,235,369	**2,287,393**	**790,162**	**26,448**	**1,027,274**	**105,909**	**337,600**
Bank guarantee provisions	2,998	2,998	300	600	2,098	-	-
Unutilised loan commitments	348,377	348,377	54,295	43,477	87,367	142,938	20,300

As of 31 December 2017	Carrying amount	Gross flow	Less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years
Financial liabilities							
Deposits from credit institutions	33,909	33,912	3,897	30,015	-	-	-
Deposits from customers other than credit institutions	790,590	791,508	641,391	1,407	24,075	124,635	-
Borrowings from international institutions	869,822	905,278	1,838	23,379	95,187	465,399	319,475
Other borrowings	17,492	19,202	-	31	306	1,307	17,558
	1,711,813	**1,749,900**	**647,126**	**54,832**	**119,568**	**591,341**	**337,033**
Bank guarantee provisions	833	833	45	-	171	617	-
Unutilised loan commitments	447,976	447,976	1,355	12	40,687	405,922	-

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 Bank, the funds attracted from the biggest 20 non-bank depositors at 31 December 2018 represent 95.47 per cent of the total amount of payables to other customers (31 December 2017: 97.13 per cent). The share of the biggest non-bank depositor of the total amount of payables to other customers is 33.70 per cent (31 December 2017: 46.07 per cent).

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

As of 31 December 2018

Financial assets	**Pledged as collateral***	**Available for collateral**	**Other****	**Total**
Cash in hand and balances in current account with the Central Bank	-	125,479	172,143	**297,622**
Receivables from banks	10,543	419,005	-	**429,548**
Loans and advances to customers	-	656,605	382,475	**1,039,080**
Receivables from the State budget	-	471,999	-	**471,999**
Financial assets at fair value through other comprehensive income	6,633	584,894	2,722	**594,249**
Securities held to maturity	-	-	-	-
Other financial assets**	-	-	12	**12**
Total financial assets	**17,176**	**2,257,982**	**557,352**	**2,832,510**

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**
Securities available for sale	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**

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 2018, funds amounting to BGN 10,543 thousand (2017: BGN 10,542 thousand) were blocked on counter-guarantees of two corporate customers, maturing as follows:

Maturity interval	Receivables from banks pledged as collateral
On demand	182
From 91 to 180 days	2,712
From 181 to one year	6,479
Over one year	1,170

At 31 December 2018, restricted securities on a legal requirement to provide for funds of the State budget amount to BGN 6,633 thousand (2017: BGN 7,515 thousand).

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

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

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

4.4. Operational risk

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

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

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

In operational risk management all operational events, which occur in the activity of various units and processes of the Bank, are strictly monitored and registered, while the events of higher frequency, as well as those of significant importance, serve as bases for the operational risk analyses in different scenarios.

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.4. Operational risk (continued)

The operational risk is measurable and monitorable, and in the process of work an operational event register is kept, which is used as a basis for analysing and improving the work processes, and minimising the conditions that would potentially result in operational events and loss for the Bank.

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

4.5. Capital management

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

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

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

	2018	**2017**
OWN FUNDS	646,679	636,570
TIER I CAPITAL	646,679	636,570
COMMON EQUITY TIER I CAPITAL	646,679	636,570
Share capital	601,774	601,774
Statutory reserves	63,882	62,997
Additional reserves	75,153	67,180
Accumulated other comprehensive income	6,047	4,905
Intangible assets	(285)	(268)
Investments in subsidiaries	(105,625)	(87,643)
Transitional adjustments to CET1 Capital	9,649	(994)
Components of or deductions from CET1 Capital - other	(3,916)	(11,381)
ADDITIONAL TIER I CAPITAL	-	-
TIER II CAPITAL	-	-

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

4. FINANCIAL RISK MANAGEMENT (continued)

4.5. Capital management (continued)

	2018	2017
TOTAL RISK EXPOSURES	1,798,134	1,151,075
Credit risk - Standardised approach	1,581,269	1,041,637
Central governments or central banks	50,976	-
Regional governments or local authorities	-	202
Public sector entities	-	9,506
Multilateral development banks	939	939
Institutions	184,806	125,576
Corporates	827,069	530,416
Retail	5,209	7,734
Secured by mortgages on immovable property	265,587	101,621
Exposures in default	166,960	188,827
Items associated with particular high risk	2,934	2,936
Equity exposures	199	152
Other items	76,590	73,728
Foreign exchange risk	105,452	-
Operational risk - Basic indicator approach	111,413	109,438
CET 1 Capital Ratio	**35.96%**	**55.30%**
Total Capital Ratio	**35.96%**	**55.30%**
Capital conservation buffer	*44,954*	*28,777*
Systemic risk buffer	*53,944*	*34,532*
Discretionary counter-cyclical buffer	-	-
Buffer of other institutions of systemic importance	*2,248*	-
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%*
Buffer of other institutions of systemic importance	*0.125%*	*0.00%*

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

5. DISCLOSURE OF FAIR VALUE

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

As of 31.12.2018		Carrying amount						Fair value			
	Note	Held-to-maturity	Loans and receivables	Held for trading	Financial assets at fair value through other comprehensive income	Other	Total	Level 1	Level 2	Level 3	Total
Assets measured at fair value											
Financial assets at fair value through other comprehensive income	21	-	-	-	594,249	-	594,249	593,520	-	-	593,520
Assets acquired from collateral foreclosure	27	-	-	-	-	27,128	27,128	-	-	27,128	27,128
Investment property	25	-	-	-	-	7,649	7,649	-	-	7,649	7,649
		-	-	-	594,249	34,777	629,026	593,520	-	34,777	628,297
Assets not measured at fair value											
Cash in hand and balances in current account with the Central Bank	16	-	297,622	-	-	-	297,622	-	297,622	-	297,622
Loans to banks	17	-	99,326	-	-	-	99,326	-	104,972	-	104,972
Current accounts and term deposits of banks	17	-	330,222	-	-	-	330,222	-	330,222	-	330,222
Loans and advances to customers	18	-	1,039,080	-	-	-	1,039,080	-	1,069,236	-	1,069,236
Receivables from the State budget		-	471,999	-	-	-	471,999	-	497,667	-	497,667
Securities held for trading	20	-	-	-	-	-	-	-	-	-	-
		-	2,238,249	-	-	-	2,238,249	-	2,299,719	-	2,299,719

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

As of 31.12.2018		Carrying amount						Fair value			
	Note	Held-to-maturity	Loans and receivables	Held for trading	Financial assets at fair value through other comprehensive income	Other	Total	Level 1	Level 2	Level 3	Total
Liabilities not measured at fair value											
Deposits from credit institutions - Current accounts and term deposits of banks	28	-	-	-	-	5,759	5,759	-	5,759	-	5,759
Deposits from customers other than credit institutions	29	-	-	-	-	1,307,52 2	1,307,522	-	1,307,933	-	1,307,933
Borrowings from international institutions	30	-	-	-	-	904,782	904,782	-	936,612	-	936,612
Other borrowings	31	-	-	-	-	17,306	17,306	-	17,876	-	17,876
	-	-	-	-	-	2,235,36	2,235,369	-	2,268,180	-	2,268,180

The fair value of securities classified as financial assets at fair value through other comprehensive income with carrying amount of BGN 729 thousand at 31 December 2018 (2017: BGN 491 thousand) carried at cost is not disclosed as the Bank is of the opinion that their fair value cannot be measured reliably.

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

5. DISCLOSURE OF FAIR VALUE (continued)

As of 31.12.2017		Carrying amount						Fair value			
	Note	*Held-to-maturity*	*Loans and receivables*	*Held for trading*	*Available for sale*	*Other*	*Total*	*Level 1*	*Level 2*	*Level 3*	*Total*
Assets measured at fair value											
Available-for-sale securities	21	-	-	-	230,903	-	230,903	230,412	-	-	230,412
Assets acquired from collateral foreclosure	27	-	-	-	-	15,875	15,875	-	-	15,875	15,875
Investment property	25	-	-	-	-	7,702	7,702	-	-	7,702	7,702
			-	-	230,903	23,577	254,480	230,412	-	23,577	253,989
Assets not measured at fair value											
Cash in hand and balances in current account with the Central Bank	16	-	447,648	-	-	-	447,648	-	447,648	-	447,648
Loans to banks	17	-	113,869	-	-	-	113,869	-	116,576	-	116,576
Current accounts and term deposits of banks	17	-	84,510	-	-	-	84,510	-	84,510	-	84,510
Loans and advances to customers	18	-	699,680	-	-	-	699,680	-	710,313	-	710,313
Receivables from the State budget		-	737,516	-	-	-	737,516	-	799,661	-	799,661
Securities held for trading	20	594	-	-	-	-	594	-	598	-	598
		594	2,083,223	-	-	-	2,083,817	-	2,159,306	-	2,159,306

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

As of 31.12.2017		Carrying amount						Fair value			
	Note	*Held-to-maturity*	*Loans and receivables*	*Held for trading*	*Available for sale*	*Other*	*Total*	*Level 1*	*Level 2*	*Level 3*	*Total*
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	-	-	-	-	790,590	790,590	-	791,212	-	791,212
Borrowings from international institutions	30	-	-	-	-	869,822	869,822	-	899,003	-	899,003
Other borrowings	31	-	-	-	-	17,492	17,492	-	18,385	-	18,385
		-	-	-	-	1,711,813	1,711,813	-	1,742,509	-	1,742,509

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

5. DISCLOSURE OF FAIR VALUE (continued)

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

Financial instrument	Fair value as of	Fair value as of	Fair value hierarchy	Valuation techniques	Significant unobservable inputs	Relationship of unobservable inputs to fair value
	31.12.2018	31.12.2017				
Investment property	7,649	7,702	Level 3	Market analogues method Under the market analogues method an assessment is made by directly comparing the property under review with sold similar properties; the price is determined on the basis of such previous transactions. When applying this approach, it is necessary to use actually similar data of the comparable properties, the properties should be in the same location and the timing of the transaction and the date of preparation of the evaluation should be close enough.	1. Market realisation coefficient (0.8-0.95) 2. Location coefficient (0.81-1.0) 3. Coefficient of specific features (status) (0.8-1.1)	The higher (lower) fair value if: • Higher (lower) market realisation coefficient • Higher (lower) location coefficient • Higher (lower) coefficient of specific features (status)
Assets, acquired from collateral foreclosure	27,128	15,875		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

The Bank discloses voluntary the fair values the assets acquired from collateral foreclosure as of 31 December 2018 and 31 December 2017.

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

5. DISCLOSURE OF FAIR VALUE (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 31.12.2018	Fair value as of 31.12.2017	Fair value hierarchy	Valuation techniques	Significant unobservable inputs	Relationship of unobservable inputs to fair value
Loans to banks	104,972	116,576	Level 2	Discounted cash flows Future cash flows are discounted using the 12 month by EURIBOR for 12 months but nor less than 0, adjusted for yield curve of Bulgarian government securities on primary market according to Bloomberg publication	N/A	N/A
Loans and advances to customers	1,069,236	710,313	Level 2	Discounted cash flows Future cash flows are measured using the officially published by BNB interest rates (unadjusted) of new loans for December 2018.	N/A	N/A
Receivables from the State budget	497,667	799,661	Level 2	Discounted cash flows Future cash flows are measured using the officially published by BNB yield of Bulgarian government securities (unadjusted) for December 2018	N/A	N/A
Securities held for trading	-	598	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 2018	N/A	N/A
Other borrowings	17,876	18,385	Level 2	Discounted cash flows Future cash flows are measured using the officially published by BNB yield of Bulgarian government securities (unadjusted) for December 2018	N/A	N/A
Borrowings from international institutions	936,612	899,003	Level 2		N/A	N/A

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

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

6. NET INTEREST INCOME

	2018	2017
Interest income		
Financial assets measured at amortised cost		
Loans and advances to customers	44,756	44,994
Receivables from the State budget	9,254	10,157
Loans to banks	1,707	2,507
Securities, measured at amortised cost	10	52
Deposits placed with other banks	1,872	945
Financial assets at fair value through other comprehensive income	4,677	2,005
Other liabilities (effect of negative interest)	1,004	88
	63,280	**60,748**
Incl. Interest income on impaired loans and receivables	**4,322**	**4,567**
Interest expenses		
Borrowings from international institutions	(6,631)	(4,464)
Deposits from customers other than credit institutions	(648)	(891)
Other borrowings	(124)	(128)
Other assets (effect of negative interest)	(2,061)	(255)
Finance lease	(21)	-
Deposits from credit institutions	(4)	(16)
	(9,489)	**(5,754)**
Net interest income	**53,791**	**54,994**

The yield on the assets, as a ratio of net profit to the balance sheet figure, is 0.83% (2017: 0.82%).

7. NET FEE AND COMMISSION INCOME

	2018	2017
Fee and commission income under IFRS 15		
Transaction-related services	594	-
Issuance of guarantees and letters of credit	1,383	-
Account maintenance	69	-
Total fee and commission income from contract with customers	**2,046**	-
Other charges	16	-
Total fees and commissions 2018	**2,062**	-
Guarantees and letters of credit	-	1,329
Account maintenance, transfers and customers' treasury operations	-	570
Servicing of debenture issues	-	252
Management of special-purpose funds of the Ministry of Finance (Note 30)	-	64
Total fees and commissions 2017	-	**2,215**

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

Fee and commission expenses		
Agent's commissions	(2)	(1)
Servicing of accounts with other banks	(29)	(30)
Transfers и treasury operations in other banks	(4)	(3)
Total fee and commission expenses	**(35)**	**(34)**
Net fee and commission income	**2,027**	**2,181**

8. NET GAIN ON FOREIGN EXCHANGE DEALS

	2018	2017
Net gain on dealing in foreign currencies	386	419
Net gain/(loss)on foreign currency translation of assets and liabilities	(7)	(10)
	379	**409**

9. NET GAIN ON SECURITIES MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

	2018	2017
Net gain on dealing in securities measured at fair value through OCI, incl. realised revaluation reserve	738	188
	738	**188**

10. OTHER OPERATING INCOME

	2018	2017
Dividends received	909	1,393
Income from rent of investment property	594	480
Refunded litigation expenses	839	348
Proceeds from disposal of assets held for sale	437	197
Proceeds from disposal of FTA (fixed tangible assets)	1	7
Other income	224	89
	3,004	**2,514**

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

11. OTHER OPERATING EXPENSES

	2018	2017
Expenses on assets held for sale	(280)	(335)
Litigation expenses	(28)	(62)
Loss on revaluation of investment property	-	-
Withholding tax	(286)	(223)
Direct operating expenses relating to investment property	(204)	(165)
Expenses on disposal of FTA	(1)	(31)
Other expenses	(658)	-
	(1,457)	**(816)**

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

	2018	2017
Expenses / Income on / from reversed impairment losses on assets, net	(5,694)	(23,091)
Expenses on /(Income from reversed) impairment on unutilised loans	472	
Expenses on /(Income from reversed) guarantee provisions, net	(1,624)	2,511
Expenses on / (Income from reversed) impairment of assets acquired from collateral foreclosure	(232)	(194)
Expenses on /(Income from reversed) provisions for securities, net	(1,703)	-
	(8,781)	**(20,774)**

The movement in the balance sheet accumulated expenses on impairment and provisions is disclosed in Notes 18B and 31.

13A. COSTS OF PERSONNEL

	2018	2017
Staff remuneration and social security	(10,245)	(8,302)
Remuneration to members of the Management and Supervisory Boards	(1,445)	(1,630)
	(11,690)	**(9,932)**

	2018	2017
Personnel costs consist of:		
Salaries	(8,920)	(7,195)
Social security	(1,132)	(936)
Social benefits	(108)	(96)
Amounts accrued on retirement benefits	(85)	(75)
	(10,245)	**(8,302)**

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

13B. GENERAL AND ADMINISTRATIVE EXPENSES

	2018	2017
Contribution to the Bank Resolution Fund (BRF)	(6,913)	(3,180)
Contribution to the Bulgarian Deposit Insurance Fund (BDIF)	(47)	(39)
Rents	(9)	(10)
Communications and IT services	(530)	(494)
Office and office equipment maintenance	(752)	(550)
Legal and consulting services	(271)	(226)
Advertising and entertainment expenses	(858)	(320)
Taxes and government charges	(207)	(199)
Hired services	(285)	(204)
Advisory services by the registered audit firms	(2)	(9)
Business trips	(88)	(45)
Audit services by the registered auditor	(158)	(131)
	(10,120)	**(5,407)**

The amounts charges for the year for services provided by the registered audit firms of the Company include: independent financial audit: BGN 158 thousand (2017: BGN 131 thousand), including agreed-upon procedures for BGN 6 thousand (2017: BGN 6 thousand), tax advisory services: BGN 0 (2017: BGN 0), other services not related to audit : BGN 2 thousand (2017: BGN 9 thousand).

14. TAXATION

	2018	2017
Current tax expense	1,396	2,004
Deferred tax (benefit)/expense due to temporary differences	60	117
Deferred tax (benefit)/expense due to changes in accounting policies	167	-
Total current tax expense	**1,623**	**2,121**

Taxes comprise: non-refundable VAT, one-off taxes, local taxes and charges, government and court charges.

	2018	2017
Accounting profit	26,753	22,266
Income tax calculated at the effective tax rate (10 per cent for 2018, 10 per cent for 2017)	2,675	2,226
Expense on non-deductible expenses	38	34
Non-deductible income	(129)	(139)
Deferred tax (benefit)/expense due to changes in accounting policies	(961)	-
Total tax expense	**1,623**	**2,121**
Effective tax rate	**6,07%**	**9.53%**

In 2018, the Bank paid advance corporate income taxes of BGN 2,640 thousand (2017: BGN 3,600 thousand).

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

14. TAXATION (continued)

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

	Assets		Liabilities		
	2018	2017	2018	2017	Changes in the statement of comprehensive income
Property and equipment	(15)	(15)	-	-	-
Other assets	(232)	(444)	-	-	212
Guarantee portfolio	-	206	-	-	(206)
Other liabilities	-	(55)	-	-	55
Securities at fair value through other comprehensive income	-	(840)	-	-	840
	(247)	**(1,148)**	**-**	**-**	**901**

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

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

15. NET CHANGE IN THE FAI RVALUE OF FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

	2018	2017
Change in the fair value of financial assets at fair value through other comprehensive income		
Gains /(Losses), which have occurred during the year	1,781	1,466
10% tax	(673)	-
Other comprehensive income for the year, net of tax	**1,108**	**1,466**

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

	2018	2017
Cash in hand	335	244
Current accounts	297,287	447,404
Incl. Minimum statutory reserves	*172,143*	*120,400*
Total cash with the Central Bank	**297,287**	**447,404**
Total cash in hand and in accounts with the Central Bank	**297,622**	**447,648**

Deposits with the Central Bank bear interest rate of -0.60 % on the excess over 105% of MRR (2017: - 0,60 %).

17. RECEIVABLES FROM BANKS

	2018	2017
Current accounts and demand deposits with local banks	111	212
Current accounts and demand deposits with foreign banks	14,938	12,512
incl. Current accounts with an original maturity of less than 90 days	*4,506*	*2,182*
Term deposits with local banks (incl. repo deals)	244,030	71,786
Term deposits with foreign banks (incl. repo deals)	71,143	-
incl. Term deposits with an original maturity of less than 90 days	*315,173*	*71,786*
Loans to local banks	98,971	101,270
Loans to foreign banks	1,467	12,599
Adjustment for impairment and uncollectability of banks	(1,112)	-
	429,548	**198,379**

At 31 December 2018, special-purpose loans, denominated and BGN and EUR, with original maturity of up to 10 years and interest rate levels ranging from 1.40 per cent to 4.50 per cent (2017:1.49 per cent to 4.40 per cent), were extended with the aim to develop small and medium-sized enterprises.

Funds amounting to BGN 10,543 thousand were blocked in current accounts with foreign banks to cover letters of credit (2017: BGN 10,542 thousand).

At 31 December 2018, loans were provided to local banks denominated in foreign currency with nominal amount of EUR 5,745 thousand and equivalent to BGN 11,236 thousand (31 December 2017 – no such loans were extended), with an original maturity until 2027 and repayment of the loans in four instalments. These are special-purpose loans extended to banks for direct lending to customers with the aim to develop small and medium-sized enterprises (SMEs) in accordance with a loan financing by the Ministry of Finance with funds provided by KfW.

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

18. LOANS AND ADVANCES TO CUSTOMERS

	2018	2017
Loans (gross amount)	1,197,889	854,853
Allowance for impairment and uncollectability of loans	(158,809)	(155,173)
	1,039,080	699,680

	2018	2017
A. Analysis by customer type (gross amount)		
Corporate and sole traders	1,194,728	850,855
Municipalities	928	1,099
Individuals	2,233	2,899
	1,197,889	854,853

	2018	2017
B. Analysis by industry sector depending on the purpose of the loan (gross amount)		
Industry, total	435,435	300,655
Industry – energy generation and distribution	*74,452*	*85,046*
Industry – manufacture of plant and equipment	*67,611*	*62,742*
Industry – manufacture of tobacco products	*149,129*	*58,773*
Industry – manufacture of foodstuffs	*51,392*	*50,032*
Industry – other industries	*92,851*	*44,062*
Construction	162,402	146,346
Transport	130,765	105,615
Financial services	113,942	77,456
Real estate transactions	49,552	49,286
Administrative and office activities	-	48,815
Trade	32,165	35,848
Government sector	77,659	32,376
Agriculture	29,159	26,984
Tourist services	108,148	16,282
Collection and disposal of garbage	4,190	8,399
Other industries	54,472	6,791
	1,197,889	854,853

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

	2018			2017		
	Individually impaired	Collectively impaired	Total	Individually impaired	Collectively impaired	Total
At 1 January	**155,173**	-	**155,173**	**141,144**	-	**141,144**
Effect of IFRS 9	10,076	-	**10,076**	-	-	-
Impairment costs	29,170	-	**29,170**	42,644	-	**42,644**
Reversed impairment	(23,476)	-	**(23,476)**	(19,553)	-	**(19,553)**
Written-off against impairment	(12,134)	-	**(12,134)**	(9,062)	-	**(9,062)**
At 31 December	**158,809**	-	**158,809**	**155,173**	-	**155,173**

19. RECEIVABLES FROM THE STATE BUDGET

	2018	2017
Acquired receivables	-	9,506
Energy Efficiency of Multi-Family Buildings National Programme (EEMFBNP)	472,803	728,010
Adjustment for impairment and uncollectability of loans (collective impairment)	(804)	-
	471,999	**737,516**

At 31 December 2018 (and at 31 December 2017 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 Energy Efficiency of Multi-Family Buildings National Programme (EEMFBNP) (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 2018 amounted to BGN 471,999 thousand (at 31 December 2017: BGN 728,010 thousand).

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

20. SECURITIES HELD FOR TRADING

	2018	2017
Corporate bonds of financial entities	-	594
	-	594

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

21.A FINANCIAL ASSETS MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

Pursuant to IFRS 9, as of 01 January 2018 the Bank has been reporting a new category of assets in its statement of financial position: financial assets measured at fair value through other comprehensive income.

	2018	2017
Government securities	540,158	-
Corporate bonds	50,808	-
Non-publicly traded companies' shares	2,722	-
Participation in investment program SIA (Note 35)	546	-
Public companies' shares	15	-
	594,249	-

Movement in financial assets measured at fair value through other comprehensive income

	2018	2017
As of 1 January	**230,903**	-
Additions (purchases)	483,171	-
Disposals (sale and/or maturity)	(119,447)	-
Net (decrease)/increase due to revaluation of financial assets measured at fair value through other comprehensive income	(378)	-
As of 31 December	**594,249**	-

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

21.B AVAILABLE-FOR-SALE SECURITIES

In 2017, the Bank reported assets available for sale in accordance with IAS 39, as follows:

	2018	2017
Government securities	-	227,917
Corporate bonds	-	-
Non-publicly traded shares	-	2,620
Participation in investment program SIA (Note 35)	-	352
Public companies' shares	-	14
	-	**230,903**

In 2018, these assets were reclassified as financial assets measured at fair value through other comprehensive income.

Movement in financial assets available for sale

	2018	2017
As of 1 January	-	**264,368**
Additions (purchases)	-	53,258
Disposals (sale and/or maturity)	-	(88,189)
Net (decrease)/increase due to revaluation of financial assets measured at fair value through other comprehensive income	-	1,466
As of 31 December	**-**	**230,903**

Financial assets measured at fair value through other comprehensive income comprise mainly government securities with the issuer being the Republic of Bulgaria or other European countries, and corporate bonds.

The non-public companies' shares held by the Bank include shares of the European Investment Fund (EIF) amounting to BGN 2,538 thousand. The portion of the nominal value of the acquired shares of EIF, which has not been paid, is due after a decision is taken by the General Meeting of Shareholders of EIF.

The remaining portion of the non-public companies' shares amounting to BGN 183 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.

The revaluation reserve formed on available-for-sale financial assets as of 31 December 2018 amounts to BGN 4,568 thousand– positive value (31 December 2017: BGN 4,947 thousand - positive value) (Note 34).

In 2018, there was no transferred or reported allowance for impairment of assets measured through other comprehensive income in current profit or loss for the year) (Note 9) (2017: there was no transferred and reported impairment of available-for-sale securities in the statement of comprehensive income).

22. INVESTMENTS IN SUBSIDIARIES

The Bank is a sole owner of the capital of National Guarantee Fund EAD, registered with the Commercial Register on 22 August 2008. The total registered share capital at 31 December 2018 consists of 800,000 shares of BGN 100 each (31 December 2017: 800,000 shares of BGN 100 per share). The registered capital at 31 December 2018 amounts to BGN 80,000 thousand (31 December 2017: BGN 80,000 thousand). The investment in the subsidiary at 31 December 2018 amounts to BGN 80,000 thousand (31 December 2017: BGN 80,000 thousand), measured at historical cost of acquisition.

The Bank is a sole owner of the capital of Micro Financing Institution Jobs, registered on 14 January 2011. The total registered share capital at 31 December 2018 amounts to BGN 7,643 thousand, split into 76,430 shares of BGN 100 each. The investment in the subsidiary at 31 December 2018 amounts to BGN 7,643 thousand (31 December 2017: BGN 7,643 thousand), measured at historical cost of acquisition.

Bulgarian Development Bank and National Guarantee Fund are owners of the capital of the Capital Investments Fund incorporated on 24 August 2018. The company's capital amounts to BGN 65 000 thousand split into 650,000 shares of BGN 100 each.

Bulgarian Development Bank subscribed 550,000 registered shares for the total amount of BGN 55 000 thousand, representing 84.62 % of the capital. National Guarantee Fund subscribed 100,000 shares for the total amount of BGN 10,000 thousand, representing 15.38 % of the Fund's capital.

At 31 December 2018, Bulgarian Development Bank paid BGN 13 750 thousand, representing 25% of the amount of the contribution into the registered capital, and National Guarantee Fund paid BGN 2 500 thousand, representing 25% of the amount of the contribution into the registered capital.

By decision of the Bank's Management Board, as recorded in Protocol 29 of 18 May 2018, Trade Centre Maritsa EOOD became an ownership of Bulgarian Development Bank EAD.

At 31 December 2018, management conducted a review for impairment of the investments in subsidiaries and found that there were no indications of impairment.

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

23. PROPERTY, PLANT AND EQUIPMENT, INTANGIBLE ASSETS

	Land and buildings	Bank equipment and computers	Fixtures and fittings	Motor vehicles	Licences and software	Total
Book value						
As of 1 January 2017	**32,553**	**2,114**	**603**	**291**	**1,071**	**36,632**
Additions	-	196	181	-	132	509
Disposals	-	(338)	(221)	-	(5)	(564)
As of 31 December 2017	**32,553**	**1,972**	**563**	**291**	**1,198**	**36,577**
Additions	-	23	106	775	105	1,009
Disposals	-	(18)	-	-	-	(18)
As of 31 December 2018	**32,553**	**1,977**	**669**	**1,066**	**1,303**	**37,568**
Accumulated depreciation						
As of 1 January 2017	**721**	**993**	**252**	**123**	**845**	**2,934**
Charge for the year	576	308	57	58	93	1,092
Disposals	-	(313)	(80)	-	(5)	(398)
As of 31 December 2017	**1,297**	**988**	**229**	**181**	**933**	**3,628**
Charge for the year	576	266	72	136	88	1,138
Disposals	-	(16)	-	-	-	(16)
As of 31 December 2018	**1,873**	**1,238**	**301**	**317**	**1,021**	**4,750**
Net book value						
At 31 December 2018	**30,680**	**739**	**368**	**749**	**282**	**32,818**
At 31 December 2017	**31,256**	**984**	**334**	**110**	**265**	**32,949**
At 1 January 2017	**31,832**	**1,121**	**351**	**168**	**226**	**33,698**

The fully depreciated property, plant and equipment still in use at 31 December 2018 amount to BGN 853 thousand at cost (2017: BGN 722 thousand) and intangible assets amount to BGN 837 thousand (2017: BGN 799 thousand) respectively.

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

24. INVESTMENT PROPERTY

	2018	2017
Carrying amount at the beginning of period	7,702	7,702
Reclassified from held for sale	-	-
Sold	(53)	-
Loss on change in the fair value included in profit and loss for the period	-	-
	7,649	7,702

The Bank holds investment properties as a result of collateral acquired on problem loans. They are leased to third parties. Rental income generated for 2018 amounts to BGN 594 thousand (2017: BGN 480 thousand) (Note 11). The fair value at 31 December 2018 has been determined by an independent certified appraiser.

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

25. ASSETS HELD FOR SALE

Properties (land, buildings and fixtures and fittings) at 31 December 2018 amounting to BGN 4,840 thousand (2017: BGN 9,924 thousand – land, buildings and fixtures and fittings) were acquired by the Bank in 2018 against payment of liabilities under problem loans of borrowers.

The assets have not been used and it is not planned to be used in the Bank's activity. Management actively seeks buyers with the purpose to sell them by the end of 2019.

Movement in assets held for sale in 2018 and 2017:	**2018**	**2017**
Carrying amount at the beginning of period	9,924	4,657
Acquired from collateral foreclosure	4,835	9,417
Reclassified to assets acquired from collateral foreclosure	(8,963)	(4,150)
Reclassified to investment property	-	-
Sold	(956)	-
Impairment	-	-
	4,840	9,924

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

26. OTHER ASSETS AND ASSETS ACQUIRED FROM COLLATERAL FORECLOSURE

	2018	2017
Assets acquired from collateral foreclosure	27,128	15,875
Other receivables	12	36
VAT refundable	545	439
Current tax receivables (Income tax overpaid)	1,244	1,596
Prepayments and advances	155	211
	29,084	**18,157**

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

Movement in assets acquired from collateral foreclosure in 2018 and 2017:	**2018**	**2017**
Carrying amount at the beginning of period	15,875	11,372
Reclassified from held for sale	8,963	4,150
Additional capitalised costs	3,096	1,341
Sold	(575)	(794)
Impairment (Note 12)	(231)	(194)
Carrying amount at the period-end	**27,128**	**15,875**

27. DEPOSITS FROM CREDIT INSTITUTIONS

	2018	2017
Deposits from local banks	4,323	32,361
Deposits from foreign banks	1,436	1,548
	5,759	**33,909**

There were no interest payable on deposits from credit institutions as at 31 December 2018 (2017: BGN 12 thousand).

	2018	2017
Term deposits	-	30,012
Demand deposits	5,759	3,897
	5,759	**33,909**

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

28. DEPOSITS FROM CUSTOMERS OTHER THAN CREDIT INSTITUTIONS

	2018	2017
Individuals	5,166	8,268
Companies and sole traders	1,209,268	688,440
Special-purpose deposits	93,088	93,882
	1,307,522	**790,590**

	2018	2017
Term deposits	605,448	206,052
Demand deposits	702,074	584,538
	1,307,522	**790,590**

Interest payable on deposits from other customers, other than credit institutions, at 31 December 2018 amounts to BGN 539 thousand (2017: BGN 156 thousand).

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

	2018	2017
Term deposits	605,448	206,052
Demand deposits	702,074	584,538
	1,307,522	**790,590**

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

29. BORROWINGS FROM INTERNATIONAL INSTITUTIONS

	2018	2017
Long-term framework loan agreement with the Council of Europe Development Bank	277,271	325,929
Long-term loans from the European Investment Bank	146,722	146,721
Long-term loans from the Nordic investment bank	11,947	16,521
Long-term loans from the Kreditanstalt für Wiederaufbau	154,223	195,667
The Export – Import Bank of China	97,727	-
Long-term loans from the Japanese Bank for International Cooperation	-	969
European Investment Fund	1,712	7,859
Industrial and Commercial Bank of China	-	19,660
China Development Bank	215,180	156,496
	904,782	**869,822**

The outstanding interest on the borrowings from international institutions as of 31 December 2018 amounts to BGN 755 thousand (2017: BGN 924 thousand).

The effective interest rates on borrowings from international institutions as of 31 December 2018 range from 0% to 1.75% (31 December 2017: from 0% to 3.39%).

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 create new and to preserve already existing jobs. The loan is unsecured.

As of 31 December 2018, the loan was fully utilised and the outstanding principal under the facility amounted to EUR 3,750 thousand equivalent to BGN 7,334 thousand (31 December 2017: EUR 5,625 thousand equivalent to BGN 11,002 thousand). The interest rate is floating, based on the 3M EURIBOR plus a 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 create new jobs, and to preserve already existing ones. The loan is unsecured.

As of 31 December 2018, the loan was fully utilised and the outstanding principal under the facility amounted to EUR 9,000 thousand equivalent to BGN 17,602 thousand (31 December 2017: EUR 11,000 thousand equivalent to BGN 21,514 thousand). The interest rate on the first tranche is floating, based on the 3M EURIBOR plus a margin, and on the second tranche it is fixed.

29. BORROWINGS FROM INTERNATIONAL INSTITUTIONS (continued)

Council of Europe Development Bank (continued)

On 23 February 2016, Bulgarian Development Bank signed a Loan agreement with the Council of Europe Development Bank (CEB) amounting to EUR 150,000 thousand. The funds have been used to finance energy efficiency and retrofitting measures under Energy Efficiency of Multi-Family Buildings National Programme (EEMFBNP). The loan has a special purpose and has been used for renovation of multi-family buildings. The repayment period of the loan is up to 10 years. As of 31 December 2018, the loan was fully utilised.

The loan is secured by a State guarantee under the State Budget of the Republic of Bulgaria Law for 2016. A Guarantee Agreement was signed between the CEB and the 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 Energy Efficiency of Multi-Family Buildings National Programme (EEMFBNP) was approved by virtue of decision of the Council of Ministers of 27 January 2015.

As of 31 December 2018, the outstanding principal under the loan amounted to EUR 129,000 thousand, equivalent to BGN 252,302 thousand (as of 31.12.2017: EUR 150,000 thousand equivalent to BGN 293,375 thousand). The interest rate on the first tranche of the loan is floating, based on 3M EURIBOR plus a margin, and on the second tranche it is fixed.

European Investment Bank

On 18 November 2016, BDB signed a contract with European Investment Bank for the amount of EUR 150,000 thousand for financing of projects of small and medium-sized enterprises. The funds are provided with the support of the EU and are backed by an EFSI (European Fund for Strategic Investment) guarantee, part of the Investment Plan for Europe – the Juncker Plan. The funds will be used to finance SMEs, including innovative projects, to support regions with high unemployment rates, as well as youth employment or start-up company projects. The loan can be allocated through partner banks, other financial intermediaries or directly. The loan is unsecured.

As of 31 December 2018, the outstanding principal under the loan amounted to EUR 75,000 thousand equivalent to BGN 146,687 thousand (as at 31 December 2017: EUR 75,000 thousand equivalent to BGN 146,687 thousand). The interest rate is floating, based on the 6M EURIBOR plus a margin.

Kreditanstalt für Wiederaufbau

On 27 July 2010, Bulgarian Development Bank AD signed a direct loan agreement for EUR 25,000 thousand with the German Development Bank Kreditanstalt für Wiederaufbau (KfW). The purpose of the loan is direct lending to small and medium sized enterprises and/or for providing credit lines to commercial banks for special-purpose business financing. The loan is unsecured. At 31 December 2018, the loan was fully utilised.

As of 31 December 2018, the outstanding principal under the facility amounted to EUR 5,882 thousand equivalent to BGN 11,505 thousand (at 31 December 2017: the outstanding principal amounted to EUR 8,824 thousand equivalent to BGN 17,257 thousand). The interest rate is floating, based on the 6M EURIBOR plus a margin.

29. BORROWINGS FROM INTERNATIONAL INSTITUTIONS (continued)

Kreditanstalt für Wiederaufbau (continued)

On 16 August 2016, Bulgarian Development Bank signed an Agreement with KfW for EUR 100,000 thousand. The funds will be used to finance energy efficiency and retrofitting measures, implemented by SMEs in Bulgaria under the Energy Efficiency of Multi-Family Buildings National Programme (EEMFBNP) The loan is secured by a State guarantee under the State Budget of the Republic of Bulgaria Law for 2016. A Guarantee Agreement was signed between KfW and the Republic of Bulgaria, represented by the Minister of Finance, which was ratified by the National Assembly. The Guarantee Agreement Ratification Act was promulgated in State Gazette on 30 December 2016. The repayment period of the loan is 7 years, with a grace period of 2 years. As of 31 December 2018, the loan was fully utilised.

As of 31 December 2018, the outstanding principal under the facility amounted to EUR 72,727 thousand equivalent to BGN 142,242 thousand (as of 31 December 2017, the outstanding principal under the facility amounted to EUR 90,909 thousand equivalent to BGN 177,803 thousand). The interest rate is floating, based on the 6M Euribor plus margin.

Nordic Investment Bank

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 purpose of the loan is financing of renewable energy projects or environmental projects; projects involving the Nordic Investment Bank member states, as well as indirect financing through commercial partner banks . The loan is unsecured. As of 31 December 2018, the loan was fully utilised.

As of 31 December 2018, the outstanding principal under the facility amounted to EUR 6,136 thousand equivalent to BGN 12,001 thousand (31 December 2017: EUR 8,489 thousand equivalent to BGN 16,603 thousand). The interest rate is floating, based on 6M EURIBOR plus a margin.

Sumitomo Mitsui Banking Corporation Europe

On 11 November 2014, BDB signed a new agreement with Sumitomo Mitsui Banking Corporation Europe for trade 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 2018, there was no outstanding principle under the loan (31 December 2017: no outstanding principle). The interest rate is floating, based on EURIBOR plus a margin.

Japan Bank for International Cooperation (JBIC)

On 17 December 2009, a Loan agreement was signed between Bulgarian Development Bank AD and Japan Bank for International Cooperation for EUR 20,000 thousand. The purpose of the loan is financing of Japanese projects and can be utilised in EUR or JPY. For a loan in EUR the applicable interest rate is fixed (CIRR plus risk margin) for 60 per cent of the amount and floating (6M EURIBOR + margin) for the rest 40 per cent. 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 2018, the loan was fully paid (31 December 2017: JPY 70,149 thousand equivalent to BGN 1,016 thousand).

29. BORROWINGS FROM INTERNATIONAL INSTITUTIONS (continued)

Progress Program of the European Investment Fund

On 24 July 2015, a loan agreement was signed between Bulgarian Development Bank AD and the Progress Program of EIF for EUR 5,000 thousand. The purpose of the loan is to finance micro-leases and micro-loans for micro and small enterprises, as well as to finance micro-loans through financial institutions. This Program targets companies with up to 10 employees and assets up to EUR 2 million (BGN 3,912 thousand). Self-employed persons, start-ups, or persons experiencing difficulties in obtaining financing are also eligible as beneficiaries.

As of 31 December 2018, the loan principal due amounted to EUR 871 thousand equivalent to BGN 1,704 thousand (31 December 2017: EUR 4,000 thousand equivalent to BGN 7,823 thousand). The interest on the loan is fixed.

Industrial and Commercial Bank of China (ICBC)

On 22 February 2016, BDB signed an inter-bank loan agreement with ICBC for EUR 20,000 thousand. The purpose of the loan is financing of the general lending activity of BDB, direct business financing or on-lending through commercial banks for investment projects and working capital. The term of the loan is two years. The loan is unsecured. As of 31 December 2018, the loan was fully paid (31 December 2017: EUR 10,000 thousand equivalent to BGN 19,558 thousand).

China Development Bank

On 12 May 2017, BDB signed a loan agreement with China Development Bank for the amount of EUR 80,000 thousand. The purpose of the loan is financing the general lending activity of BDB – investment and working capital loans. BDB could also use the funds to support strategic projects within the Belt & Road initiative. The tenor of the loan is 10 years, with a 2-years grace period. The loan is unsecured. As of 31 December 2018, the loan was fully utilized.

As of 31 December 2018, the outstanding principal under the loan amounted to EUR 80,000 000 thousand equivalent to BGN 156,466 thousand (as of 31 December 2017: EUR 80,000 000 thousand equivalent to BGN 156,466 thousand). The interest rate is floating based on the 6M EURIBOR plus margin.

On 13 December 2018, BDB signed a new financing agreement with the China Development Bank amounting to EUR 300,000 thousand. The funds were granted as a first tranche under the framework agreement signed in July 2018 for EUR 1.5 billion. The funds may be used to finance projects within the Belt & Road initiative and/or projects in support of SMEs, energy, communications, transport, agriculture in Bulgaria or for other purposes agreed by BDB and CDB. The term of the contract is 10 years.

As of 31 December 2018, the outstanding principal under the loan amounted to EUR 30,000 thousand equivalent to BGN 58,675 thousand (as of 31 December 2017: no amounts due under the loan). The interest rate is floating based on the 6M EURIBOR plus a margin.

The Export – Import Bank of China

On 28 September 2017, BDB signed an agreement with the Export – Import Bank of China for the amount of EUR 50,000 thousand. This was the first loan agreement between BDB and the Export – import Bank of China, following the financial cooperation agreement, signed in 2014 between the two institutions and setting their interest in joint financing of key projects or areas. The funds can be used to finance the overall lending activity of BBD, a short-term and mid-term trade financing, trans-border economic and commercial transactions between China and Bulgaria. The loan tenor is 5 years. The loan is unsecured.

As of 31 December 2018, the loan was fully utilised; the outstanding principal under the loan amounted to EUR 50,000 thousand equivalent to BGN 97,792 thousand (31 December 2017: no amounts were utilised under the loan). The interest rate is floating based on the 6M EURIBOR plus a margin.

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

30. OTHER BORROWINGS

	2018	2017
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	6,070	6,256
	17,306	**17,492**

There were no interest liabilities accrued on other borrowings as of 31 December 2018 (2017: 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 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 Promoter for the purpose of financing micro, small and medium-sized enterprises. The term of the agreement is 10 years as from the date of transfer of the funds, while the latter along with the due interest shall be repaid bullet at the end of the period.

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

As of 31 December 2018, the outstanding principal and the capitalised interest amounted to EUR 5,745 thousand equivalent to BGN 11,236 thousand (as of 31 December 2017: EUR 5,745 thousand equivalent to BGN 11,236 thousand). The loan interest is capitalised quarterly and is based on 3M EURIBOR plus a margin.

As of 31 December 2018, the Bank has extended under this contract loans to commercial banks amounting to EUR 5,745 (31 December 2017: no funds were extended). This amount was included in the summarised table of the receivables from financial institutions, presented in Note 17.

KfW funds provided by the Ministry of Finance for trust management

The Bank has 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 financing of small and medium-sized enterprises. The Ministry of Finance bears the risk under the loans to partner-banks. The Bank selects the partner-banks and transfers the funds to those approved; gathers information and performs periodic reviews of the funds utilisation, monitors the timely interest and principal payments to the special account of the Ministry of Finance.

As of 31 December 2018, the outstanding principal of the funds under trust management with the Bank amounts to EUR 3,104 thousand equivalent to BGN 6,070 thousand (31 December 2017: EUR 3,199 thousand equivalent to BGN 6,256 thousand.

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

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

31. PROVISIONS

	2018	2017
Bank guarantee provisions	2,998	833
Litigation provisions	187	97
	3,185	**930**

Bank guarantee provisions consist of the amounts the Bank estimates as highly probable to be required to be actually paid to third parties. Out of them, BGN 699 thousand (2017: BGN 818 thousand) relates to bank guarantees on "Guarantee Fund for Micro Lending" project of MLSP(Ministry of labor and social policy), and BGN 2,299 thousand (2017: BGN 15 thousand) relates to individual guarantees issued.

Litigation provisions relating to future payments under lawsuits relating to labour disputes amount to BGN 187 thousand.

The following table presents the movement in provisions by guarantees:

	2018	2017
Balance as of 1 January	**833**	**3 145**
Effect IFRS 9	92	-
Charged over the year	2,287	4
Utilised over the year	919	198
Reversed over the year	(1,133)	(2,514)
Balance as of 31 December	**2 998**	**833**

32. OTHER LIABILITIES

	2018	2017
Payables to personnel for salaries and social security	460	384
Retirement benefit liabilities	400	366
Charges on debenture loans and guarantees	48	61
Tax liabilities	318	267
Accruals for expenses	287	698
Payables to EIF	5	148
Finance lease liabilities	561	-
Other creditors	142	575
	2,221	**2,499**

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

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

32. OTHER LIABILITIES (continued)

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

In accordance with the Labour Code each employee is entitled to indemnity on retirement amounting to two gross monthly salaries, and if he / she has worked for more than 10 years for the Bank – to six gross monthly salaries at the time of retirement. The Bank estimated the amount of these liabilities by using mathematical models and the services of a certified actuary. On the basis of the calculations made, the amount of BGN 400 thousand was included in the separate statement of financial position at 31 December 2018 (31 December 2017: BGN 366 thousand).

	2018	2017
Present value of the liability at 1 January	**366**	**229**
Current service cost	101	49
Interest expense	6	7
Amounts paid in the period	(19)	-
Actuarial (gains)/losses from changes in demographic and financial assumptions and actual experience	(54)	81
Present value of the liability at 31 December	**400**	**366**

	Amounts on retirement for old age and length of service		Amounts on retirements due to illness		Total	
	2018	2017	2018	2017	2018	2017
Actuarial gain/(loss) at 1 January	(41)	22	-	-	(41)	22
Actuarial gain / (loss) recognized in other comprehensive income for the period	33	(63)	-	-	33	(63)
Actuarial gain/(loss) at 31 December	(8)	(41)	-	-	(8)	(41)

The following actuarial assumptions are used in calculating the present value of the liabilities as of 31 December 2018:

- 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 2015 – 2017;
- 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 – 1.0 per cent (2017: 1.4 per cent);
- assumptions for the future level of working salaries in the Bank are based on the Bank's development plan for 2019 – 5 per cent compared to the 2018 level and for 2020 and subsequent years – 5 per cent compared to the previous year level.

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

32. OTHER LIABILITIES (continued)

The effect for 2018 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)	17	(14)
Change in the present value of the liability as of 31 December 2018 ("+"- increase, "–"- decrease)	60	(49)

	Increase by 1% of interest rate	Decrease by 1% of interest rate
Change in the interest and current service costs ("+"- increase, "–"- decrease)	(9)	12
Change in the present value of the liability as of 31 December 2018 ("+"- increase, "–"- decrease)	(50)	62

	Increase by 1% of staff turnover rate	Decrease by 1% of staff turnover rate
Change in the interest and current service costs ("+"- increase, "–"- decrease)	(15)	19
Change in the present value of the liability as of 31 December 2018 ("+"- increase, "–"- decrease)	(53)	65

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

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

33. SHARE CAPITAL

	2018	2017
Share capital		
Ordinary shares issued paid in cash	587,964	587,964
Ordinary shares issued – in-kind contribution (land for the building of the bank)	12,200	12,200
Ordinary shares issued - in-kind contribution (the building of the bank)	1,610	1,610
	601,774	**601,774**

The capital of the Bank is composed by 6,017,735 ordinary registered voting shares with par value of BGN 100 each.

The Bulgarian Development Bank Act provides that not less than 51 per cent of shares forming the Bank's capital should be owned by the State; the shares of the State amounting to not less than 51 per cent of the registered share capital are non-transferable. Also, a specific limit is established with regard to the remaining shareholders, other than the Bulgarian State through the Ministry of Finance. Shareholders may be: the Council of Europe Development Bank, the European Investment Bank, the European Investment Fund as well as other banks for development in EU member states. The Bank's shares may not be pledged and the rights thereon may not be subject to transfer deals.

In August 2017, by decision of the SB, the Bank's shares were transferred from the Ministry of Finance to the Ministry of Economy and as of 31 December 2018, 99.99 per cent of the Bank's shares were held by the State through the Ministry of Economy (31 December 2017: 99.99 per cent of the Bank's shares were held by the State through the Ministry of Finance).

34. RESERVES

In accordance with the general provisions of the Commercial Act, the Bank shall allocate to Reserve Fund at least 1/10 of its profit for the year until the reserves reach 10 percent of the share capital as stipulated in the Articles of Association. Pursuant to the Articles of Association of the Bank, the Bank shall set aside to the Reserve Fund at least ½ of its after-tax annual profit until the reserves reach 50 percent of its share capital.

The Reserve Fund may be used by the Bank only to cover its current or prior period losses, and not for distribution of dividends, without the authorisation of Bulgarian National Bank.

Moreover, the Credit Institutions Act stipulates that the banks in Bulgaria cannot distribute dividends before accumulating the minimum reserves (mainly the Reserve Fund) required by law or by their Articles of Association, or if the distribution of dividends will result in violation of the regulatory capital adequacy ratios. The requirement under the Bulgarian Development Bank Act is similar.

As of 31 December 2018, the Reserve Fund of the Bank amounted to BGN 63,882 thousand. (31 December 2017: BGN 62,997 thousand).

As of 31 December 2018, the Additional Reserves of the Bank amounted to BGN 75,145 thousand (31 December 2017: BGN 67,138 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.

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

34. RESERVES (continued)

In 2018, after a regular General Meeting of Shareholders of the Bank a decision was passed not to distribute dividends against the profit net of the contribution to the Reserve Fund (2017: dividend of BGN 19,314 thousand was paid against the profit).

The remaining balance from the profit of Bulgarian Development Bank AD for 2017, net of the contributions to the Reserve Fund, was taken to Additional Reserves.

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 financial assets measured at fair value through other comprehensive income held at the end of each reporting period are recognised in equity, in a special components thereof formed by the Bank and titled Reserve for financial assets measured at fair value through other comprehensive income. 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 2018, the reserve is a positive value amounting to BGN 4,112 thousand (31 December 2017: BGN 4, 947 thousand – positive value).

35. CONTINGENCIES AND COMMITMENTS

	2018	2017
Contingent liabilities		
Bank guarantees and letters of credit	56,073	71,510
incl. with cash collateral	(15,539)	(9,472)
Letters of credit with borrowed funds, accounted as loan commitment	-	21
Guarantee provisions (Note 31)	(2,998)	(833)
	37,536	**61,226**
Irrevocable commitments		
Unutilised amount of approved loans	348,377	447,976
incl. letters of credit with borrowed funds	-	*(21)*
Unpaid portion of shares of the Capital Investment Fund	41,250	-
Participation in the SIA investment program	1,410	1,603
Unclaimed portion of par value of EIF shares	4,694	4,694
	395,731	**454,252**
	433,267	**515,478**

As of 31 December 2018, agreements with five partner banks were concluded by the Bank and bank guarantees amounting to BGN 1,551 thousand (31 December 2017: five partner banks and bank guarantees issued amounting to BGN 1,818 thousand) were issued.

35. CONTINGENCIES AND COMMITMENTS (continued)

On 17 July 2015, Bulgarian Development Bank AD signed a funds management contract with EIF for accession to the SIA (Social Impact Accelerator) investment program 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. In 2018, a Consent for extending the investment period of the SIA Fund by 1 year. 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. The term of the program is 10 years.

As of 31 December 2018, twelve equity contributions were made under the initiative amounting to EUR 279 thousand equivalent to BGN 546 thousand (2017: BGN 180 thousand equivalent to BGN 352 thousand) (Note 21).

In 2015, the Bank launched a new program for indirect financing of micro, small and medium-sized businesses subject to a maximum of BGN 150,000 thousand. Under the program BDB will be able to assume part of the risk – up to 30 per cent of the amount of the individual sub-loans - on loans granted by partner banks to businesses. At 31 December 2018, the Bank signed agreements with five partner banks and the so-formed portfolio of guarantees amounted to BGN 2,790 thousand (31 December 2017: five partner banks and portfolio of guarantees amounting to BGN 3,576 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 Bank, issued under the Micro-credits Guarantee Fund Project of MLSP are not secured. In case of activation of a component of a guarantee issued by the Bank, the payment thereon is not assessed as ultimate loss because the partner-bank is obliged to undertake all necessary measures for realising the received collateral of the non-performing loan and to reimburse the respective amount to BDB.

The non-paid portion of the nominal value of EIF shares held by the Bank shall become due for payment after a special decision for this purpose taken by European Investment Fund's General Meeting of Shareholders. By the issue date of this financial statement no such a decision has been taken.

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

36. CASH AND CASH EQUIVALENTS

	2018	2017
Cash in hand (Note 16)	335	244
Current accounts with the Central Bank (Note 16)	297,287	447,404
Receivables from banks with original maturity up to 3 months (Note 17)	319,679	73,968
	617,301	521,616

The following table summarises the movements in the liabilities arising from financing activity, including cash-flow and non-monetary changes, with a reconciliation between the opening and closing balances in the statement of financial position of the liabilities arising from financing activity for the year ended 31 December 2018.

	1 January 2018	Cash inflows	Cash outflows	Effect of changes in exchange rates	Accruals under the effective interest rate method*	Other	31 December 2018
Current borrowings from international institutions	869,821	156,254	(121,259)	(34)	-	-	904,782
Current liabilities on other borrowings	17,492	16	(202)	-	-	-	17,306
Total liabilities from financing activity	**887,313**	**156,270**	**(121,461)**	**(34)**	**-**	**-**	**922,088**

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

*The interest accruals of BGN 6,631 thousand are included in the operating cash flows of the Bank.

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

Entity/person	*Type of control*
Ministry of Economy	Majority shareholder of the capital of the Bank representing the State
Ministry of Finance	Under joint control with the State
National Guarantee Fund EAD	Subsidiary
Micro Financing Institution EAD	Subsidiary
Capital Investments Fund EAD	Subsidiary
Maritsa EOOD	Subsidiary
Holding Bulgarian State Railways EAD	Company under joint control with the State
Bulgarian Institute for Standardization	Company under joint control with the State
South Stream Bulgaria AD	Company under joint control with the State
"I C J B" AD	Company under joint control with the State
Bulgarian Energy Holding EAD	Company under joint control with the State
Kinteks EAD	Company under joint control with the State
Energy Investment Company EAD	Company under joint control with the State
Water Supply and Sewerage EOOD Plovdiv	Company under joint control with the State
Water Supply and Sewerage EOOD Shumen	Company under joint control with the State
TPP Maritsa East 2 EAD	Company under joint control with the State
State Consolidation Company EAD	Company under joint control with the State
Eco Anthracite EAD	Company under joint control with the State
Saint Ekaterina University Multiprofile Hospital for Active Treatment	Company under joint control with the State
Montazhi EAD	Company under joint control with the State

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

Related party balances in the statement of financial position :

Assets

Entity/person	*Type of balance*	2018	2017
Ministry of Finance	Securities at fair value through other comprehensive income	460,963	-
Ministry of Finance	Securities available for sale	-	227,917
Micro Financing Institution EAD	Loans and advances to customers	6,104	8,148
Companies under joint control with the State	Loans and advances to customers	90,673	98,006
Companies under joint control with the State	Securities at fair value through other comprehensive income	43,931	-
Total for the subsidiaries		***6,104***	***8,148***

Liabilities

Entity/person	*Type of balance*	2018	2017
National Guarantee Fund EAD	Liabilities to customers on deposits	118,828	130,268
Ministry of Finance	Other borrowings	17,306	17,492
Micro Financing Institution JOBS EAD	Liabilities to customers on deposits	649	338
Trade Centre Maritsa EOOD	Liabilities to customers on deposits	2	-
Capital Investments Fund EAD	Liabilities to customers on deposits	16,250	-
Companies under joint control with the State	Liabilities to customers on deposits	911,985	510,682
Total for the subsidiaries		***135,729***	***130,606***

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

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

Related party transactions:

Entity/person	*Type of relation*	2018	2017
Ministry of Finance	Fee and commission income	62	64
	Interest income	2,971	1,611
	Interest expenses	(124)	(128)
National Guarantee Fund EAD	Fee and commission income	1	2
	Interest expenses	(141)	(154)
	Rental income	33	-
	Dividend income	771	1,246
Micro Financing Institution JOBS EAD	Fee and commission income	2	3
	Interest income	150	88
	Rental income	27	-
	Dividend income	121	69
		1,105	***1,408***
		(141)	***(154)***
Companies under joint control with the State	Interest income	4,883	7,830
	Fee and commission income	227	498
	Interest expenses	(25)	(739)
	Other operating income	34	210

Commitments and contingencies with related parties:

Entity/person	*Type*	2018	2017
Micro Financing Institution JOBS EAD	Unutilised amount of a loan approved	20,300	2,800
Micro Financing Institution JOBS EAD	Bank guarantees issued	2	2
Capital Investments Fund EAD	Commitment on unpaid subscribed capital	41,250	-
Companies under joint control with the State	Unutilised amount of a loan approved	41,708	27,290
Companies under joint control with the State	Bank guarantees issued	9,332	4,993
Total for the subsidiaries		**61,552**	**2,802**

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	**2018**	**2017**
Payables to customers on deposits	462	288
Remuneration payable	49	53
Loans and advances to customers	136	142

Transactions with key management personnel	**2018**	**2017**
Remuneration and social security contributions	(1,445)	(1,630)
Interest income	4	4

38. EVENTS AFTER THE DATE OF THE FINANCIAL STATEMENTS

On 12 March 2019, Bulgarian Development Bank incorporated a subsidiary - BDB Leasing EAD with capital of BGN 2 million, fully paid-in, and with main object of activity: finance and operating lease of assets.

On 13 March 2019, Bulgarian Development Bank incorporated a subsidiary - BDB Factoring EAD with capital of BGN 2 million, fully paid-in, and with main object of activity: factoring.

Both companies were not operational as at the date of these financial statements.

In March 2019, Fitch Ratings Agency upgraded the outlook of the credit rating of Republic of Bulgaria from Stable to Positive. During the same month, the credit rating of Bulgarian Development Bank was upgraded from BBB, Stable Outlook to BBB, Positive Outlook.