D Commerce Bank AD

Consolidated management report and corporate governance statement

Independent Auditor's Report

Annual Consolidated Financial Statements

as at 31 December 2017
in accordance with IFRS

Supervisory Board:	**Fuat Guven** **Bahattin Gurbuz** **Valeri Borisov Borisov**
Management Board:	**Anna Ivanova Asparuhova** **Martin Emilov Ganchev** **Plamen Ivanov Dermendzhiev** **Valentina Dimitrova Borisova** **Zahari Dimitrov Alipiev**
Executive Directors:	**Anna Ivanova Asparuhova** **Martin Emilov Ganchev**
Director of Planning, Control and Financial Reporting Directorate:	**Milena Duneva**
Chief Accountant:	**Mariela Peykova**
Director of Legal Directorate and Chief Legal Advisor:	**Teodora Mateeva**
Address of Management:	**Sofia** **8, Gen. Totleben Blvd.**
Auditors:	**AFA OOD** **BAKER TILLY KLITOU AND PARTNERS OOD**

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CONSOLIDATED MANAGEMENT REPORT

AND

CORPORATE GOVERNANCE STATEMENT

OF

D COMMERCE BANK GROUP

for 2017

March 2018

I. Group profile

D Commerce Bank Group (the Group) comprises the parent (D Commerce Bank AD) and its subsidiaries. Information regarding the Group companies is presented below:

The parent

D Commerce Bank AD is a joint-stock company, holding a general banking license to perform banking operations in the country and transactions abroad.

The Bank's main activities in 2017 were related to attracting deposits from customers, granting loans to business customers and individuals, servicing payments of customers in the country and abroad, trading securities, performing repurchase agreements on the interbank market, dealing in foreign currencies, issuing letters of credit and bank guarantees and providing other financial services in Bulgaria.

Subsidiaries

D Insurance Broker EOOD

In 2013 D Commerce Bank AD acquired 100% of the shares of Viza Consult EOOD, a sole owner limited liability company. The name of the company was changed to D Insurance Broker EOOD and its seat – to Sofia, Krasno Selo Region, 8, Gen. Totleben blvd. The company's principal activities include: insurance brokerage, intermediation by assignment for the conclusion and performance of insurance and/or reinsurance contracts and the related consultancy services.

D Imoti EOOD

The company was established by D Commerce Bank AD in October 2013. Its seat and address of management is in Sofia, Krasno Selo Region, 8, Gen. Totleben blvd. The company's principal activities include purchase-and-sale of real estate, design, furnishing, construction of real estate for sale, rental. As at 31 December 2017 the share capital of the company amounts to BGN 10 thousand. At the end of 2017, D Commerce Bank made a payment related to an increase of the subsidiary's capital at the amount of BGN 4.09 thousand; as at 31 December 2017, this capital was not yet registered with the Commercial Register.

D Leasing EAD

D Leasing EAD was established in 2014 and was registered as a financial institution with a full license from BNB. D Leasing EAD was incorporated as a joint-stock company and the sole owner of its capital is D Commerce Bank AD. As at 31 December 2017 the share capital of the company amounts to BGN 1.2 million.

1. Group management

As at 31 December 2017, the capital of the parent company is held by Mr. Fuat Guven, who holds directly 66.7% of the capital and through Fortera EAD, UIC 175194303 – 33.3%.

D Commerce Bank AD has a two-tier management system which implies a Management Board and a Supervisory Board. The Supervisory Board (SB) appoints the members of the Management Board (MB), approves the empowerment of the executive members – Executive Directors and determines the remuneration of the MB members.
As at 31 December 2017 the persons charged with the overall management of the Bank as members of the Supervisory Board include:

- Fuat Guven – Chairperson of the SB;
- Bahattin Gurbuz – Member of the SB;
- Valeri Borisov Borisov – Member of the SB.

As at 31 December 2017 the Management Board of the Bank comprises the following members:

- Anna Ivanova Asparuhova - Chairperson of the MB and Executive Director;
- Martin Emilov Ganchev - Member of the MB and Executive Director;
- Plamen Ivanov Dermendzhiev - Member of the MB;
- Valentina Dimitrova Borisova – Member of the MB;
- Zahari Dimitrov Alipiev – Member of the MB.

2. Changes in the management and the registration of the parent in 2017

During the period 1 January 2017 – 31 December 2017 the following changes in the management and the registration of the Bank have been made:
By virtue of resolution of the Supervisory Board dated 28 September 2017, two new members of the Managing Board of D Commerce Bank were elected – Valentina Dimitrova Borisova and Zahari Dimitrov Alipiev. This fact was recorded in the Commercial Register at the Registry Agency in the Bank's file on 8 November 2017.
By virtue of resolution of the General Meeting of Shareholders of D Commerce Bank AD dated 1 December 2017 Ms. Emel Guven was dismissed from the position of member of the Supervisory Board of D Commerce Bank AD and Mr. Fuat Guven was elected member of the Supervisory Board. This fact was recorded in the Commercial Register at the Registry Agency on 29 December 2017.
By virtue of resolution of the Supervisory Board dated 29 December 2017, Mr. Fuat Guven was elected Chairperson of the Supervisory Board of the parent.

3. Information regarding the individuals managing and representing the parent company

As at 31 December 2017 the Bank has two Executive Directors and five members of the Management Board:

- Ms. Anna Ivanova Asparuhova – Chairperson of the Management Board and Executive Director;
- Mr. Martin Emilov Ganchev – Member of the Management Board and Executive Director;
- Mr. Plamen Ivanov Dermendzhiev – Member of the Management Board;
- Ms. Valentina Dimitrova Borisova – Member of the Management Board;
- Mr. Zahari Dimitrov Alipiev – Member of the Management Board.

In accordance with the Credit Institutions Act, the provisions of the Articles of Association of D Commerce Bank AD and its court registration, the Bank is represented jointly by all members of the MB, or jointly by two Executive Directors.
The Executive Directors and Members of the MB hold no interest in the Bank's share capital.

4. Changes in the management and the registration of the subsidiaries in 2017

During the period 1 January 2017 – 31 December 2017 the following changes in the management and the registration of D Insurance Broker EOOD have been made:
By virtue of resolution dated 8 January 2018 the General Manager Milena Rosenova Mihaylova was dismissed and a new General Manager was appointed, Desislava Borislavova Spasova. This fact was recorded in the Commercial Register at the Registry Agency in the Bank's file on 31 January 2018.

5. Information regarding the individuals managing and representing the subsidiaries

Desislava Borislavova Spasova – General Manager of D Insurance Broker EOOD – a subsidiary of the Bank;

Katerina Hristova Hristova – General Manager of D Imoti EOOD – a subsidiary of the Bank;

Ivaylo Georgiev Ivanov – Chairperson of the Board of Directors of D Leasing EAD – a subsidiary of the Bank;

Victoria Lyubomirova Nevenchina – Member of the Board of Directors of D Leasing EAD – a subsidiary of the Bank;

Zorka Yordanova Samokoliyska - Member of the Board of Directors of D Leasing EAD – a subsidiary of the Bank.

No contracts under Art. 240, b) of the Commercial Act were concluded in 2017.

6. Information in compliance with Art. 39, item 5 and item 6 of the Accountancy Act and Art. 187, e) and Art. 247 of the Commercial Act

6.1 Under Art. 39, item 5 - not applicable;

6.2 Under Art. 187, e) - not applicable;

6.3. Under Art. 247, para 2;

- item 1 - The total remunerations received in 2017 by the Members of the MB and the SB of the Bank and the persons charged with the management and representation of its subsidiaries amounted to BGN 1,395 thousand.
- item 2 - No deals of this nature were performed in 2017;
- item 3 - There are no restrictions on the rights of the Boards' members to hold shares and bonds of the company (the Bank);
- item 4 - To the best of our knowledge the participation of the Members of the SB and the MB of the Bank as unlimited partners, holding more than 25% of the capital of other entities, and their participation in the management of other companies or cooperatives as procurators, general managers or board members is as follows:

Valeri Borisov Borisov - Member of the SB (in the period 1 January 2017 - 31 December 2017):

1. Elkabel AD, UIC 102008573 - Member of the Supervisory Board;
2. Borisov & Borisov Law Firm, BULSTAT 175640079 - Manager;
3. Interus OOD, UIC 831644428 - partner with a share exceeding 25%.

Emel Guven - Member of the Supervisory Board (in the period 1 January 2017 - 29 December 2017):

1. Varna Moda, UIC 121063663 - Member of the Board of Directors;
2. Elkabel AD, UIC 102008573 - Member of the Supervisory Board;
3. Gama Invest AD, UIC 831283821 - Member of the Board of Directors;
4. Alfa Deri Konfeksyon Turism, Turkey - Member of the Board of Directors.

Fuat Guven - Member of the Supervisory Board, elected Chairperson of the Supervisory Board (in the period 29 December 2017 - 31 December 2017):

1. Fortera AD, UIC 175194303, Sofia, 12, Cherni Vrah Boulevard – ultimate owner of the capital, Chairperson of the Board of Directors and Executive Director;
2. Gama Invest AD, UIC 831283821, Sofia, 12, Cherni Vrah Boulevard – ultimate owner of the capital through Vassilevi Bros OOD, Chairperson of the Board of Directors and Executive Director;

3. Elkabel AD, UIC 102008573, Burgas, 15, Odrin Street – shareholder with about 95% interest and Chairperson of the Supervisory Board;
4. Aidatour AD, UIC 836143710, Haskovo, 1, Atlanticheski Square – Member of the Board of Directors and Executive Director, ultimate owner of the capital;
5. Varna Moda AD, UIC 121063663, Sofia, 12, Cherni Vrah Boulevard – Chairperson of the Board of Directors and Executive Director, ultimate owner of the capital;
6. ET Shop Shipka Fuat Guven, Turkey, through permanent establishment in the Republic of Bulgaria;
7. Emelda Deri Ve Textil Sanayi Ve Dis Ticaret Ltd Sti, Turkey, including through permanent establishment in the Republic of Bulgaria, Registration Number of the Chamber of Commerce, Instabul: 281 558 – 229 140, Istanbul, Zeytinburnu, Kazlicesme, Demirhane Caddesi, Beskardesler Sok 8-10 – majority shareholder and General Manager;
8. Shop Shipka Fuat Given OOD, UIC 175205415, Sofia, 12, Cherni Vrah Boulevard – actual /ultimate/ owner of the capital through ET Shop Shipka Fuat Guven, Turkey and through FORTERA AD, and General Manager;
9. Emelda EOOD, UIC 175205365, Sofia, 12, Cherni Vrah Boulevard – ultimate owner of the capital and General Manager;
10. Trakia 97 EOOD, UIC 126073031, Svilengrad, Garata Quarter, Duty Free Zone – sole owner of the capital and General Manager;
11. Stil 93 OOD, UIC 831303003, Sofia, 12, Cherni Vrah Boulevard – ultimate owner of the capital through Vassilevi Bros OOD and General Manager;
12. Eleforce OOD, UIC 131237742, Sofia, 12, Cherni Vrah Boulevard – ultimate owner of the capital through Vassilevi Bros OOD and General Manager;
13. Kardzhali Tabak AD, UIC 108024351, Kardzhali, 1, Republikanska Street – indirect shareholding through Aidatour AD, Member of the Board of Directors and Executive Director;
14. Shipka-Fuat-Guven-Varna OOD, UIC 000100591, Varna, St. St. Constantine and Helena resort complex, Commercial Centre constituting part of St St Constantine And Helena – ultimate owner of the capital through Vassilevi Bros OOD and General Manager;
15. Svilengrad-Gas AD, UIC 200462966, Svilengrad, Svilena Hotel, floor 1, apartment 2 – majority shareholder;

16. Elkabel – Co EOOD /in liquidation/, UIC 102208556, Burgas, 15, Odrin Streen – indirect shareholding through Elkabel AD;
17. Svilengrad Gas Service EOOD, UIC 201025058, Svilengrad, Svilena Hotel, floor 1, apartment 2 – sole owner of the capital and General Manager;
18. Vassilevi Bros OOD, UIC 010752510, Sofia, Izgrev Region, 5, Shteryu Atanasov Street – owner of the capital – personally and through Le Roi Enterprises Limited, London, United Kingdom of Great Britain and Northern Ireland, and General Manager;
19. Elkabel Cyprus Limassol AD, Cyprus;
20. Alfa Deri Konfeksiyon Tourism, Turkey, registered in the Commercial Register, Turkey, Istanbul, Zeytinburnu, 8-10 Kazlicesme – majority shareholder;
21. Inter Kim Petrol Ve Petrokimiya EOOD, Turkey, Istanbul, majority shareholder;
22. Plas Kim Petrol Ve Petrokimiya Urulenti Dis Tic OOD, Turkey, Istanbul, majority shareholder;
23. Beta Turistik Tesis Isletmeciligi Ltd Sti, Turkey, Istanbul, majority shareholder;
24. AO Fregat, Moscow, Izlaylovo Quarter, 1, Uralska Boulevard, sole owner of the capital;
25. Le Roi Enterprises Limited, London, United Kingdom of Great Britain and Northern Ireland – owner of the capital and General Manager.

Martin Emilov Ganchev - Member of the Management Board and Executive Director (in the period 1 January 2017 - 31 December 2017):

1. D Leasing EAD, UIC 203159604 – Chairperson of the Board of Directors in the period 1 January 2017 – 17 May 2017, when he was deleted as Member of the Board of Directors of D Leasing EAD.

** Note: D Leasing EAD is a subsidiary of D Commerce Bank AD.*

Plamen Ivanov Dermendzhiev - Member of the Management Board (in the period 1 January 2017 - 31 December 2017):

1. Fund for Sustainable Urban Development of Sofia EAD, UIC 202033232 - Member of the Supervisory Board.

- Item 5 - To the best of our knowledge no contracts were concluded in 2017 under Art. 240, b) of the Commercial Act.

II. Seat and headquarters of the Group

The seat and headquarters of D Commerce Bank Group is: Sofia, Sofia Municipality, Krasno Selo Region, Totleben blvd.

III. Group management responsibilities

The management of D Commerce Bank Group is required by the Bulgarian legislation to prepare annual financial statements for each financial year that give a true and fair view of the property and financial position of the Group as at the end of the respective reporting period and of its financial performance for that period.

The management confirms that in the preparation of these reports:

- appropriate accounting policies have been used and applied consistently;
- that reasonable and prudent judgements and estimates have been used;
- the statutory applicable accounting standards have been followed consistently;
- the annual consolidated financial statements have been prepared on a going concern basis.

The management hereby states that:

- it has made the best estimates and decisions, as necessary;
- has complied with the requirements of all International Financial Reporting Standards applicable in accordance with the national banking accounting legislation in Bulgaria;
- the annual consolidated financial statements present the Group's performance with a reasonable extent of accuracy;
- it has undertaken all possible measures to safeguard the assets of the Bank and its subsidiaries and to prevent fraud.

IV. Membership and associations

- Association of Banks in Bulgaria;
- Bulgarian Stock Exchange - Sofia AD;
- BORICA - BANKSERVICE AD;
- Central Depository AD;
- MasterCard International;
- S.W.I.F.T.;
- European Payments Council - SEPA Credit Transfer Scheme;
- Association of Bank Payments Safety (ABPS);
- Bulgarian - Turkish Business Association;
- Association of Bulgarian and Turkish Businessmen (ABTBM);

- North-Eastern Bulgarian - Turkish Business Association;
- Bulgarian Industrial Association;
- Confederation of Employers and Industrialists in Bulgaria (CEIB).

D Commerce Bank Group participates or is an agent in the following payment systems and payment service providers:

- Bank Organisation for Payments Initiated by Cards (BORICA);
- Bank Integrated System for Electronic Payments (BISERA and BISERA7-EUR);
- Real-Time Interbank Gross Settlement System (RINGS);
- Trans-European Automated Real-time Gross Settlement Express Transfer System (TARGET2);
- WESTERN UNION agent;
- EasyPay agent.

V. Branch network

In accordance with Art. 39, item 7 of the Accountancy Act the Group presents its structural units and the changes made in 2017.

In 2017, structural changes were made in the branch network in relation to adopting the new sales-focused business model, according to which the Bank operates through 58 structural units, including: Headquarters, 5 regional financial centres (FRC), 32 financial centres (FC), 8 offices and 12 remote workplaces (IRM) in various cities in Bulgaria. The regional financial centres operate as regional centres (RC) focusing on servicing medium-sized and large corporate customers - RC Sofia, RC Plovdiv, RC Burgas, RC Varna and RC Pleven.

VI. Financial performance of the Group

In accordance with Art. 39, item 1 and 2 of the Accountancy Act the Group presents its financial and non-financial performance indicators representing its development.

In 2017 D Commerce Bank Group continued to overcome successfully the challenges related to the intense competition at the Bulgarian banking market and the difficulties arising from the very limited business activity. The Group managed not only to withstand the impact of the difficult macroeconomic situation, but to focus on the changing needs of its customers by offering competitive products and services. During the year D Commerce Bank Group focused its business strategy primarily on:

- Continuing work on the optimisation of the bank's assets and liabilities management;
- Increase of the number of corporate and individual customers and the volume of transactions;

- Further enhancement of the quality and effectiveness of the bank services and products offered, related to the primary banking operations - attraction of deposits and granting of financing to various customer projects;
- Loan portfolio optimisation and improvement of its quality;
- Increased efficiency of risk management;
- Provision of competitive services through development of information technologies.

MAIN FINANCIAL INDICATORS - CONSOLIDATED DATA

Financial results (BGN'000)	2016	2017
Net interest income	21,254	20,422
Net fee and commission income	7,554	9,355
Net trading income	9,008	4,992
Other operating income, net	3,149	1,996
Operating income	**40,965**	**36,765**
Administrative operating expenses	(22,418)	(23,255)
Result before impairment	**18,547**	**13,510**
Net impairment loss on financial assets	(17,020)	(1,406)
Net impairment loss on non-financial assets	(449)	(110)
Profit before income tax	**1,078**	**11,994**
Balance sheet (BGN'000)	**2016**	**2017**
Total assets	726,382	754,429
Loans and advances to customers (gross)	395,939	426,191
Due from banks	45,966	38,486
Securities	137,742	118,394
Due to customers	620,133	635,850
Due to banks	10,991	9,036
Equity	92,072	103,570
Key ratios (%)	**2016**	**2017**
Gross loans to deposits	63.8	67.0
Balance sheet provisions to gross loans	9.5	9.1
Expenses to operating income	52.0	63.3
Net interest income to total assets	2.9	2.7
Impairment to loans	4.3	0.3
Return on assets	0.1	1.6
Return on equity	1.2	11.6
Capital adequacy	19.1	19.6
Liquidity ratio	34.5	33.5

In 2017, D Commerce Bank Group reported good financial results, and profit before tax increased, reaching BGN 12 million, as compared to BGN 1 million in 2016.

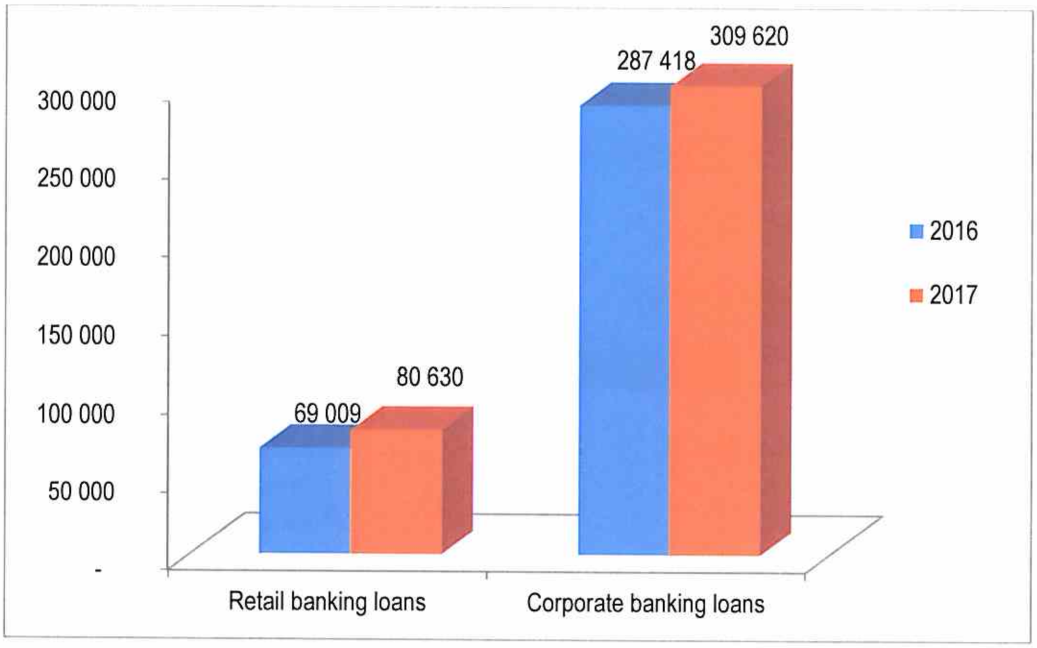
This had a positive impact on the profitability indicators; return on equity reached 11.6%, and return on assets – 1.6%.

The total amount of Group assets as at the end of 2017 reached BGN 754 million, which is an increase by 4% as compared to 2016.

Gross loans and advances to customers are up by 8% or BGN 30.2 million year-on-year. The amount of customer borrowings as at 31 December 2017 is BGN 635.8 million, increasing by 3% on annual basis.

Due from banks are down by BGN 7.4 million or 16% year-on-year, which is due to the significant liquidity of the Bank and the attempt for optimum efficient liquidity management.

Loans granted



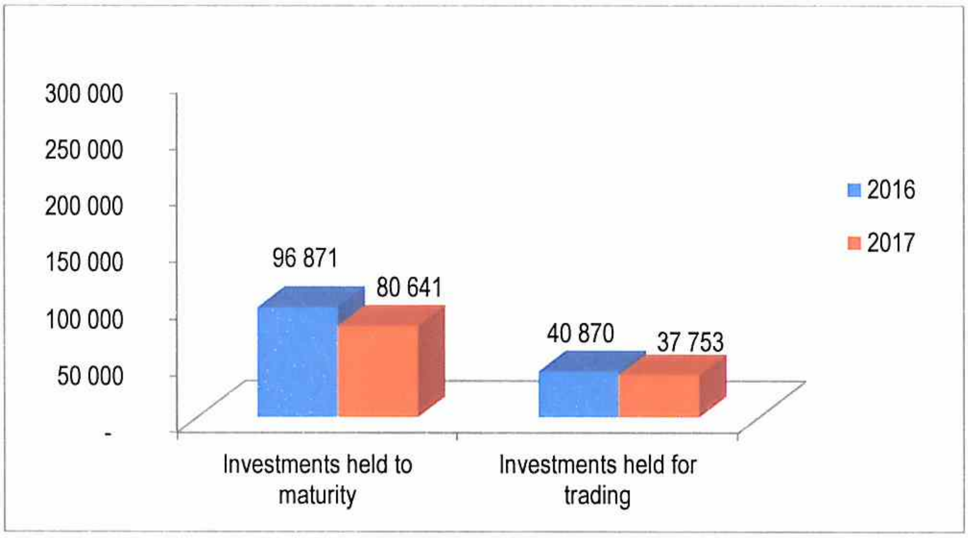
* Corporate banking includes budget and public companies (court and awarded loans are excluded)

* Retail banking includes individuals and small businesses (court and awarded loans are excluded)

In 2017 the Group's corporate loans share of the gross portfolio is 73%. Corporate portfolio increased by 7.7% on annual basis or by BGN 22.2 million.

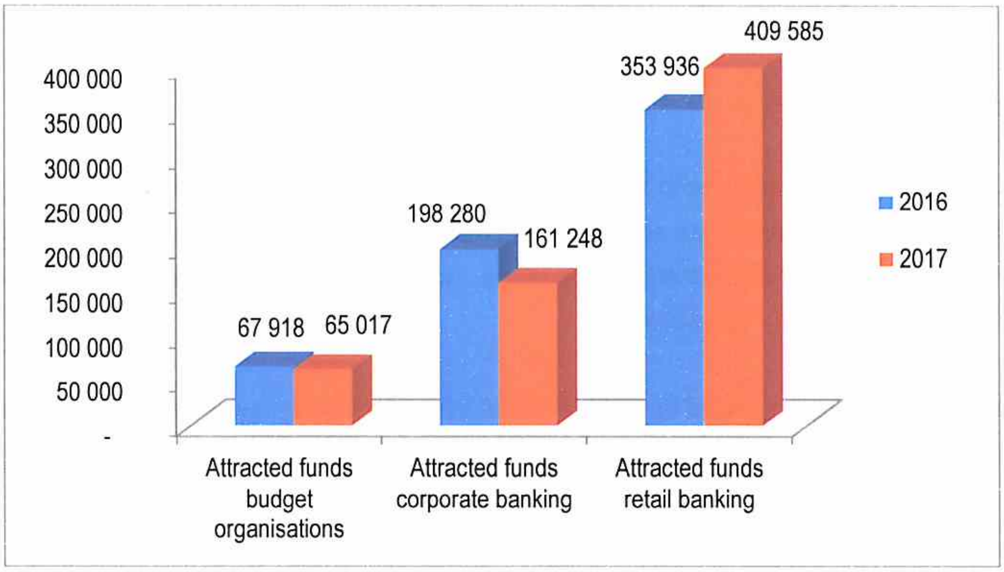
Retail loans increase by 16.84% year-on-year. Consumer and housing loans are up by BGN 3.6 million and BGN 7.5 million, respectively.

Securities portfolio



In 2017 the Bank reduced its securities portfolio by BGN 19 million, with a decrease in securities classified as held to maturity of BGN 16 million and decrease in securities classified as held for trading of BGN 3 million.

Attracted funds

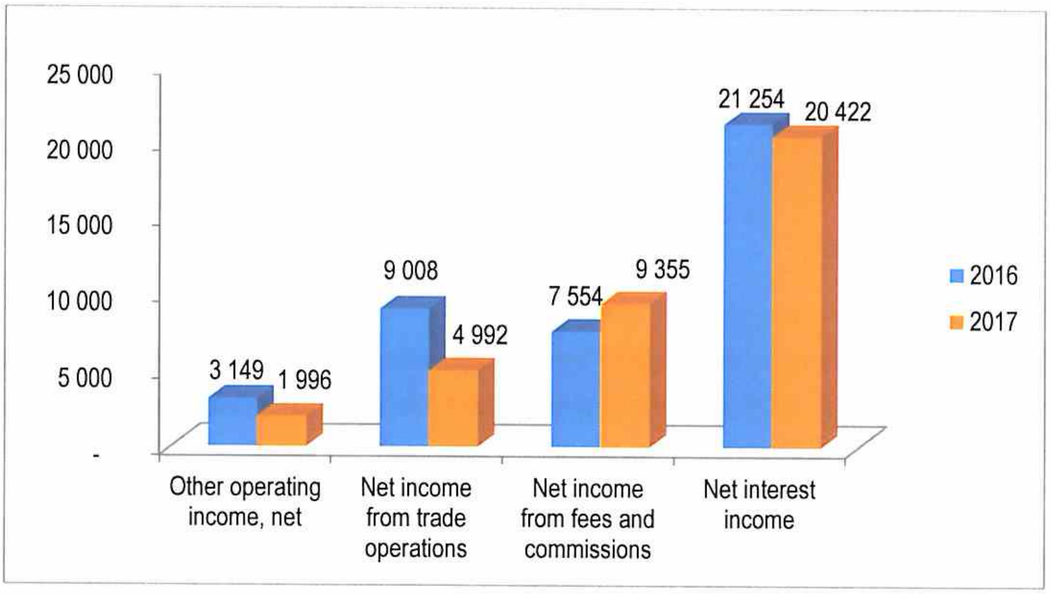


Funds attracted in corporate banking report a decrease by 19% on annual basis or BGN 37 million. In 2017 the Bank adjusted its interest rates downwards in order to retain an average level within the banking system. In parallel the Bank is striving to follow a balanced asset and liability management policy aimed at optimising the results attained.

Funds attracted from budget organisations are down by BGN 2.9 million on annual basis.

The increase in funds attracted from retail banking amounts to BGN 55.6 million or 16% on annual basis. In 2017 the Bank decreased the interest rates on the funds attracted from individuals and legal entities in accordance with the market trends observed during the year.

Operating income



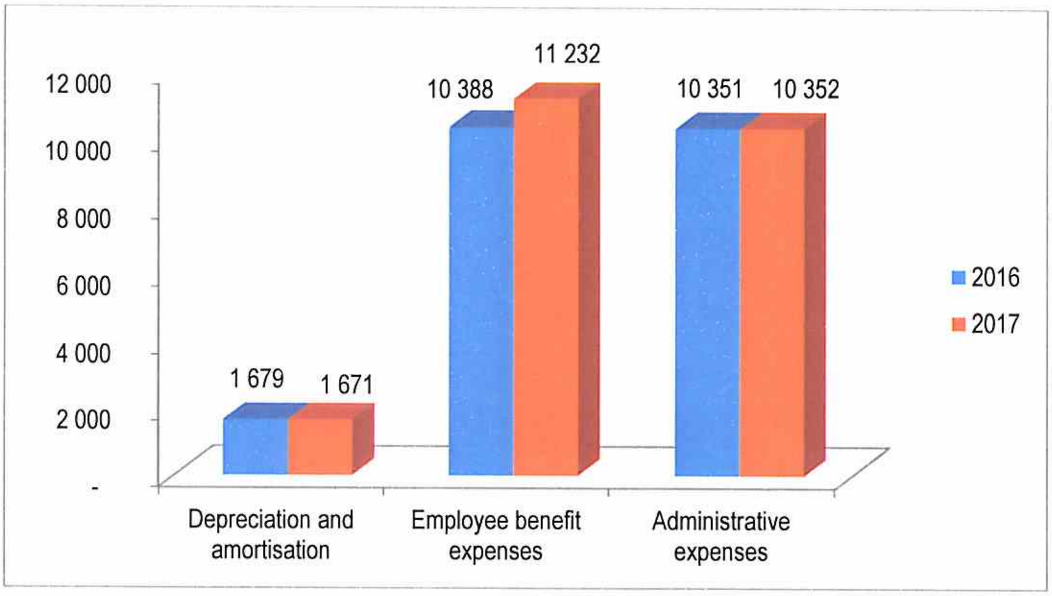
In 2017 the net operating income of the Group reached BGN 36.8 million.

Over the period, interest income decreased to 23.9 million, which is the biggest decrease in interest income from the held-to-maturity securities portfolio at the amount of BGN 0.7 million. There is also a decrease in interest income from loans, which reflects the market trends of decrease in interest rates offered by the Bank.

Net fee and commission income increased by 24%, or BGN 1.8 million, year-on-year. The increase was in fee and commission income from customer accounts, payment transactions and loan-related services.

Other operating income, net, decreased to BGN 1.1 million, the main influence being the lower profit level from the sales of investment property and other assets held for sale.

Operating expenses



The operating expenses of the Group were strictly controlled in 2017 and they increased by BGN 0.8 million as compared to 2016.

Personnel expenses in 2017 are up by 8% year-on-year.

There was no significant change in administrative expenses on annual basis.

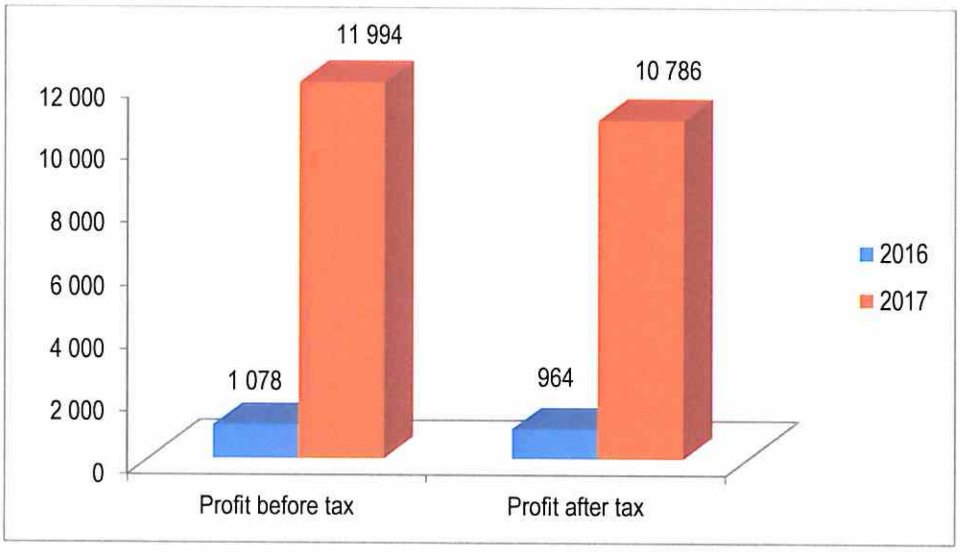
Additional audit services

The audit firms which perform audit of the Bank's annual financial statements (separate and consolidated) will carry out in April 2018 an engagement for agreed-upon procedures under International Standard on Related Services 4400 Engagements to perform agreed-upon procedures, for which they will also issue a Report of factual findings in relation to the reliability of internal control systems in accordance with Art. 76, Para 7, item 1 of the Credit Institutions Act and Ordinance 76, Art. 5 on the contents of the auditor's report for supervisory purposes as at 31 December 2017 (AFA OOD also issued such reports to the Bank as at 31 December 2016, in April 2017). In addition, AFA OOD performs services related to compliance review of Bank's transfers for both 2016 (in 2017) and 2017 (in 2018).

Impairment loss expense

In 2017 impairment loss reached BGN 1.4 million, decreasing on annual basis.

Net result



In 2017 the Group managed to multiply its net result and improve its key profitability and efficiency indicators.

Number of customers and accounts

In 2017 the number of the Bank's customers is up by 3% and the number of active accounts is close to that in the previous year.

VII. Risk management

In accordance with Art. 45, in relation to Art. 39, item 8 of the Accountancy Act the Group presents its risk management policies and its exposure to the respective type of risk.

1. Credit risk

Credit risk and counterparty risk is the present or potential risk to the income and capital of the Group arising due to the failure of the debtor to discharge the requirements of any agreement signed with the Group and / or failure to act in accordance with the contractual terms and conditions. Credit risk includes transaction risk, collateral risk (residual risk), sovereign risk and concentration risk. Credit risk arises mainly in relation to the lending activities of the Group companies, including corporate and retail banking. The Group is exposed to credit risk arising from other activities, such as investment in debt securities, trading activities, capital markets and other arrangements. Credit risk is the biggest risk the Group is facing. It is managed and controlled through centralised special risk units within the Group.

Transaction risk is associated with the specific loans and the probability of the borrower's ability to repay the liability, as well as the ultimate loss in case of insolvency of the borrower, following realisation of the collateral on the loan and the implementation of other mitigation factors, is assessed.

Collateral risk involves mainly:

- Risk of sudden decline in the value of the collaterals;
- Collaterals becoming illiquid and non-marketable;
- Insufficient procedures or non-performance of the appropriate steps to verify the applicability of the collateral agreements in all relevant jurisdictions.

The risk of deterioration of the credit rating or financial position of the borrower is the current or potential risk to the Group's income and the capital arising as a result of the deteriorated financial position of the borrower and / or downgrading of the internal or external credit rating of the borrower.

Concentration risk refers to exposures (direct or indirect) which may arise within a certain risk category or between different risk categories within the Group and which may lead to: losses significant enough to jeopardise the financial position and / or the Group's ability to continue its principal activities or may cause significant change in the Group's risk profile.

The Group identifies concentration risk as one of the important potential sources of material loss which may have significant impact on its financial result and capital.

Concentration risk is considered both in view of the Group's balance sheet exposures, and in view of its off-balance sheet exposures and exposures resulting from the different financial instruments. Asset concentration risk is closely related to credit risk, analysed and measured as part of the overall credit risk management process, but it can be manifested in any other type of risk.

The Group structures the level of credit risk undertaken by setting tolerable risk limits to a single borrower, or a group of borrowers, and by sector. Exposures to banks and financial institutions are limited further by sub-limits covering balance and off-balance sheet exposures. The efficient diversification of the Group's loan portfolio is a major priority.

Specific credit risk management is performed by the Provisional Council of the parent and is monitored by the Management Board. The credit risk management function ensures the implementation of appropriate policies and the compliance of these policies with the related procedures and controls for current monitoring of each type of credit exposure.

The parent company management currently monitors the credit risk resulting from the concentration of financial assets by economic sectors, as well as by counterparty on the basis of approved limits. The regulatory limits and intra-bank limits for maximum exposures to a single person and economically related persons, including counterparty banks are assessed and analysed periodically. The overall credit exposure to a single sector as a percentage of the total loan portfolio is monitored periodically and is reviewed by the Management Board of the Bank.

The Group's maximum exposure to credit risk, including financial assets recognised in the consolidated statement of financial position and contingent liabilities carried off-balance sheet is disclosed in *Note 3.1. Credit risk* to the consolidated annual financial statements of the Group for 2017.

2. Market risk

Market risk is the risk that the value of an instrument may fluctuate due to changes in the market prices, whether due to instrument- or issuer- (counterparty)-specific factors, or factors relevant to all instruments traded at the market and the probability of such changes having an adverse effect on the Group's financial position. The most frequent market risk factors include interest rates, foreign exchange rates, commodity prices, equity instrument prices and other market variables. Market risk may be the function of one, several or all factors and in many cases in may be extremely complex.

One of the objectives of the Group is to set the market risk level it is ready to undertake. Market risk appetite should be assessed in view of safeguarding the capital of the Group companies and the possibility for exposure to other risks. The main objective is to increase the return, while at the same time keeping exposures susceptible to market risk within or below a level that is set in advance.

The Group has defined the risk framework concerning transactions and investments in financial instruments by implementing limits by type of financial instrument, by counterparty, by country, securities portfolio VaR limits, modified duration limit, individual limits. The benchmark reflects the long-term strategy concerning the combination of market and credit risk that the Group companies managements are ready to undertake in order to attain the investment targets set for the Group. Market risk management is aimed at:

- protecting the Group against unforeseen market losses and contributes to stable profits through independent identification, assessment and understanding of the market risks underlying the business;
- development of transparent, objective and consistent information regarding market risk as basis for the decision making process;
- setting the framework and minimum market risk management and control standards within the Bank;
- ensuring compliance with the regulatory requirements of the local and foreign regulators;
- development of a framework which will ultimately allow the Group to gain competitive advantage through risk-based decision making.

2.1. Interest rate risk

Interest rate risk is the current or potential risk of changes in the income and capital of the Group due to adverse movements in the interest rates. It is manifested in the possible decrease in the Group's income or increase in the Group's expenses as a result of changes in the basic interest rates.

The Group is exposed to interest rate risk, when the interest rate sensitivity of its assets and liabilities is mismatched. Through interest rate risk management the Group strives to smooth out the interest income and interest expense gap, in order to ensure adequate profitability and high value at tolerable risk level. Considering interest rate risk both from the point of view of income and from the point of view of economic value is extremely important. The volatility of income is the starting point for interest rate analysis, since significant decrease in the income may jeopardise the capital adequacy level. However, measurement of the effect on the economic value (the present value of the expected net inflows to be received by the Group) provides more comprehensive view of the potential long-term effects on the Group's overall exposure. The difference between interest-sensitive assets and interest-sensitive liabilities in the separate maturity ranges is the so-called imbalance or GAP method.

The following approaches to interest rate risk management are used through the application of the imbalance method, depending on the specific conditions:

- Balance - ensuring parity between the Group's interest-sensitive assets and liabilities;
- Restructuring of the asset and liability portfolios in case of occurrence of cyclic movements in interest rates;
- Setting of the interest rates, and their type (fixed or floating), on the Group's assets and liabilities depending on the development trends at the domestic and international financial markets.

The Group's exposure to interest rate risk as at 31 December 2017 is disclosed in *Note 3.2.1. Interest rate risk* in the notes to the consolidated annual financial statements of the Group as at 31 December 2017.

2.2. Currency risk

Currency risk is the risk of losses related to the Group's positions in foreign currency. These positions give rise to specific risk resulting from the movements of the exchange rates of the different foreign currencies to the national currency. This is predetermined by the fact that when the Group has an open position in foreign currency (the assets in foreign currency are not equal to the liabilities in the same currency), the translation of the latter generates foreign exchange gains or losses for the Group. The Group controls currency risk through strict daily monitoring scrutiny and an implemented system of limits.

The Group's exposure to currency risk as at 31 December 2017 is disclosed in *Note 3.2.2. Currency and price risk* in the notes to the consolidated annual financial statements of the Group as at 31 December 2017.

2.3. Liquidity risk

Liquidity risk is the risk of the Group's failure to meet its current and potential payment liabilities as they fall due without incurring unacceptable losses.

To manage this risk the Group maintains highly liquid assets in different currencies at any time. The control and monitoring of the overall liquidity are performed currently by the Asset and Liabilities Management Committee of the Bank (ALMC).

The Group's exposure to liquidity risk as at 31 December 2017 is disclosed *in Note 3.3. Liquidity risk* in the notes to the consolidated annual financial statements of the Group as at 31 December 2017.

3. Transaction risk

Transaction risk is the risk of loss resulting from inadequate or non-functional internal processes, individuals and systems or external events as a result of internal fraud, external fraud, inappropriate employment or safety at work practices or recruitment of employees, through customer, product or business practices, break-downs or destruction of assets or functional sites, breakdowns of the IT system, telecommunications or other technologies, or failures or errors in the execution of the transactions, entry, processing or delivery. This risk includes IT risk, legal risk and non-compliance risk.

IT risk is the current or potential risk to the income and capital arising from inadequate information technologies and processes, related to the integrity and consistency of the information flows, and the ability to manage and control the latter, or resulting from inadequate IT strategy and policy or the improper use of these technologies in the Group.

Legal risk and non-compliance risk are the current or potential risks to the income and capital arising as a result of breach or non-compliance with laws, rules, guidance, arrangements, recommended practices and standards of ethics.

The parent maintains and upgrades an internal operational risk analysis and assessment system, which was updated in 2017 and which includes the internal regulations and a specialised internal body – the Risk Events Assessment Committee, responsible for coordination of operational risk management activities and supporting the process of achieving effectiveness and efficiency of the control environment at the parent. The main objective in the management of transactional risks is to safeguard (keep) the Group's assets and its reputation and to ensure organisational and financial optimisation (efficiency). Risk management should ensure the effective implementation of the risk framework and that well-defined steps are in place. The objective is to facilitate the decision making process through good understanding of the risks and their potential impact. The Group is striving to establish and maintain systematic and consistent approach to identify and manage risk; to update and duly implement the risk framework in accordance with the best practices and the legal requirements; to foresee and prevent the risks and minimise them; to create the conditions for health and safety at work and equal treatment of the employees; to ensure sufficient insurance coverage and compliance with the requirements of the effective regulatory framework; to undertake measures to prevent any damage, loss, injury, death, as well as reduction of the cost of risk; to ensure ways and opportunities for sharing, better awareness and training to all employees of the Group for the detection of risks and their impact.

The Group's exposure to transaction risk as at 31 December 2017 is disclosed in *Note 3.4. Capital management* in the notes to the consolidated annual financial statements of the Group as at 31 December 2017.

Custodial services

The Bank performs safekeeping of assets on clients' behalf in its capacity as investment intermediary. As disclosed in Note 2.25 (Significant Accounting Policies) to the Group's consolidated financial statements, such assets are not presented in the consolidated statement of financial position, because they do not constitute Group's assets. It is disclosed in Note 3.4. *Custody of assets* to the consolidated financial statements that the parent carries out its trust business in accordance with the requirements of Ordinance 38 of the FSC.

VIII. Operating activities of the Group

1. Corporate banking

Over 2017, as a result of the flexibility and team approach already established over previous years, the Corporate Banking Directorate continued the best practices adopted over the last 3-4 years at the parent. It preserved its effectiveness and the high quality and speed of work, aimed at the continued development of the parent's corporate portfolio, while maintaining acceptable risk levels.

A total of 215 loan transactions were reviewed and approved, of which the total number of renegotiations of existing exposures was 110, and the total number of new loan proposals was 105. The Corporate Banking Directorate negotiated and developed a new volume of loans and bank guarantees to corporate clients, approved by the competent bodies of the parent, amounting to a total of BGN 155.7 million. Of them, BGN 107.2 was effectively absorbed by the end of the year, and the remaining loans at the amount of BGN 24.95 million are to be absorbed in 2018.

Market pressure, from the perspective of credit resource pricing, also affected D Commerce Bank AD. A direct effect thereof is that in 2017 there were early repayments of several large exposures, at the total amount of BGN 31.74 million, which resulted in the Bank's failure to meet the volumes planned. The early repayments, on the other hand, had a positive effect on profitability, as a result of receipt of the respective early repayment charges.

As a result of the credit process, the medium-sized and big corporate segment at the end of 2017 reached a total amount of BGN 279.6 million. The net annual growth of the credit portfolio for big and medium-sized corporate clients amounts to BGN 26.1 million, or 10.3% as compared to results at the end of 2016.

The portfolio distribution between the big and medium-sized segment is 27%/73%. The numeric representation of this ratio is as follows:

- Big corporate clients – BGN 76.1 million;
- Medium-sized corporate clients – BGN 203.5 million.

There was no change in the ratio as compared to 2016, and this is line with the policy for risk diversification and non-permission of big concentrations. Along with achieving satisfactory growth, the Bank continues to maintain a moderate risk appetite level, without there being unusual or unmanageable deteriorations in the portfolio quality.

To support its sales growth, in 2017 the parent supplemented its product portfolio with two new standardized loan products and improved the loan products intended for target clients. The aim of the new products is to offer as fast and simplified procedure as possible for loan review, approval and disbursement – receiving collateral valuation within a single day.

The update of the agricultural loan against subsidies is the result of the new possibilities, guidance and legislative amendments, and the optimization of processes and rights. In addition to it, a sales product was created – a calculator facilitating the sale and calculating the amount of eligible funding.

To improve the process of loan granting and reduce the documentary burden on clients, access was provided to the new electronic service of the National Revenue Agency, which increased possibilities for performing checks in public registers. Thus, apart from simplifying the process for clients, we also managed to shorten the time needed for loan transaction approval.

We continued to analyse the parent's charges and commissions income, suggesting changes to achieve higher profitability, while maintaining good market positioning.

Throughout the year, there was a strongly manifest trend of reduction in interest rates on deposit and savings product for all participants in the country's business processes – including corporate business, which necessitated the preparation of frequent analysis and the review of the Bank's deposit products' interest rates. As a result from activities following almost monthly market analyses and an analysis of the maturity structure of deposits with competitive banks and within D Commerce Bank AD, interest costs were reduced by 12% through effective deposit management at product level and the application of interest rates which provide an incentive for attracting new funds.

In the middle of 2017 the Bank successfully implemented a new website, with a modern design, in support for demand for the products of Corporate Banking and to facilitate remote banking.

In order to shorten the time needed for decision making and absorption of approved loan proposals, the Corporate Banking Directorate carried out a detailed analysis of proposals' timeframe – from initial talks and receiving the client's request until the final signing of loan agreements and absorption. As a result, optimization was proposed in the decision-making process on loan proposals, which was ultimately approved by the Supervisory Board of the parent and which will allow the Bank to offer faster and more adequate solutions to its customers, while maintaining the quality of analysis and creditworthiness assessment.

For 2018, the Corporate Banking Directorate has set even more ambitious objectives, namely – net increase of the loan portfolio by almost 23%, achieving an amount of almost BGN 330.0 million. Along with the steep growth in volumes, next year we will also be working on overall implementation of the plans for net interest profitability, mostly profitability from charges and commissions.

In order to achieve the above objectives, the team of the Corporate Banking Directorate will count on both the provision of high-quality and flexible services to existing clients, who are expected in 2018 to further develop their business endeavors, and attracting new clients using varies banking products, with a potential for transaction business. We will focus on increasing the number of products used per client, and on enhancing clients' banking intensity. The sectors with good perspectives and growth opportunities in 2018, which the Corporate Banking Directorate will target, are subsidized programmes related to agriculture, the food industry, infrastructural programmes, projects servicing the chemical and pharmaceutical industry, as well as agricultural producers who have been the Bank's clients. Traditionally, the Corporate Banking Directorate will develop its positive experience and best practices in the construction and tourist sector, where it has proven achievements.

2. Retail banking

In 2017 the parent (the Bank) continued the successful development of the retail banking segment. Through reorganisation of the structural units, a new business model was implemented in the branch network, which allowed for a unified sales method for servicing clients at all locations. By introducing the new model and including more functionalities in the positions of all employees in the branch network, it was possible to provide higher service quality to existing customers, with proactive sales of new products and services. Over the year, efforts were invested in improving processes and products, and in increasing trade activity throughout the branch network. In 2017, the process of natural persons' credit card approval and registration was automated.

Meeting/presentations were held in cities in the country, with an increased focus on housing loans, with existing and potential partners/intermediaries, to which the new conditions and the ongoing housing loan campaign "Our Home" were presented, as well as the conditions on consumer loans, credit cards and packages for natural persons offered by D Commerce Bank AD. Around 40 people were present at each of the meetings organised in cities outside Sofia, and the Sofia meeting was attended by approximately 90 representatives of the best known agencies and intermediaries in the city, thanks to which image advertising and good positioning on local housing loan markets were achieved for the target customers group.

Over the last year, the number of newly disbursed loans increased, at a high quality of the loan portfolio. The annual growth achieved in the loan portfolio of Retail Banking was BGN 12.6 million, or 19%.

The market of loan products for natural persons last year was characterized by increase demand for home purchase loans, as a result of the decreased interest rates on deposits and the moderate demand of consumer loans, in the conditions of high competition between financial institution and decreasing interest rates on loans. In order to preserve the good pace of sales and increase the loan portfolio, we applied measures related to decreasing interest rates on the major types of loans and providing special offers to groups of clients, thus also aiming to increase cross sales. Over the year, there was an increase in the number and volume of newly disbursed loans in the two main portfolios – home and consumer loans for natural persons. Housing loans increased by BGN 7.5 million, or 36%, and consumer loans – by BGN 3.6 million, or 15%, as compared to 2016. Throughout the year, there was a strongly manifest trend of decrease in interest rates on deposits and savings products for natural persons, which necessitated the preparation of frequent analyses and the review of our deposits' interest rates. Despite the interest rate decrease, attracted funds increased by 18% or BGN 60.4 million as at the end of 2017. As a result of optimising interest rates on attracted funds over the year, interest costs decreased by 12% or BGN 0.3 million as compared to the previous year.

In 2017 we also increased the number and volume of newly disbursed loans in the Small Business segment, but due to repayments over the year on the part of target customer groups, we failed to achieve the planned portfolio growth. Nevertheless, an annual growth of 8% or BGN 1.8 million was achieved. We increased the number of newly disbursed loans by 11% as compared to the previous year, and the number of active clients – by 7%.

To fulfill its objectives in the Small Business segment, the Bank continued its commercial initiatives to encourage and increase sales in the branch network, which was supported by improved loan products intended for target sectors and various campaigns to increase cross sales. Attracted funds under current accounts and deposits from small business clients increased by BGN 12.8 million or 23% year-on-year.

To support sales growth, we supplemented the product portfolio in the segment with two new standardized loan products, and improved loan products intended for target clients.

Microloans constitute part of our strategy to optimize the loan business – optimally simplified procedure, reduced documentation, and quick approval.

The update of the agricultural loan against subsidies is the result of the new possibilities, guidance and legislative amendments, and the optimization of processes and rights. In addition to it, a sales product was created – a calculator facilitating the sale and calculating the amount of eligible funding.

To improve the process of loan granting and reduce the documentary burden on clients, access was provided to the new electronic service of the National Revenue Agency, which increased possibilities for performing checks in public registers. Thus, apart from simplifying the process for clients, we also managed to shorten the time needed for loan transaction approval.

The year was dynamic with respect to changes in interest rates. In 2017, the Bank updates its interest rates numerous tomes, following almost monthly market analyses and an analysis of the maturity structure of bank deposits. The Bank's interest costs were reduced by 12% through effective deposit management at product level and the application of interest rates which provide an incentive for attracting new funds.

In the third quarter of 2017 we successfully implemented a motivation scheme for additional financial incentives to employees in the branch network as a major instrument to encourage sales activity. This motivation scheme served as the main instrument for achieving a lasting increase in the number of Bank's products from the Natural Persons and Small Business segments.

In the second quarter of the year, the Bank launched four new services, united under the common name "PERIODIC TRANSFERS". The services aim to better satisfy customer needs and create the possibility for remote account administration through automation of recurrent payments. The four services include the following functionalities: fixed periodic transfer, credit card installment, determining the client's desired maximum or minimum availability for a given account.

The Bank developed "PACKAGE PROGRAMMES FOR NATURAL PERSONS" in June 2017 and launched new products – MODERATO PACKAGE and ALLEGRO PACKAGE. The packages involve using bank and communication services at preferential tariffs for monthly subscription fee. In the second half of the year, the Bank organised two campaigns for consumer and housing loan sales, in which the loan was offered in combination with a package programme.

In 2017, a new customer service was developed – automatic payment of utility bills, allowing the clients to pay their monthly electricity, water, TV, internet and other bills without having to visit the Bank or a cash desk of the respective operator. The new service can be used from a client's all current and savings accounts.

We continued to analyse the Bank's charges and commissions income, offering changes in order to achieve better profitability while maintaining good market positioning, In 2017, there was an overhaul of the Bank's policy on foreign currency payments. We developed different charge rates depending on the transfers' amount and differentiated charges for the three possible value dates for execution.

In the middle of 2017, the Bank successfully implemented a new website with modern design.

Work began on creating a Customer Service Call Centre to channel calls to Bank's clients. A team was set up and employee training commenced. The call centre launch will result in enhancing customer service, achieving a single service level, and optimising the workload of employees in the branch network.

Over the last year, a VIP service area was created in the Bank's head office, intended for clients who could potentially develop business relations with the Bank, including owners, company managers, and natural persons with higher deposit and loan exposures. The main aim of the service is to make D Commerce Bank a leading bank serving clients with high income and business development potential, using the widest possible range of banking products and services.

In 2017, the Bank successfully followed the approved card business development strategy, with the aim of meeting clients' needs and optimising processes. The following activities were carried out, jointly with MasterCard, Borica AD, and as internal projects:

Transfer of keys from the system of Borica AD for MasterCard chip cryptogram for key transfer (CVC1/CVC3/AAV) to MasterCard's Stand In.

Launching a project for M Chip Advance certification in accordance with the requirements of MasterCard, which makes the use of M/Chip Advance mandatory as of 1 January 2018. The new functionality ensures higher security and is obligatory for all issuer banks in Europe.

Launching a project with MasterCard and Borica AD to meet the requirements for use of the Automatic Billing Updated (ABU) platform, which ensures maintaining updated information about card holders and aims to reduce the rejection of remote transactions resulting for expired validity for changes in other card parameters. This improves customer satisfaction upon online shopping and phone orders. Use of the platform is mandatory for Bulgaria's banks as of 1 January 2018.

A change was made in accordance with the revised standard for sending information on transactions executed in Bulgaria – Global Collection Only Data Collection – reporting for all transactions executed on the territory of Bulgaria for which no clearing and settlement is provided by the MasterCard network. The transactions should be submitted marked as collection-only.

Extending the validity of Borica keys for the 3D secure service.
Developing project documentation – description of functionalities related to card business services for the Bank's Call Centre project and establishing connection in order to identify Borica AD's clients outside the Bank's working hours.
Participation in Borica AD's National Card Scheme project. The Bank signed a participation agreement, providing a possibility for processing NCS cards at the Bank's devices and a further possibility for card issuing following project initiation and subsequent successful certification, as well as participation in the Council of NCS participants, which is an advantage, providing the Bank with information on the project's progress.
Enriching the scope of POS services with repeated authorisation, no-show transactions and advance deposit transactions.
A joint campaign was held with MasterCard to encourage the use of card products – "Everywhere with you! Fewer borders, more freedom".
Participation in a campaign with MasterCard and store.bg to increase the number of online transactions.
Participation in a MasterCard campaign – encouraging contactless payments –Disneyland Paris 25th Anniversary.
A training was conducted for the directors and staff at FC – loan specialists, front office employees and responsible accountants, on card products and the specifics of use and registration in BIS Banker.
Existing clients' devices were replaced in relation to the introduction of contactless payments.
The number of installed and operational ATM terminals as at 31 December 2017 is 70, which allows the Bank to provide this service in more than 61 settlements in the country.
D Commerce Bank AD offers its clients the cash advance service (cash withdrawal from POS at bank offices) in 50 bank offices, as well as payment service at 175 POS terminals at commercial outlets and municipalities, with a total of 135 companies.

3. Public customers

As part of the parent's (Bank's) structure the Public Customers Department is responsible for the relations of the Bank with its customers under the Public Procurement Act, the Regulation on exercising the state's rights in business entities with state holding, and other applicable regulations related to the implementation of the public procurement procedures.
The department's targets for 2017 were focused on an increase in the sector with respect to the loan portfolio and the customer base, both as number and in volume.
Increasing the number of public customers, in addition to the volumes of the department-specific business, also contributes to increasing sales of products for natural entities. Public procedure for complex servicing create actual prerequisites from increasing volumes in other segments as well, and for reaching agreements on current and forecast future transactions for contracting

authorities, as well as for offering to their employees the full range of products for individual customers – accounts, card products, deposits, credits, investment services, etc.

The Bank managed to keep clients to whom funding was granted under the previously high interest rate levels by renegotiating loans at levels corresponding to the market rates. In addition, thanks to the Bank's high-quality service – both in terms of qualified consultations in the selection of loan products, and in terms of flexibility and speed in the approval of loan proposals, signing of agreement, and absorption of funds, it executed loan transactions in the conditions of the legally allowed direct negotiation.

In 2017 the unit participated in all launched and eligible procedures, and was awarded half of them. The average loan interest rate was preserved in accordance with the planned budget.

With regards to borrowings, the amount of borrowings in 2017 amounted to BGN 97.7 million.

The Public Customers Department performs a continuous process of negotiating interest rate cuts on its depositors' existing accounts in accordance to market interest trend. Irrespective of the methodological decrease of interest rates on public clients' accounts, the funds outflow was managed, and client loyalty was stabilized. It is important to highlight the specifics and dynamics of the borrowings market, which to a great extent impacts the process of increasing newly attracted clients, resp. resources. In view of this, and in view of the methodical rate decrease on existing clients' accounts – there was logical decrease in borrowings as compared to 2016, but in addition – forecasting was objective, in view of exceeding the 2017 budget with respect to borrowings.

4. Financial markets and investments

Over 2017 the Bank worked on ensuring liquidity and investing available funds, and on providing the operating liquidity needed for current payments through money market transactions.

The Bank continued to maintain a relatively high securities portfolio, and as at the end of the reporting period, the total volume of securities held by the Bank was just below BGN 120 million.

In 2017, the main priority in the field of investments was reducing the portfolio's sensitivity to market risks. New investments focused on short-term instruments with higher profitability. BGN 14 million was invested in short-term syndicated loans to banks.

2017 was also very successful for foreign exchange trade, the net result from this activity amounting to BGN 4.97 million.

Over the last year, the Bank continued to serve clients in its capacity as investment intermediary. In this field, it executed several repurchase transactions, which brought an additional income of BGN 172 thousand.

A major priority over the last year was adapting activities to the requirements of MIFID II and MIFIR II. Therefore, the MIFID II/MIFIR project was developed and implemented, revising the Bank's entire internal regulations with respect to its capacity as investment intermediary. Major organizational changes were identified and made, which created the base for better process automation in the field of investment services.

5. D Insurance Broker EOOD

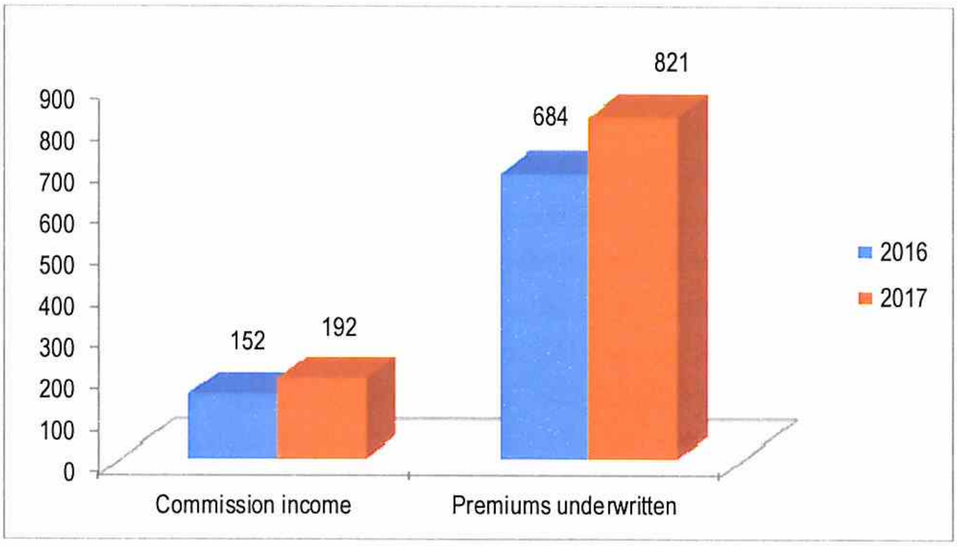
In 2017 the subsidiary has underwritten 1,161 non-life insurance contracts and 13 life insurance contracts.

The total premium income underwritten in 2017 amounted to BGN 821 thousand.

Commissions realised on the insurance contracts amounted to BGN 192 thousand.

The increase in premiums underwritten on annual basis amounted to BGN 137 thousand which represents growth of 20% year-on-year. The company reported an increase in commissions received in 2017 on insurances underwritten and actual premiums collected by BGN 40 thousand or 26% compared to 2016.

Revenue and premiums written



D Insurance Broker has contracts with the following insurance companies:

- Allianz Bulgaria IJSC
- Armeets IJSC
- Bulstrad VIG IJSC
- IJSC Bulgaria AD
- IJSC Victoria AD
- DZI General Insurance AD
- Generali Insurance AD
- Euroins AD
- Euroins - Health Insurance ISOJSC
- AIG Europe Limited (Bulgaria branch)

- IC Lev Ins AD
- IC Medico 21
- OZK AD
- IC Uniqua AD
- HDI Insurance AD

Accounting profit amounting to BGN 85 thousand was reported in 2017 (2016: BGN 59 thousand).

6. D Leasing EAD

The subsidiary D Leasing EAD provides leasing services both to customers of the D Commerce Bank Group and to external customers.

As a commercial entity one of the objectives of D Leasing EAD is to provide financing at the most market relevant and efficient terms, so as to maximise the profits for its shareholder, while at the same time addressing the ever changing expectations of its customers. The aim is to develop and update the products and services offered all the time and thus become a recognised financial institution at the leasing market in Bulgaria and expand the product range offered by D Commerce Bank Group.

As at 31 December 2017 the subsidiary's assets amount to BGN 2,241 thousand. The company has provided financing to its target groups in the form of finance leases at the amount of BGN 1,967 thousand, generated in 40 leasing deals.

The liabilities of the subsidiary represent mainly liabilities under a loan agreement signed with D Commerce Bank AD amounting to BGN 846 thousand, as well as with the Bulgarian Development Bank AD amounting to BGN 199 thousand, under the Leasing Line Programme, supported by the European Investment Fund and the Microfinance Mechanism of the European Union.

In 2017 interest income amounted to BGN 152 thousand, which stands for approximately 90% of the total income generated by the company during the period, other operating income amounted to BGN 15 thousand, the main portion of which is due to the income from the delivery of specialised plant and equipment.

7. D Imoti EOOD

The primary business of D Imoti EOOD involves the acquisition and sale of real estate, design, furnishing, construction of real estate for sale, leasing. The company did not perform active operations in 2017.

IX. Development plans

In accordance with Art. 45, in relation to Art. 39, item 4 o the Accountancy Act the Group presents its expected strategic development plans for 2018:

D Commerce Bank Group envisages:

- Sustainable growth and development of the parent and its subsidiaries;

- Creating and maintaining a strong image as a serious player in the banking products and services market;
- Establishment of full synergy between corporate and retail banking, activation of cross-selling;
- Modernisation of the existing and development of new products and services tailored to meet customers' needs;
- Building and maintaining a sustainable customer relationships, based on loyalty and added value;
- Further development of alternative distribution channels for attraction of new business, initiatives and sales campaigns, marketing support;
- Improvement of the internal organisation, aimed at attaining market standards in processing and approval of loan transactions;
- Intensive staff training and customer service excellence.

X. Events after the date of the financial statements in accordance with Art. 45 in relation to Art. 39, item 3 of the Accountancy Act

No events have occurred after the date of the consolidated annual financial statements that may have impact on the Bank's financial statements as at 31 December 2017.

Date: 30 March 2018

Anna Asparuhova
Executive Director
D COMMERCE BANK AD

Martin Ganchev
Executive Director
D COMMERCE BANK AD

CORPORATE GOVERNANCE STATEMENT

D Commerce Bank Group (the Group) comprises D Commerce Bank AD (the parent, the Bank) and its three subsidiaries - D Leasing EAD, D Insurance Broker EOOD and D Imoti EAD.

Composition and operation of the administrative, management and supervisory bodies and their committees

The parent

D Commerce Bank AD has a two tier management system. The General Assembly of the shareholders elects the Supervisory Board, which in turn elects the members of the Management Board, the Executive Directors and set their remuneration.

Management Board - it is responsible for the overall organisation and efficient functioning of the risk management system in the Bank and its development directions; it sets the risk appetite of the Bank, approves all policies, rules and procedures concerning risk management, approves a system of limits aimed at mitigation of the major bank risks and restriction of these risks within the desired level.

Executive Directors - they organise the work related to the proper implementation of the risk management policies adopted and the compliance with the approved limits, which they are directly in charge of, they control the work of the individual structural levels with respect to risk analysis and assessment.

Risk Committee - the Supervisory Board of the Bank performs the Risk Committee functions by advising and providing guidance to the Bank's Management Board in relation to the overall current and future risk strategy and the Bank's risk appetite and supports control over its implementation by the top management team.

Asset and Liability Management Committee - it is a liquidity management body authorised to draw up action plans in case of unforeseen outflows due to unexpected or adverse circumstances, taking into account the possible impact of the alternative scenarios on the Bank or on the market as a whole, as well as combinations thereof; it exercises current control and analyses the Bank's capital adequacy and proposes to the MB draft resolution for changes in the asset and liability structure and the possibilities for their diversification, if necessary; it reviews all policies, rules, procedures and limits concerning the management of all types of risks and submits them for approval by the Management Board; analyses the current condition of the Bank's assets and liabilities, monitors the risks related to the management of its liquidity and the financial instruments market and proposes specific measures in case of deviation from the approved limits or in case of extraordinary situations.

Credit Committee - a standing collective body the main activity of which is aimed at assessment of credit risk arising in relation to specific loan transactions or the total loan exposure of a party or a group of related parties and approval of the parameters thereon within its powers, and with its proposals and resolutions facilitates the increase of the loan portfolio through efficient choice of loan transactions.

Provisional Council - it is a specialised advisory and control body of the Bank's MB the primary activity of which is aimed at minimising the risk of losses to the Bank through a system for monitoring, assessment, classification and provisioning of the risk exposures; it assesses and classifies the risk exposures, makes decisions as to the impairment loss rates under IAS 39 and the loss risk on each classified risk exposure and on the regular exposure portfolios having similar risk characteristics; makes resolutions for the restructuring of risk exposures and proposes to the MB to approve them.

Risk Events Assessment Committee - it is a specialised internal body of the D Commerce Bank AD management in the area of transaction risk management and control; it makes decisions as to the final recording of operational events occurred, assesses the potential losses, analyses the data recorded in the accounting ledgers.

Complaints, Signals, and Objections Review Committee - it is a standing collective body responsible for the review of complaints, signals and objections filed with D Commerce Bank AD, discussing, analysing and making decisions on the cases brought before it.

Information System Security Committee - it has a planning and coordination function in relation to the activities concerning the security of the Bank's information systems, approves the procedures for the application of the information security rules and proposes them for approval by the Bank's Management Board.

Emergency Action Plan Management Committee - it is responsible for the drawing up of the Bank's Emergency Action Plan, it is in charge of the selection of a methodology for testing the continuity plan, responsible for the overall organisation and implementation of tests, analyses the possibilities to contract insurance in order to recover the losses in case of occurrence of risks that cannot be fully controlled.

Coordination Group on the Implementation of the Measures Against Money Laundering, Financing of Terrorism and Specialised Regulatory Control, Working Conditions Committee, Problematic Loans Committee, Audit Committee, General Services Committee, IT Services Committee.

Subsidiaries

D Leasing EAD

D Commerce Bank AD is sole owner of the capital of the company. The Management Board of D Commerce Bank AD is representative of the sole owner of the capital.

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

Board of Directors - it manages the company in accordance with the requirements of the effective legislation and the Articles of Association of the company, as well as the resolutions of the sole owner of the capital and is responsible for its operational management.

Impairment Committee - it makes decision as to the classification and definition of the impairment loss on risk exposures.

D Insurance Broker *EOOD* is managed and represented by its General Manager.

D Imoti EOOD is managed and represented by its General Manager.

Diversity policy applied to the administrative, management and supervisory bodies

The policy ensuring the diversity in the selection of the members of the Management Board of the parent sets out the legal requirements to the Management Board members, including the executive members of the Bank's MB members, the requirements aimed at ensuring diversity in the selection of the Bank's Management Board members are set out, there are underlying detailed criteria the members of the Bank's management body need to meet and the qualities they have to possess.

Main features of the internal control and risk management systems of the Group companies related to the financial reporting process

The internal financial reporting control system and D Commerce Bank Group reporting system is developed based on analysis of the good reporting and control practices in Bulgaria and big multinational groups, and in compliance with the national legislative requirements, including those concerning companies and groups listed at regulated markets. It is subject to continuous monitoring, further development and enhancement by the management.

The internal financial reporting control system and the reporting of the parent is a set of behavioural and technical principles, rules, tools, procedures and controls, which are customised and adapted to the Bank's specifics, its operations and reporting system. It is aimed at:

- Ensuring current monitoring and direction of the reporting activities towards their objectives and the expectations of the various users and towards achieving the required effectiveness and efficiency, including with respect to the utilisation of the resources; and
- Ensuring adequate and timely addressing of detected business risks, which influence the financial, management and operational reporting.

It is specifically developed to give the management satisfaction that:

- The Bank is in compliance with the applicable legislative requirements in the area of accounting, reporting and the other areas directly related thereto, and particularly the requirements of the Accountancy Act and the International Financial Reporting Standards;
- The directions and guidelines of the top management with respect to reporting and documentation are complied with in the Bank;
- The required efficiency and effectiveness of the financial - accounting process, including consolidation and documentary support are in place;
- There is high level of certainty with respect to the safeguarding and maintenance of the Bank's assets, including prevention of fraud and errors; and
- There is trustworthy, quality and timely financial and operational information available to internal and external users.

The main components of the internal control system with respect to financial reporting include:

- Adoption and compliance with the ethic principles and conduct rules that have been introduced with the Code of Ethics of D Commerce Bank AD also with respect to financial reporting and all processes, procedures and actions of each staff member of the Bank related thereto;

- Development and definition of an optimum structure of units engaged in financial reporting-related processes, with clearly defined responsibilities and delegated powers and duties, including through written internal documents;
- Development of recruitment, training and development policies concerning the personnel engaged in the accounting and financial reporting processes;
- Development, implementation and maintenance of control procedures and rules at each stage of the processes related to the accounting and financial reporting, with a priority on the gradual introduction of the formal written procedures; and
- Development of procedures for risk identification, monitoring and management in relation to the accounting and financial reporting, including development of adequate measures and steps to minimise them;
- Development and maintenance of adequate organisation of the information system, including access control, entry, processing and retrieval of data, changes in the system, allocation of the duties between the people engaged therewith, as well as storage and protection of the integrity and authenticity of the data in the system.

Control environment

Ethic principles and rules related to the accounting and financial reporting processes

The management at the various levels within D Commerce Bank Group has introduced and monitors continuously the compliance with the ethic values such as integrity, independence and impartiality as the foundations of the professional conduct of all individuals involved in the Bank's accounting and financial reporting related processes. They represent the framework underlying the control environment and have had impact on the efficiency of the model design, the administration and current monitoring of the remaining internal control elements in the accounting and financial reporting area. A conduct with integrity and ethics is the result of the established general ethics and conduct standards of the Bank. They are clearly communicated with the entire financial - accounting and control personnel, and are constantly reaffirmed in the practice.

The ethic principles governing the professional conduct, which all individuals engaged directly or indirectly in the accounting and financial reporting processes should comply with include: objectivity; impartiality; independence; prudence; transparency; methodological justification; consistency and use of independent experts. The principles are applied at all stages of the financial reporting process in: the selection of accounting policies; the closing of the accounts for accounting purposes; the drawing up and application of accounting estimates and the drawing up statutory and management financial statements, other statutory reports and documents, containing financial information.

The Code of Ethics regulates and relates to the professional conduct of the employees, the relations between the Bank's customers and its officers, the relations between the employees, protection of the Bank's interests, prevention of conflicts of interests, as well as the ways to address such, if the occur. The Code of Ethics is aimed at:

- setting the ethical standards for the professional conduct of the employees;
- offering norms of conduct to facilitate the employees in making a decision to taking appropriate action in areas where conflicts may arise between the ethic principles, the tasks assigned and the personal culture of the employee;
- creating unity through overcoming conflicts and disagreements;
- creating amicable atmosphere between the employees, facilitating sharing of experience and building and development of professionalism.

The creation and assertion of the Bank's positive image is aimed through the compliance with the rules of conduct underlying the Code and accepted by all employees. The conduct rules set out in the Code form an unfaltering part of the daily work of the Bank's employees, whereby the compliance with the ethic rules of conduct ensures the lawfulness of their actions and protection against ungrounded accusations by the Bank's customers. The work of the employees is carried out in compliance with the principles of lawfulness, loyalty, integrity, impartiality, responsibility and accountability. The recruitment process to employ individuals to work at the Bank takes into account the personal qualities meeting the professional ethics requirements. Each individual appointed to work for the Bank is obliged to perform the tasks assigned to the best of their abilities.

The subsidiaries follow the approved rules, policies and procedures of the parent taking into account their own specifics.

Management bodies in charge of the individual components of the overall accounting and financial reporting process in the Group

The parent (the Bank)

The management bodies responsible and authorised with respect to the financial reporting process and other related processes include: the Management Board, the Director of the Central Accounting Directorate, the Director of the Planning, Financial Reporting Control Directorate and the Head of the Internal Audit Unit. Their functions and responsibilities may be summarised as follows:

- The Management Board adopts and approves: the accounting policies and changes therein in each reporting period, the accounting estimates made as at the date of each reporting period, including the methodology applied; the financial statements and reports and other publicly available documents, containing financial information; the functions, organisation and responsibilities of all structural units and their managers, engaged in and related to financial reporting; the development, implementation and current monitoring of the functioning of the individual components of the internal control system, including the activities of the Internal Audit Department;
- The Director of the Central Accounting Directorate organises and manages the accounting reporting of the Bank - controls and provides methodological guidance of the bookkeeping, is responsible for the development and implementation of the accounting reporting methods and techniques; is responsible for the process of closing of the accounts and all accounting estimates, proposes and develops accounting policies and changes therein, follows up on any current amendments in IFRS;
- The Director of the Planning, Control and Financial Reporting Directorate is responsible for the overall organisation, methodological support and implementation of the process for preparation of the separate and consolidated financial statements of the Bank, including the ongoing control, guidance, monitoring and analyses of the financial statements for consolidation purposes of the D Commerce Bank Group companies, communicates with the regulators, draws up analyses, projections and management reporting information, is in contact with internal and external expert bodies, consultancy and audit firms;
- The Internal Audit Unit performs ex-post control over the transactions and activities related to the preparation of the Bank's financial statements and the compliance with the internal controls introduced in relation to the individual recurring and non-recurring processes. It monitors and provides assistance for the attainment of the Bank's objectives and tasks. It facilitates the efficient, effective and economic utilisation of the resources, as well as the adequate control over the various risks. It provides support for the protection of the value of the Bank's assets. The Unit monitors the lawfulness of the operations, the proper implementation of the policies, plans, internal rules and procedures. Expresses opinions on the adequacy of the internal control systems and the risk management of the process arrangement, as well as the monitoring and reporting systems and their adequacy and efficiency.

Subsidiaries

D Leasing EAD - the bodies responsible and authorised with respect to the financial reporting process and other related processes include the Board of Directors and the Chief Accountant.

D Insurance Broker EOOD - the bodies responsible and authorised with respect to the financial reporting process and other related processes include the General Manager and the Chief Accountant.

D Imoti EOOD is managed and represented by its General Manager - the bodies responsible and authorised with respect to the financial reporting process and other related processes include the General Manager and the Chief Accountant.

Human resource policies and practice in the financial - accounting departments

The Group companies have established policies and rules related to the management of the human resources engaged in the financial reporting process and the processes related thereto. These include the introduced and applied policies and procedures for the recruitment and appointment of such personnel, focusing on the education and professional experience, computer literacy and knowledge of foreign languages by the candidates. During the recruitment process priority is given to the requirements underlying the job descriptions of the individual positions.

Personnel management policies also include policies related to the continuous additional professional training, updating and expansion of the knowledge and skills of the specialists employed. The Bank updates and adopts upcoming personnel training plans every year. Training courses are conducted obligatory in case of changes in the regulations, IFRS, tax laws and other concerning directly their work. The objective of this policy is to update and expand the professional expertise of the staff and to enhance their skills in order to improve the efficiency in the performance of their duties.

Risk assessment process related to the financial reporting of the Group

The Management Board, the Director of the Central Accounting Directorate and the Director of the Planning, Control and Financial Reporting Directorate of the parent play a key role in the process of continuous identification, monitoring and control over the business risks, including the identification and control of the effects thereof, which also influence directly certain accounting processes and items, the financial reporting of D Commerce Bank Group. They perform joint overall monitoring on the risk management process.

The risk factors concerning the reliable financial reporting include external and internal events, transactions and circumstances that may occur and may have adverse impact on the Group companies' ability to create, maintain and process accounting and operating data in a way ensuring trustworthy financial reporting, statements and reports. The key factors identified by the Group include the following:

- The following are identified as external risks: changes in the business and market environment of the parent (the Bank) and its subsidiaries, as well as in the products and services offered by the Group; the activities of the competitors; changes in the legislation and the regulatory framework; changes in key suppliers or customers / groups of customers; unscrupulous or ill-natured acts of external parties; fast corporate growth and growth of the Group; development of the entities in which the Bank holds significant investments in the form of interests and / or loans granted.
- The following are identified as part of the internal risks: changes in the technical infrastructure of the Group, in the way and intensity of use of the available assets and resources; launching of new products and services; new accounting policies and IFRS; changes in the staff of the directorates responsible for the financial reporting; changes in the information systems; errors in the work and / or insufficient knowledge or skills of the personnel; fast expansion of the operations; use of many estimates - in particular use of fair values and calculation of recoverable amounts of certain non-current assets involving external experts.

The risk factors of recurring nature and / or related to the application of the accounting policies and estimates are monitored currently by the Directors of the Central Accounting Directorate and the Planning, Control and Financial Reporting Directorate of the parent (the Bank), who propose solutions concerning the management and appropriate recording of their effects in the financial statements. The newly emerging risk factors are identified, assessed and developed by the Director of the Central Accounting Directorate and the Director of the Planning, Control and Financial Reporting Directorate. Consultancy assistance provided by independent consultants is used as necessary, including with respect to the application of new IFRSs. The Management Board of the parent (the Bank) is responsible for the overall monitoring of the risk management process in relation to financial reporting.

Bodies responsible for the control functions over the financial reporting process

The Supervisory Board reviews the annual financial statements - separate and consolidated and the profit distribution proposals and presents to the sole owner of the capital the annual management report of the parent, including the consolidated management report.

The Audit Committee monitors independently the implementation of the financial reporting processes, the accounting policies applied and the effectiveness of the internal control system of the Bank, including risk management, as well as the performance and results from the internal and external audit.

Information system

Parent

The information system of D Commerce Bank AD includes infrastructure (physical and hardware components), software, people, procedures and data. In 2016 the Bank introduced a new e-banking system. It encompasses all customer service processes electronically. The system is customised and implemented taking into account the specifics of the Bank itself. The functionalities of the system allow for customer service identical to that provided at the front office. The e-banking system has modern dynamic design allowing the use of all types of end devices and offers intuitive user navigation. The system is protected two-fold (OTP - e-transactions dynamic key authorisation method).

In addition to the main information system (BANKER) the Bank uses the following systems: CARD MANAGEMENT SYSTEM, Portfolio Management System, Securities Servicing System, Document System, Loan Approval System. They are linked via interfaces. The quality of the information generated by the systems gives the management the basis for making adequate, well-grounded and timely decisions in the management of and control over the activities related to the preparation of various financial and management accounts, as well as other publicly available documents containing financial information.

In 2017, the main information system BANKER underwent a number of upgrades of specific technologies, such as the LOANS module, the Loan Approval Module, and a new customer service technology was implemented – the New Front Office Module. There was considerable modernization of the technology administering the rights of BANKER users, and additional functionalities were added to implement a role-based approach to user right management in

BANKER. допълнителни функционалности осигуряващи ролево базиран подход на управление на правата на потребителите в БАНКЕР.

In 2017, the Bank's IT infrastructure was modernized, upgrading the Bank's private network and the server infrastructure at the Bank's main data centre. Both projects aimed to increase the IT infrastructure's productivity, accordingly the processes provided thereby.

In 2017, the Bank modernized its corporate website in order to provide a sales channel compliant with the latest marketing and technological trends in these areas. The new corporate website is intuitive and product-oriented, developed through reliable information technologies in line with current IT security requirements.

The information system relevant to the financial reporting objectives and process encompasses methods and documentation which:

- identify and record all valid transactions;
- describe the transactions in a timely fashion and with sufficient detail allowing their proper classification for financial reporting purposes;
- measure the transactions in a way allowing the recording of their appropriate monetary amounts in the financial statements;
- cut-off the period during which the transactions have been originated in order to allow their recognition in the respective accounting period;
- present the transactions and the related financial statement disclosures appropriately in accordance with the requirements of the reporting framework.

Different departments within the structure of the Information Technologies Directorate are responsible for the smooth and risk-free operation of the Bank's information system. Their functions are allocated in accordance with their functional characteristics as follows:

IT Operations - a structure directly responsible for the current support of the applications used in the Bank and the interfaces between them. Testing of development products. Implementation of releases;

IT Development - a structure directly responsible for the change management process through which changes in the Bank's applied systems are made. Testing of development products

IT Infrastructure - a structure maintaining the hardware, communications and server infrastructure of the Bank;

IT Help Desk - a structure assigned with the first line of support to the external IT service users.

The Central Accounting Directorate of the Parent

The Directorate is headed by a Director who performs the functions of a chief accountant of D Commerce Bank AD. The Directorate is also composed of deputy chief accountant and experts. Its structure includes Accounting Methodology, Taxes and Accounting Department, Budgetary Orders Department, Account Bans Department and Back Office and Branch Network Department. According to its functional description the Directorate aggregates and carries out fully the Bank's accounting - reporting functions, the internal accounting control. The appropriate and consistent application of the developed accounting policies, the development and implementation of internal chart of accounts; reporting methodologies, current bookkeeping, schedules, the preparation and / or processing of the inputs to the accounting estimates jointly with the involved experts, as well as the reporting of deviations and mismatches to the Management Board and the compliance with the regulatory requirements in the area of accounting, taxation and other related fields form part of the responsibilities of the Directorate.

The accounting policies of the Group are reviewed as necessary and are subject to approval by the Management and Supervisory Boards. The revised accounting policies are published through the internal system for disclosure of updated and new policies.

The choice of the reporting framework is based on the requirements of the Accountancy Act. D Commerce Bank AD applies International Financial Reporting Standards (IFRS), endorsed by the European Union. Ongoing control for the appropriate application of IFRSs is exercised by the Central Accounting Directorate and the Planning, Control and Financial Reporting Directorate. Further confirmation of the accuracy of the application is obtained by the internal auditors.

Planning, Control and Financial Reporting Directorate of the Parent

The Directorate is headed by a Director and includes the following departments - Budget and Planning, Financial Reporting and Management Information and Income and Expense Control. According to the functional description the Directorate is responsible for the organisation and management of annual and mid-term business development plans and the budget of the Bank, as well as control over the attainment of the business targets set and the execution of the annual budget. It develops an annual budget system by profit centre, product and segment. It prepares analyses and reports of the bank system and benchmarks the Bank's key indicators against the market (market share, interest rates, etc.). The Directorate organises and manages the control over the reported income, volumes and execution of the annual budget targets. It participates in the development of the methodology rules and procedures for the setting of business objectives, income, expenses and investments. The Directorate prepares daily schedules concerning the financial position of the Bank against certain indicators for management purposes, as well as monthly reports on the Bank's financial position. It is in charge of the control over the Bank's expenditures and the budgetary spending during the year. The Planning, Control and Financial Reporting Directorate exercises control over the spending of the investment funds allocated in the Bank's budget during the year. It organises, manages and controls the process of preparation of the information - analytical overviews, reports, monitoring of the macroeconomic development, political and other events and their impact on the Bank's business and plans. It prepares annual financial statements in accordance with IFRS, annual financial statements for local needs, for the Deposit Insurance Fund, the Financial Supervision Commission, the Bulgarian Stock Exchange, international financial institutions providing external financing. It participates in the preparation of different reports for supervision purposes, in relation to BNB regulation, bank statistics, payment balance. The Directorate is involved in the development of the internal regulations framework of the Bank, as well as in the enhancement of the planning methodology. Makes proposals for optimisation of the Bank's asset structure. It organises, coordinates, manages and controls the overall activities related to the collection, summary, analysis and dissemination of the statutory statistic and financial information about the Bank.

The preparation of the Group's financial statements for public use is the result of a comprehensive closing of the accounts process in each reporting period. This process is made formal as a result of the rules and guidelines documents approved by the management. They are related to certain actions and procedures, and respectively the drawing up of documents by officers from the Central Accounting Directorate, the Planning, Control and Financial Reporting Directorate or other responsible officers and such actions and procedures are dealing with: stocktaking; account analyses; mailing of confirmation letters; best estimates such as depreciation and amortisation, revaluation, impairment and accruals, which have to be based on reasonably justified assumptions; study and analysis of various legal documents (agreements, lawsuits, legal adviser opinions); study and assessment of expert reports (valuers, actuaries, internal auditors, other external experts and officers); preparation of schedules and consolidation packages; preparation, analyses and discussion of draft financial statements.

With respect to the subsidiaries the functions related to the consistent application of the adopted accounting policies, the development and implementation of the internal charts of accounts; reporting methodologies, current bookkeeping; ongoing accounting analysis and control of the reporting data and documentation, the development of annual and mid-term business development plans and the Bank's budget, as well as the preparation of annual financial statements in accordance with IFRS, annual financial statements for local needs are performed by the Chief Accountant of the respective company and the Department he or she is heading.

Control activities

The control activities envisaged in the developed and implemented internal controls by process include: reviews of the execution and performance results; processing of the information; physical controls and allocation of duties and responsibilities.

The general controls related to the financial reporting may be categorised as procedures related to ongoing and periodic reviews and analysis of the financial indicators and the inputs thereto. They include reviews and analysis of the actual reported results against the budgeted, projected, prior period results, against the system as a whole and against the target group. They may usually contain proposals for optimisation or revision of certain budgets.

The controls underlying the information systems of the Group cover both applied programme controls and the overall IT controls, which represent policy and procedures facilitating the ensuring of the continuous proper functioning of the information systems. The typical controls underlying the applied programmes include: checks of the mathematical accuracy of the records, maintenance and review of accounts and trial balances, automated controls, such as input checks and numbering sequence checks, and non-automated follow up of the exception reports. The overall IT controls include: programme change controls, controls restricting the access to programmes or data, controls over the implementation of new releases of software applications and system software controls restricting the access or the ongoing monitoring of the use of system auxiliary functions which may change financial data or records without leaving a trail for subsequent tracking.

Physical controls applied include:

- measures ensuring the physical safeguarding of the assets - secure facilities and premises, and special access terms to assets and documents;
- special approval procedure for access to computer programmes and data files;
- periodic stock-taking - procedures for the organisation and conducting of stock-taking by means of counting / weighing the stocks / sending suitable confirmation letters and comparison of the amounts in the checklists and in the accounting documents / ledgers.

Internal controls are also envisaged in the developed and implemented procedures for the management, organisation and implementation of the main routine processes (delivery and sales), as well as the processes for the drawing up and acceptance of the complex estimates (depreciation and amortisation, impairment, revaluation, actuarial calculations and long-term provisions). These are focused on: authorisation of individual transactions and the primary documents issued; reviews and checks of the documents issued and the assets involved in the transaction; subsequent re-calculation and comparison with other documents (agreements, orders, confirmations, price lists, etc.) and individuals, as well as separation of the duties and responsibilities of the officers involved in each step of the respective process in order to ensure mutual control, and to reduce the possibilities to put an individual in a position to both execute and conceal error or fraud in the ordinary course of performance of his / her duties.

The Group is in process of continuous expansion of the formal control procedures and activities.

Ongoing monitoring of the controls

An important priority of the management, particularly the Director of the Central Accounting Directorate and the Director of the Planning, Control and Financial Reporting Directorate is to establish and maintain ongoing and efficient internal control. The current monitoring of the controls by the management includes judgement as to whether they function as envisaged and whether they are appropriately modified in order to reflect the changing conditions.

The ongoing monitoring of the controls may involve activities such as management review as to whether internal management reports are prepared in a timely manner, and whether key data therein are reconciled by means of confirmation from third parties and its expectations, assessment by the internal auditors as to the compliance with the policies and procedures related to the implementation of the routine processes by the personnel involved, supervision over the observance of the ethical norms or the generally accepted business practices. The ongoing monitoring is carried out in order to ensure that controls continue to function effectively over time.

The internal auditors as well as the officers charged with supervision, monitoring or control functions also contribute to the ongoing monitoring of the internal controls over the entities processes through their assessment of individual controls or groups of controls. They usually provide such information periodically in the course of performance of their duties and functions, as well as their assessments regarding the functioning of specific internal controls, with a specific focus on the assessment of their effectiveness, they communicate information regarding the strengths and weaknesses in the internal controls with the respective individuals and make recommendations as to their improvement.

The Supervisory Board may check any action related to the Group's operations, may check the accounting documentation and ledgers at any time and make conclusions as to the Group's position.

The Audit Committee monitors the effectiveness of the internal controls of the parent (the Bank) and the risk management system, recommends the appointment of the registered auditor (external auditor) of the Bank and assesses the external auditor's independence, the Bank's policy concerning the compliance with the requirements of the regulations significant for the true and fair presentation of the financial statements.

The ongoing monitoring activities include the use of information from outside sources which depicts issues or outlines areas that need improvement. Such sources are the customers, suppliers, the supervision authority, namely the BNB, the regulatory, namely the FSC. Furthermore, in implementing the ongoing monitoring activities the management always takes into account the communications with the external auditors related to the internal controls and any weaknesses and recommendations made by them.

The Group companies are not issuers of securities and have no plans of becoming public entities. The Corporate Governance Code in relation to the requirements of Art. 100 (n), para 8, items 1 and 2 of the Public Offering of Securities Act (POSA) is not applicable to D Commerce Bank Group.

Anna Asparuhova
Executive Director
D COMMERCE BANK AD

Date: 30 March 2018

Martin Ganchev
Executive Director
D COMMERCE BANK AD

D Commerce Bank AD

Independent Auditor's Report

INDEPENDENT AUDITORS' REPORT

To the shareholders of D Commerce Bank AD

REPORT ON THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS

Opinion

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

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2017, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) 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 *Auditors' Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants (IESBA Code)* together with the ethical requirements of the Independent Financial Audit Act (IFAA) that are relevant to our audit of the consolidated financial statements in Bulgaria, and we have fulfilled our other ethical responsibilities in accordance with the requirements of the IFAA and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

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

<table>
<tr><th>Key Audit matter</th><th>How this key audit matter was addressed in our audit</th></tr>
<tr><td colspan="2">Impairment of loans and advances to customers
The Group's disclosures regarding the impairment of loans and advances to customers are provided in Note 3.1. Credit Risk and Note 15 Loans and advances to customers to the consolidated financial statements.</td></tr>
<tr><td>Loans and advances to customers represent a substantial proportion (51%) of the Group's total assets as at 31 December 2017. As disclosed in Notes 3.1. and 15 to the consolidated financial statements, the management determines impairment losses on loans and advances to customers, with identified objective evidence for impairment, on an individual and on a portfolio basis. The gross amount of these loans as at 31 December 2017 is BGN 426,191 thousand, and the accumulated impairment losses for them amount to BGN 38,903 thousand.

The determination of impairment losses on loans and advances to customers requires the application of significant judgments and key assumptions for the final calculations by the management with respect to the expected collectability of the credit exposures, mostly with respect to the period and amount of expected future cash flows, including based on market assessment and collateral realization, as</td><td>In this area, our audit procedures included, among others:
• Inquiries and obtaining an understanding of the Group's process of determining impairment losses on loans and advances to customers in the Group.
• Inspection and review of the internal policies and procedures related to the process of determining impairment losses, as well as the process of monitoring and management of loans granted to customers. Inquiries to Group experts responsible for credit risk management.
• Assessment and testing of the design and operating effectiveness of key controls in the process of approval and ongoing monitoring on loans and advances in the Group as well as of determining their impairment. Use of our IT experts to perform, assess, and test general IT controls.
• Analysis of the Group's credit portfolio and other analytical procedures as to its structure, composition and development trends, including</td></tr>
</table>

well as to the analysis of information on historical default experience. Due to the significance of the above described circumstances that: a/ the materiality of loans and advances to customers for which objective evidence exists for impairment as a reporting item for the Group's consolidated financial statements, and b/ the inherent uncertainty of using numerous judgements and assumptions by management in calculating the impairment losses on loans and advances to customers on an individual and on a portfolio basis, we have considered this matter as a key audit matter.	whether impairment losses follow its development. • Tests and analyses, based on a sample of loans and advances to customers, for which the Group has not identified objective evidence for impairment, for the purpose of assessing their correct classification in the respective risk group by the Group. • For a risk-based sample of loans, performing test of details to assess the adequacy of the individual impairment losses booked. The following audit procedures were performed with regard to the respective sample exposures: o analysis of the financial position and results of borrowers, and inspection of information and documents related to loan servicing; o review of collateral valuation reports of the respective exposures; for some collaterals, we used our expert appraisers regarding the assumptions and methods applied in the valuations of collateral realisable value; o analysis and assessment of the key assumptions and judgments of the management in the calculation of specific allowances for individual exposures. • Review and evaluation of the models used in the calculation of collective impairment on portfolio basis, including of the inputs, sequence of assumptions and analysis of the development of the parameters applied. Test recalculations of specific parameters in the model and the total amount of the collective impairment allowance as at 31 December 2017. • Performing audit procedures on subsequent events focused on the development of loans and advances to customers from the above mentioned sample after the reporting date, in order to assess the sequence of assumptions used by the Group

	with respect to expected future cash flows. • Assessment of the relevance and adequacy of the Group's disclosures in relation to its exposure to credit risk and to impairment losses for loans and advances to customers.

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

Management is responsible for the other information. The other information comprises the management report, including information about the Bank's activity in its capacity as investment intermediary, and the corporate governance statement, prepared by management in accordance with Chapter Seven of the Accountancy Act, but does not include the consolidated financial statements and our auditor's report thereon.

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

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

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

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs as applicable in 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 consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease its operations, or has no realistic alternative but to do so.

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

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in

our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements.

- We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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

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

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure of information 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 responsible for the performance of our audit and the audit opinion expressed by us, in accordance with the requirements of the IFAA applicable in Bulgaria. In accepting and performing the joint audit engagement, in respect to which we are reporting, we have considered the Guidelines for

Performing Joint Audits, issued on 13 June 2017 by the Institute of Certified Public Accountants in Bulgaria and the Commission for Public Oversight of the Registered Auditors in Bulgaria.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Additional Matters to be Reported under the Accountancy Act

In addition to our responsibilities and reporting in accordance with ISAs, described above in the *Information Other than the Consolidated Financial Statements and Auditors' Report Thereon* section, in relation to the management report, the corporate governance statement and the non-financial declaration, we have also performed the procedures added to those required under ISAs in accordance with the *"Guidelines Regarding New Extended Reports and Communication by the Auditor"* of the professional organisation of Registered Auditors in Bulgaria – Institute of Certified Public Accountants (ICPA). These procedures refer to testing the existence, form and content of this other information to assist us in forming an opinion about whether the other information includes the disclosures and reporting provided for in Chapter Seven of the Accountancy Act applicable in Bulgaria and Art. 100(m), paragraph 8, where applicable, of the Public Offering of Securities Act.

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

Based on the procedures performed, our opinion is that:

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

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

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

- AFA OOD and Baker Tilly Klitou and Partners OOD were appointed as statutory auditors of the consolidated financial statements of the Group for the year ended 31 December 2017 by the General Meeting of Shareholders held on 31 October 2017, for a period of one year.
- The audit of the consolidated financial statements of the Bank for the year ended 31 December 2017 represents a third total consecutive statutory audit engagement carried out by AFA OOD and a first total statutory audit engagement carried out by Baker Tilly Klitou and Partners OOD.
- We hereby confirm that the audit opinion expressed by us is consistent with the additional report dated 29 March 2018, provided to the Bank's Audit Committee, in compliance with the requirements of Art. 60 of the Independent Financial Audit Act.
- We hereby confirm that no prohibited non-audit services, referred to in Art. 64 of the Independent Financial Audit Act, were provided.
- We hereby confirm that in conducting the audit we have remained independent of the Group.

Audit firm
AFA OOD:

Valia Iordanova
General Manager

Renny Iordanova
Registered Auditor in Charge of the Audit

38, Oborishte Street
1504-Sofia, Bulgaria

Audit firm
Baker Tilly Klitou and Partners OOD:

Krasimira Radeva
General Manager
Registered Auditor in Charge of the Audit

5, Stara Planina Street, floor 5
1000-Sofia, Bulgaria

30 March 2018

This is a translation from Bulgarian of the Independent Auditors' Report on the Consolidated Financial Statements of D Commerce Bank Group for the year ended 31 December 2017.

D Commerce Bank AD

Annual Consolidated Financial Statements

as at 31 December 2017
in accordance with IFRS

CONTENTS

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
for the year ended 31 December 2017

	Notes	2017 BGN'000	2016 BGN'000
Interest income		23 894	25 294
Interest expense		(3 472)	(4 040)
Net interest income	4	**20 422**	**21 254**
Fee and commission income		10 420	8 514
Fee and commission expense		(1 065)	(960)
Net fee and commission income	5	**9 355**	**7 554**
Net trading income	6	4 992	9 008
Other operating income, net	7	1 996	3 149
Operating income		**36 765**	**40 965**
Net impairment loss on financial assets	8	(1 406)	(17 020)
Net impairment loss on non-financial assets	9	(110)	(449)
Administrative operating expenses			
Personnel expenses	10	(11 232)	(10 388)
Depreciation and amortisation	10,18,19,20	(1 671)	(1 679)
Other administrative expenses	10	(10 352)	(10 351)
		(23 255)	**(22 418)**
Profit before income tax		**11 994**	**1 078**
Income tax expense	11	(1 208)	(114)
Net profit for the year		**10 786**	**964**
Other comprehensive income:			
Items that will not be reclassified to profit or loss:			
Remeasurements of defined benefit pension plans	27	(3)	(3)
		(3)	**(3)**
Items that may be reclassified to profit or loss:			
Net change in fair value of available-for-sale financial assets		715	(229)
		715	**(229)**
Other comprehensive income for the year, net of tax	12	**712**	**(232)**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**11 498**	**732**
Net profit for the year attributable to:			
Equity holders of the parent		10 786	964
Total comprehensive income attributable to:			
Equity holders of the parent		11 498	732

The accompanying notes on pages 5 to 95 form an integral part of these consolidated financial statements.

Anna Asparuhova
Executive Director

Martin Ganchev
Executive Director

Milena Duneva
Preparer

Financial statements on which an auditors' report is issued dated: 30 March 2018	
Audit firm "AFA" OOD:	Audit firm "Baker Tilly Klitou and Partners" OOD:

D COMMERCE BANK GROUP

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
as at 31 December 2017

	Notes	31 December 2017 BGN'000	31 December 2016 BGN'000
ASSETS			
Cash and balances with the Central Bank	*13*	155 621	132 492
Due from banks	*14*	38 486	45 966
Loans and advances to customers	*15*	387 288	358 393
Available-for-sale securities	*16*	37 753	40 871
Held-to-maturity securities	*17*	80 641	96 871
Investment property	*18*	13 001	15 475
Property and equipment	*19*	28 312	28 504
Intangible assets	*20*	671	612
Current tax assets	*21*	27	193
Other assets	*22*	12 629	7 005
TOTAL ASSETS		**754 429**	**726 382**
LIABILITIES			
Due to banks	*23*	9 036	10 991
Due to customers	*24*	635 850	620 133
Current tax liabilities	*25*	282	130
Deferred tax liabilities	*26*	80	104
Other liabilities	*27*	5 611	2 952
TOTAL LIABILITIES		**650 859**	**634 310**
EQUITY			
Equity attributable to equity holders of the parent			
Share capital		75 000	75 000
Reserves		17 618	15 998
Retained earnings		10 952	1 074
TOTAL EQUITY	*28*	**103 570**	**92 072**
TOTAL EQUITY AND LIABILITIES		**754 429**	**726 382**

The accompanying notes on pages 5 to 95 form an integral part of these consolidated financial statements.

The consolidated financial statements on pages 1 to 95 were approved for issue by the Management Board of the Bank and signed on 30 March 2018 by:

Anna Asparuhova
Executive Director

Martin Ganchev
Executive Director

Milena Duneva
Preparer

Financial statements on which an auditors' report is issued dated: 30 March 2018	
Audit firm "AFA" OOD:	Audit firm "Baker Tilly Klitou and Partners" OOD:

CONSOLIDATED STATEMENT OF CASH FLOWS
for the year ended 31 December 2017

	Notes	2017 BGN'000	2016 BGN'000
Cash flows from operating activities			
Profit before tax		11 994	1 078
Adjustments for non-cash items			
Net impairment loss on financial assets	*8*	1 406	17 020
Net impairment loss on non-financial assets	*9*	110	449
Depreciation and amortisation	*10,18,19,20*	1 671	1 679
Net interest income	*4*	(20 422)	(21 254)
Cash flows used in operating activities before changes in operating assets and liabilities		**(5 241)**	**(1 028)**
Changes in operating assets			
Decrease in due from banks		32	-
Decrease in available-for-sale securities		3 741	17 698
Increase in loans and advances to customers		(27 058)	(47 565)
Decrease in assets held for sale		-	4 995
(Increase)/Decrease in other assets		(4 015)	2 844
Changes in operating liabilities			
Increase in due to clients		15 340	49 252
Increase/(decrease) in other liabilities		1 582	(2 748)
Interest received		21 451	24 756
Interest paid		(3 126)	(3 511)
Net cash flows used in operating activities before income tax		*2 706*	*44 693*
Income tax paid		(1 257)	(133)
Net cash flows from operating activities		**1 449**	**44 560**
Cash flows from investing activities			
Purchases of property and equipment		(1 173)	(619)
Proceeds from sale of property and equipment		176	4
Purchases of investment property		-	(2 852)
Proceeds from sale of investment property		2 132	986
Purchases of intangible assets		(256)	(424)
Sales of held-to-maturity securities		-	6 933
Proceeds from held-to-maturity securities upon maturity		15 318	12 510
Net cash flows from investing activities		**16 197**	**16 538**
Cash flows from financing activities			
Proceeds from banks		209	5 941
Repayments to banks		(2 166)	(25)
Net cash flows (used in)/from financing activities		**(1 957)**	**5 916**
Net increase in cash and cash equivalents		**15 689**	**67 014**
Cash and cash equivalents at the beginning of the year	*29*	178 418	111 404
Cash and cash equivalents at the end of the year	*29*	**194 107**	**178 418**

The accompanying notes on pages 5 to 95 form an integral part of these consolidated financial statements.

Anna Asparuhova
Executive Director

Martin Ganchev
Executive Director

Milena Duneva
Preparer

Financial statements on which an auditors' report is issued dated: 30 March 2018	
Audit firm "AFA" OOD:	Audit firm "Baker Tilly Klitou and Partners" OOD:

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
for the year ended 31 December 2017

	Notes	Share capital	Statutory reserves	Reserve for available-for-sale financial assets	Retained earnings	Total equity
		Attributable to equity holders of the parent				
		BGN'000	BGN'000	BGN'000	BGN'000	BGN'000
Balance at 1 January 2016		**75 000**	**15 431**	**261**	**648**	**91 340**
Changes in equity for 2016						
Equity increase through contribution		-	-	-	-	-
Distribution of profit for:		-	535	-	(535)	-
* *reserves*		-	*535*	-	*(535)*	-
Total comprehensive income for the year, including:		-	-	(229)	961	732
* *net profit for the year*		-	-	-	*964*	*964*
* *other comprehensive income, net of taxes*		-	-	*(229)*	*(3)*	*(232)*
Balance at 31 December 2016	*28*	**75 000**	**15 966**	**32**	**1 074**	**92 072**
Changes in equity for 2017						
Distribution of profit for:		-	905	-	(905)	-
* *reserves*		**-**	**905**	**-**	**(905)**	-
Total comprehensive income for the year, including:		-	-	715	10 783	11 498
* *net profit for the year*		-	-	-	*10 786*	**10 786**
* *other comprehensive income, net of taxes*		-	-	*715*	*(3)*	**712**
Balance at 31 December 2017	*28*	**75 000**	**16 871**	**747**	**10 952**	**103 570**

The accompanying notes on pages 5 to 95 form an integral part of these consolidated financial statements.

Anna Asparuhova *Executive Director*	Martin Ganchev *Executive Director*	Milena Duneva *Preparer*

Financial statements on which an auditors' report is issued dated: 30 March 2018	
Audit firm "AFA" OOD:	Audit firm "Baker Tilly Klitou and Partners" OOD:

1. CORPORATE INFORMATION ON THE GROUP

D Commerce Bank Group (the Group) comprises D Commerce Bank AD (the Bank, the parent) and its three subsidiaries – D Leasing EAD, D Insurance Broker EOOD and D Imoti EAD.

1.1. General information

Parent company

D Commerce Bank AD (formerly Demirbank (Bulgaria) AD) was established on 15 April 1999 as a joint-stock company. The registered address of the Bank is: 8, Gen. E. I. Totleben Blvd., Sofia. D Commerce Bank AD is a universal bank with a full license to provide banking services in the country and abroad, in domestic and foreign currency, and to perform all other transactions under art. 2, para 1 and 2 of the Credit Institutions Act.

Subsidiaries

D Leasing EAD

D Leasing was entered in the Commercial Register kept at the Registry Agency on 29 July 2014 as a sole owner joint-stock company. 100% of the share capital is held by D Commerce Bank AD. Company's seat and registered address is: 8, Gen. Totleben Blvd., Sofia.

D Insurance Broker EOOD

D Insurance Broker EOOD is a sole owner limited liability company. Sole owner of the capital is D Commerce Bank AD. The circumstances related to the acquisition of 100% of Company's capital by the Bank were entered in the Commercial Register kept at the Registry Agency on 31 July 2013.

Company's seat and registered office is: 8, Gen. Totleben Blvd., Krasno Selo Region, Sofia.

D Imoti EOOD

D Imoti EOOD is a sole owner limited liability company, entered in the Commercial Register kept at the Registry Agency on 14 October 2013. Sole owner of Company's capital is D Commerce Bank AD. Company's seat and registered office is: 8, Gen. Totleben Blvd., Krasno Selo Region, Sofia.

1.2. Ownership and management

Parent company

As at 31 December 2017, the capital of the Bank (parent company) is held by Mr. Fuat Guven, who holds directly 66.7% of the capital and through FORTERA EAD, UIC 175194303 – 33.3%. The Bank has a two-tier management system which implies a Management Board and a Supervisory Board.

As at 31 December 2017, the management of the parent company, being the Management Board (MB), is composed of 5 (five) members, namely: Anna Ivanova Asparuhova – Chairperson of the MB and Executive Director; Martin Emilov Ganchev – Member of the MB and Executive Director; Plamen Ivanov Dermendzhiev – Member of the MB; Valentina Dimitrova Borisova – Member of the MB; Zahari Dimitrov Alipiev – Member of the MB.

As at 31 December 2017, those charged with the governance of the parent company represent the Supervisory Board (SB), which is composed of 3 (three) members, namely: Fuat Guven – Chairman of the SB, Valeri Borisov – Member of the SB, Bahattin Gurbuz – Member of the SB.

In accordance with the Credit Institutions Act the provisions of the Articles of Association of D Commerce Bank AD and its court registration, the Bank is represented jointly by all members of the MB, or jointly by two Executive Directors. The Executive Directors of the Bank as at 31 December 2017 are: Anna Ivanova Asparuhova – Chair-person of the MB and Executive Director and Martin Emilov Ganchev – Member of the MB and Executive Director.

The parent company (the Bank) has an Audit Committee, which monitors the work of its external auditors, the operation of the internal audit, the management of risk and the accounting activities as well as the financial reporting process.

The composition of the Audit Committee is as follows: Toma Stoilov – Chairman, Vasilka Ivanova – Member, Ekaterina Mangafova - Kapincheva.

Subsidiaries

The Bank is sole owner of the three subsidiaries – D Leasing EAD, D Insurance Broker EOOD and D Imoti EOOD.

D Leasing EAD

The management of D Leasing EAD, i.e. the Board of Directors, as at 31 December 2017 is as follows: Ivaylo Georgiev Ivanov, Victoria Lyubomirova Nevenchina and Zorka Iordanova Samokovliyska. The company is represented jointly by any two of the three members of the Board of Directors.

D Insurance Broker EOOD

The company is managed and represented by Milena Rosenova Mihaylova – General Manager.

D Imoti EOOD

The company is managed and represented by Katerina Hristova Hristova – General Manager.

As at 31 December 2017, the total staff number of the Group is 430 employees (31 December 2016: 417 employees).

1.3. Structure and principal activities of the Group

1.3.1. The *structure* of the Group comprises D Commerce Bank AD as a parent company and the subsidiaries listed below:

	Country	31.12.2017 BGN '000	Interest %	31.12.2016 BGN '000	Interest %
D Leasing EAD	Bulgaria	1,200	100%	1,000	100%
D Insurance Broker EOOD	Bulgaria	24	100%	24	100%
D Imoti EOOD	Bulgaria	10	100%	10	100%
Paid but still unregistered increase in the capital of D Imoti EOOD	Bulgaria	4,090		-	
		5,324		**1,034**	

The table below presents information about the date when the parent has obtained control over the respective subsidiary:

	Date of acquisition of control
D Leasing EAD	29 July 2014
D Insurance Broker EOOD	9 July2013
D Imoti EOOD	14 October 2013

1.2.3. Principal activities

Parent company

The parent company (the Bank) holds a general banking license issued by the Central Bank of Bulgaria, the Bulgarian National Bank (BNB), and is allowed to perform all banking operations permitted by the Bulgarian law.

The Bank's main activities in 2017 were related to attracting deposits from customers, granting loans to business customers and individuals, servicing payments of customers in the country and abroad, trading securities, performing repurchase agreements on the interbank market, dealing in foreign currencies, issuing letters of credit and bank guarantees and providing other financial services in Bulgaria.

As at 31 December 2017 the Bank has established 53 structural units, including Headquarters, 32 Financial Centres, 8 Offices and 12 remote workplaces (IRM) in various cities in Bulgaria.

Subsidiaries

D Leasing EAD is a financial institution in the meaning of Art. 3a of the Credit Institutions Act and by virtue of Order No BNB-135013 of 1 December 2014 it is entered in the Financial Institutions Register kept by the BNB.

The main activity of the company includes the following types of transactions: finance leases, guarantee transactions, money brokerage, acquisition of receivables on loans and other forms of financing (factoring, forfeiting, etc.), acquisition of interests in credit institutions or other financial institutions, granting of loans with funds not raised through public attraction of deposits or other recoverable funds.

The principal activities of *D Insurance Broker EOOD* include insurance brokerage or intermediation by assignment for the conclusion and performance of insurance and / or reinsurance contracts and the related consultancy services (following the receipt of a license), as well as other activities and transactions not forbidden by law, excluding security guards and similar activities.

The principal activities of *D Imoti EOOD* include the purchase-and-sale of real estate, design, furnishing, construction of real estate for sale, rental.

The Bank and its subsidiaries carry out their activities entirely on the territory of the Republic of Bulgaria

1.4. Main indicators of the economic environment

The main economic indicators of the business environment that have affected the Group's activities throughout the period 2014 – 2017 are presented in the table below:

Indicator	**2014**	**2015**	**2016**	**2017**
GDP in million levs	83,634	88,571	94,130	99,708 *
Actual growth of GDP	1.3%	3.6 %	3.9%	4.0%*
Year-end inflation (HICP)	-2.0%	-0.9%	-0.5%	1.8%
Average exchange rate of USD for the year	1.47	1.76	1.77	1.73
Exchange rate of the USD at year-end	1.61	1.80	1.86	1.63
Basic interest rate at year-end	0.02	0.01	0.00	0.00
Unemployment rate at year-end	10.7%	10.0%	8.0%	7.1%

** BNB forecast for 2017; Source: BNB*

1.5. Legal environment

The Bank's activity is regulated by the Credit Institutions Act and its bylaws, and BNB performs surveillance and controls compliance with banking legislation.

2. SUMMARY OF THE SIGNIFICANT ACCOUNTING POLICIES OF THE GROUP

2.1. Basis for the preparation of the consolidated financial statements

The consolidated financial statements of D Commerce Bank AD have been prepared in accordance with all International Financial Reporting Standards (IFRS), which comprise Financial Reporting Standards and the International Financial Reporting Interpretations Committee (IFRIC) interpretations, approved by the International Accounting Standards Board (IASB), as well as the International Accounting Standards (IAS) and the Standing Interpretations Committee (SIC) interpretations, approved by the International Accounting Standards Committee (IASC), which are effectively in force on 1 January 2017 and have been accepted by the Commission of the European Union. IFRSs as adopted by the EU is the commonly accepted name of the general purpose framework – the basis of accounting equivalent to the framework definition introduced by § 1, p. 8 of the Additional Provisions of the Accountancy Act "International Accounting Standards" (IASs).

For the current financial year the Group has adopted all new and/or revised standards and interpretations, issued by the International Accounting Standards Board (IASB) and respectively, by the International Financial Reporting Interpretations Committee (IFRIC), which are relevant to its activities.

The adoption of these standards and/or interpretations, effective for annual periods beginning on 1 January 2017, has not caused changes in Group's accounting policies, apart from the introduction of some new and the extension of already existing disclosures, without resulting in other changes – in the classification or measurement of separate reporting items and transactions.

The new and/or amended standards and interpretations include:

- *IAS 7 (amended) "Statement of Cash Flows" – regarding disclosure initiative (in force for annual periods beginning on or after 1 January 2017 – endorsed by EC).*This amendment is an important clarification of the standard itself with a focus on the information provided to the users of financial statements in order to improve their understanding of the liquidity and the financing activities of the entity. The amendment requires that additional disclosures and clarifications be prepared in regards to the changes of liabilities of the entity from: (a) changes arising from financing activities as a result of transactions leading to changes in cash flows; or (b) changes resulting from non-cash transactions such as acquisitions and disposals, interest accrual, foreign currency exchange gains and losses, changes in fair values and other similar. Changes in the financial assets should be included in this disclosure if the resulting cash flows are presented under financing activities (e.g. in certain hedge transactions). It is allowed to include also changes in other items as part of the disclosure if they are presented separately.
- *IAS 12 (amended) "Income Taxes" (in force for annual periods beginning on or after 1 January 2017 – endorsed by EC) – recognition of deferred tax assets for unrealised losses.* This amendment clarifies deferred tax assets in cases where an asset is measured at fair value and that fair value is below the tax base. The amendment clarifies that: (a) temporary differences arise regardless of whether the carrying amount of the asset is less than its tax

base; (b) the respective entity should assess, when estimating its future taxable profits, whether it could deduct an amount higher than the carrying amount of the asset or not; (c) if, according to the tax legislation, there are restrictions for the use of taxable profits against which particular deferred tax assets can be recovered, the review and assessment of deferred tax assets recoverability should be made in combination with the remaining deferred tax assets of the same type; and (d) the deductions for tax purposes resulting from the reversal of deferred tax assets are excluded from the estimated future taxable profit that is used to evaluate the recoverability of those assets.

At the date when these consolidated financial statements have been approved for issue, there are several new standards and interpretations as well as amended standards and interpretations, issued but not yet in force for annual periods beginning on or after 1 January 2017, which have not been adopted for early application.

The management of the Bank has concluded that out of them the following are likely to have a potential impact in the future for changes in the accounting policies and the classification and values of reporting items in the consolidated financial statements of the Group for subsequent periods, namely:

- *IAS 40 (amended) "Investment Property" – regarding transfers of investment property (in force for annual periods beginning on or after 1 July 2018 – endorsed by EC).* The amendment refers to an additional clarification regarding the terms and criteria that allow transfers of property, incl. property under construction and/or undergoing reconstruction and alteration to, or from, the category 'investment property'. Such transfers are only eligible when the property meets, or respectively, ceases to meet, the criteria and definition of investment property – when evidence exists for a change in its use. A change in the intents and plans of the management are not regarded as evidence for a change in use. The amendment may be applied prospectively or retrospectively, subject to compliance with the rules set thereby.
- *IFRS 7 (amended) "Financial Instruments: Disclosures" – regarding the relief from the requirement to restate comparatives and the related thereto disclosures when applying IFRS 9 (in force for annual periods beginning on or after 1 January 2018 – endorsed by EC).* The amendment is related to a relief from the requirement to restate the comparative financial statements and the option to present modified disclosures on the transition from IAS 39 to IFRS 9 as at the date of the standard application by the Company and whether it chooses the option to restate prior periods.
- *IFRS 9 "Financial Instruments" (in force for annual periods beginning on or after 1 January 2018 – endorsed by EC).* This is a new standard for financial instruments. It is ultimately intended to replace IAS 39 in its entirety. The replacement project has passed through three phases: Phase 1: Classification and measurement of financial assets and financial liabilities; Phase 2: Hedge accounting; and Phase 3: Impairment methodology. At present, IFRS 9 has been issued four times: in November 2009, October 2010, November 2013 and finally in July 2014. Phase 1: Classification and measurement of financial assets and financial liabilities – by the first issues it replaces those parts of IAS 39 that refer to the classification and measurement of financial instruments. It sets out new principles, rules and criteria for classification, measurement and derecognition of financial assets and

liabilities, including hybrid contracts. IFRS 9 introduces a requirement that financial assets are to be classified based on entity's business model for their management and on the contractual cash flow characteristics of the respective assets. It establishes two primary measurement categories for financial assets: amortised cost and fair value. The new rules will lead to changes mainly in the accounting for financial assets as debt instruments and financial liabilities designated at fair value through current profit or loss (for credit risk). A specific feature of the classification and the measurement model for financial assets at fair value is the addition of a new category – fair value through other comprehensive income (for certain debt and capital instruments). Phase 2: Hedge accounting – a new chapter to IFRS 9 has been added for this purpose whereby a new hedge accounting model is introduced that permits consistent and complete reflection of all financial and non-financial risk exposures, subject to hedge transactions, and also, better presentation of risk management activities in the financial statements and especially, their relation to hedge transactions, and the scope and type of documentation to be used. In addition, the requirements to the structure, contents and presentation approach for hedge disclosures have been improved. Furthermore, an option is introduced fair value changes of own debts, measured at fair value through profit or loss, in the part thereof due to changes in the entity's own credit quality, to be presented in other comprehensive income rather than in profit or loss. Phase 3: Impairment methodology – the amendment introduces the application of the 'expected loss' model. Under this model all expected credit losses of an amortisable financial instrument (asset) shall be recognised in three stages, depending on its credit quality change, and not only if a trigger event has occurred as per the current model under IAS 39. The three stages are: upon the initial recognition of the financial asset – impairment for the 12-month period or for the full lifetime of the asset; and respectively, upon the incurrence of the actual impairment. They also set out how to measure impairment losses and respectively the application of the effective interest rate. The impairment of debt instruments measured at fair value through the other comprehensive income is determined and measured by applying the same methodology which is used for financial assets at amortised cost. The Bank's management has organised and carried out an overall project to survey and assess the impact of changes to occur in the accounting policy and financial reporting as a result of the new standard, including on the values and classification of assets, liabilities, transactions and results of the Group with respect to: loans and advances granted to clients, securities available for sale, held-to-maturity securities and due from banks, as well as liabilities to banks and clients. The effects of the analyses and preliminary restatement and classification made thereby are disclosed in *Note 2.26.*

• *IFRS 9 (amended) "Financial Instruments" – regarding prepayment features with negative compensation (in force for annual periods beginning on or after 1 January 2019 – endorsed by EC).* This change covers two aspects: (a) it amends the existing requirements in IFRS 9 by enabling entities to measure at amortised cost some financial assets and their passing of the "contractual cash flow characteristics" test, despite the availability of "prepayment features with negative compensation". Negative compensation exists when the terms of the contract allow the debtor to make an early repayment of the instrument prior to its maturity, and the amount repaid may differ from the outstanding principal and interest, but this negative compensation should be reasonable and relevant to the early termination of the contract. Prepayment itself is not a sufficient assessment indicator, i.e. depending on the interest rate prevailing at the time of termination a payment may also be made in favour of the contracting party effecting the early repayment. The calculation approach of this compensation payment must be the same for both the case of an early repayment penalty and the case of an early repayment gain. Moreover, the respective asset should belong to the category of assets "held to collect contractual cash flows" according to the entity's business model; b) it confirms that when a financial liability measured at amortised cost is modified but not derecognised, the effect of the modification should be recognised in the profit or loss. The effect is measured as the difference between the original negotiated cash flows and the ones, following the modification, discounted at the original effective interest rate.

- *IFRS 15 "Revenue from Contracts with Customers" (in force for annual periods beginning on or after 1 January 2018 – endorsed by EC).* This is an entirely new standard. It introduces a single complex of principles, rules and approaches for recognition, accounting for and disclosure of information about the nature, amount, timing and uncertainties related to revenue and cash flows arising from contracts with customers. It will supersede all current standards related to revenue recognition, mainly IAS 18 and IAS 11 and the interpretations thereto. The main principle of the new standard is to provide a stepwise model whereby revenue amount and timing reflect the obligation characteristics and performance of each of the parties to the transaction. The key components include: (a) contracts with customers that are commercial in their substance and assessment of the probability for collecting contractual amounts by the entity in line with the terms and conditions of the particular contract; (b) identification of the separate performance obligations under the contract for providing of a good or service, that is distinct from the other assumed contractual commitments/promises, from which the customer would obtain benefits; (c) transaction price determination – the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer – special attention is paid to the variable component of price, the financing component, as well as the non-cash consideration; (d) allocation of the transaction price to separate performance obligations under the contract – usually on a stand-alone sale price of each component; and (e) the point of time or the period of revenue recognition – when an entity satisfies a performance obligation by transferring control of a promised good or service to the customer, which could occur at a point in time or over time. Clarifications are provided regarding: (a) identification of the performance obligations based on specific promises for the delivery of goods or services; (b) determining whether an entity acts as principal or agent in the provision of goods or services, and (c) license transfers. The expectation is that the introduction of this standard may lead to the more material changes: (a) in complex contracts with bundled sales of goods and services a clear distinction will be required between the goods and services of each component and provision of the contract; (b) probability for a change in the time of sale recognition; (c) expanding of disclosures; and (d) introduction of additional rules for recognising the revenue from a particular type of contracts – licences; consignment; one-time collection of preliminary fees; guarantees and other similar. The standard allows a full retrospective approach or a modified retrospective approach from the beginning of the current reporting period with particular disclosures for prior periods. The Bank's management has analysed and assessed the potential impact on the

Group's accounting policy and based on the preliminary results believes the effect would be limited to certain banking service fees and revenue from non-banking transactions.

• *IFRS 16 "Leases" (in force for annual periods beginning on or after 1 January 2019 – endorsed by EC).* This standard has an entirely new concept. It establishes new principles for the recognition, measurement and presentation of a lease by introducing a new model with the objective to ensure a more faithful and adequate representation of such transactions both for lessee and lessor. The standard will supersede the effective so far standard related to leases – IAS 17. (a) The main principle of the new standard is the introduction of a single lessee accounting model in the statement of financial position – an asset will be recognised for all contracts with duration of more than 12 months in the form of a 'right-of-use', which will be subsequently depreciated over the duration of the contract, and respectively, a financial liability will be stated for the lease liability under the contracts. This is the significant change in the current accounting practice. The standard allows an exception and retaining the current practice for leases of low-value assets and short-term leases. (b) There would not be any significant changes for lessors and they would continue to account for leases as per the old standard IAS 17 – as operating and finance lease. As far as the new standard introduces a more thorough concept, a more detailed analysis of contractual terms should be carried out on their part as well and it is possible that grounds for reclassification of particular lease transactions may occur for them (lessors), too. The new standard requires more extensive disclosures. The Bank's management is conducting preliminary analysis and assessment of the possible effects on the Group's accounting policy.

• *Annual Improvements to IFRSs 2014-2016 Cycle (December 2016) – improvements to IFRS 12 (in force for annual periods beginning on or after 1 January 2017 – endorsed by EC), IFRS 1 and IAS 28 (in force for annual periods beginning on or after 1 January 2018 – not endorsed by EC).* These improvements introduce partial amendments to and editions of the respective standards primarily with a view to remove the existing inconsistency or ambiguities in the application of the rules and requirements of individual standards as well as to set out more precise terminology. These amendments are basically focused on the following items or transactions:(a) the scope and requirements to the disclosures under IFRS 12 shall apply also to entities that are classified under IFRS as held for sale, as held for distribution or as discontinued operations, with the exception of aggregate financial information; (b) removal of certain exemptions in the application of IFRS 1 with regards to IFRS 7, IAS 19 and IFRS 10; and (c) the choice of venture capital funds or other similar entities to measure their investments in associates or joint ventures at fair value through profit or loss should be made for each individual investment in associates or joint ventures upon initial recognition (IAS 28).

• *IFRIC 22 "Foreign Currency Transactions and Advance Consideration" (in force for annual periods beginning on or after 1 January 2018 – not endorsed by EC).* This Interpretation applies to the accounting for a foreign currency transaction or part of it on the receipt of advance consideration before the entity recognises the related asset, expense or income. In these cases the entities shall recognise first a non-monetary asset for the advance consideration (advance consideration paid on supply of assets or services) or a non-monetary liability for deferred income (advance consideration received from clients on sales). Upon receipt of such advance consideration in a foreign currency, the transaction date shall be used to determine the exchange rate while in case of multiple payments the entity shall determine a date of the transaction for each individual payment. Following this, the interpretation clarified that upon the initial recognition of the respective asset, expense or income, as a result of the payment or receipt of advance consideration or a series of payments or receipts in a foreign currency, the transaction date is the date of initial recognition of the non-monetary asset or liability (in case of one-off payment/receipt) or the date of each separate payment/receipt. This Interpretation may be applied on a fully retrospective basis or prospectively, either: (a) from the beginning of the reporting period in which it is first applied; or (b) from the beginning of the period preceding the period in which the entity first applies the interpretation.

- *IFRIC 23 (amended) "Uncertainty over Income Tax Treatments" (in force for annual periods beginning on or after 1 January 2019 – not endorsed by EC).* This Interpretation provides guidance on the accounting for income tax when tax treatments involve uncertainty that affects the application of IAS 12. It does not apply to taxes or other state levies outside the scope of IAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments. The Interpretation addresses the following: (a) whether an entity considers uncertain tax treatments separately; (b) the assumptions an entity makes about the examination and assessment of tax treatments by taxation authorities; (c) how an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; (d) how an entity considers and treats changes in facts and circumstances; and (e) an entity has to determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments.

In addition, with regard to the stated below new standards, amended/revised standards and new interpretations, issued but not yet in force for annual periods beginning on 1 January 2017, the management of the Bank has concluded that they are unlikely to have a potential impact for changes in the accounting policies, and the consolidated financial statements of the Group:

- *IAS 28 (amended) "Investments in Associates and Joint Ventures" – regarding long term interests in associates and joint ventures (in force for annual periods beginning on or after 1 January 2019 – not endorsed by EC).* The amendment clarifies that an entity applies IFRS 9 including its impairment requirements regarding long term interests in associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied. A change in the intents and plans of the management are not regarded as evidence for a change in use.
- *IFRS 2 (amended) "Share-based Payment" – Classification and measurement of share-based payment transactions (in force for annual periods beginning on or after 1 January 2018 – not endorsed by EC).* These amendments clarify three major issues: (a) the treatment of the conditions and effects related to obtaining vested rights in the measurement and accounting for cash-settled share-based payment transactions; (b) approach for the classification of share-based payment transactions with net settlement features for the purposes of withholding personal tax for entity's employees (in the form of equity instruments) – by introducing an exception from the common rule in order to achieve a facilitation in the practice, these transactions shall be classified in a way as if in the absence of the net share settlement feature; and (c) a new rule of accounting whereby a

modification to the terms and conditions of a share-based payment transaction changes its classification from cash settled to equity settled.

- *IFRS 4 (amended) "Insurance Contracts" in force for annual periods beginning on or after 1 January 2018 – endorsed by EC).* This amendment is related to the need to synchronise the reporting of entities that issue insurance contracts and which fall within the scope of IFRS 9, but prior to the adoption of the future IFRS 17. It defines two approaches – the overlay approach and the temporary deferral approach (subject to certain conditions) under IFRS 9. Both approaches are valid until the entry into force of the new IFRS 17.

- *IFRS 10 (amended) – "Consolidated Financial Statements" and IAS 28 (amended) – "Investments in Associates and Joint Ventures" – regarding the sale or contribution of assets between an investor and its associates or joint ventures (postponed effective date, to be determined by the IASB).* These amendments address the accounting treatment of the sale or contribution of assets between an investor and its associates or joint ventures. They confirm that the accounting treatment depends on whether the assets sold or contributed constitute in substance a business as defined in IFRS 3. If these assets as an aggregate do not meet the definition of a business, then the investor shall recognise gain or loss only to the extent of other unrelated investor's interests in the associate or joint venture. In cases of sale or contribution of assets, which as an aggregate constitute a business, the investor shall recognise the full gain or loss on the transaction. The amendments will be applied on a prospective basis. IABS postponed the initial date of application of these amendments for an indefinite period.

- *IFRS 17 "Insurance Contracts" (in force for annual periods beginning on or after 1 January 2021 – not endorsed by EC).* This is an entirely new accounting standard on all types of insurance contracts, including some guarantees and financial instruments, and includes rules on recognition and measurement, presentation and disclosure. The standard will supersede the effective so far standard related to insurance contracts – IFRS 4. It establishes an entirely new overall model for insurance contracts' accounting, covering all relevant accounting aspects.

- *Annual improvements to IFRSs 2015-2017 Cycle (December 2017) – improvements to IAS 23, IAS 12 and IFRS 3 in relation to IFRS 11 (in force for annual periods beginning on or after 1 January 2019 – not endorsed by EC).* These improvements introduce partial amendments to and editions of the respective standards primarily with a view to remove the existing inconsistency or ambiguities in the application of the rules and requirements of individual standards as well as to set out more precise terminology. These amendments are basically focused on the following items and transactions: (a) they clarify that when an entity acquires control over a business which constitutes a joint venture, it should restate its previous holding in the business under IFRS 3. It is further clarified that when an entity acquires a joint control over a business which constitutes a joint venture, it should not restate its previous holding in the business under IFRS 11; (b) they clarify that all tax consequences on dividend income (i.e. upon profit distribution) should be stated within profit or loss irrespective of how they occurred – upon the application of IFRS 12; and (c) they clarify if under special-purpose loans concluded to finance a specific asset remain outstanding after the asset is ready for its intended use or disposal, these loans become part of general-purpose financing, and capitalisation rate is calculated under IAS 23.

2.2. Basis of measurement

The consolidated financial statements of the Bank have been prepared on a historical cost basis, except for available-for-sale financial instruments, which have been measured at fair value.

2.3. Functional and presentation currency

The parent and its subsidiaries maintain their accounting books in Bulgarian Lev (BGN), which is accepted as being their functional and presentation currency. Starting from 1 July 1997, the Bulgarian Lev was fixed under the Bulgarian National Bank Act to the German Mark at the ratio of BGN 1 : DEM 1, and with the introduction of the Euro as the official currency of the European Union as of 1 January 1999, it was fixed to the Euro at a ratio of BGN 1.95583 : EUR 1.

The data in the consolidated financial statements and the notes thereto is presented in thousand Bulgarian Levs (BGN'000) except where it is explicitly stated otherwise.

2.4. Use of estimates

The presentation of the consolidated financial statements in accordance with International Financial Reporting Standards requires the management to make best estimates, accruals and reasonable assumptions that affect the reported values of assets and liabilities, the amounts of income and expenses and the disclosure of contingent receivables and payables as at the date of the financial statements. These estimates, accruals and assumptions are based on the information, which is available at the date of the consolidated financial statements, and therefore, the future actual results might be different from them (whereas in a situation of financial crisis the uncertainties are much more significant). Items requiring more subjective judgement or having higher level of complexity, or where assumptions and estimates are material for the consolidated financial statements, are disclosed in *Note 2.24*.

2.5. Definitions and consolidation principles

2.5.1. Definitions

Parent company

The parent is an investor that controls one or more companies (entities). Having control means that the investor is exposed, or has rights, to variable returns from its involvement with the investee, and has the ability to affect those returns through its power over the investee.

The parent is D Commerce Bank AD *(Note 1)*.

Subsidiary company

A subsidiary is a company, or another entity, that is controlled directly or indirectly by the parent.

The subsidiaries include: D Leasing EAD, D Insurance Broker EOOD and D Imoti EAD *(Note 1)*.

2.5.2. Consolidation principles

The consolidated financial statements include the financial statements of the parent – D Commerce Bank AD and the subsidiaries – D Leasing EAD, D Insurance Broker EOOD and D Imoti EAD, prepared as at 31 December, which is the date when the financial year of the Group ends.

For the purposes of consolidation, the financial statements of the subsidiaries are prepared for the same reporting period as that of the parent using consistent accounting policies.

Consolidation of a subsidiary

Subsidiaries are consolidated as of the date when the Group (ultimately, the parent) obtains control and they are excluded from consolidation as of the date when it is deemed that control is transferred outside the Group (ultimately, the parent).

A subsidiary is consolidated applying the full consolidation method, on a line-by-line basis for the financial statements of the parent and the subsidiary, using the same accounting principles and uniform accounting policies. The investments of the parent are eliminated against its share in the equity of the subsidiary. All intra-group transactions and balances, including unrealised intra-group gains or losses, are eliminated. The consolidation procedures take into account also the effects of deferred taxes.

Acquisition of a subsidiary

The acquisition (purchase-and-sale) method of accounting is used on the acquisition of a subsidiary by the Group. The acquisition cost (consideration paid) includes the fair value as at the exchange date of the assets given, the incurred or assumed liabilities and the equity instruments issued by the acquirer in exchange of the control over the acquiree. It includes also the fair value of any asset or liability resulting from a contingent consideration arrangement. The costs associated with the acquisition are recognised and are taken directly to the current expenses for the period in which they are incurred.

All identifiable assets acquired and liabilities and contingent (crystallised) liabilities assumed in the business combination are initially measured at their fair values at the date of exchange. Any excess of the acquisition cost of the subsidiary over the share of the acquirer in the fair value of the net identifiable assets, liabilities and contingent (crystallised) liabilities acquired is treated and recognised as goodwill. If the acquirer's share in the fair value of the net identifiable assets acquired exceeds the acquisition cost of the business combination, such excess is recognised immediately in the consolidated statement of profit or loss and other comprehensive income of the Group. Any non-controlling interest in a business combination is measured at the proportionate share of the acquiree's net assets.

When a business combination to acquire a subsidiary is achieved in stages, all investments previously held by the acquirer are measured at fair value on the acquisition date and the effects of such remeasurement are recognised in the current period profit or loss of the Group, including all effects previously reported in the other components of comprehensive income are recycled.

Disposal of a subsidiary

On sale or other form of loss (transfer) of control over a subsidiary:

- The carrying amounts of the assets and liabilities (including any attributable goodwill) of the subsidiary are derecognised at the date when control is lost;
- The carrying amount of the non-controlling interest in the subsidiary is derecognised from the consolidated statement of financial position at the date when control is lost;
- The fair value of the consideration received from the transaction, event or operation that resulted in the loss of control is recognised;
- All components of equity representing unrealised gains or losses are reclassified in the profit or loss, or are taken directly to the accumulated profits - in accordance with the requirements of the respective IFRS these equity components are subject to;
- Any resulting difference is recognised as gain or loss on disposal (sale) of a subsidiary in the consolidated statement of comprehensive income (in the current period profit or loss) attributable to the parent.

Transactions with non-controlling interests

The Group treats transactions with non-controlling interests as transactions with equity holders of the Group. The effects from sales of shares of the parent to holders of non-controlling interests that do not result in a loss of control are not treated as components of the Group's current period profit or loss, but rather as movements in the components of its equity. And vice versa, when the parent purchases additional shares from holders of non-controlling interest, without acquisition of control, the difference between the consideration paid and the respective share in the carrying amount of net assets acquired by the subsidiary is directly recognised in the consolidated statement of changes in equity, usually in the 'accumulated profits' reserve.

When the Group ceases to have control and significant influence, any retained minority investment as interest in the capital of the respective entity is remeasured to its fair value, with the change in carrying amount recognised in profit or loss. Respectively, any amounts previously recognised in other comprehensive income in respect of that entity are reported in the same way as in a direct disposal of all components related to the initial investment (in a subsidiary or associate).

2.6. Comparatives

In these consolidated financial statements, the Group presents comparative information for one prior year.

Where necessary, comparative data is reclassified (and restated) in order to achieve comparability in view of the current year presentation changes.

2.7. Foreign currency transactions

Upon its initial recognition, a foreign currency transaction is recorded in the functional currency (Bulgarian Lev) whereas the exchange rate to BGN at the date of the transaction or operation is applied to the foreign currency amount. Cash and cash equivalents, loans and receivables, investments in securities, payables, deposits and other payables, such as monetary reporting items denominated in foreign currency, are recorded in the functional currency by applying the exchange rate as quoted by BNB every day. At 31 December, these amounts are presented in BGN at the closing exchange rate of BNB.

The non-monetary items in the consolidated statement of financial position, which are initially denominated in a foreign currency, are accounted for in the functional currency by applying the historical exchange rate at the date of the transaction and are not subsequently re-valued at the closing exchange rate.

Foreign exchange gains or losses arising on the settlement or recording of foreign currency transactions at rates different from those, at which they were converted on initial recognition, are recognised in the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year) in the period in which they arise and are presented on the *'net trading income'* line item.

2.8. Interest income and expense

Interest income and expense are recognised in the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year) on accrual basis for all interest-bearing financial instruments to the extent it is probable that the Bank will receive economic benefits and the income can be measured reliably. The effective interest rate method is used for interest income and expense. The effective interest rate is the interest rate that discounts the future inflows and outflows that are expected to be generated during the life of a financial instrument or a shorter period of time, as appropriate, exactly to the instrument's net cost. The calculation of the effective interest rate takes into account all contractual terms and conditions of the financial instrument, including fees and other inherent costs directly attributable to the instrument that are part of the effective interest rate, but excluding future loan losses.

Interest income and expense include the amortisation of any discount or premium, or other differences between the initial carrying amount of an interest-bearing instrument and its amount at maturity, calculated on effective interest rate basis.

Interest income includes coupons earned on available-for-sale debt securities, interest on placements (deposits) with other banks, contractual interest on loans and advances to customers, dividends, as well as 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 accrual and effective interest rate basis. It includes interest on: deposits due to banks, deposits due to customers, as well as other long-term borrowings.

2.9. Fee and commission income and expense

Bank service fee and commission income is recognised in the period of or at the time the service is rendered. Fees and commissions on bank guarantees are recognised on a systematic basis over the period of the exposure so as to match the cost of providing the service. Fees on loan commitments / facilities, which are likely to be transformed into a granted loan, are deferred and recognised upon the loan granting and are included in the calculation of the effective interest rate. Fees or fee components related to commitments, which are unlikely to result in a loan granting, are recognised in the period of the commitment.

Fee and commission expenses, related to the servicing of nostro accounts with other banks, are recognised at the time or during the period of the underlying service.

2.10. Gains or losses on trading operations

The results from trading operations include: interest income on securities held for trading, including dividends thereon, gains or losses from operations with securities held for trading, gains or losses from operations in foreign currency, as well as net gain or loss from revaluation of foreign currency assets and liabilities.

2.11. Financial instruments

2.11.1. Financial assets

The Group usually classifies its financial assets in the following categories: 'loans and receivables' (which also include cash and cash equivalents), 'available-for-sale financial assets' and 'held-to-maturity financial assets'. The classification depends on the nature and purpose of the financial assets at the date of their acquisition. The management determines the classification of the financial assets of the Group at the time of their initial recognition on the statement of financial position.

The Group usually recognises its financial assets in the consolidated statement of financial position on the trade date, being the date on which it has committed to purchase the respective financial assets. This includes transactions performed under a regulated framework – purchases and sales of financial assets that presume a settlement and assets transfer to be performed in a generally accepted manner established by law or relevant market convention. Loans and advances to customers are recognised when the funds are transferred to customer's account. Respectively, the Group recognises amounts due to customers when funds are received to the Bank.

All financial assets are initially measured at their fair value plus the directly attributable transaction costs, except for the financial assets at fair value through profit or loss (including such held for trading).

Financial assets are derecognised from the Group's consolidated statement of financial position when: (a) the rights to receive cash (flows) from these assets have expired; or (b) have been transferred from the Bank; or (c) the Group has committed to transfer the cash flows received without significant delay and has transferred substantially all risks and rewards of ownership of the assets to another entity (person), or if the Group has neither transferred, nor has retained substantially all risks and rewards, but has transferred control over the asset.

If the Group retains substantially all risks and rewards associated with the ownership of a particular transferred financial asset, or has retained control, it continues to recognise the asset on its statement of financial position, but also recognises the respective secured liability (loan) for the consideration received.

Financial assets and liabilities are offset and the net amount is reported in the consolidated statement of financial position if, and only if, the Group has a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liabilities simultaneously.

(a) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. This group of financial assets includes: cash in current accounts and deposits with the Central Bank, amounts due from banks, loans and advances to customers, other receivables. They are measured in the consolidated statement of financial position at their amortised cost using the effective interest method less any allowance for impairment. Interest income is recognised on effective interest basis. It is presented in the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year).

Loans and advances that have been initially originated in the Group are recognised when cash is actually advanced to borrowers or another financial or non-financial asset is provided to borrowers and are initially measured at fair value, which is usually equal to the value of the provided cash and / or other assets.

Loans and advances acquired by the Group are recognised when a significant part of the benefits and risks incidental to the ownership are received by the Group and are initially measured at the value of the amount paid or at the determined fair value of the transferred asset.

(b) Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative assets that are either designated as available-for-sale or are not classified in any other category.

The Group classifies as available-for-sale financial assets debt or equity securities, intended to be held for an indefinite period of time and which may be sold in response to the needs for liquidity or material changes in their yield or prices.

Available-for-sale securities are subsequently measured at fair value based on different valuation models: quoted market prices, adjusted market prices or models based on discounted cash flows.

Unrealised gains and losses arising from changes in the fair value of securities classified as available-for-sale are recognised directly in a separate component of equity in the consolidated statement of changes in equity through the other comprehensive income until the financial assets are sold or impaired. Then, the accumulated gains or losses, included in equity in prior periods, are recognised in the consolidated statement of profit or loss and other comprehensive income for the reporting period (within profit or loss for the year) on the line item *'net trading income'*.

During the holding period of debt instruments, classified as available-for-sale, the Group recognised interest income by applying the effective interest rate method.

Dividends on shares, classified as available-for-sale financial assets, are recognised and carried to the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year) on the line item *'other operating income, net'* when the Group's entitlement to these dividends is established.

When a financial asset classified as held for sale is transferred to the held-to-maturity category the fair value of the respective asset on the date of such reclassification is deemed the asset's amortised cost. Subsequently the asset and any gain or loss reported until the date of the reclassification to the other comprehensive income are amortised until the maturity using the effective interest rate method.

Financial assets are reclassified from the held for sale category to the held-to-maturity category only once, when there is a change in the Group's intention and ability to hold the asset to its maturity.

The Group is not allowed to reclassify a financial asset to the held-to-maturity category, if during the current financial year or the two preceding years it has sold or reclassified more than an insignificant part of the held-to-maturity portfolio before its maturity.

(c) Financial assets held-to-maturity

Held-to-maturity financial assets are non-derivative instruments that represent debt securities with fixed or determinable payments and fixed maturities, on acquisition of which the Bank has the positive intention and ability to hold to maturity, regardless of being tradable on a stock market. These assets are initially measured at acquisition cost, and subsequently – at amortised cost using the effective interest rate method, less allowance for impairment, if any. The latter is presented in the consolidated statement of profit or loss and other comprehensive income on the line item *'net impairment loss on financial assets'*.

Interest income is recognised on effective interest basis in the consolidated statement of profit or loss and other comprehensive income (profit or loss for the year) on the line item *'net interest income'*.

The Group may reclassify an asset from the 'held-to-maturity' financial assets category to the 'available-for-sale' financial assets and respectively, sell the asset, if and only if: (a) the asset is so close to maturity or redemption date (within three months) that the changes in the market rate or interest will not have significant effect on the financial asset's fair value; (b) such reclassification is made once the Group has collected significantly all of the original principal on all financial assets through determined payments or early payments; or (c) the reclassification is related to an isolated event outside the Group's control, it is not a recurring event and the Group has had no reasonable reasons to anticipate such an event.

If the Group reclassifies and sells a significant part of its 'held-to-maturity' portfolio before its maturity or in cases other than the above-mentioned, the Group: (a) ceases to classify securities in the 'held-to-maturity' category over the next two years; and (b) all of its currently existing securities in the 'held-to-maturity' category are reclassified in the 'held for sale' category and are recognised in the consolidated statement of financial position at fair value.

(d) Repurchase agreements

The Group companies enter into securities agreements to resell / repurchase similar securities on a predetermined future date at an agreed-upon fixed price (repo-agreements). Securities purchased under agreements to resell (reverse repo) at a specified future date are not recognised in the consolidated statement of financial position. The paid amounts are carried as receivables from repo-agreements with customers and / or banks, as collateralised by the underlying security. The difference between the purchase price and the resale price is treated as interest and accrued over the period of the life of the agreement, using the effective interest rate method.

Securities sold under repurchase agreements (repo) continue to be recognised in the consolidated statement of financial position as assets at fair value through profit or loss or as assets available-for-sale. The proceeds from the sale of the securities are reported as liabilities under repo-deals. The difference between the sales price and the repurchase price is treated as interest expense and is accrued over the life of the agreement using the effective interest rate method.

Impairment of financial assets

All financial assets classified in the categories: 'loans and receivables', 'financial assets held-to-maturity', 'available-for-sale financial assets' are subject to review for impairment. At each date of preparation of consolidated statement of financial position the management makes a judgement on whether objective evidence and indications exist for impairment of a financial asset or a group of financial assets in these categories.

(a) Loans and amounts due from banks and other customers

The management of the parent (the Bank) assesses at each date of preparation of consolidated statement of financial position whether there is any objective evidence that certain individual loans and receivables, or a group of loans and receivables of similar characteristics have indications of impairment. A loan or a group of loans or other receivables is impaired when there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset and that these events have an impact on the estimated future cash flows of the asset and this impact can be reliably measured.

The criteria used by the Bank to determine that there is objective evidence of an impairment loss include: delinquency (delay) in the contractual payments of principal and interest; significant financial difficulties experienced by the borrower and in the generation of sufficient cash flows; breach of key covenants and ratios (indicators) of the loan agreement; deterioration of the borrower's financial, market and competitive position of the borrower; deterioration in the state and quality of collaterals provided by the borrower; initiation of liquidation and / or bankruptcy proceedings of borrowers and other similar indicators.

For individually reviewed and measured loans and receivables the impairment amount is calculated as the difference between the carrying amount of a particular receivable in the statement of financial position and its recoverable amount, which is the present value of the expected cash flows from the receivable, including recoverable guarantees and collaterals discounted using the original effective interest rate (specific impairment). Impairment losses are recognised in the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year) on the line item *'net impairment loss on financial assets'*. Accrual of interest income from an impaired receivable continues and is recognised based on the new carrying amount, after the impairment, using the effective interest rate that was used to discount the future cash flows for the purposes of the impairment calculation.

For collectively reviewed and measured loans and receivables impairment loss is calculated based on average impairment loss parameters by groups of loans having similar characteristics and risk. These parameters are estimated based on the historical experience and statistic observations and calculations and observed indicators per types of borrowers, loans, delinquency and collaterals (collective impairment). The accumulated impairment losses are taken to allowance accounts. For those components of the loan portfolio as at the date of the consolidated statement of financial position, for which there are not yet individually crystallised impairment loss events, an impairment test is performed at a portfolio level of loans having similar characteristics – industry, type, location, types of collateral, type of borrower, purpose of the loan, delinquency and other relevant facts and circumstances. Impairment loss is recognised when based on the Bank's historical experience and its current observations of the patterns of developments in this group identify common events which represent an indication of incurred losses – current economic conditions and business environment in which the borrowers operate and other factors that influence the loan portfolio, but are not related to a particular exposure. In this case the Bank recognises collective impairment to cover general credit risk on portfolio basis.

The Bank currently assesses whether there is objective evidence for impairment with regard to each particular credit exposure or another receivable, regardless of whether it is individually material. Each loan is classified in one of the following risk groups adopted by the Bank – 'standard loans', 'watch', 'non-performing' or 'loss' depending on the period of delayed payment of principal and / or interest and based on the analysis of the financial position of the borrower, the sources for repayment of its debts to the Bank and the type, quality and value of the provided collateral.

The amounts of impairment are calculated on the basis of internal policies, rules and techniques developed by the Bank.

All loans and receivables are reviewed and analysed by the Bank on a monthly basis for assessing the risk exposures and impaired loans. All new events, circumstances and facts are analysed. Any subsequent change in the amounts and maturity of the expected future cash flows, compared to the prior estimates, result in a change in the allowances for loan impairment, whereas additional losses or reversals of previously recognised losses are booked as an increase or decrease in the impairment losses in the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year) on the line item *'net impairment loss on financial assets'*. Impairment losses are reversed only when the quality of the loan has improved so that reasonable assurance exists as to the timely collection of the principal and interest in accordance with the original contractual terms of the loan agreement. Subsequent recoveries or decreases in the impairment allowances due to events occurring after the write-down are reversed in the consolidated statement of profit or loss and other comprehensive income.

When a loan or another receivable is uncollectable, it is written-off against the related allowance for impairment losses. Such loans and receivables are written-off after all necessary legal procedures have been completed and the final loss has been determined.

(b) Available-for-sale financial assets

Available-for-sale financial assets are impaired if there is objective evidence that shows a significant and prolonged decline in the fair value of the respective asset or group of assets. Financial assets measured at cost are impaired when there is evidence that their carrying amount is higher than the expected recoverable amount.

With regard to debt instruments, the Bank assesses on an individual basis whether objective evidence for impairment loss exists by following an approach analogous to that for the 'loans and receivables category' – stable trends for decreases in the expected future cash flows and/or permanent decrease in the value of the main collateral (if any). Therefore, the impairment loss is the difference between their amortised cost and the current fair value, less impairment loss recognised in the current profit or loss in prior periods. The fair value of debt instruments is determined based on quoted market prices or using the discounted cash flows method applying current market interest rates for similar financial assets. The accrual of interest income on impaired available-for-sale financial debt assets continues and is recognised on the basis of the new carrying amount of the asset, after the impairment, applying the effective interest rate used to discount the future cash flows for the purposes of impairment calculation. If in subsequent periods a new event occurs as a result of which the fair value of the instruments increases, the reversal of the impairment is similarly reported through the profit or loss for the year.

Evidence for impairment of equity instruments exists when there is significant and prolonged decline in the fair value of the instrument below its cost. The Bank has adopted more than 30% decline in the fair value as significant decline and more than six months as prolonged decline for assets quoted in active equity instrument markets.

Indicators for the impairment of equity instruments not quoted in active markets include events and facts that might influence the quality of the counterparty, as well as the country of the counterparty. With respect to counterparty quality the Bank analyses and monitors any adverse events related to the quality of the assets, capital, yield, liquidity, regulatory environment, financial environment, shareholding structure, management quality, product diversification, partnerships and strategic importance. With respect to the quality of the country the Bank observes and analyses any adverse events related to deterioration of the economic situation, political or social turmoil, accumulation of excessive budget, quasi budget and other deficits, accumulation of public debt, deterioration of the market environment and loss of refinancing opportunities of maturing debt through the financial markets, devaluation of the state currency, bans over payments or supplies.

The recoverable amount of equity instruments is determined based on valuation models using the discounted cash flows method for forecasting the development of the entity issuing the instrument. In such cases the cumulative loss – representing the difference between the acquisition cost of the equity instrument and its current fair value or recoverable amount is transferred from the equity component to the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year) to the line item *'net impairment loss on financial assets'*. Impairment losses recognised for equity instruments held for sale are not reversed through the current period profit or loss. All subsequent increases in the fair value are recognised once again in equity components through the other comprehensive income.

(c) Held-to-maturity financial assets

'Held-to-maturity' financial assets are assessed individually if objective evidence for impairment exists. The approach to determine impairment losses is similar to that used for financial assets in the 'loans and receivables' category. If such evidence exists the amount of the impairment loss is measured as the difference between the carrying amount (amortised cost) of the financial assets and the present value of the expected future cash flows.

Impairment losses are recognised currently in the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year) on the line item *'net impairment loss on financial assets'*.

2.11.2. Financial liabilities and equity instruments

The Group classifies its liabilities, debt and equity instruments either as financial liabilities or as equity in accordance with the substance of the contractual arrangements with the respective counterparty regarding these instruments. The Group companies determine the classification of their financial liabilities at the time of their origination. All financial liabilities held by the Group are classified as other financial liabilities and are carried at amortised cost.

The financial liabilities of the Group include: amounts due to banks and customers under deposits, borrowed funds under loan agreements and other agreements and other current liabilities.

They are initially recognised in the consolidated statement of financial position at fair value, net of the directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method.

Interest expense is carried currently to the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year) systematically over the life of the instrument.

Financial liabilities are derecognised when the obligation under the liability is discharged, or cancelled, or the counterparty loses its entitlement.

2.12. Leases

2.12.1. Finance lease

The Group as a lessor

Finance leases, which transfer substantially all the risks and rewards incidental to ownership of an asset outside the Group, are derecognised from the lessors' assets and are presented in the consolidated statement of financial position as a receivable at an amount equal to the net investment in the lease. The difference between the carrying amount of the leased asset and the immediate (fair selling) value is recognised in the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year) at the inception of the lease contract (upon the transfer of the asset). Finance lease income is allocated over the accounting periods so as to reflect the continuous periodic rate of return on the outstanding portion of the Group's net investment associated with the lease and are reported as interest in the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year) on the line item *'interest income'*.

The Group as a lessee

Finance leases, which transfer to the Group substantially all the risks and rewards incidental to ownership of the leased asset, are capitalised in the consolidated statement of financial position of the lessee and are presented as leased property or plant and equipment at their immediate selling price or, if lower, at the present value of the minimum lease payments. The lease payments are apportioned between the finance cost (interest) and the attributable portion of the lease liability (principal) so as to achieve a consistent interest rate on the remaining outstanding principal balance of the lease liability. Interest expense is included in the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year) on the line item *'interest expense'*.

Assets acquired under finance lease are depreciated on the basis of their useful economic life and within the lease term.

2.12.2. Operating lease

The Group as a lessor

Lessor continues to hold a substantial part of all the risks and rewards incidental to ownership of the particular asset. Therefore, the asset is still included in its tangible fixed assets while its depreciation for the period is included in the current expenses of the lessor.

The income of the Group as a lessor under operating leases is recognised on a straight-line basis over the lease term and is presented in the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year) on the line item *'other operating income, net'*.

The Group as a lessee

Leases where the lessor continues to hold a substantial part of all the risks and rewards incidental to ownership of the particular asset are classified as operating leases. Therefore, the asset is not included in the consolidated statement of financial position of the lessee.

The payments of the Group as a lessee in relation to operating lease are recognised as an expense in the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year) on a straight-line basis over the lease term. They are presented on the line item *'other administrative expenses'*.

2.13. Property and equipment

Group's property and equipment (tangible fixed assets) are presented in the consolidated financial statements at acquisition cost (cost) less the accumulated depreciation and any impairment losses in value.

Initial measurement

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

The Group has set a value threshold of BGN 150, below which the acquired assets, regardless of having the features of fixed assets, are treated as current expense at the time of their acquisition.

Subsequent measurement

The approach chosen by the Group for subsequent measurement of property and equipment, is the cost model under IAS 16, i.e. acquisition cost (cost) less any accumulated depreciation and any accumulated impairment losses in value.

Depreciation methods

The Group applies the straight-line depreciation method for property and equipment. The useful life per group of assets has been determined considering: the physical wear, the characteristic features of the equipment, the intentions for future use and the expected obsolescence, and is as follows:

	years	**%**
▪ Buildings	65	1,5
▪ Machinery, computer hardware and equipment	6.7-7	15-50
▪ Furniture and fixtures	6,7	15
▪ Motor vehicles	4	25
▪ Leasehold improvements – for the term of the rental agreement		

The useful life, set for equipment, is reviewed at the end of each year and in case of any material deviation from the future expectations on the period of use, the latter is adjusted prospectively.

Subsequent costs

Repair and maintenance costs are recognised as current expenses as incurred. Subsequent costs incurred in relation to property, plant and equipment having the nature of replacement of certain components and significant parts or improvements and restructuring, are capitalised in the amount of the respective asset whereas the residual useful life is reviewed at the capitalisation date. At the same time, the non-depreciated part of the replaced components is derecognised from the amount of the assets and is recognised in the current expenses for the period of restructure.

Impairment of assets

The carrying amounts of property and equipment in the consolidated statement of financial position are reviewed for impairment when events or changes in circumstances indicate that they might permanently differ from their recoverable amount. If any such indications exist that the estimated recoverable amount of an asset is lower than its carrying amount in the consolidated statement of financial position, the latter is adjusted to the recoverable amount of the asset. The recoverable amount of property and equipment is the higher of the fair value less costs to sell or the value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market conditions and assessments of the time value of money and the risks, specific to the particular asset. Impairment losses are recognised in the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year) on the line item *'net impairment loss on non-financial assets'*.

Gains and losses on disposal (sale)

Property and equipment are derecognised from the consolidated statement of financial position when they are permanently withdrawn from use and no future economic benefits are expected therefrom or on disposal.

Gains and losses arising from the disposal of assets are determined as the difference between the disposal proceeds and the carrying amount of the asset in the consolidated statement of financial position at the disposal date. Gains and losses on disposal are recognised in the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year) on the line item *'other operating income, net'*.

2.14. Investment property

The Group treats as investment property real estate owned thereby representing buildings and parts of buildings rented out, land adjacent to the rented buildings, and such acquired and held for permanent investment purposes.

The Group acquires properties which have served as collateral on non-performing loans by classifying them as investment property, when its intention is to rent them out on a long-term basis or because of expected future increases in the value of the property due to its particular qualities and advantages.

Initial measurement

Investment property is initially measured at cost. The cost of a purchased investment property comprises its purchase price and any directly attributable expenditure – professional fees, broker commissions, property transfer taxes, etc. The initial measurement includes all permanently attached tangible fixed assets and other assets without which the investment property would not be suitable for its designation. The acquisition cost of investment properties acquired as collateral on non-performing loans is usually the price determined at the public sale or the bilaterally agreed price.

Subsequent measurement

Investment properties are presented in the consolidated statement of financial position at acquisition cost (cost) less accumulated amortisation and any impairment losses in value.

Any *subsequent costs* related to an investment property are stated in increase of its carrying amount when leading to an increase in the expected economic benefits compared to the initially determined ones. All other subsequent costs on property maintenance are recognised as current expenses when incurred.

Depreciation methods

The Group uses the *straight-line method for depreciation* of the buildings included in its group of investment property. The useful life of buildings, components of investment properties is assessed in the range of 25 to 65 years. Land is not depreciated.

Transfers to, or from, the group of 'investment property' is made only when there is a change in the pattern of use of the particular property.

Impairment of assets

The carrying amounts of property and equipment in the consolidated statement of financial position are reviewed for impairment when events or changes in circumstances indicate that they may differ permanently from their recoverable amounts. If any such indications exist that the estimated recoverable amount of an asset is lower than its carrying amount in the consolidated statement of financial position, this amount is adjusted to the recoverable amount of the asset. Impairment losses are recognised in the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year) on the line item *'net impairment loss on non-financial assets'*.

Gains and losses on disposal (sale)

Investment properties are derecognised from the consolidated statement of financial position when they are permanently withdrawn from use and no future economic benefits are expected therefrom or on disposal.

Gains or losses arising from the disposal of investment property are determined as the difference between the net disposal proceeds and the carrying amount of the asset at the disposal date. They are stated net on the line item *'other operating income, net'* in the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year).

2.15. Intangible assets

Intangible assets are stated in the consolidated financial statements at acquisition cost (cost) less accumulated amortisation and any impairment losses in value.

Amortisation methods

The Group applies the straight-line amortisation method for the intangible assets with determined useful life by group of assets as follows:

	Years	%
▪ Software	5	20
▪ Licences	6,7	15

Impairment of assets

The carrying amount of the intangible assets is subject to review for impairment when events or changes in the circumstances indicate that the carrying amount might exceed their recoverable amount. Then the impairment loss is included as an expense in the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year) on the line item *'net impairment loss on non-financial assets'*.

Gains and losses on disposal (sale)

Intangible assets are derecognised from the consolidated statement of financial position when they are permanently withdrawn from use and no future economic benefits are expected therefrom or on disposal. The gains or losses arising from the disposal of an item of intangible assets are determined as the difference between the consideration received and the carrying amount of the asset at the disposal date. They are recognised on a net basis in the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year) on the line item *'other operating income, net'*.

2.16. Non-current assets held for sale

Non-financial assets are classified as held for sale if their carrying amount is expected to be recovered through sale, rather than through continued use in the Group companies' operations. Usually these assets have been initially accepted by the Group as collaterals and are subsequently acquired by the Group as a result of 'debt for ownership' exchange from borrowers that are not repaying their liabilities in accordance with the contractual terms and conditions of the loan.

Non-current assets classified in this group are available for immediate sale in their present condition. They are classified in this category only when the Group companies' management has a clear intent and a priority to sell them in the foreseeable future (within 1 year) and has started procedures to actively seek buyers.

Assets classified as held for sale are presented in the consolidated statement of financial position separately and are measured at the lower of their carrying amount (initially, acquisition cost) and their fair value less the estimated direct costs to sell. Any impairment recognised is presented on the line item *'net impairment loss on non-financial assets'* in the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year).

Non-current assets in this classification group are not depreciated.

2.17. Assets acquired through collateral

Assets representing property and equipment, acquired against debt as full or partial repayment of a loan are initially measured at acquisition cost, including the attributable transaction costs.

Following initial recognition these assets are measured at the lower of their carrying amount and their net selling price.

Assets acquired through collateral are presented in the consolidated statement of financial position on the line item *'other assets'*. Gains and losses related to the realisation of these assets are presented in the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year) on the line item *'other operating income, net'*.

2.18. Provisions and contingent liabilities

Provisions are recognised when the Group companies have a present obligation, constructive or legal, as a result of a past event and it is probable that an outflow of resources will be required to settle the obligation. The measurement of provisions is based on the best estimate made by the Group companies' management at the date of preparation of the consolidated statement of financial position concerning the expenses required for the settlement of the particular obligation. The estimate is discounted if the obligation is long-term.

Contingent liabilities are obligations arising as a result of past events the existence of which can be confirmed only by the occurrence or non-occurrence of one or more uncertain future events, not entirely within the control of the Group, or it is not probable that an outflow of resources will be required to settle the obligation. They are not recognised in the consolidated statement of financial position but are specifically disclosed *(Note 30)*.

In its ordinary course of business the parent provides bank guarantees the nature of which is a substitute for loans, good performance guarantees, tender, customs guarantees, letters of credit to its customers. These are treated as contingent liabilities until the occurrence of an event that results in a real liability to the Bank to make payment to a counterparty of its customer in favour of which the particular guarantee has been issued. Such an event is the filing of a claim to the Bank to make payment under the commitment undertaken. In such cases the Bank recognises the guaranteed amount as balance sheet debt.

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

The employment and social security relations with the Group companies' personnel are based on the provisions of the Labour Code and the effective social security legislation in Bulgaria.

Short-term benefits

Short-term benefits in the form of remuneration, bonuses and social payments and benefits (due for payment within 12 months after the end of the period when the employees have rendered the service or have satisfied the required terms) are recognised as an expense in the consolidated statement of profit and loss and other comprehensive income (within profit or loss for the year), unless a particular IFRS requires capitalisation thereof to the cost of a particular asset during the period when the service has been rendered and/or the requirements for receipt of the benefits have been met, and as a current liability (less any amounts already paid and deductions due) at their undiscounted amount.

At each consolidated financial statements date, the Group companies assess the expected accumulating compensated absences, which amount is expected to be paid as a result of the unused entitlement to accumulating leave. The measurement includes the estimated amounts of employee's remuneration and the statutory social security and health insurance contributions due by the employer thereon.

Long-term retirement benefits

Defined contribution plans

The major duty of each company of the Group as an employer in Bulgaria is to make the mandatory social security contributions for the hired employees to the Pensions Fund, the Supplementary Mandatory Pension Security (SMPS) Fund, to the General Diseases and Maternity (GDM) Fund, the Unemployment Fund, the Labour Accident and Professional Diseases (LAPD) Fund, the Guaranteed Receivables of Workers and Employees (GRWE) Fund and for health insurance. The rates of the social security and health insurance contributions are defined annually in the Law on the Budget of State Social Security and the Law on the Budget of National Health Insurance Fund for the respective year. The contributions are split between the employer and employee in line with rules of the Social Security Code (SSC).

The pension plans, applied by the Group companies in their capacity as employers, are defined contribution plans. Under these plans, the employer pays defined monthly contributions to the government funds as follows: Pensions Fund, GDM Fund, Unemployment Fund, LAPD Fund as well as to universal and professional pension funds – on the basis of rates fixed by law, and has no legal or constructive obligation to pay further contributions if the funds do not hold sufficient means to pay the respective individuals the benefits they have worked-out over the period of their service. The obligations referring to health insurance are analogous.

There is no established and functioning private voluntary social security scheme at the Group. The contributions, payable by the Group under defined contribution plans for social security and health insurance, are recognised as a current expense in the statement of profit or loss and other comprehensive income (within profit or loss for the year) unless a particular IFRS requires this amount to be capitalised to the cost of an asset, and as a current liability at their undiscounted amount along with the accrual of the respective employee benefits to which the contributions refer and in the period of rendering the underlying service.

Defined benefit plans

In accordance with the Labour Code, the each company of the Group in its capacity as an employer in Bulgaria is obliged to pay an indemnity to its personnel when coming of age for retirement, at an amount which, depending on the length of service with the entity, varies between two and six gross monthly salaries at the employment termination date. In their nature these are unfunded defined benefit schemes.

The calculation of the amount of these liabilities necessitates the participation of qualified actuaries in order to determine their present value at the date of the financial statements, at which they are presented in the consolidated statement of financial position, and respectively, the change in their value is presented in the consolidated statement of profit or loss and other comprehensive income whereby: (a) current and past service costs, interest costs and the effects of curtailment and settlements are recognised immediately when incurred and are presented in current profit or loss under 'personnel expenses'; and (b) effects from remeasurement of obligations that in substance represent actuarial gains and losses are recognised immediately when occurred and are presented to other comprehensive income on the line item *'remeasurements of defined benefit pension plans'*. Actuarial gains and losses arise from changes in the actuarial assumptions and experience adjustments.

At the end of each reporting period, the Bank assigns certified actuaries who issue a report with their calculations about the long-term retirement benefit obligations to personnel. For this purpose, they apply the Projected Unit Credit Method. The present value of the defined benefit obligation is determined by discounting the estimated future cash flows, which are expected to be paid within the maturity of this obligation, and using the interest rates of long-term government bonds of similar term, quoted in Bulgaria where the Bank itself operates.

Termination benefits

In accordance with the local provisions of the employment and social security regulations in Bulgaria, each company of the Group in its capacity as an employer is obliged to pay certain types of indemnities upon termination of the employment contracts prior to retirement.

The Bank recognises employee benefit obligations on employment termination before the normal retirement date when it is demonstrably committed, based on a publicly announced plan, including for restructuring, to terminating the employment contract with the respective individuals without possibility of withdrawal or in case of formal issuance of documents for voluntary redundancy. Termination benefits due more than 12 months are discounted and presented in the consolidated statement of financial position at their present value.

2.20. Income taxes

The *current income taxes* of the Group companies are determined in accordance with the requirements of the Bulgarian tax legislation – the Corporate Income Taxation Act (CITA). The nominal income tax rate in Bulgaria for 2017 is 10 % (2016: 10%).

Deferred income taxes are determined using the liability method for all temporary differences of the Group companies as at the date of preparation of the consolidated financial statements between the carrying amounts of the assets and liabilities and their tax bases.

Deferred tax liabilities are recognised for all taxable temporary differences, with the exception of those originating from recognition of an asset or liability, which has not affected the accounting and the taxable profit/(loss) at the transaction date.

Deferred tax assets are recognised for all deductible temporary differences and the carry-forward of unused tax losses, to the extent that it is probable they will reverse and a taxable profit will be available or taxable temporary differences might occur, against which these deductible temporary differences can be utilised, with the exception of the differences arising from the recognition of an asset or liability, which has affected neither the accounting nor taxable profit /(loss) at the transaction date.

The carrying amount of all deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is probable that they will reverse and sufficient taxable profit will be available or taxable temporary differences will occur in the same period, to allow the deferred tax asset to be deducted or offset.

Deferred taxes, related to items directly credited or charged as other components of comprehensive income or as an equity item in the consolidated statement of financial position, are also reported directly in the respective component of the comprehensive income or the equity item in the statement of financial position.

Deferred tax assets and liabilities are measured at the tax rates and on the bases that are expected to apply to the period and type of operations when the asset is realised or the liability – settled (repaid) on the basis of the tax laws that have been enacted or substantively enacted, and at tax rates of the country (Bulgaria) under the jurisdiction of which the respective deferred asset or liability is expected to be recovered or settled.

As at 31 December 2017 the deferred income taxes of the Group companies are computed at a tax rate of 10%, which is also valid for 2018 (31 December 2016: 10%).

2.21. Cash and cash equivalents

For the purposes of the consolidated statement of cash flows cash and cash equivalents comprise cash on hand, cash at current accounts with other banks, placements with other banks – payable at sight and/ or with original maturity of up to 3 months, as well as unrestricted balances with the Central Bank.

2.22. Share capital and reserves

D Commerce Bank AD is a joint-stock company and it is obliged to register in the Commercial Register a certain amount of ***share capital***, which should serve as a security for the receivables of the Bank's creditors (the parent). Shareholders are liable for the obligations of the Company up to the amount of the capital share held by each of them and may claim refunding of this interest only in liquidation or bankruptcy proceedings.

The share capital represents the non-distributable capital of the bank and is presented at the nominal value of the issued shares.

The Bank and its joint-stock subsidiaries from the Group are obliged to set aside a ***Reserve Fund (statutory reserve)*** in accordance with the requirements of the Commercial Act on distribution of the profit *(Note 28)*.

Available-for-sale financial assets reserve is being set aside from the difference between the carrying amount of the available-for-sale financial assets and their fair values at the revaluation date. The revaluation reserve is transferred to the current profit and loss in the consolidated statement of profit or loss and other comprehensive income, when the financial assets are sold or in case of lasting and prolonged impairment.

Dividends on ordinary shares are recognised as a liability and decreased at the expense of accumulated losses when there is a decision of the General Meeting of Shareholders.

2.23. Fair value measurement

Some of the Group's assets and liabilities are measured and presented at fair value on recurring basis and / or fair values are only disclosed for financial reporting purposes. These include:

(a) for the purpose of measurement and presentation at fair value in the consolidated financial statements:

- ✓ *financial instruments* – available-for-sale securities.

(b) for the purpose of fair value disclosures in the consolidated financial statements:

- ✓ *financial instruments* – securities held-to-maturity ; amounts due from banks; loans and advances to customers; amounts due to banks and customers;
- ✓ *non-financial assets* – investment properties; assets held for sale.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between independent market participants at the measurement date. Fair value is an exit price and is based on the assumption that the sale transaction will take place either in the principal market for this asset or liability or in the absence of a principal market – in the most advantageous market for the asset or liability. Both the designated as a principal market and the most advantageous market are markets to which the Group companies must have an access.

Fair value is measured from the perspective of using the assumptions and judgments that potential market participants would use when pricing the respective asset or liability assuming that market participants act in their economic best interest.

In measuring the fair value of non-financial assets the starting point is always the assumption what would be the highest and best use of the particular asset for the market participants.

The parent has developed internal rules and procedures for measuring the fair value of various types of assets and liabilities.

The Group applies various valuation techniques that would be relevant to the specific features of the respective conditions and for which it has sufficient available inputs while trying to use at a maximum the publicly observable information, and respectively, to minimize the use of unobservable information.

It uses the three acceptable approaches – *the market approach, the income approach and the cost approach* – whereas the most frequently applied valuation techniques include direct and/or adjusted quoted market prices, market comparables (analogues) and discounted cash flows.

If an active market exists the Group uses direct quoted (unadjusted) prices to determine the fair value of the respective financial instrument.

If the market for the respective financial instrument is not active the Group establishes its fair value using a particular valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flows analyses and option pricing models. The valuation technique chosen makes maximum use of market inputs, relies as little as possible on estimates specific to the Bank, incorporates all factors that market participants would consider in setting a price, and is consistent with the accepted economic methodologies for pricing of financial instruments. Inputs to the valuation techniques reasonably represent market expectations and measures for risk-return factors inherent in the financial instrument. The Group calibrates the valuation techniques and tests their validity using prices from observable current market transactions in the same instrument or based on other available observable market data.

Fair values reflect the credit risk of the instrument and include adjustments to account for the credit risk of the Group companies and the counterparty, where appropriate. Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties, to the extent that the Group believes a third-party market participant would take them into account in pricing a transaction.

The definition of the fair value of non-financial assets is carried out periodically (annually). The Group uses the expertise of external independent licensed valuers in determining the fair value of its investment properties for the purpose of disclosures in the consolidated financial statements. The selection of valuers is made on the basis of the following criteria: applied professional standards, professional experience and knowledge, reputation and market status. The need for rotation of the external valuers is assessed periodically. The application of the valuation approaches and techniques as well as the inputs used in all cases of fair value measurements are subject to mandatory discussion and agreement between the external expert valuers and the respective officers in charge within the Group companies. The final fair value measurements are subject to approval by the Group companies. The fair values of assets held for sale is their selling price agreed between the Group companies and the respective buyers.

All assets and liabilities that are measured and/or disclosed in the consolidated financial statements at fair value, are categorised within the following fair value hierarchy, namely:

- Level 1 — Quoted (unadjusted) market prices in active markets for identical assets or liabilities;
- Level 2 — Valuation techniques that use inputs other than directly quoted prices but are observable, either directly or indirectly, including where the quoted prices are subject to significant adjustments; and
- Level 3 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

The Group applies fair values determined at all three levels of the fair value hierarchy.

For assets and liabilities that are recognised at fair value in the consolidated financial statements on a recurring basis, the Group companies assess at the date of preparation of each set of financial statements whether transfers between the fair value hierarchy levels are required for an asset or liability depending on the inputs available and used as at that date.

For the purposes of fair value disclosures, the Group aggregates the respective assets and liabilities on the basis of their nature, basic characteristics and risks as well as of the fair value hierarchical level *(Note 2.24.2.1 and Note 2.24.2.2).*

2.24. Critical accounting judgments on applying the Bank's accounting policies. Key estimates and assumptions of high uncertainty.

The items presuming a higher level of subjective assessment or complexity or where the assumptions and accounting estimates are material for the consolidated financial statements, are disclosed as follows:

2.24.1. Impairment loss on loans and advances

At the date of each consolidated financial statements the Bank reviews its loan portfolios in order to detect the existence and to calculate losses from such impairment. When considering whether to recognised impairment loss in the consolidated statement of profit or loss and other comprehensive income (the profit or loss for the year), the Bank's management assesses whether there are and what are the visible indicators and data, such as objective evidence that there is measurable decline in the cash flows expected to be received from the loan portfolio as a whole, or respectively, a decrease associated with a specific loan in this portfolio. These include indications and data of adverse change in the payment ability of borrowers in a specific group or of a specific borrower, or national, economic or other developments that pose a risk for a specific group / type of loans. The analysis of the risk of impairment losses and uncollectability groups the loans in risk credit groups based on three key criteria: financial position and performance, including ability for generating own cash flows, problems in the servicing, including past due interest and matured principal payments, and collateral provided in view of its type and realisation opportunities.

In determining the future cash flows patterns the Bank's management uses estimates, judgements and assumptions based on the historical experience from impairment of assets having similar characteristics of credit risk (collective impairment). The same approach is used in the assessment of individual loans, however taking into account the quality of the collaterals (specific impairment). The methodology and assumptions used in estimating the amount and timing of the future cash flows are reviewed on regular basis in order to minimise the differences between the estimated and the actual losses incurred *(Note 8)*.

2.24.2. Fair value measurement

2.24.2.1. Measurement of the fair value of financial instruments

(a) Financial instruments measured at fair value in the consolidated financial statements

Available-for-sale securities held by the Group representing: (a) debt securities is fixed or determinable payments and fixed maturity (government securities – bonds); (b) corporate shares or interests in the equity of other entities (minority interests) and (c) corporate bonds are measured and presented at fair value in the consolidated statement of financial position (Level 1). The measurement policy adopted by the Group estimates the average price based on the 'ask' and 'bid' quotes on the last working day of the reporting period (year), published in an international information system for financial instruments, eliminating the highest and the lowest quotes (extreme values).

(b) Financial instruments not measured at fair value in the consolidated financial statements

The Group classifies financial instruments not measured at fair value in the consolidated financial statements, for which fair value disclosures are required, in the following categories: *cash and balances with the Central Bank; due from banks; loans and advances to customers; securities held-to-maturity; due to banks and customers.* The Group determines the fair value of these categories of financial assets and liabilities using the following techniques and assumptions:

Cash and balances with the Central Bank

This item includes cash on hand and balances on current accounts with BNB, including the minimum statutory reserves.

The fair value of *cash on hand* coincides with their carrying and nominal amounts. The Group classifies this item's fair value as Level 1 in the fair value hierarchy.

The fair value of *balances on current accounts with BNB*, including the *minimum statutory reserves* is close or coincides with their carrying (amortised) amount. The Group classifies these items as Level 2 in the fair value hierarchy.

Due from banks

Amounts due from banks include interbanking deposits and nostro accounts.

The fair value of floating or fixed rate items with an original maturity *up to* 3 months, coincides or is close to their carrying (amortised) amount.

The fair value of floating or fixed rate items and original maturity *over* 3 months is determined using the discounted cash flows method applying average current interest rates quoted on the money market for instruments with similar risk and maturity.

The Group classifies amounts *due from banks* at Level 2 of the fair value hierarchy.

Loans and advances to customers

Loans and advances to customers are presented net, less the accumulated impairment The definition of the fair value of *loans and advances to customers* is based on valuation models, such as discounted cash flows techniques and it is classified by the Group at Level 3 of the fair value hierarchy.

The inputs to the valuation techniques include the estimated cash flows over the life of the loan and average interest rates for the respective term and currency published by BNB. For loans classified as loss the Group recognises the discounted carrying amount of the loan as their fair value.

Held-to-maturity securities

The fair value of *held-to-maturity securities*, representing debt securities with fixed or determinable payments and fixed maturities (government securities – bonds and corporate bonds) is based on average market quotes in an active market and it is classified at Level 1 in the fair value hierarchy. It is determined by the Group as the average of the 'ask' and 'bid' quotes on the last working day of the reporting period (year), published in an international information system for financial instruments, eliminating the highest and the lowest quotes (extreme values).

Other financial assets

The other financial assets include mainly receivables under a lease agreement and payments under card transactions.

The fair value of these items coincides with or is close to their carrying (amortised) amount as far as they are of short-term nature.

The Group classifies *other financial assets* at Level 3 of the fair value hierarchy.

Due to banks

The amounts due to banks include placements (deposits) and borrowings in the form of loans.

The fair value of floating or fixed rate items with an original maturity *up to* 3 months, coincides with or is close to their carrying (amortised) amount.

The fair value of floating or fixed rate items and original maturity *over* 3 months is based on the discounted cash flows using average interest rates quoted in the money market for instruments having similar risk, currency and maturity.

The Group classifies the fair value of these assets at Level 2 of the fair value hierarchy.

Due to customers

The amounts due to customers include funds attracted from individuals, legal entities and municipalities in the form of term deposits and current accounts.

The fair value of floating or fixed rate items with an original maturity *up to* 3 months, coincides with or is close to their carrying (amortised) amount. The fair value of floating or fixed rate items with original maturity *over* 3 months is calculated using the discounted cash flows technique applying average interest rates for the respective term and currency published by BNB.

The Group classifies the fair value of these assets at Level 2 of the fair value hierarchy.

Other financial liabilities

The other financial assets include mainly transfers for execution, guarantees under assignment agreements and letters of credit and estimate accruals.

The fair value of these items coincided with or is close to their carrying (amortised) amount as far as they are of short-term nature.

The Group classifies *other financial liabilities* at Level 3 of the fair value hierarchy.

The table below presents the carrying amounts and fair values of the Group's financial instruments, including their fair value hierarchy levels.

As at 31.12.2017		Carrying amount					Fair value			
	Note	Held-to-maturity	Loans and receivables	Available-for-sale	Other	Total	Level 1	Level 2	Level 3	Total
		BGN '000	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000
Financial assets measured at fair value										
Available-for-sale securities	16	-	-	37,753	-	**37,753**	37,753	-	-	**37,753**
Total		**-**	**-**	**37,753**	**-**	**37,753**	**37,753**	**-**	**-**	**37,753**
Financial assets not measured at fair value										
Cash and balances with the Central Bank	13	-	155,620	-	-	**155,620**	17,692	137,928	-	**155,620**
Due from banks	14	-	38,486	-	-	**38,486**	-	38,486	-	**38,486**
Loans and advances to customers	15	-	387,288	-	-	**387,288**	-	-	392,236	**392,236**
Held-to-maturity securities	17	80,641	-	-	-	**80,641**	84,954	-	-	**84,954**
Other financial assets	22	-	720			**720**	-	-	720	**720**
Total		**80,641**	**582,114**	**-**	**-**	**662,755**	**102,646**	**176,414**	**392,956**	**672,016**
Financial liabilities not measured at fair value										
Due to banks	23	-	-	-	9,036	9,036	-	9,036	-	**9,036**
Due to customers	24	-	-	-	635,850	635,850	-	637,698	-	**637,698**
Other financial liabilities	27	-	-	-	3,885	3,885	-	-	3,885	**3,885**
Total		**-**	**-**	**-**	**648,771**	**648,771**	**-**	**646,734**	**3,885**	**650,619**

31 December 2016		Carrying amount					Fair value			
	Note	Held-to-maturity	Loans and receivables	Available-for-sale	Other	Total	Level 1	Level 2	Level 3	Total
		BGN '000	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000
Financial assets measured at fair value										
Available-for-sale securities	16	-	-	40,871	-	**40,871**	40,871	-	-	**40,871**
Total		**-**	**-**	**40,871**	**-**	**40,871**	**40,871**	**-**	**-**	**40,871**
Financial assets not measured at fair value										
Cash and balances with the Central Bank	13	-	132,492	-	-	**132,492**	17,267	115,225	-	**132,492**
Due from banks	14	-	45,966	-	-	**45,966**	-	45,966	-	**45,966**
Loans and advances to customers	15	-	358,393	-	-	**358,393**	-	-	361,394	**361,394**
Held-to-maturity securities	17	96,871	-	-	-	**96,871**	102,026	-	-	**102,026**
Other financial assets	22	-	761			**761**	-	-	761	**761**
Total		**96,871**	**537,612**	**-**	**-**	**634,483**	**119,293**	**161,191**	**362,155**	**642,639**
Financial liabilities not measured at fair value										
Due to banks	23	-	-	-	10,991	**10,991**	-	10,991	-	**10,991**
Due to customers	24	-	-	-	620,133	**620,133**	-	620,101	-	**620,101**
Other financial liabilities	27	-	-	-	1,485	**1,485**	-	-	1,485	**1,485**
Total		**-**	**-**	**-**	**632,609**	**632,609**	**-**	**631,092**	**1,485**	**632,577**

2.24.2.2. Measurement of the fair value of non-financial instruments

(a) Fair value of assets held for sale

The Group determines the fair value of assets held for sale based on the estimated selling price of the respective assets for which there is high level of certainty that they will be realised in the short-term (up to 1 year). Assets held for sale are designated at Level 3 in the fair value hierarchy.

(b) Fair value of investment property

The fair value of investment property is calculated with the assistance of external, independent licensed valuers. It is designated at Level 3 based on the inputs to the valuation technique used. The fair value determined is the sum of the weighted average values derived as a result of the application of different valuation methods. The following valuation techniques and methods have been used: market approach, income approach and cost approach. The significant unobservable inputs in determining the fair values of investment properties include: costs to manage the property, determined as a percentage of the gross annual income from the property; rate of return for the revenue generated by the property; adjusting coefficients in relation to market benchmark transactions.

The table below present the carrying amounts and fair values of the Group's non-financial assets, designated at Level 3 of the fair value hierarchy:

Non-financial assets	**Note**	**Carrying amount**	**Fair value**	**Carrying amount**	**Fair value**
			Level 3		**Level 3**
		31.12.2017	**31.12.2017**	**31.12.2016**	**31.12.2016**
		BGN '000	**BGN '000**	**BGN '000**	**BGN '000**
Investment property	18	13,001	18,052	15,475	16,719
Total		13,001	18,052	15,475	16,719

2.24.3. Actuarial calculations

Actuary-type calculations based on assumptions related to mortality, personnel turnover rate, future salary levels and discount factor, which the management has accepted as reasonable and adequate to the Bank, have been used to determine the present value of long-term retirement benefit obligations to personnel *(Note 27)*.

2.25. Custodial services

The parent (the Bank) performs safekeeping on clients' behalf in its capacity as investment intermediary. Such assets are not recognised in the consolidated statement of financial position, since they do not constitute Group's assets.

2.26. Potential impact of the adoption of the new IFRS 9 Financial Instruments

The Group adopted the new standard as of its effective date – 1 January 2018, and has chosen the modified retrospective method, without restating comparatives for 2017.

Throughout 2017, the Group, through the parent, continued work on the special project for IFRS 9 adoption, which commenced as early as 2016. Preliminary analysis was carried out of the expected effect of the application of IFRS 9 in its three main aspects, namely: classification and measurement, impairment, and hedging. The evaluation was based on information available by the end of 2017, but work on the project is still being finalized, as results are subjected to critical review, recalculations and checking of calculations and key assumptions. Therefore, it is possible that after the project is finalized the end evaluation of effects may be different.

In 2017, in relation to the project for adoption of the new IFRS 9, the Group carried out the following activities:

<u>*Classification and measurement*</u>

The Bank has developed a new document, "*Policy for classification and measurement of financial instruments*", in accordance with the requirements and guidance of IFRS 9. The policy constitutes a framework for:

a. establishing internal business model for financial asset management;

The Group evaluates the business models applied at the level of groups of assets which are managed in the same way in order to achieve the specific business objectives set, share common risk characteristics, and their performance is monitored by management collectively, on a portfolio basis. The business model evaluation is based on forecast scenarios and reflects management's expectation for the realisation of cash flows from financial assets managed in the respective business model. The policy envisages performing subsequent tests with regards to the presentation of the initially this defined business models, and in case of need, adequate changes are permitted in subsequent periods.

b. analysis and assessment of the characteristics of contractual cash flows of the financial instruments;

Determining the characteristics of contractual cash flows is the second factor that determines the classification and measurement of financial assets. The analysis is performed at the level of financial instruments and aims to establish to what extent contractual cash flows represent solely the payment of principal and interest outstanding for the instrument's term. For standardised products, the analysis is done at a portfolio level. The process of analysis is designated as the so-called "cash flows test – SPPI" (solely payment of principal and interest). In basic loan agreements, the most important elements that determine the interest rate, are consideration for the value of money over time and for the credit risk, but the interest may also comprise consideration to cover other basic risks related to holding a financial asset for a given period. In the analysis, the Group companies also apply specific judgements and consider different relevant factors, such as the payment currency, the period of interest determination and payment, etc.

c. *defining criteria for initial classification and subsequent measurement.*

As a result from the preliminary analysis during the project implementation, the Group concluded that the adoption of IFRS 9 would not result in material changes and transfers with respect to the classification, and respectively – the measurement of financial instruments, as compared to the policy applied so far.

Financial assets which are currently classified in groups measured at fair value, will preserve this classification following the adoption of IFRS 9, and:

- The Group has no financial assets currently classified, stated and measured "at fair value through profit or loss";
- Debt instruments currently classified as "available-for-sale" will be reclassified and measured within the Group "at fair value through other comprehensive income" (FVOCI), since they are expected to be held both to generate cash flows, and for sale, in order to provide current liquidity.
- For equity instruments classified and stated as "available-for-sale" financial assets, the Group intends to select the option of statement at FVOCI upon the standard's adoption.

The Group manages loans and advances from customers in a business model with the purpose of collecting contractual cash flows. For the purpose of adoption of IFRS 9, the project included an analysis of the contractual characteristics of the different credit products and agreements. The conclusion is that loans and other due from customers qualify for measurement at amortised cost, therefore, no reclassification is necessary upon the adoption of IFRS 9. Analogous conclusions were reached with respect to due from banks and debt instruments measured at amortised cost.

<u>*Impairment*</u>

For the purpose of applying the requirements and rules for impairment of financial assets in accordance with the new IFRS 9, a new document has been developed, "*Policy for impairment of changes in credit quality, determining expected credit losses in accordance with IFRS 9 and categorisation of risk exposures in accordance with Regulation (EU) No 575/2013.*" The policy constitutes a framework for determining:

a. *expected credit losses for 12 months or for the lifetime of the financial instrument;*

Expected credit losses (ECL) are recognised based on the probability of default throughout the lifetime of the financial instrument, unless there is a significant change in the credit risk after the initial recognition – in this case, expected credit losses are stated for a 12-month period. 12-month expected credit losses represent the portion of the total credit losses for the instrument's lifetime that result from default that may occur within 12 months from the reporting date.

b. *Approach and models for impairment of financial assets – on a collective and individual basis;*

The parameters that influence the amount of expected credit losses (ECL) are determined on a collective or individual basis, depending on the type and nature of the respective financial instruments. The Group's companies determine ECL on an individual basis for all instruments whose risk classification is Stage 3 under IFRS 9, for investments in debt securities, for exposures to banks as short-term receivables from banks, funds blocked as collaterals in repurchase transactions, and others similar to them. Collective determination is applied for expected credit losses from loans grouped in portfolios based on common product characteristics. The main parameters that are considered in the judgement made to form "homogeneous" portfolios are:

- comparability of product and/or risk parameters;
- internal client segmentation based on the requested funding and the generated annual sales revenue;
- repayment method and collateral type;
- amount of total exposure of a client;

The portfolio approach is also applied for exposures whose risk classification falls into Stage 1 or Stage 2.

c. *criteria for assessing increased credit risk;*

For the purpose of determining impairment losses, the Group compares credit risk levels and their change at the end of the respective reporting period, i.e. the probability of default as at the date of the financial statement and as at the date of the asset's initial recognition. In the case of loan commitments, the judgement refers to the probability of loan default, and in the case of financial guarantees – to the probability of contractual default by the guarantee debtor. The analysis of changes is done based on the whole available relevant information which is accessible to the Group's companies and can be justified without investing unnecessary resources. This information includes:

- historical data on the performance and behaviour of certain financial instruments or other financial instruments with similar risk characteristics;
- data about the current performance and behaviour of the instruments under review – number of days past due;
- justified presumptions and assumptions which are expected to have a future impact on the credit risk of the assets under review.

d. risk classification based on financial assets' credit quality;

The analysis of changes in the credit quality of financial assets as compared to their initial recognition determines their risk classification in three main stages, as well as subsequent recognition of their impairment:

- *Stage 1 (performing exposures)* – allocation of financial assets without indications for increase in the credit risk as compared to the initial evaluation. The Group recognises 12-month ECL for all financial assets classified in Stage 1. Interest revenue is recognised based on the effective interest rate on the gross carrying amount of the instrument;
- *Stage 2 (underperforming exposures)* – allocation of financial assets with increased credit risk, but without objective evidence of impairment as grounds for incurring losses (there is no exposure default). The Group recognises lifetime ELC in case of Stage 2 classification. Interest revenue is recognised based on the effective interest rate on the gross carrying amount of the instrument;
- *Stage 3 (credit-impaired exposures)* – allocation of financial assets with increased credit risk and objective evidence of impairment (exposures for which default exists). The Group recognises lifetime ELC in case of Stage 3 classification. Interest revenue is recognised based on the effective interest rate on the instrument's amortised cost, i.e. net of credit allowance.

e. determining and modelling risk parameters;

The main risk parameters that affect the ECL amount are:

- *Probability of Default (PD),* which is the likelihood that counterparty will be unable to meet its debt obligations. For each portfolio in the case of collectively evaluated exposures, the Group's companies maintain historical information on the migration of exposures from Stage1/Stage 2 to Stage 3 (default).

The 12M PD value is first determined based on the observed rates of underperformance and is calculated as moving average for a period comprising at least 3 years. Moreover, the Group's companies make adjustments to the 12M PD historical values thus calculated in order to account for current or expected economic conditions that may differ from those in the analysed historical periods. The macroeconomic indicators used by the Group include: gross domestic product (GDP), unemployment rate, harmonized consumer price index, house price index, income per capita.

- *Exposure at default (EAD)* represents the potential amount of the exposure as at the time of default. The Exposure at Default amount is determined depending of the type of loan, taking into consideration the loan amount and the contracted unabsorbed amounts as per the expected absorption rate.

- *Loss Given Default (LGD)*– the ratio between the loss from exposure due to the counterpart's default, and the amount of the exposure at default.

To determine the LGD parameter, the Group's companies calculate the potential loss that would occur is a given exposure is defaulted and the only source of collection of the receivable would be the collateral realisation. For Stages 1 and 2, the average LGD amount is calculated based on a 3-year period for credit exposures. For Stage 3, LGD is calculated as the difference between the exposure at default (EAD) and the realisable amount of the collateral and is presented as a percentage of EAD. The LGD parameter is determined separately for each exposure in Stage 3 in the credit portfolio, depending on the collateral and on whether the probability of default evaluation is done on an individual or collective basis.

f. methods for the calculation and presentation of expected credit losses by types of financial assets

The estimate of expected credit losses is an average value weighted by the probability of default through the lifetime of a specific instrument by assessing the scope of possible outcomes. Credit losses represent the present value of the difference between the cash flows due under the contract and the cash flows that the Group's companies expect to receive, by taking into consideration the amounts and the time of their expected receipt. Upon assessing future cash flows, the Group's companies also take into consideration the flows from collateral realisation and other loan facilities stated in the contract. In order to determine expected credit losses, the difference between contractual and expected cash flows with discounted with the initial effective interest rate of the transaction or the credit loss-impaired effective interest rate for purchase or originated credit-impaired financial assets. The financial assets impairment losses are recognised within profit and loss, accordingly – in the impairment allowance, and:

- For financial assets stated at amortised cost, the accumulated allowance is deducted from the instrument's carrying amount in the consolidated statement of financial position.
- For debt instruments stated at fair value through other comprehensive income, the expected credit loss constitutes a portion of the negative change in fair value, due to increased credit risk. These assets are still stated at fair value in the consolidated statement of financial position; the accumulated allowance is not deducted from the instrument's carrying amount, but is recognised in the consolidated other comprehensive income as remeasurement allowance for the respective instrument. Upon subsequent write-off of the instrument, the accumulated remeasurement reserve, adjusted for the allowance amount, is recognised in the consolidated profit or loss for the respective period.

IFRS 9 requires that with respect to all financial assets stated at amortised cost or at fair value through other comprehensive income, including financial guarantees and undrawn loan commitments, the Group should recognise expected credit losses for 12 months for the instrument's lifetime depending on the change in the credit risk as compared to the asset's initial recognition.

Equity instruments are not subject to independent testing for credit impairment under the new IFRS 9. This is a significant change in the model of assessing credit losses. The Group does not expect this to have a material effect upon the standard's adoption.

The estimated initial effect, calculated as at 31 December 2017, on the Group's consolidated statement of financial position and equity, is summarised in the table below:

	01.01.2018
	BGN'000
Due from banks	(8)
Loans and advances to customers	(1,158)
Investments in debt instruments at amortised cost	-
Effect on *Total assets*	**(1,166)**
Provisions	-
Effect on *Total liabilities*	-
Retained earnings	(1,244)
Impairment loss allowance for financial assets at fair value through other comprehensive income	78
Effect on *Total equity and liabilities*	**(1,166)**

Hedging

The Group does not recognise active financial instruments for which a hedge relation has been found to exist; therefore, the first-time adoption of the hedge requirements under IFRS 9 will not impact the indicators in its financial statements.

3. RISK MANAGEMENT POLICY DISCLOSURES

In the ordinary course of its business activities, the Group is exposed to a variety of financial risks the most important of which are credit risk, market risk (including interest rate and currency risk) and liquidity risk. The general risk management is focused on the difficulty to forecast financial markets and to minimise the potential adverse effects that might affect the financial performance and position of the Bank and the Group companies. Financial risks are currently identified, measured and monitored through various control mechanisms introduced in order to establish adequate prices for the bank services and types of products and funds borrowed thereby, as well as to assess adequately the market circumstances of its investments and the forms for maintenance of free liquid funds through preventing undue risk concentration. The Group manages its business transactions according to the type of risk involved and on the basis of the different categories of trading instruments held.

Risk management structure

The main units which are directly responsible for risk management in the Group are located in the Bank (the Parent) and are as follows:

Supervisory Board – performs overall supervision of risk management as well as the functions of a Risk Committee;

Management Board – responsible for the overall risk management approach and for approving risk management strategies and principles;

Assets and Liability Management Committee – analyses the current position of the Bank's assets and liabilities, monitors the risks related to the Bank's liquidity management and the financial instruments market and proposes specific measures in case of variance from the set limits;

Credit Committee and Provisional Council – current analysis of credit transactions from the perspective of credit risk management, mainly of the Bank;

Risk Events Assessment Committee – takes decisions for the ultimate registration of occurred events, makes assessment of the losses, analyses registered data, mainly of the Bank;

Executive Directors of the Bank and the subsidiaries exercise operating control over all banking and respectively other business transactions with a view to comply and maintain currently the set limits for the particular types of risks;

The Central Bank exercises additional supervision on the risk management in the Bank (the parent) by requesting periodic reports and subsequent control on the observance of the regulatory set maximum exposure levels to particular types of risks.

Measurement and management of major risks

The management of the parent (the Bank) has approved various internal rules and methodologies for risk measurement based on statistical models or historical experience.

Control over and management of the risks is structured mainly on the basis of limits set by type of operation. These limits reflect the Bank's strategy and its market position, as well as the level of the specific risk that the Bank defines as being acceptance for its operations.

Reports on the specific types of risks are prepared periodically for the purposes of subsequent analysis and possible adjustment of already set limits by individual types of transactions and deals.

3.1. Credit risk

Credit risk is the risk that the customers / counterparties will fail to pay to the Group, and particularly – to the Bank (the parent) any amounts due in full and in due time.

The management of the specific credit risk in the Bank is performed by the Provisional Council of the Bank and is supervised by the Management Board. The credit risk management function ensures that appropriate policies are established and the compliance of these policies with the related current monitoring procedures and controls for each type of credit exposure. At the subsidiary D Leasing EAD this function is performed by the Impairment Committee and is supervised by the Board of Directors of the company.

Loans and receivables

Exposure to credit risk portfolio in the Bank is managed through regular analysis of the borrower's ability to meet their principal and interest repayment obligations and through the mechanisms of establishing appropriate lending limits. Credit risk is reduced in part by obtaining different types of collateral.

The monitoring process and review of the quality of the loan portfolio is defined in the periodic (quarterly) monitoring guidelines of the Bank. Such monitoring is aimed at establishing whether there are changes in the business and status of business customers and the extent to which the requirements set upon the approval of the transaction are complied with. The review of the quality of the loan portfolio is performed on a monthly basis. If any breaches in the contractual payments are found additional information is required and the reasons resulting in the delay are analysed. The Bank's customers are classified in four internal risk groups – standard, watch, non-performing and loss. Impairment losses are assessed based on reports obtained by the business units in the portfolios of which the transactions with the customers are managed and the monthly loan portfolio impairment is determined in accordance with methodology for definition of the estimated loss on the expected cash flows and definition of a percentage for collective impairment on portfolio basis. Additional criteria applied by the Bank in determining the impairment on an individual basis are regulated using three key categories: (a) delays of the customer / the Group companies in the Bank; (b) financial position of the customer / the Group companies in the Bank and (c) legal action against the customer.

Renegotiated loans are loans that have been renegotiated at the request and initiative of the customer and are usually due to changes resulting from movements in the prevailing market conditions. They may include changes of the terms and conditions of the loan, without any concessions that the Bank otherwise would not offer and which are not due to deterioration of the financial position of the borrower. The management monitors renegotiated loans on a continuous basis in order to ensure that all criteria have been met and that it is probable that future payments would not fall past due. The loans continue to be subject to individual or collective impairment. After the renegotiation of the terms and conditions any impairment is calculated using the original effective interest rate as calculated before the changes in the terms and conditions. Following renegotiation the loans are classified in the classification risk group to which they were allocated before the renegotiation.

An exposure is considered restructured when the Bank makes a concession in favour of a debtor suffering or about to suffer difficulties in discharging their financial obligations. A concession by the Bank involves one of the following: (a) changes in the previously set terms and conditions of the agreement for which it is believed that the borrower will fail to discharge due to the financial difficulties resulting in failure to service the debt; (b) partial or full refinancing of the problematic debt agreement; (c) making such changes in the previously set terms and conditions of the agreement so as that the amended terms and conditions are in favour of the borrower and that they are more favourable as compared to those other borrowers of the Bank having similar risk profile would be offered at that time; and d) an amendment involving repayment through taking over of collateral.

Restructured loans are subject to individual or collective impairment. The original effective interest rate on the loan is used for the purpose of calculation of the individual impairment. After the restructuring these loans are taken to the classification risk group to which they were allocated before the restructuring.

A loan ceases to be classified as restructured when all of the conditions listed below are met: (a) the contract is serviced, including when it was reclassified from non-performing but indications already exist that it should not be considered non-performing; (b) the minimum two-year probation period as of the date on which a restructured exposure is believed to be serviced has expired; and (c) at least during half of the probation period regular payments of amounts that are not insignificant have been made.

The Group companies, mainly the parent, try to use collateral as a form of reduction and management of the risks associated with the financial assets. Collateral may be in the form of cash, securities, letters of credit, guarantees, real estate, receivables, inventories, other non-financial assets. Collateral is initially measured at fair value – upon the signing of the agreement and subsequently their valuation is updated – on a revolving principle. To the extent possible the Group uses market data to measure financial assets held as collateral. Other financial assets the market value of which cannot be determined are measured using models. Non-financial collateral, such as real estate, is recognised based on the valuations provided by independent appraisers.

Loan commitments

The primary purpose of instruments in the form of guarantees and letters of credit of the Bank is to ensure that funds are available to the customer as required. Guarantees and letters of credit which represent irrevocable commitments that the Bank will make payments in the events that a customer cannot meets its obligations to a third party, carry the same credit risk as loans. Documentary and commercial letters of credit, which are written undertaking by the Bank on behalf of a customer, authorise a third party to draw drafts on the Bank up to a stipulated amount by observing specific terms and conditions. They are secured by a definite quantity of goods and therefore carry less risk than a direct borrowing.

The undrawn portions of authorised credit agreements in the form of loans, guarantees or letters of credit represent commitments of the Bank. With respect to credit risk the Group is potentially exposed to loss in an amount equal to the total undrawn commitments. However, the likely amount of the loss is less than the total unused commitments since most of these types of commitments require the customer to maintain specific credit standards. The Group monitors on a current basis the utilisation of the loan as longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Debt securities

The Group uses ratings assigned by external credit rating agencies such as Standard&Poor's, Moody's, Fitch to manage the risk of its debt security exposures. In the absence of official ratings the Bank uses a methodology for assessment of the financial position of counterparty banks. This methodology is based on the assessment criteria used in the CAMELOS model and summary and analysis of a minimum set of data for the assessed bank.

Maximum exposure to credit risk

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

Financial assets	**31.12.2017**	**31.12.2016**
	BGN '000	**BGN '000**
Cash and balances with the Central Bank	155,621	132,492
Due from banks	38,486	45,966
Loans and advances to customers	387,288	358,393
Held-to-maturity securities	80,641	96,871
Available-for-sale securities	37,753	40,871
Other financial assets	720	761
Total financial assets	**700,509**	**675,354**

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

	31.12.2017	**31.12.2016**
	BGN '000	**BGN '000**
Bank guarantees and letters of credit	47,341	51,857
Undrawn amount of authorised loans	48,388	49,926
	95,729	**101,783**
Maximum credit risk	**796,238**	**777,137**

At 31 December the maximum exposure to credit risk, the coverage of the maximum credit exposure with the collateral accepted by the Group, measured at fair value and the net exposure to credit risk by type of financial assets are presented below:

31.12.2017	**Maximum exposure to credit risk**	**Coverage of the maximum credit exposure with the collateral accepted by the Bank measured at fair value**				**Net exposure to credit risk**
		Cash	*Real estate*	*Other acceptable collateral*	*Total acceptable collateral*	
	BGN'000	*BGN'000*	*BGN'000*	*BGN'000*	*BGN'000*	*BGN'000*
Cash and balances with the Central Bank	155,620	-	-	-	-	155,620
Due from banks	38,486	-	-	-	-	38,486
Loans and advances to customers	387,288	4,471	266,594	7,619	278,684	108,604
Available-for-sale securities	37,753	-	-	-	-	37,753
Held-to-maturity securities	80,641	-	-	-	-	80,641
Other financial liabilities	720	-	-	-	-	720
Total	**700,509**	**4,471**	**266,594**	**7,619**	**278,684**	**421,825**

31.12.2016	**Maximum exposure to credit risk**	**Coverage of the maximum credit exposure with the collateral accepted by the Bank measured at fair value**				**Net exposure to credit risk**
		Cash	*Real estate*	*Other acceptable collateral*	*Total acceptable collateral*	
	BGN'000	*BGN'000*	*BGN'000*	*BGN'000*	*BGN'000*	*BGN'000*
Cash and balances with the Central Bank	132,492	-	-	-	-	132,492
Due from banks	45,966	-	-	-	-	45,966
Loans and advances to customers	358,393	6,000	242,956	16,828	265,784	92,609
Available-for-sale securities	40,871	-	-	-	-	40,871
Held-to-maturity securities	96,871	-	-	-	-	96,871
Other financial assets	761	-	-	-	-	761
Total	**675,354**	**6,000**	**242,956**	**16,828**	**265,784**	**409,570**

Collateral

The Group, mainly the Bank, accepts as collateral various types of real estate such as residential, commercial and administrative, hotels and other estate, and in some cases production buildings, vacant land or agricultural land. The value of the mortgaged property in most cases fully covers the loan amount. The accepted collaterals are initially measured at their current liquidation value, which is determined by independent, certified appraisers in accordance with a list approved by the Bank's management, or by the Bank's internal appraisers. In the course of periodic reviews of the loan status the accepted collateral is revalued following the same procedure.

Other collateral includes pledges over movable property, surety and promissory notes. The Bank requires 100% coverage when the collateral is surety or promissory note, while pledges over movable property are accepted as a supplement to the main collateral.

The table below presents the fair value of all ***types of collateral*** held by the Group as at 31 December 2017 and 31 December 2016:

	Loans and advances to customers	
	31.12.2017	**31.12.2016**
	BGN '000	**BGN '000**
Against loans provisioned individually and on a portfolio basis:		
Mortgages of real estate	216,439	112,493
Cash deposits	5,400	2,717
Other collateral	1,685,675	348,923
	1,907,514	**464,133**
Against past due but unprovisioned loans:		
Mortgages of real estate	22,686	57,521
Cash deposits	623	752
Other collateral	132,653	191,125
	155,962	**249,398**
Against neither past due, nor provisioned loans:		
Mortgages of real estate	54,483	402,095
Cash deposits	1,964	6,385
Other collateral	900,699	1,255,355
	957,146	**1,663,835**

Loans and receivables

Due from banks

The table below presents amounts due from banks as at 31 December 2017 and 31 December 2016 based on Moody's ratings.

	31.12.2017	**31.12.2016**
	BGN'000	**BGN'000**
Aa1 to A3	12,767	8,278
Baa1 to Ba3	108	374
Without rating	25,611	37,314
	38,486	**45,966**

In accordance with Regulation (EU) No 575/2013 of the European Parliament and of the Council, dated 26 June 2013, exposures to bank institutions for which a credit assessment by a nominated External Credit Assessment Institution (ECAI) is not available shall be assigned the credit quality of the respective central government of the jurisdiction – in this case being Republic of Bulgaria with a credit rating Baa2.

Loans and advances to customers

The table below provides information on the carrying amount of loans and advances granted, the coverage of the maximum loan exposure by the collateral accepted by the Group measured at fair value and the net exposure to credit risk as at 31 December allocated to the internal risk groups of the Group companies:

31.12.2017	Carrying amount	Coverage of the maximum credit exposure with the collateral accepted by the Bank measured at fair value				Net exposure to credit risk
		Cash	*Real estate*	*Other acceptable collateral*	*Total acceptable collateral*	
	BGN'000	BGN'000	BGN'000	BGN'000	BGN'000	BGN'000
Standard exposures	358,621	3,787	239,941	6,931	250,659	107,962
Watch exposures	4,305	633	2,967	100	3,700	605
Non-performing exposures	7,200	-	7,012	150	7,162	38
Loss	17,162	50	16,673	439	17,162	-
	387,288	**4,470**	**266,593**	**7,620**	**278,683**	**108,605**
including:						
Exposures to companies	*330,258*	*3,670*	*231,483*	*7,489*	*242,642*	*87,616*
Exposures to individuals	*57,030*	*800*	*35,110*	*131*	*36,041*	*20,989*

31.12.2016	Carrying amount	Coverage of the maximum credit exposure with the collateral accepted by the Bank measured at fair value				Net exposure to credit risk
		Cash	*Real estate*	*Other acceptable collateral*	*Total acceptable collateral*	
	BGN'000	BGN'000	BGN'000	BGN'000	BGN'000	BGN'000
Standard exposures	319,822	5,961	206,121	16,117	228,199	91,623
Watch exposures	6,871	30	5,495	387	5,912	959
Non-performing exposures	11,865	-	11,833	5	11,838	27
Loss	19,835	9	19,507	319	19,835	-
	358,393	**6,000**	**242,956**	**16,828**	**265,784**	**92,609**
including:						
Exposures to companies	*312,535*	*5,103*	*216,584*	*16,828*	*238,515*	*74,020*
Exposures to individuals	*45,858*	*897*	*26,372*	-	*27,269*	*18,589*

Credit exposures to companies

The credit exposures to companies are subject to individual credit appraisal and impairment testing. The creditworthiness of a company tends to be the most relevant indicator of credit quality of a loan exposure to it. However, collateral provides additional security and the Group requires from its customers to provide it. The Group, mainly the Bank, accepts collaterals in the form of first ranking mortgage of real estate, rights over all of their assets, as well as other guarantees and titles.

The Group periodically analyses the collateral provided in terms of possible changes in their value due to alteration in the market conditions, regulatory framework or because of subsequent disposal arrangements of the borrower with respect to the collateral. If these valuation changes lead to breach in the requirements as to the sufficiency of the collateral, the Group companies require extra collateral security in a certain period of time.

The Group considers all individual cases and assesses the risks related to the options for renegotiation of the original terms and conditions of concluded agreements upon request by the counterparty. With respect to the Bank these terms and conditions are usually related to: extension of the terms for utilisation of loans because of non-compliance with the schedules of the construction works or the investment project, increase / decrease in the authorised loan amount, interest rates, especially with regard to loans with floating interest rate or the repayment schedules in view of the amounts of specific repayment instalments and individual maturities, and in certain cases – changes in the accepted collateral.

Credit exposures to individuals

Residential mortgage lending

The table below presents credit exposures from mortgage loans to customers – individuals – by range of the loan-to-value (LTV) ratio. LTV is calculated as the ratio of the gross amount of the loan to the value of the collateral. The gross amount does not include any impairment allowances. The valuation of the collateral excludes future costs to acquire and sell the collateral. The value of the collateral for residential mortgage loans is based on the collateral value at the origination of the loan, updated based on assessment of residential property changes.

	31.12.2017 **BGN '000**	**31.12.2016** **BGN '000**
Loan-to-value (LTV) ratio		
Less than 50%	4,226	3,203
Over 50% to 70%	7,306	6,114
Over 70% to 90%	13,884	9,543
Over 90% to 100%	2,537	1,582
Over 100%	318	318
Total	**28,271**	**20,760**

Internal risk groups of loans and advances to customers

The table below presents information about the gross and carrying amount of loans and advances to customers and the impairment charged as at 31 December, allocated by internal risk group of the Group and default:

31.12.2017	Not past due and not provisioned	Provisioned on an individual basis	Provisioned on a portfolio basis	Past due but not provisioned	Total
	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000
Standard exposures	108,208	89	249,791	3,314	361,402
Watch exposures	743	620	-	3,066	4,429
Non-performing	3,557	133	-	3,604	7,294
Loss	331	46,692	-	6,043	53,066
Allowance for impairment	-	*(36,148)*	*(2,755)*	-	*(38,903)*
Carrying amount	**112,839**	**11,386**	**247,036**	**16,027**	**387,288**

31.12.2016	Not past due and not provisioned	Provisioned on an individual basis	Provisioned on a portfolio basis	Past due but not provisioned	Total
	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000
Standard exposures	249,223	260	59,647	11,613	320,743
Watch exposures	2,041	1,677	-	3,397	7,115
Non-performing	3,695	6,683	-	2,921	13,299
Loss	192	47,708	-	6,882	54,782
Allowance for impairment	-	*(36,631)*	*(915)*	-	*(37,546)*
Carrying amount	**255,151**	**19,697**	**58,732**	**24,813**	**358,393**

The carrying amount of *past due but not provisioned loans and advances to customers* as at 31 December, by number of days past due, is as follows:

Days past due	31.12.2017 BGN '000	31.12.2016 BGN '000
up to 30 days	4,472	12,718
30-60 days	2,087	1,249
60-90 days	2,075	1,044
90-180 days	1,630	3,737
over 180 days	5,763	6,065
Carrying amount	**16,027**	**24,813**

Debt securities

Available-for-sale securities

The table below presents the carrying amounts of available-for-sale securities grouped by rating assigned by Moody's as at 31 December 2017 and 31 December 2016:

	31.12.2017 BGN'000	**31.12.2016 BGN'000**
Aa1 to A3	1,958	3,908
Baa1 to Ba3	30,875	32,214
Without rating	4,920	4,749
	37,753	**40,871**

Held-to-maturity securities

Held-to-maturity securities at the amount of BGN 80,641thousand (31 December 2016: BGN 96,871 thousand) are with a rating Baa2 determined against the rating of the respective security published by Moody's rating agency.

Credit risk - concentration

The management of the parent company (Bank) currently monitors the credit risk of financial assets concentration both by industry sector and by individual counterparties based on approved limits. They are defined as follows:

- ✓ Total limit to bank-counterparty – determined on the basis of the official rating of the bank assigned by internationally recognised credit rating agencies. It includes limits of the following types of transactions: deposit limit, forex limit, trade / portfolio limit;
- ✓ Internal rating of the countries and bank-counterparties – determined on the basis of Methodology for Defining the Internal Credit Rating of Countries and Bank-counterparties developed by the Bank through assessment of their financial position;
- ✓ Limit for maximum exposures to a single person or economically related parties – determined with respect to credit exposures to customers – non-financial institutions within the meaning of Art. 395 of Regulation (EU) 575/2013;
- ✓ Limit by lending target industry – determined based on analysis and findings regarding the specific sectors that D Commerce Bank AD finances in accordance with its strategy (condition, perspectives, yield, development trends in the short- and long-term) and the level of classified loans for the respective target industry;
- ✓ Limits on the term –determined based on analysis and findings regarding statistical data presented by BNB on the distribution of loans by maturity, maturity structure of liabilities and the expectations of D Commerce Bank AD regarding the development of its deposit business and classified exposures;
- ✓ Limits by amount – determined based on analysis and findings regarding statistical data presented by BNB on the distribution of loans by amount, strategy of D Commerce Bank AD for the development of its market position and the level of classified exposures;
- ✓ Limits by currency – determined based on statistical data presented by BNB on the distribution of loans by currency, structure of liabilities by currency and the level of classified loans by currency.

The regulatory limits and the internal bank limits for maximum exposures of the Group companies, and mainly the parent, to a single person and economically related parties, including to banks-counterparties, are assessed and analysed periodically and are reported to the Bank's Management Board.

Loans and receivables

Loans and advances to customers

Credit risk concentration by lending target industry is presented in the table below:

	31.12.2017 BGN '000	%	31.12.2016 BGN '000	%
Trade and services	62,464	15%	61,782	16%
Individuals and households	60,746	14%	49,030	12%
Construction – buildings	59,879	14%	53,800	14%
Agricultural production and trade	58,123	13%	56,149	14%
Production	45,831	11%	47,056	12%
Tourism	44,611	10%	42,533	11%
Insurance / leases/ finance	19,415	5%	26,564	7%
Trade in fuel/energy carriers	16,179	4%	10,112	3%
Pharmacy, healthcare	12,390	3%	13,188	3%
Construction – roads, facilities, networks	12,194	3%	5,315	1%
State and local government	8,659	2%	13,335	3%
Transport and communications	3,231	1%	5,193	1%
RES – photovoltaic power plants	2,663	1%	3,260	1%
Scrap trade	101	0%	356	0%
Other	19,705	5%	8,284	2%
Total before impairment	**426,191**	100%	**395,957**	100%
Allowance for impairment	(38,903)		(37,564)	
Total	**387,288**		**358,393**	

Credit risk concentration by primary business of the customers is presented in the table below:

	31.12.2017 BGN '000	%	31.12.2016 BGN '000	%
Trade	62,452	15%	99,752	25%
Individuals and households	60,340	14%	48,904	12%
Tourism	42,854	10%	35,133	9%
Construction	38,938	9%	36,696	9%
Agriculture	37,232	9%	26,956	7%
Light industry	36,192	8%	36,294	9%
Real estate/leases	25,025	6%	30,585	8%
Services	21,238	5%	1,990	1%
Insurance/finance	18,153	4%	15,412	4%
Heavy industry	13,487	3%	8,126	2%
Culture/entertainment	12,813	3%	558	0%
Health/pharmaceutical	11,747	3%	7,803	2%
Energy	11,436	3%	7,214	2%
Public	10,649	2%	13,336	3%
Waste/wastewater	6,396	2%	7,607	2%
Transport	5,941	1%	6,111	2%
Wood/paper/packaging	3,748	1%	3,657	1%
Transport vehicles	2,863	1%	2,025	1%
Computer technologies	642	0%	697	0%
Publishing	530	0%	573	0%
Other	3,515	1%	6,510	2%
	426,191	100%	**395,939**	100%
Allowance for impairment	(38,903)		(37,546)	
Total	**387,288**		**358,393**	

The table below presents information on Bank's concentration in large credit exposures as at 31 December:

	31.12.2017		31.12.2016	
	BGN'000	% of capital	BGN'000	% of capital
The largest total credit exposure *	22,551	24,63%	21,477	23,75%
Total amount of the five largest credit exposures *	94,055	102,74%	98,034	108,42%
Total amount of all credit exposures * - over 10% of capital	140,276	26,94%	156,089	31,35%

* Including related customers – at amortised cost and off-balance sheet commitments

A big exposure is any exposure equal to or exceeding 10% of the Bank's capital, determined in accordance with Regulation 575/2013.

3.2. Market risk

Market risk is the risk of adverse movements in the level of interest rates, foreign currency exchange rates and the prices of equity instruments. These movements may affect the Group's profitability.

The Group manages the portfolios of financial instruments owned thereby considering the changing market conditions. The market risk exposure is managed in accordance with the risk limits as determined by the Bank's management through purchase and sale of financial instruments or by opening of hedging positions.

3.2.1 Interest rate risk

Banking activity within the Group leads to continuous maintenance of positions sensitive to the movement of market interest rates, which impacts its financial position and cash flow dynamics. Interest rate risk is the possibility of a potential change in the net interest income or the net interest rate margin and the market value of equity due to changes in the total market interest rate levels.

Interest rates on assets and liabilities denominated in Bulgarian Levs are usually based on the movements of the basic interest rate determined by BNB. Interest rates on assets and liabilities denominated in Euro are based on the quotations of the European Central Bank.

In case of floating rate assets and liabilities, the Group is exposed to the risk of changes in the basic interest points, which serve for the definition of interest rates, being the difference between the characteristics of floating rate indices, such as the basic interest rate, the six-month LIBOR or different types of interest. The risk management policy is aimed at optimising the net interest income and achieving market interest rate levels consistent with the Groups strategy.

Risk management procedures are related to the current maintenance of a reasonable interest margin between the applicable interest rates for borrowings and to active bank transactions and are applied in the context of the Group's sensitivity to interest rate fluctuations.

The Group monitors continuously interest rate movements in foreign currencies, the mismatch in interest rate levels and in the maturity structure of its assets and liabilities. It also monitors price changes and the yields of traded government securities. Interest rate risk is actively monitored by the Analyses, Risk Management and Liquidity Departments in order to ensure compliance with the market risk limits. Assets and Liabilities Management Committee monitors currently interest rate risk to which the Bank is exposed and takes decisions as to changes in the interest rates.

The following table summarises the Group's interest rate risk. It includes information on the carrying amount of Group's financial assets and liabilities based on the contractual interest rates and their maturity structure and sensitivity to changes in the interest rates by period.

Interest sensitivity analysis

31 December 2017	Financial assets and liabilities						
	Carrying amount	Up to 3 months	3 – 6 months	6 – 12 months	1 – 5 years	Over 5 years	Interest-free
	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000
Cash and balances with the Central Bank	155,621	-	-	-	-	-	155,621
Due from banks	38,486	38,486	-	-	-	-	-
Loans and advances to customers	387,288	356,778	6,913	13,868	4,668	5,060	-
Available-for-sale securities	37,753	25,379	2,035	-	10,198	-	141
Held-to-maturity securities	80,641	12,417	-	-	66,011	2,214	-
Other financial assets	720	-	-	-	-	-	720
Total assets	**700,509**	**433,060**	**8,948**	**13,868**	**80,877**	**7,274**	**156,482**
Due to banks	(9,036)	(9,036)	-	-	-	-	-
Due to customers	(635,850)	(432,001)	(65,037)	(106,090)	(32,722)	-	-
Other financial liabilities	(3,885)	-	-	-	-	-	(3,885)
Total liabilities	**(648,771)**	**(441,037)**	**(65,037)**	**(106,090)**	**(32,722)**	**-**	**(3,885)**
Change	**51,738**	**(7,977)**	**(56,089)**	**(92,222)**	**48,155**	**7,274**	**152,597**

31 December 2016	Financial assets and liabilities						
	Carrying amount	Up to 3 months	3 – 6 months	6 – 12 months	1 – 5 years	Over 5 years	Interest-free
	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000
Cash and balances with the Central Bank	132,492	-	-	-	-	-	132,492
Due from banks	45,966	45,966	-	-	-	-	-
Loans and advances to customers	358,393	318,750	10,105	13,299	6,710	9,529	-
Available-for-sale securities	40,871	20,843	7,294	-	12,643	-	91
Held-to-maturity securities	96,871	9,642	-	5,999	55,837	25,393	-
Other financial assets	761	-	-	-	-	-	761
Total assets	**675,354**	**399,201**	**17,399**	**19,298**	**75,190**	**34,922**	**133,344**
Due to banks	(10,991)	(10,991)	-	-	-	-	-
Due to customers	(620,133)	(474,213)	(43,148)	(78,334)	(24,438)	-	-
Other financial liabilities	(1,485)	-	-	-	-	-	(1,485)
Total liabilities	**(632,609)**	**(485,204)**	**(43,148)**	**(78,334)**	**(24,438)**	**-**	**(1,485)**
Change	**42,745**	**(86,003)**	**(25,749)**	**(59,036)**	**50,752**	**34,922**	**131,859**

Sensitivity of the financial result to changes in interest rates

The table below demonstrates the Group's sensitivity to possible changes in interest rates by 0.10 points and 0.20 points calculated on the basis of an average monthly structure of interest rate sensitive assets and liabilities maintained by the Group and under the assumption that the effects of all other variables are ignored. The effect is measured and presented as impact on the post-tax consolidated financial result and on the equity.

Interest-sensitive assets and liabilities currency	Increase / (decrease) in interest rate	Impact on post-tax financial result	Impact on equity
		2017	2017
		BGN '000	BGN '000
BGN	10 bp/(10 bp)	128/(128)	128/(128)
Other currency	10 bp/(10 bp)	194/(194)	194/(194)
BGN	20 bp/(20 bp)	256/(256)	256/(256)
Other currency	20 bp/(20 bp)	383/(383)	383/(383)

Interest-sensitive assets and liabilities currency	Increase / (decrease) in interest rate	Impact on post-tax financial result	Impact on equity
		2016	2016
		BGN '000	BGN '000
BGN	10 bp/(10 bp)	100/(100)	100/(100)
Other currency	10 bp/(10 bp)	189/(189)	189/(189)
BGN	20 bp/(20 bp)	199/(199)	199/(199)
Other currency	20 bp/(20 bp)	378/(378)	378/(378)

3.2.2. Currency and price risk

Foreign currency risk

Currency risk is the risk of impact of fluctuations in the prevailing foreign currency exchange rates on the Group's financial position and cash flows as a result of open foreign currency positions. The net exposure in each currency is constantly monitored by the Bank's management and the Financial Markets and Investments Directorate, as well as the members of the Assets and Liabilities Management Committee.

The Group is exposed to currency risk when performing transactions in financial instruments denominated in foreign currency. After the introduction of the Currency Board in the Republic of Bulgaria the Bulgarian Lev is pegged to the Euro. Therefore, there is no open currency risk related thereto and only movements of the exchange rate of the Bulgarian Lev to currencies outside the Eurozone affect the figures in the consolidated financial statements.

Foreign currency risk is the risk of adverse impact of fluctuations in the prevailing foreign currency exchange rates on the Group's financial position and cash flows. The Group's policy is to keep the major portion of its assets and liabilities denominated in Euro or Bulgarian levs. In addition, the Group does not perform significant operations and does not hold open positions in currencies other than the Euro.

Financial Markets and Investments Directorate at the Parent manages the Bank's assets and liabilities within the determined limits in order to achieve the set objectives and indicators for return on investments. The amount of the open currency position of the Bank by currency is monitored on a daily basis and the necessary measures are undertaken to minimise the potential losses for the Bank due to changes in the exchange rates. Analyses show that the Group is exposed to minimum currency risk because it maintains limited daily open exposures of the different types of currencies other than the Euro, which has a fixed exchange rate to the Bulgarian Lev.

The table below summarises the Group's exposure to foreign currency risk. It includes financial instruments and contingent liabilities and commitments of the Group at carrying amount, categorised by currency.

31 December 2017	In USD	In EUR	In BGN	In other currency	Total
Financial assets	**BGN'000**	**BGN'000**	**BGN'000**	**BGN'000**	**BGN'000**
Cash and balances with the Central Bank	1,209	23,416	130,611	385	**155,621**
Due from banks	13,413	22,013	1,901	1,159	**38,486**
Loans and advances to customers	4,961	216,731	165,596	-	**387,288**
Available-for-sale securities	-	31,437	6,316	-	**37,753**
Held-to-maturity securities	-	35,599	45,042	-	**80,641**
Other financial assets	245	166	309	-	**720**
Total financial assets	**19,828**	**329,362**	**349,775**	**1,544**	**700,509**
Financial liabilities					
Due to banks	-	-	9,036	-	**9,036**
Due to customers	19,307	206,943	408,152	1,448	**635,850**
Other financial liabilities	1,125	1,370	1,363	27	**3,885**
Total financial liabilities	**20,432**	**208,313**	**418,551**	**1,475**	**648,771**
Net balance sheet currency position	**(604)**	**121,049**	**(68,776)**	**69**	**51,738**
Off-balance sheet currency position	**628**	**(122)**	**-**	**(66)**	**440**
Open foreign currency position	**24**	**-**	**-**	**3**	**27**
Contingent liabilities and commitments	**5**	**33,628**	**62,096**	**-**	**95,729**

31 December 2016	In USD	In EUR	In BGN	In other currency	Total
Financial assets	**BGN'000**	**BGN'000**	**BGN'000**	**BGN'000**	**BGN'000**
Cash and balances with the Central Bank	1,051	13,132	117,950	359	**132,492**
Due from banks	28,292	15,992	492	1,190	**45,966**
Loans and advances to customers	6,334	208,476	143,583	-	**358,393**
Available-for-sale securities	-	34,570	6,301	-	**40,871**
Held-to-maturity securities	-	41,826	55,045	-	**96,871**
Other financial assets	278	142	341	-	**761**
Total financial assets	**35,955**	**314,138**	**323,712**	**1,549**	**675,354**
Financial liabilities					
Due to banks	-	-	10,991	-	**10,991**
Due to customers	45,702	194,964	377,930	1,537	**620,133**
Other financial liabilities	43	349	1,092	1	**1,485**
Total financial liabilities	**47,745**	**195,313**	**390,013**	**1,538**	**632,609**
Net balance sheet currency position	**(9,790)**	**118,825**	**(66,301)**	**11**	**42,745**
Off-balance sheet currency position	**10,036**	**(1,046)**	**-**	**-**	**8,990**
Open foreign currency position	**246**	**-**	**-**	**11**	**257**
Contingent liabilities and commitments	**18**	**31,982**	**69,783**	**-**	**101,783**

With respect to monetary assets and liabilities denominated in a foreign currency, which are not hedged, the Group maintains an acceptable net exposure by purchasing and selling foreign currency at spot rates, where appropriate.

Foreign currency sensitivity analysis

Foreign currency sensitivity is determined from the fluctuations in the exchange rates of the currencies in which the Group companies maintain open positions. As at the date of the financial statements this is mainly the US Dollar. The analysis of the Group's sensitivity to the fluctuations in the exchange rates is based on the condition and structure of the consolidated foreign currency assets and liabilities and the open foreign currency position as at 31 December. The effect of foreign currency sensitivity in case of 10 % increase/decrease in the current exchange rates of the Bulgarian Lev to the US Dollar and the other foreign currency exposures based on the structure of the foreign currency assets and liabilities as at 31 December and under the assumption that the influence of the other variables is ignored, is measured and presented as impact on the post-tax consolidated financial result and on the equity.

The influence of the US dollar and the other currencies on the (post-tax) consolidated profit of the Group in case of 10% increase in their exchange rates to the Bulgarian Lev is insignificant.

The management of the parent is of the opinion that the above analysis of the foreign currency sensitivity based on the balance sheet structure of the consolidated foreign currency assets and liabilities also reflects the foreign currency sensitivity of the Group during the year.

Securities price risk

Price risk is one of the market risks which is related to the decrease in the value of the investment as a result of adverse changes in the market prices. The main factors that influence prices are macroeconomic factors reflecting the overall position of the issuer, the political situation, the specifics of the industry sector, the expectations of the local and international markets and the market participants based both on actual information and often on subjective circumstances. The sharp decline in security prices would be unfavourable in several respects, such as occurrence of financial losses and potential deterioration of liquidity, loss of market positions. The Group manages this type of risk, mainly through the parent, by including in its portfolio different types of securities and only securities of prime issuers, of medium and high credit quality. The formal financial instrument liquidity criteria are studied upon each decision to purchase financial instruments, as well as periodically thereafter, in accordance with the internal rules of the parent.

3.3. Liquidity risk

Liquidity risk is the risk that the Group might be unable to meet its obligations as they fall due as a result of customer deposit withdrawals, cash requirements resulting from contractual commitments or other cash outflows. Such outflows would deplete cash resources available to the Group for customer lending, trading activities and investments. In extreme circumstances the lack of liquidity may result in reductions in the consolidated financial statements of financial positions and sales of assets, or potentially in the Group's inability to fulfil its lending commitments. The risk that the Group is unable to meet its obligations is inherent mainly for all banking operations and can be affected by a range of institution-specific or market-wide events, including, but not limited to credit events, systemic shocks and natural disasters.

The Group's liquidity management process is carried out under the supervision by the Financial Markets and Investments Department at the parent and includes:

- Day-to-day funding through control over the future cash flows in order to meet the resource requirements. This includes replenishment of funds as they mature or are borrowed by customers.
- Control over the liquidity ratios of the consolidated statement of financial position against internal or regulatory requirements; and
- Management of the concentration and profile of the Group's debt maturities.

Monitoring and reporting take the form of cash flow measurement and projections for the next day, week or month, as these are key periods for liquidity management. The starting points for those projections is an analysis of the contractual maturity of financial liabilities and the expected collection date of financial assets.

The Group develops appropriate policies, mainly through the parent, which ensure:

- sufficient liquid assets to meet liabilities as they arise;

- a prudent proportion of medium-term assets funded by medium-term liabilities; and
- liquidity control on a daily basis.

The Management Board of the parent designates the Assets and Liabilities Management Committee (ALMC) as the body responsible for the liquidity management.

ALMC is a permanent collective body responsible for the management of assets and liabilities, as well as the development and use of a system for managing the liquidity of D Commerce Bank AD. As the body for liquidity management it is competent to draw action plans in case of unforeseen outflows of funds due to unexpected events or unfavourable circumstances, taking into account the possible impact of alternative scenarios for the Bank or the market as a whole, as well as combination thereof. The ALMC analyses all reports on liquidity, stress tests and scenarios in a liquidity crisis in accordance with the requirements of the banking legislation and the Liquidity Management Rules. The Committee monitors the reports for the currency structure of assets and liabilities, the reports for open positions and risk structure of the securities portfolio.

Liquidity requirements to support calls under guarantees are considerably less than the amount of the commitments because the Group does not generally expect a third party to draw funds under the agreement. The total outstanding contractual amount of such commitments does not necessarily represent future cash requirements as many of these commitments will expire or will be terminated without being funded.

Financial Market and Investments Directorate at the Parent controls unmatched medium-term assets, the level and type of undrawn lending commitments, the use of overdraft facilities and the impact of off-balance sheet liabilities such as guarantees and standby letters of credit.

The sources for funding are monitored regularly in order to maintain a wide diversification by currency, geographic location, providers, products and term.

With respect to years 2017 and 2016, D Commerce Bank AD does not fall within the scope of the legal requirement of *Regulation 575* for consolidation statements for supervision purposes to the extent the financial results of subsidiaries fall within the scope of the exceptions provided for in *Section 3, Art. 19, para 1, items „a" and „b" of Regulation 575.* Therefore the table below presents the percentage ratio between the liquid assets and liabilities of the Bank alone, calculated individually:

	2017	**2016**
	%	**%**
As at 31 December	33,48	34,51
Average for the period	30,20	29,64
Highest for the period	33,48	34,51
Lowest for the period	27,49	24,77

The table below presents the maturity structure of the consolidated financial assets and liabilities of the Group at carrying amounts and the Group's off-balance sheet commitments:

31 December 2017	**Carrying amount**	**Up to 1 month**	**1-3 months**	**3 months to 1 year**	**1 – 5 years**	**Over 5 years**
	BGN '000	**BGN '000**	**BGN '000**	**BGN '000**	**BGN '000**	**BGN '000**
Cash and balances with the Central Bank	155,621	155,621	-	-	-	-
Due from banks	38,486	38,486	-	-	-	-
Loans and advances to customers	387,288	8,983	23,606	108,033	173,225	73,441
Available-for-sale securities	37,753	2,700	5,366	8,472	19,249	1,966
Held-to-maturity securities	80,641	13,466	240	-	64,762	2,173
Other financial assets	720	-	720	-	-	-
Total assets	**700,509**	**219,256**	**29,932**	**116,505**	**257,236**	**77,580**
Due to banks	9,036	2	18	1,203	4,871	
Due to customers	635,850	384,695	39,401	173,115	38,122	2,942
Other financial liabilities	3,885	-	3,885	-	-	517
Total liabilities	**648,771**	**384,697**	**43,304**	**174,318**	**42,993**	-
						3,459
Undrawn loan commitments and contingent commitments	**95,729**	**30,327**	**2,094**	**13,325**	**49,347**	**636**

31 December 2016	**Carrying amount**	**Up to 1 month**	**1-3 months**	**3 months to 1 year**	**1 – 5 years**	**Over 5 years**
	BGN '000	**BGN '000**	**BGN '000**	**BGN '000**	**BGN '000**	**BGN '000**
Cash and balances with the Central Bank	132,492	132,492	-	-	-	-
Due from banks	45,966	45,966	-	-	-	-
Loans and advances to customers	358,393	10,567	48,633	84,057	145,202	69,934
Available-for-sale securities	40,871	118	75	2,117	36,661	1,900
Held-to-maturity securities	96,871	10,866	241	5,999	54,822	24,943
Other financial assets	761	-	761	-	-	-
Total assets	**675,354**	**200,009**	**49,710**	**92,173**	**236,685**	**96,777**
Due to banks	10,014	-	14	588	2,353	7,059
Due to customers	620,134	387,239	69,038	134,181	27,426	2,250
Other financial liabilities	1,485	-	1,485	-	-	-
Total liabilities	**631,633**	**387,239**	**70,537**	**134,769**	**29,779**	**9,309**
Undrawn loan commitments and contingent commitments	**101,782**	**23,075**	**209**	**25,566**	**52,261**	**671**

The consolidated financial assets and liabilities and the off-balance sheet commitments of the Group by remaining term to maturity determined against the contractual maturity as at the date of the consolidated statement of financial position are presented below. The table is prepared on the basis of undiscounted cash flows and the earliest date on which a payable becomes due for payment. The amounts include principal and interest for balance sheet items, and the undrawn loan commitments and contingent commitments are presented at the off-balance sheet amount of the commitment.

31 December 2017	Up to 1 month	1-3 months	3 months to 1 year	1 – 5 years	Over 5 years	Total
	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000
Cash and balances with the Central Bank	155,621	-	-	-	-	155,621
Due from banks	38,486	-	-	-	-	38,486
Loans and advances to customers	59,684	27,662	120,995	181,899	88,575	478,815
Available-for-sale securities	2,707	5,408	8,728	20,432	2,067	39,342
Held-to-maturity securities	13,589	314	1,125	70,374	2,257	87,659
Other financial assets	-	720	-	-	-	720
Total assets	**270,087**	**34,104**	**130,848**	**272,705**	**92,899**	**800,643**
Due to banks	15	29	1,303	5,232	3,007	9,586
Due to customers	382,703	42,980	171,250	33,650	-	630,583
Other financial liabilities	-	3,885	-	-	-	3,885
Total liabilities	**382,718**	**46,894**	**172,553**	**38,882**	**3,007**	**644,054**
Undrawn loan commitments and contingent commitments	**30,327**	**2,094**	**13,325**	**49,347**	**636**	**95,729**

31 December 2016	Up to 1 month	1-3 months	3 months to 1 year	1 – 5 years	Over 5 years	Total
	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000
Cash and balances with the Central Bank	132,492	-	-	-	-	132,492
Due from banks	45,978	-	-	-	-	45,978
Loans and advances to customers	63,471	42,326	95,516	150,440	84,995	436,748
Available-for-sale securities	125	117	2,554	38,307	2,293	43,396
Held-to-maturity securities	11,000	314	7,448	61,932	26,308	107,002
Other financial assets	-	761	-	-	-	761
Total assets	**253,066**	**43,518**	**105,518**	**250,679**	**113,596**	**766,377**
Due to banks	-	40	1,898	7,329	8,427	17,694
Due to customers	395,257	72,797	132,660	21,213	-	621,927
Other financial liabilities	-	1,485	-	-		1,485
Total liabilities	**395,257**	**74,322**	**134,558**	**28,542**	**8,427**	**641,106**
Undrawn loan commitments and contingent commitments	**26,988**	**6,327**	**53,764**	**15,684**	**671**	**103,344**

3.4. Custody of assets

The Bank is registered as an investment intermediary and carried out transactions on clients' behalf in accordance with Ordinance 38 of the Financial Supervision Commission (FSC). The Bank has an approved policy with respect to trusted transactions on clients' behalf, developed in accordance with the requirements of Art. 28-31 of Ordinance 38 of the FSC.

3.5. Capital management

Equity management

Package CRD IV (Directive 2013/36/EU and Regulation (EU) No 575/2013) became effective in 2014. It includes requirements for calculation and reporting of capital requirements and financial information. The scope, frequency and timeliness for presentation of this information to the regulatory body are introduced by Regulation (EU) No 680/2014 of 16 April 2014. As a result, regulatory capital requirements of D Commerce Bank AD are based on the provisions of the Package CRD IV, Reporting requirements under Regulation (EU) No. 680/2014 – Equity and capital requirements – COREP.

(1) Regulatory capital

For regulatory purposes the equity of the Bank consists of the following elements:

- Tier 1 capital (the whole amount is classified as Common equity Tier 1 capital), which consists of issued capital, share premium and general reserves reduced by the following deductions – goodwill, intangible assets and other regulatory adjustments related to items that are included in balance sheet capital or assets of the Bank but are treated differently for capital adequacy regulation.
- Tier 2 capital: includes revaluation reserves from real estate used for banking activity reduced by regulatory adjustments related to items that are included in the balance sheet capital or assets of the Bank, but are treated differently for capital adequacy regulation.

The Bank calculates the total capital adequacy ratio as a percentage of equity (regulatory) capital and risk-weighted assets. Risk-weighted assets represent the amount of risk-weighted assets for credit, market and operational risk. Tier 1 capital adequacy is the ratio between Tier 1 capital and risk-weighted assets. The total capital adequacy ratio cannot be less than 13.5%, and Tier 1 capital adequacy ratio – less than 11.5%.

Capital items

Equity (capital base)	**Basel III 31.12.2017 BGN '000**	**Basel III 31.12.2016 BGN '000**
Common equity Tier 1 capital		
Equity instruments paid-in	75,000	75,000
Reserves	16,850	15,964
Accumulated other comprehensive income	779	67
Decreases in Common equity Tier 1 capital:		
Intangible assets	(661)	(597)
Other transitional adjustments to Common equity Tier 1 capital	(17)	227
Common equity Tier 1 capital instruments of financial companies where the institution has significant investments	(276)	-
Excess of the amount deducted from the additional Tier 1 capital items over the additional Tier 1 capital	(132)	(239)
Total	**91,543**	**90,422**
Tier 2 capital	-	-
Equity	**91,543**	**90,422**

Risk-weighted assets	31.12.2017 BGN '000	31.12.2016 BGN '000
Risk-weighted balance sheet exposure	366,771	375,180
Risk-weighted off-balance sheet exposure	39,785	41,021
Total risk-weighted assets for credit risk	**406,556**	**416,201**
Total exposures to position, currency and commodity risk	**50**	**2,338**
Total risk exposures to operational risk	**59,700**	**54,013**
Total risk exposures	**466,306**	**472,522**

Capital ratios	31.12.2017	31.12.2016
Total capital ratio	19,63%	19,13%
Tier I capital ratio	19,63%	19,13%

The policy of D Commerce Bank AD (as a parent) at Group level for management and capital allocation is determined by the Bank's Management Board. The allocation of capital among the various operations and activities is aimed at optimising the profitability of allocated capital. The process is carried out under the supervision of the Asset and Liabilities Management Committee as a review of the levels of commitment of the Bank for credit, market and operational risk.

4. NET INTEREST INCOME

Net interest income includes:

	2017 BGN '000	2016 BGN '000
Interest income		
Loans and advances to customers	20,435	20,784
Held-to-maturity securities	2,511	3,244
Available-for-sale securities	654	966
Deposits with banks	294	300
	23,894	**25,294**
Interest expense		
Deposits from customers	(2,920)	(3,824)
Current accounts at other banks	(328)	(60)
Deposits from banks	(224)	(156)
	(3,472)	**(4,040)**
Net interest income	**20,422**	**21,254**

Interest income includes accrued interest on impaired loans amounting to BGN 11,020 thousand in 2017 (31 December 2016: BGN 4,732 thousand).

This is a translation from Bulgarian of the consolidated financial statements of D Commerce Bank Group for year 2017.

5. NET FEE AND COMMISSION INCOME

Net fee and commission income includes:

	2017 BGN '000	2016 BGN '000
Fee and commission income		
Cash operations and money transfers	4,288	4,045
Communication fees	2,037	1,738
Fees and commissions on loans	2,450	1,305
Customers' accounts fees	1,085	824
Bank guarantees and letters of credit	526	507
Other	34	95
	10,420	**8,514**

	2017 BGN '000	2016 BGN '000
Fee and commission expense		
Electronic debit card fees	(797)	(689)
Nostro accounts in other banks	(126)	(114)
Cash clearance	(41)	(44)
Securities transactions	(23)	(29)
Other	(78)	(84)
	(1,065)	**(960)**
Net fee and commission income	**9,355**	**7,554**

6. NET TRADING INCOME

Net trading income includes:

	2017 BGN '000	2016 BGN '000
Net gain on foreign currency transactions	4,098	6,324
Net gain on transactions in held-to-maturity securities	878	67
Net gain on revaluation – transactions in available-for-sale securities *(Note 12)*	17	44
Net gain on revaluation of foreign currency assets and liabilities	(1)	419
Net loss on transactions in available-for-sale securities	-	2,154
Net trading income	**4,992**	**9,008**

7. OTHER OPERATING INCOME, NET

Other operating income, net of the Group includes:

	2017 BGN '000	2016 BGN '000
Income from sale of investment property	2,228	*1,856*
Carrying amount of investment property sold	(2,132)	*(985)*
Gain on sale of investment property	96	871
Sale of other assets	*1,416*	2,400
Carrying amount of other assets sold	*(565)*	(1,181)
Gain on sale of other assets	851	1,219
Income from sale of property and equipment	*7*	*7*
Carrying amount of property and equipment sold	(5)	*(6)*
Gain on sale of property and equipment	2	1
Income from sale of assets held for sale	-	*4,995*
Carrying amount of sold assets held for sale	-	*(4,995)*
Result from sale of assets held for sale	-	-
Income from rent-out of investment property	204	216
Income from sale of non-financial services	280	151
Other operating income	563	691
	1,996	**3,149**

8. NET IMPAIRMENT LOSS ON FINANCIAL ASSETS

The net impairment loss on financial assets includes:

	2017 BGN '000	2016 BGN '000
Impairment of loans and advances	*8,455*	*18,127*
Reversed impairment of loans and advances	*(7,060)*	*(1,175)*
Net change in impairment loss on loans and advances	1,395	16,952
Impairment of other receivables	11	68
	1,406	**17,020**

The net change in impairment loss on loans and advances is as follows:

	2017 BGN '000	2016 BGN '000
Impairment of loans on an individual basis (specific), net	(476)	16,354
Impairment of loans related by common credit risk on a portfolio basis (collective), net	1,871	598
	1,395	**16,952**

9. NET IMPAIRMENT LOSS ON NON-FINANCIAL ASSETS

The net impairment loss on non-financial assets includes:

	2017 BGN '000	2016 BGN '000
Impairment of investment property	*124*	*27*
Reversed impairment of investment property	*(67)*	*-*
Net change in the impairment of investment property	57	27
Impairment charges for other assets	53	-
Impairment loss on VAT receivable	-	422
Total	**110**	**449**

10. ADMINISTRATIVE OPERATING EXPENSES

Administrative operating expenses include:

	2017 BGN '000	2016 BGN '000
Personnel expenses	11,232	10,388
Depreciation and amortisation expense	1,671	1,679
Other administrative expenses	10,352	10,351
	23,255	**22,418**

Personnel expenses include:

	2017 BGN '000	2016 BGN '000
Current wages and salaries	9,250	8,667
Social security/health insurance contributions	1,583	1,447
Accruals for long-term retirement benefit obligations *(Note 27)*	59	63
Accruals for unused paid leaves	340	211
Total	**11,232**	**10,388**

Other administrative expenses include:	2017 BGN '000	2016 BGN '000
Rentals	1,724	1,706
Bank Restructuring Fund	1,377	1,414
Other taxes and charges	1,337	1,177
Communication and IT services	1,125	1,160
Annual contribution to the Bulgarian Deposit Insurance Fund	1,077	1,158
Security and cash collection services	1,025	1,087
Materials	695	735
Maintenance of office, office equipment, vehicles	463	436
Consulting, audit and legal services	379	461
Advertising and representation events	327	184
Insurance	146	145
Business trip costs	53	42
Membership fees	33	33
Other expenses	591	613
Total	**10,352**	**10,351**

The Bulgarian Deposit Insurance Fund determines the due premium contribution of each bank by taking into accounts its risk profile and the amount of the guaranteed deposits with the bank for the previous year, calculated as the average amount of the guaranteed deposits at the end of each quarter.

The premium contributions may be annual, extraordinary, annual premium contributions at reduced amount.

The accrued expenses on statutory audit of the separate financial statements for the year amount to BGN 69 thousand (2016: BGN 44 thousand).

11. INCOME TAX EXPENSE

The main components of the income tax expense for the periods ended 31 December are:

	2017 BGN'000	2016 BGN'000
Consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year)		
Taxable profit for the year under tax return	12,323	88
Current income tax expense for the year – 10% (2016: 10 %)	(1,232)	(8)
Deferred income taxes related to:		
Origination and reversal of temporary differences	24	(106)
Total income tax expense carried to the consolidated statement of profit or loss and other comprehensive income (within profit or loss for the year)	**(1,208)**	**(114)**
Reconciliation of income tax expense applicable to the accounting profit or loss		
Accounting profit for the year	11,994	1,078
Income tax – 10% (2016: 10%)	(1,199)	(108)
From unrecognised amounts as per tax returns related to:		
increases – BGN 96 thousand (2016: BGN 68 thousand)	(9)	(6)
decreases – none (2016: none)		-
Total income tax expense carried to the statement of profit or loss and other comprehensive income (within profit or loss for the year)	**(1,208)**	**(114)**

The tax effects related to other components of comprehensive income are as follows:

	2017 BGN'000			2016 BGN'000		
	Pre-tax amount	**Tax effects recognised in equity**	**Amount net of tax**	**Pre-tax amount**	**Tax effects recognised in equity**	**Amount net of tax**
Items that will not be reclassified to profit or loss						
Remeasurements of defined benefit pension plans	(3)	-	(3)	(3)	-	(3)
Items that may be reclassified to profit or loss						
Net change in fair value of available-for-sale securities	715	-	715	(229)	-	(229)
Total other comprehensive income for the year	712	-	712	(232)	-	(232)

12. OTHER COMPREHENSIVE INCOME

Other comprehensive income includes:	***2017 BGN '000***	***2016 BGN '000***
Net change in fair value of available-for-sale financial assets:		
Gains (Losses) incurred during the year	*716*	*(648)*
Less: Reclassification adjustments for (gains)/losses included in profit or loss for the current year (Note 6)	*(1)*	*419*
	715	(229)
Remeasurements of defined benefit pension plans *(Note 27)*	(3)	(3)
	712	(232)
Income tax relating to items of other comprehensive income	-	-
Total comprehensive income for the year	**712**	**(232)**

13. CASH AND BALANCES WITH THE CENTRAL BANK

	31.12.2017 BGN '000	**31.12.2016 BGN '000**
Cash on hand *(Note 29)*	17,693	17,267
Balances with the Central Bank *(Note 29)*, including:	137,928	115,225
Current account	*8,509*	*18,962*
Minimum required reserve in BGN	*129,419*	*96,263*
	155,621	**132,492**

The Bulgarian National Bank may accrue interest in BGN on the minimum required reserve and the excessive reserves at an amount set by the BNB Management Board. The interest on excessive reserves may be a negative figure unless the excessive reserves have been required as a result of a supervisory measure.

14. DUE FROM BANKS

	31.12.2017 BGN '000	**31.12.2016 BGN '000**
Term deposits	14,399	28,083
Current accounts and demand deposits	24,079	17,843
Local banks	*13,880*	*9,177*
Foreign banks	*10,199*	*8,666*
Restricted deposits with foreign banks	8	40
	38,486	**45,966**

15. LOANS AND ADVANCES TO CUSTOMERS

As at 31 December the carrying amount of loans and advances to customers includes:

	31.12.2017 BGN '000	31.12.2016 BGN '000
Loans	417,771	386,470
Finance lease receivables	8,420	9,469
Impairment of loans and finance lease receivables	(38,903)	(37,546)
	387,288	**358,393**

The table below presents the amortised cost of loans granted and finance lease receivables by customer type:

Customer type	**31.12.2017 BGN '000**	**31.12.2016 BGN '000**
Enterprises	**362,714**	**344,264**
Individuals		
- consumer loans	31,563	27,578
- residential mortgage loans	28,272	20,760
Total individuals	**59,835**	**48,338**
Agricultural producers	**3,642**	**3,337**
	426,191	**395,939**

The movements in the impairment loss on loans and advances to customers and finance lease receivables are as follows:

	2017 BGN '000	2016 BGN '000
Balance at 1 January	**(37,546)**	**(30,250)**
Impairment charged	(8,455)	(18,127)
Reversed impairment	7,060	1,175
Write-offs	38	9,656
Balance at 31 December	**(38,903)**	**(37,546)**

As at 31 December the balance of impairment on loans and advances to customers and finance lease receivables includes:

	31.12.2017 BGN '000	31.12.2016 BGN '000
Impairment on an individual basis (specific)	36,148	36,630
Impairment on a portfolio basis (collective)	2,755	916
	38,903	**37,546**

The *net investment in finance leases* is the difference between the gross investment in the finance lease, less the unearned finance income and the accrued impairment. It is as follows:

Net investment in finance leases	**31.12.2017 BGN '000**	**31.12.2016 BGN '000**
Gross investment in finance leases	11,696	13,846
Unearned finance income	(3,276)	(4,377)
Net minimum lease payments	**8,420**	**9,469**
Allowance for impairment	(62)	(31)
Net investment in finance leases	**8,358**	**9,438**

The structure of *net investment in finance leases* is as follows:

	31.12.2017 BGN '000	**31.12.2016 BGN '000**
Net investment in finance leases		
Maturity of up to 1 year	998	1,155
Maturity of 1 to 5 years	996	1,553
Maturity of more than 5 year	6,364	6,730

The concentration of the Group in the ten largest groups of exposures to customers is as follows:

	31.12.2017 BGN '000	**31.12.2016 BGN '000**
Total gross carrying amount of the ten largest exposures to customers*	149,320	156,089
Percentage of the amount of gross loans and off-balance sheet commitments (Note 3.1)	28,61%	31,36%

* Including related customers, balance sheet and off-balance sheet commitments

16. AVAILABLE-FOR-SALE SECURITIES

Available-for-sale securities as at 31 December, presented by original maturity, are as follows:

	Nominal amount	Fair value	Interest rate (coupon)	Effective interest rate	Maturity
	31.12.2017 BGN '000	31.12.2017 BGN '000	31.12.2017 BGN '000	31.12.2017 BGN '000	31.12.2017 BGN '000
Government bonds – Republic of Bulgaria					
Short-term bonds denominated in BGN	*2,530*	2,545	*1.10 %*	*0.68%*	*January 2018*
Medium-term bonds denominated in BGN	*3,490*	*3,663*	*1.85%*	*1.00%*	*February 2020*
Medium-term bonds denominated in EUR	*3,619*	*3,600*	*-0.25%*	*0.45%*	*January 2019*
	9,639	9,808			
Government bonds – Republic of Turkey					
Medium-term bonds denominated in EUR	4,890	5,442	*4.35 %-5.88 %*	*1.76 %-2.43 %*	*April 2019 - November 2021*
Corporate shares					
Shares denominated in BGN	*20*	*107*	-	-	-
Shares denominated in EUR	-	*34*	-	-	-
	20	141			
Corporate bonds					
Short-term bonds denominated in EUR	*13,542*	*13,624*	*0.00% - 2.671%*	*0.78% - 2.80%*	*March 2018-July 2018*
Medium-term bonds denominated in EUR	*6,748*	*6,704*	*0.141 % - 4.875 %*	*1.51 %-4.57%*	*March-August 2021*
Long-term bonds denominated in EUR	*1,662*	*2,034*	*6.00 %*	*4.69%*	*April 2023*
	21,952	22,362			
Total	**36,501**	**37,753**			

	Nominal amount	Fair value	Interest rate (coupon)	Effective interest rate	Maturity
	31.12.2016 BGN '000	31.12.2016 BGN '000	31.12.2016 BGN '000	31.12.2016 BGN '000	31.12.2016 BGN '000
Government bonds – Republic of Bulgaria					
Medium-term bonds denominated in BGN	*6,020*	*6,243*	*1.10 %-1.85%*	*0.67 %-0.99 %*	*January 2018 - February 2020*
Medium-term bonds denominated in EUR	*5,429*	*5,375*	*-0.13%*	*0.45%*	*January 2019*
	11,449	11,618			
Government bonds – Republic of Turkey					
Medium-term bonds denominated in EUR	4,890	5,358	*4.35 %-5.88 %*	*1.68 %-2.38 %*	*April 2019 – November 2021*
Corporate shares					
Shares denominated in BGN	*20*	*58*	-	-	-
Shares denominated in EUR	-	*33*	-	-	-
	20	91			
Corporate bonds					
Short-term bonds denominated in USD	*1,956*	*1,955*	*0.00%*	*0.67%*	*November 2017*
Medium-term bonds denominated in EUR	*20,290*	*19,880*	*0.00 % -4.875 %*	*0.79 %-4.56%*	*March 2018-August 2021*
Long-term bonds denominated in EUR	*1,662*	*1,969*	*6.00 %*	*4.65%*	*April 2023*
	23,908	23,804			
Total	**40,267**	**40,871**			

As at 31 December 2017, the has no blocked securities, provided as collateral on budgetary accounts (31 December 2016: none).

The table presented below shows reconciliation between the opening and closing balances of the fair values of available-for-sale investments:

	31.12.2017	31.12.2016
Balance at 1 January	**40,871**	**58,734**
Increase (purchases)	3,069	18,431
Decrease (sales and / or maturity)	(6,773)	(35,860)
Net increase from revaluation of available-for-sale securities to fair value	715	154
Movements in interest accrued	(129)	(374)
Foreign currency translation differences	-	(214)
Balance at 31 December	**37,753**	**40,871**

17. HELD-TO-MATURITY SECURITIES

As at 31 December the carrying amount of held-to-maturity securities includes:

	Nominal amount 31.12.2017 BGN '000	Amortised cost 31.12.2017 BGN '000	Fair value 31.12.2017 BGN '000	Interest rate (coupon) 31.12.2017 BGN '000	Effective interest rate 31.12.2017 BGN '000	Maturity 31.12.2017 BGN '000
Government bonds						
Government bonds – Republic of Bulgaria – in BGN	43,501	45,042	47,883	*2.50% -5.00 %*	*2.10 %-5.17 %*	*January 2018 - July 2023*
Government bonds – Republic of Bulgaria – in EUR	34,791	35,599	37,071	*2.00 % -4.50 %*	*2.18 % -2.91 %*	*July 2019 - March 2022*
	78,292	**80,641**	**84,954**			

	Nominal amount 31.12.2016 BGN '000	Amortised cost 31.12.2016 BGN '000	Fair value 31.12.2016 BGN '000	Interest rate (coupon) 31.12.2016 BGN '000	Effective interest rate 31.12.2016 BGN '000	Maturity 31.12.2016 BGN '000
Government bonds						
Government bonds – Republic of Bulgaria – in BGN	52,951	55,045	58,574	*2.50% -5.00 %*	*2.10 %-5.18 %*	*January 2017 - July 2023*
Government bonds – Republic of Bulgaria – in EUR	40,659	41,826	43,452	*2.00 % -4.50 %*	*2.18 % -3.87 %*	*July 2017 - March 2022*
	93,610	**96,871**	**102,026**			

Held-to-maturity investments are short- and medium-term debt securities for which the Bank has the intention and ability to hold to maturity.

As at 31 December 2017, held-to-maturity investments at the total amount of BGN 68,981 thousand (31 December 2016: BGN 71,209 thousand) are blocked as collateral on budgetary funds.

18. INVESTMENT PROPERTY

	2017 BGN '000	2016 BGN '000
Book value		
Balance at 1 January	**16,654**	**14,795**
Additions	-	2,852
Disposals	(2,280)	(993)
Balance at 31 December	**14,374**	**16,654**
Depreciation and impairment loss		
Balance at 1 January	**1,179**	**924**
Depreciation charge for the period	285	236
Disposals	(148)	(8)
Allowance for impairment	57	27
Balance at 31 December	**1,373**	**1,179**
Carrying amount at 1 January	**15,475**	**13,871**
Carrying amount at 31 December	**13,001**	**15,475**

As at 31 December 2017, the fair value of investment property is BGN 18,052 thousand (2016: BGN 16,716 thousand) *(Note 2.24.2.2).*

19. PROPERTY AND EQUIPMENT

	Land and buildings		Information equipment		Furniture and fixtures		Other		Assets in progress		Total	
	2017 BGN '000	2016 BGN '000	2017 BGN '000	2016 BGN '000	2017 BGN '000	2016 BGN '000	2017 BGN '000	2016 BGN '000	2017 BGN '000	2016 BGN '000	2017 BGN '000	2016 BGN '000
Book value												
Balance at 1 January	27,105	27,105	4,286	3,990	3,119	3,084	3,925	3,927	782	578	39,217	38,684
Additions	-	-	1	82	-	-	-	-	1,172	536	1,173	619
Disposals	-	-	(272)	(75)	(128)	(8)	(4)	(3)	(169)	-	(573)	(86)
Transfer	-	-	787	289	150	43	108	-	(1,044)	(332)	1	-
Balance at 31 December	27,105	27,105	4,802	4,286	3,141	3,119	4,029	3,924	741	782	39,818	39,217
Depreciation and impairment loss												
Balance at 1 January	1,057	672	3,667	3,376	2.501	2,196	3,489	3,284	-	-	10,714	9,528
Depreciation charge for the year	385	384	387	366	248	309	169	207	-	-	1,189	1,268
Disposals	-	-	(265)	(75)	(128)	(5)	(4)	(3)	-	-	(397)	(83)
Balance at 31 December	1,442	1,056	3,789	3,667	2,621	2,500	3,654	3,488	-	-	11,506	10,713
Carrying amount												
Carrying amount at 31 December	25,663	26,049	1,013	619	520	619	375	436	741	782	28,312	28,504
Carrying amount at 1 January	26,048	26,433	619	614	618	888	436	643	782	578	28,504	29,156

As at 31 December 2017, the Group's tangible fixed assets included: land amounting to BGN 2,137 thousand (31 December 2016: BGN 2,137 thousand) and buildings of carrying amount BGN 23,526 thousand (31 December 2016: BGN 23,912 thousand).

As at 31 December 2017, the property, plant and equipment include assets at book value BGN 8,097 thousand (31 December 2016: BGN 6,633 thousand), which have been fully depreciated but still in use in the operations.

20. INTANGIBLE ASSETS

	Software 2017 BGN '000	2016 BGN '000
Book value		
Balance at 1 January	**1,427**	**1,118**
Additions	255	424
Disposals	(43)	(115)
Balance at 31 December	**1,639**	**1,427**
Amortisation and impairment loss		
Balance at 1 January	**815**	**754**
Amortisation charge for the year	195	175
Disposals	(42)	(114)
Balance at 31 December	**968**	**815**
Carrying amount at 1 January	**612**	**364**
Carrying amount at 31 December	**671**	**612**

21. CURRENT TAX RECEIVABLES

Current tax receivables include:

	31.12.2017 BGN '000	31.12.2016 BGN '000
Corporate tax	27	127
Value added tax	-	66
Total	**27**	**193**

22. OTHER ASSETS

Other assets include:	31.12.2017 BGN '000	31.12.2016 BGN '000
Assets acquired through collateral	*11,675*	*5,918*
Impairment charge	*(53)*	*-*
	11,622	5,918
Guarantee deposits with suppliers	347	331
Prepayments	224	233
Other assets	436	523
Total	**12,629**	**7,005**

Including:	31.12.2017 BGN '000	31.12.2016 BGN '000
Non-financial assets	11,909	6,244
Financial assets	720	761
Total	**12,629**	**7,005**

23. DUE TO BANKS

Due to banks represent funds attracted from banks and related mainly to credit lines with a carrying amount as at 31 December 2017 being BGN 9,036 thousand (31 December 2016: BGN 10,991 thousand).

Due to banks are negotiated under the following terms and conditions:

	Amount	Currency	Maturity	31.12.2017 BGN '000	31.12.2016 BGN '000
Bulgarian Development Bank AD	10,000	BGN '000	31.05.2025	8,836	10,014
Bulgarian Development Bank AD	500	BGN '000	01.10.2017	-	977
Bulgarian Development Bank AD	1,500	EUR '000	30.04.2023	200	-
Total				**9,036**	**10,991**

Change in liabilities from financing activities

The table below presents the reconciliation between the opening and closing balances in the consolidated statement of financial position for the liabilities from financing activities for the year ended 31 December 2017:

	01.01.2017	*Interest paid*	*Outgoing cash flows*	*Accruals under the effective interest rate method*	*31.12.2017*
Due to banks	10,991	(155)	(1,955)	155	**9,036**
Total liabilities from financing activities	**10,991**	**(155)**	**(1,955)**	**155**	**9,036**

24. DUE TO CUSTOMERS

	31.12.2017	**31.12.2016**
	BGN '000	**BGN '000**
Individuals		
- term deposits	213,067	186,309
- saving accounts	73,948	73,024
- demand deposits	41,655	31,721
	328,670	**291,054**
Private entities and other financial institutions		
- term deposits	79,649	82,426
- demand deposits	227,531	246,653
	307,180	**329,079**
	635,850	**620,133**

As at 31 December 2017, 8% of the total amounts due to customers (31 December 2016: 8%) represent funds of the sole owner – shareholder and parties related thereto.

Deposits from customers include customer deposits restricted by the Bank: as collateral for loans and issued bank guarantees at the amount of BGN 14,037 thousand (31 December 2016: BGN 19,354 thousand), as well as accounts subject to special terms and conditions: accumulation accounts at the amount of BGN 304 thousand (31 December 2016: BGN 2,589 thousand).

25. CURRENT TAX LIABILITIES

Current tax liabilities include:

	31.12.2017 BGN '000	31.12.2016 BGN '000
Value added tax	179	24
Final income tax	46	61
Withholding tax	36	27
One-off taxes on expenses	17	16
Personal income tax	4	2
	282	**130**

The following tax audits and inspections have been carried out in relation to the Group companies by the issue date of these consolidated financial statements:

D Commerce Bank AD:

- under VAT Act – until 31 December 2009;
- full-scope tax audit – until 31 December 2009;
- National Social Security Institute – until 31January 2015.

D Leasing EAD

- under VAT Act – until 31 October 2016.

No tax audits and inspections have been carried out with respect to the subsidiaries *D Insurance Broker EOOD* and *D Imoti EOOD.*

A tax audit shall be performed within a 5-year period after the end of the year when the tax return for the respective liability has been submitted. The tax audit confirms the ultimate tax payable of the tax liable entity, except in the cases explicitly provided for by law.

26. DEFERRED TAXES

Deferred income taxes as at 31 December are related to the following items of the consolidated statement of financial position:

	temporary difference	*tax*	*temporary difference*	*tax*
	31.12.2017 BGN'000	***31.12.2017 BGN'000***	***31.12.2016 BGN'000***	***31.12.2016 BGN'000***
Property, equipment and investment property	(3,218)	(322)	(2,580)	(258)
Total deferred tax liabilities	**(3,218)**	**(322)**	**(2,580)**	**(258)**
Tax loss	29	3	97	10
Accruals for unused leaves of personnel and bonuses	424	43	259	26
Long-term retirement benefit obligations	378	38	322	32
Other receivables	700	70	700	70
Available-for-sale financial assets	883	88	169	16
Total deferred tax assets	**2,414**	**242**	**1,547**	**154**
Deferred income tax assets, net	**(804)**	**(80)**	**(1,033)**	**(104)**

On recognising deferred tax assets, the probability for a reversal of the individual differences and the abilities of the Group companies to generate sufficient taxable profit in the future, have been taken into account.

The change in the balance of deferred taxes for 2017 was as follows:

Deferred tax (liabilities)/ assets	***01.01.2017***	***Recognised in the current profit and loss***	***31.12.2017***
	BGN '000	**BGN '000**	**BGN '000**
Property, equipment and investment property	(258)	(64)	(322)
Accruals for paid leaves of personnel and bonuses	26	17	43
Long-term retirement benefit obligations	32	6	38
Tax loss	10	(7)	3
Other receivables	70	-	70
Available-for-sale financial assets	16	72	88
Total	**(104)**	**24**	**(80)**

The change in the balance of deferred taxes for 2016 was as follows:

Deferred tax (liabilities)/ assets	*01.01.2016*	*Recognised in the current profit and loss*	*31.12.2016*
	BGN '000	BGN '000	BGN '000
Property, equipment and investment property	(204)	(54)	(258)
Accruals for paid leaves of personnel and bonuses	21	5	26
Long-term retirement benefit obligations	28	4	32
Tax loss	51	(41)	10
Other receivables	21	49	70
Assets held for sale	46	(46)	-
Available-for-sale financial assets	39	(23)	16
Total	**2**	**(106)**	**(104)**

27. OTHER LIABILITIES

Other liabilities include:

	31.12.2017 BGN '000	31.12.2016 BGN '000
Transfers in progress	2,341	279
Prepaid credit account management fees	619	606
Advances from the sale of assets acquired from collaterals	537	74
Current liabilities to personnel and social security	390	228
Long-term retirement benefit obligations	378	322
Guarantees on cession agreements and letters of credit	89	232
Other liabilities	1,257	1,211
	5,611	**2,952**

Including:	31.12.2017 BGN '000	31.12.2016 BGN '000
Financial liabilities	3,885	1,485
Non-financial liabilities	1,726	1,467
	5,611	**2,952**

Current liabilities to personnel of the Group companies include accruals for unused leaves and the social security contributions thereon.

The *long-term retirement benefit obligations* to personnel include the present value of Bank's liability, at the date of the consolidated statement of financial position, to pay indemnities to its employees upon coming of age for retirement.

In accordance with the Labour Code in Bulgaria, every employee is entitled to an indemnity on retirement at the amount of two gross monthly salaries, and if he or she has worked for the same employer during the last 10 years of their service the indemnity amounts to six gross monthly salaries at the time of retirement. This is a defined benefits plan. *(Note 2.19).*

For the purpose of establishing the amount of the liability as at 31 December 2017, the Group has assigned actuarial valuation by using the services of a certified actuary.

The movements in the present value of retirement benefit obligations to personnel are as follows:

	2017 BGN '000	2016 BGN '000
Present value of the obligation at 1 January	**322**	**280**
Interest cost	5	5
Current service cost	54	58
Payments made in the year	(6)	(24)
Remeasurement gains or losses for the year	3	3
Present value of the obligation at 31 December	**378**	**322**

The amounts accrued in the consolidated statement of profit or loss and other comprehensive income as long-term retirement benefits of personnel are as follows:

	2017 BGN '000	2016 BGN '000
Current service cost	54	58
Interest cost	5	5
Components of defined benefit plan costs recognised in profit or loss *(Note 10)*	**59**	**63**
Remeasurement gains or losses on the retirement benefit obligations, including:		
Actuarial losses arising from changes in financial assumptions	19	25
Actuarial losses arising from changes in demographic assumptions	(71)	(1)
Actuarial losses arising from experience adjustments	55	(21)
	3	**3**
Components of defined benefit plans cost recognised in other comprehensive income ***(Note 12)***		
Total	**62**	**66**

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

- mortality rate – in accordance with the table issued by the National Statistics Institute for the total mortality rate of the population in Bulgaria for the period 2014 – 2016 (31 December 2016: 2013 – 2015);
- staff turnover rate – applied probability of leave prior to retirement of 2.00% per year (2016: between 0 % and 15% for the five age groups formed).

- discount factor – the rate applied is based on the effective annual interest rate 1.50% (31 December 2016: 2.00%). It is grounded on the market yield on the long-term government securities (of 10-year maturity). Considering that the average term to pensioning is longer than 13 years, the discount rate has been established through extrapolation;
- the assumption for the future level of the salaries is based on the information provided by Bank's management and amounts to 2% annual growth for 2017 and for each subsequent year against the prior reporting period (2016: 5%).

28. CAPITAL AND RESERVES

Share capital

As at 31 December 2017, the registered share capital of D Commerce Bank AD (the parent) amounts to BGN 75,000 thousand (31 December 2016: BGN 75,000 thousand), distributed in 75,000 ordinary registered dematerialised voting shares with a par value of BGN 1,000 each.

The share capital structure is as follows:

Shareholder	Shares held as at 31.12.2017	Percentage	Shares held as at 31.12.2016	Percentage
Fuat Guven	50,000	66.67%	50,000	66.67%
Fortera EAD	25,000	33.33%	25,000	33.33%
Total	**75,000**	**100%**	**75,000**	**100%**

The *share capital* and the number of shares were not changed in 2017 and 2016.

Reserves

Bank's *reserves* are summarised in the table below:

	31.12.2017 BGN '000	31.12.2016 BGN '000
Statutory reserves (Reserve Fund)	16,871	15,966
Available-for-sale financial assets reserve	747	32
Total	**17,618**	**15,998**

Statutory reserves (Reserve Fund)

The Credit Institutions Act does not prescribe specific rules for the setting aside of *statutory reserves (Reserve Fund)*. The Bank sets aside such reserve under the requirements of the general provisions of the Commercial Act, namely: at least one tenth of the post-tax profit, funds paid above the nominal amount on issuance of capital, the sum of the additional payments made against privileges granted on the acquired shares, other sources specified in the Articles of Association or designated by resolution of the General Assembly until the Reserve Fund reaches up to 1/10 of the share capital determined by the Articles of Association. In addition, under the Credit Institutions Act banks are not allowed to pay dividends before reaching the minimum reserves required by law or by the Articles of Association, or in case the distribution of dividends will result in violation of the regulatory capital adequacy ratios.

The Bank may use the funds from the *statutory reserve (Reserve Fund)* to cover current or prior period losses, but cannot use it for distribution of dividends without permission by BNB.

As at 31 December 2017, the *statutory reserves (Reserve Fund)* of the Group amount to BGN 16,871 thousand (31 December 2016: BGN 15,966 thousand) whereas the minimum amount required under the Commercial Act is reached.

The movements in the *statutory reserves (Reserve Fund)* are as follows:

	2017 BGN '000	2016 BGN '000
Balance at 1 January	**15,966**	**15,431**
Distribution of profit	905	535
Balance at 31 December	**16,871**	**15,966**

The *available-for-sale financial assets reserve* is set aside as a result of the effect of the subsequent measurement of available-for-sale investments at fair value.

As at 31 December 2017, it amounts to BGN 747 thousand (31 December 2016: BGN 32 thousand).

The movements in the *available-for-sale financial assets reserve* are as follows:

	2017 BGN '000	2016 BGN '000
Balance at 1 January	**32**	**261**
Gains /(Losses) on remeasurement to fair value for the year	716	(648)
Cumulative (gains)/losses reclassified to current profit or loss upon sale/realisation of available-for-sale financial assets	(1)	419
Balance at 31 December	**747**	**32**

Retained earnings amount to BGN 10,952 thousand as at 31 December 2017 (31 December 2016: BGN 1,074 thousand).

The movements of *retained earnings* are as follows:

	2017 BGN '000	2016 BGN '000
Balance at 1 January	**1,074**	**648**
Net profit for the year	10,786	964
Distribution of profit to reserves	(905)	(535)
Actuarial losses from remeasurements	(3)	(3)
Balance at 31 December	**10,952**	**1,074**

29. CASH AND CASH EQUIVALENTS

For the purposes of the consolidated statement of cash flows cash and cash equivalents comprise the following balances with original maturity up to 3 months:

	31.12.2017 BGN '000	31.12.2016 BGN '000
Cash on hand *(Note 13)*	17,693	17,267
Current accounts with the Central Bank *(Note 13)*	8,509	18,962
Minimum obligatory reserve (*Note 13*)	129,419	96,263
Amounts due from banks with original maturity of up to 90 days *(Note 14)*	38,486	45,926
Cash and cash equivalents in the statement of cash flows	**194,107**	**178,418**

30. CONTINGENT LIABILITIES AND COMMITMENTS

Guarantees and letters of credit

The Group provides guarantees and letters of credit to guarantee the performance of its customers to third parties. These arrangements have fixed limits and are generally valid for a period of up to one year.

The amounts of concluded agreements for undertaken commitments and contingent liabilities are presented in the table below.

	31.12.2017 BGN '000	31.12.2016 BGN '000
Contingent liabilities		
Bank guarantees and letters of credit		
- in BGN	45,026	43,629
- in foreign currency	2,315	8,228
	47,341	**51,857**
Irrevocable commitments		
Undrawn amount of authorised loans		
- in BGN	25,491	27,201
- in foreign currency	22,897	22,725
	48,388	**49,926**
	95,729	**101,783**

Nature of instruments and credit risk

These commitments of contingent nature are bearers of off-balance sheet credit risk as only arrangement fees and provisions for potential losses are recognised in the statement of financial position until the commitments expire or are fulfilled. The amounts reflected in the table below with respect to guarantees represent the maximum accounting loss that would be recognised as at the date of the financial statements if the counterparties fail to discharge their contractual liabilities in full. Many of the contingent liabilities will expire without being paid fully or partially. Therefore, the amounts do not represent expected future cash flows. Collaterals held for the issuance of bank guarantees and letters of credit are 100% and represent mainly deposits restricted with the Bank, mortgage of real estate, bank guarantees issued by other banks and promissory notes.

When conditions for enforcement of an issued guarantee occur the Bank assesses the possibilities for recourse to the counterparty and potential realisation of the collaterals provided.

Court proceedings

As at 31 December 2017, respectively as at 31 December 2016, there were no material legal claims against Group companies that might have a significant impact on the Group and/or its financial position.

31. RELATED PARTY TRANSACTIONS

(a) Outstanding balances with related parties

Account type	Relation type	31.12.2017 BGN '000	31.12.2016 BGN '000
Deposits, current and escrow accounts	Entity under a common control through a main shareholder	45,001	45,132
Deposits and current accounts	Shareholder	4,938	2,303
Deposits and current accounts	Key management personnel	1,864	1,580
		51,803	49,015
Loans granted	Entity under a common control through a main shareholder	3,911	4,268
Loans granted	Key management personnel	423	441
Loans granted	Shareholder	3	2
		4,337	4,711
Issued guarantees and letters of credit	Entity under a common control through a main shareholder	1,379	1,513
		1,379	1,513

(b) Related party transactions

Income / expense	Relation type	2017 BGN '000	2016 BGN '000
Interest income	Entity under a common control through a main shareholder	152	152
Interest income	Key management personnel	15	18
		167	170
Commissions income	Entity under a common control through a main shareholder	50	63
Commissions income	Key management personnel	1	1
Commissions income	Shareholder	1	1
		52	65
Interest expense	Entity under a common control through a main shareholder	118	489
Interest expense	Shareholder	15	68
Interest expense	Key management personnel	11	13
		144	570

(c) Remuneration of key management personnel

	2017 BGN '000	2016 BGN '000
Remuneration of key management personnel	1,395	1,044

The members of the key personnel are disclosed in *Note 1*.

32. EVENTS AFTER THE DATE OF THE CONSOLIDATED FINANCIAL STATEMENTS

There are no events, occurred after the reporting period, which could affect the consolidated financial statements of the Group as at 31 December 2017.