Allianz Bank Bulgaria AD

Annual Financial Statements
for the year ended 31 December 2017
With independent Auditors' Report thereon

Annual activity report

Corporate Governance Declaration

Translation from the original Bulgarian version, in case of divergence the Bulgarian original shall prevail.

CONTENTS

Statement of profit or loss

For the year ended 31 December

In thousands of BGN	Note	2017	2016 *Restated**
Interest income	9	72,561	81,867
Interest expense	9	(6,614)	(13,237)
Net interest income	9	65,947	68,630
Fee and commission income	10	23,244	21,477
Fee and commission expense	10	(2,730)	(2,502)
Net fee and commission income	10	20,514	18,975
Net trading income	11	3,085	2,776
Net investment income	12	287	4,823
Total income from banking operations		89,833	95,204
Other operating income, net	14	1,240	1,202
Net impairment loss on financial assets		(13,337)	(13,065)
Administrative and other expenses	13	(46,978)	(49,497)
Profit before tax		30,758	33,844
Income tax expense	15	(2,894)	(3,589)
Profit for the year		27,864	30,255

**See note 9.*

The statement of profit or loss is to be read in conjunction with the accompanying notes from 1 to 34, which are an integral part of these financial statements.

Georgi Zamanov
Chief Executive Director

Rossen Stanimirov
Executive Director

Lyuba Pavlova
Chief Accountant

In accordance with an Independent Auditors' Report:

KPMG Audit OOD

Dobrina Kaloyanova
Authorised representative

Tzvetelinka Koleva
Registered auditor, responsible for the audit

AFA OOD

Valia Iordanova
Authorised representative

Renny Iordanova
Registered auditor, responsible for the audit

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Statement of comprehensive income

For the year ended 31 December

In thousands of BGN	**Note**	**2017**	**2016**
Profit for the year		27,864	30,255
Other comprehensive income			
Items that may be reclassified to profit or loss:			
Net change in fair value of available-for-sale financial assets		4,603	1,703
Income tax related to items of other comprehensive income that may be reclassified to profit or loss		(460)	(170)
		4,143	1,533
Items that will not be reclassified to profit or loss:			
Remeasurements of defined benefit plans	27	(29)	(66)
Income tax related to items of other comprehensive income that will not be reclassified to profit or loss		-	-
		(29)	(66)
Other comprehensive income for the year, net of tax		4,114	1,467
Total comprehensive income for the year		31,978	31,722

The statement of other comprehensive income is to be read in conjunction with the accompanying notes from 1 to 34, which are an integral part of these financial statements.

Georgi Zamanov
Chief Executive Director

Rossen Stanimirov
Executive Director

Lyuba Pavlova
Chief Accountant

Allianz Bank Bulgaria AD Head Office 1 Sofia

In accordance with an Independent Auditors' Report:

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София Рег. № 045

София Рег. № 015

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Statement of financial position

In thousands of BGN	Note	31 December 2017	31 December 2016 *Restated**
Assets			
Cash and cash equivalents	16	812,888	683,417
Financial assets held for trading	17	34,132	35,603
Loans and advances to banks and other financial institutions	18	38,306	32,122
Loans and advances to customers	20	1,099,404	1,088,839
Financial assets available-for-sale	19.1	169,734	168,224
Financial assets held-to-maturity	19.2	386,720	431,194
Property, plant and equipment	21	7,600	8,902
Intangible assets	22	5,075	3,936
Other assets	24	6,097	8,235
Total assets		2,559,956	2,460,472
Liabilities			
Deposits from banks		108	111
Deposits from customers	25	2,272,523	2,153,309
Other borrowings	26	59,342	85,971
Provisions for guarantees		494	24
Current tax liabilities		897	810
Deferred tax liabilities	23	144	159
Other liabilities	27	7,360	2,978
Total liabilities		2,340,868	2,243,362
Equity			
Share capital		69,000	69,000
Statutory reserve		9,850	9,850
Retained earnings		131,615	133,780
Fair value reserve		8,623	4,480
Total equity	28	219,088	217,110
Total liabilities and equity		2,559,956	2,460,472

**See notes 20 and 24.*

The statement of financial position is to be read in conjunction with the accompanying notes from 1 to 34, which are an integral part of these financial statements.

Georgi Zamanov	Rossen Stammirov	Lyuba Pavlova
Chief Executive Director	*Executive Director*	*Chief Accountant*

In accordance with an Independent Auditors' Report:

KPMG Audit OOD		AFA OOD	
Dobrina Kaloyanova	Tzvetelinka Koleva	Valia Iordanova	Renny Iordanova
Authorised representative	*Registered auditor, responsible for the audit*	*Authorised representative*	*Registered auditor, responsible for the audit*

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Statement of cash flows

For the year ended 31 December

In thousands of BGN	**Note**	**2017**	**2016**
Cash flows from operating activities			
Profit for the year		27,864	30,255
Adjustments for non-cash operations:			
Net impairment losses from financial assets		13,337	13,065
Depreciation and amortization	21,22	2,315	2,544
Dividend income	12	(287)	(115)
Net interest income	9	(65,947)	(68,630)
Net (gain) from operations with financial assets, including currency revaluations		(3,778)	(4,550)
Net (gain)/loss on revaluation of financial assets, held for trading		693	(368)
Tax expense	15	2,894	3,589
Cash flows used in operating activity before changes in operating assets and liabilities		(22,909)	(24,210)
Changes in operating assets and liabilities			
Financial assets held for trading		778	(5,908)
Loans and advances to banks and other financial institutions		(7,823)	(19,981)
Loans and advances to customers		13,302	80,494
Other assets		183	(450)
Depossits from banks		(2)	(50,990)
Deposits from customers		118,871	174,301
Other borrowed funds		(26,629)	(5,868)
Other liabilities		4,353	(3)
		80,124	147,385
Dividends received		287	115
Interest received		46,594	68,800
Interest paid		(4,185)	(11,260)
Net cash flows used in operating activities before income tax paid			
Income tax paid		(3,282)	(1,924)
Net cash flows from operating activities		119,538	203,116
Cash flows from investing activities			
Purchases of property, plant and equipment	21	(769)	(1,664)
Purchases of intangible assets	22	(1,383)	(766)
Purchases of investment securities		(25,602)	(142,247)
Proceeds from sale and maturity of investment securities		71,745	22,535
Net cash flows from/(used in) investing activities		43,991	(122,142)

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Statement of cash flows, continued

For the year ended 31 December

In thousands of BGN	Note	2017	2016
Cash flows from financing activities			
Dividends paid		(30,000)	(10,167)
Net cash flows from/used in financing activities		(30,000)	(10,167)
Net increase in cash and cash equivalents		133,529	70,807
Cash and cash equivalents at 1 January		683,417	612,116
Effect of exchange rate fluctuations on cash and cash equivalents held		(4,058)	494
Cash and cash equivalents at 31 December	16	812,888	683,417

The statement of cash flows is to be read in conjunction with the accompanying notes from 1 to 34, which are an integral part of these financial statements.

Allianz Bank Bulgaria AD Head Office 1 Sofia

Georgi Zamanov
Chief Executive Director

Rossen Stanimirov
Executive Director

Lyuba Pavlova
Chief Accountant

In accordance with an Independent Auditors' Report:

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Одиторско дружество София Рег. № 045 КПМГ Одит ООД

Одиторско дружество София Рег. № 015 АФА ООД

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Statement of changes in equity

In thousands of BGN	Note	Share capital	Statutory reserves	Fair value reserves	Retained earnings	Total equity
Balance at 1 January 2016		69,000	9,850	2,947	113,758	195,555
Total comprehensive income for the year						
Profit for the year		-	-	-	30,255	30,255
Other comprehensive income, net of tax		-	-	1,533	(66)	1,467
Total comprehensive income for the year		-	-	1,533	30,189	31,722
Transactions with shareholders						
Dividends to shareholders		-	-	-	(10,167)	(10,167)
Balance at 31 December 2016	28	69,000	9,850	4,480	133,780	217,110
Total comprehensive income for the year						
Profit for the year		-	-	-	27,864	27,864
Other comprehensive income, net of tax		-	-	4,143	(29)	4,114
Total comprehensive income for the year		-	-	4,143	27,835	31,978
Transactions with shareholders						
Dividends to shareholders		-	-	-	(30,000)	(30,000)
Balance at 31 December 2017	28	69,000	9,850	8,623	131,615	219,088

The statement of changes in equity is to be read in conjunction with the accompanying notes from 1 to 34, which are an integral part of these financial statements.

The financial statements are approved to be published by the Management Board of the Bank on 23 April 2018.

Georgi Zamanov
Chief Executive Director

Rossen Stanimirov
Executive Director

Lyuba Pavlova
Chief Accountant

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Notes to the Annual Financial Statements

1. **(a) Legal statute and ownership**

Allianz Bank Bulgaria AD (The Bank) is incorporated in the Republic of Bulgaria and its registered office is in Sofia, Vazrazdane Municipality, 79 Maria Louisa Blvd.

The Bank is a commercial bank and has a general banking license issued by the Bulgarian National Bank (BNB) according to which it is allowed to conduct all banking transactions in the country.

The ultimate parent and controlling entity of the Bank is Allianz SE, Germany.

(b) Management

As at 31 December 2017, the Management Board of the Bank consists of six members: Georgi Zamanov, Rosen Stanimirov, Hristina Marcenkova, Ivaylo Stoyanov, Marieta Petrova and Kamelya Guleva.

As at 31 December 2017, the Supervisory Board of the Bank is composed of the following members: Dimitar Zhelev, Christoph Plein, Raymond Seamer, Reiner Franz, Valter Lipollis and Kay Muller.

In the Bank operates an Audit Committee that monitors the work of its external auditors, internal auditing, risk management and accounting and financial reporting.

As at 31 December 2017, the Audit Committee has the following members: Maksim Sirakov, Stefan Stefanov and Kay Muller.

(c) Structure of the Bank

As at 31 December 2017, the Bank has 84 structural units, inluding central management, 32 banking centers, 43 financial centers, 8 small financial centers located in 43 settlements in the country.

2. **Basis of accounting**

The financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union[1].

They were authorised for issue by the Bank`s Management Board on 23 April 2018.

The Bank presents comparative information in these financial statements for one prior year.

When necessary, comparative data are reclassified (and restated) in order to achieve comparability with changes in performance in the current year. Except as disclosed in notes 9, 20 and 24, the Bank applies its accounting policies consistently.

The Bank presents its statement of financial position in order of liquidity of the assets and the liabilities.

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[1] The IFRS Accounting Framework, adopted by the EU, is essentially the designated International Accounting Standards (IAS) as set out in the Accountancy Act and defined in § 1 (8) of its Additional Provisions.

Notes to the Annual Financial Statements

3. Basis of measurement

The financial statements have been prepared on a historical cost basis, except for financial assets held for trading and available-for-sale financial assets which are measured at fair value, and obligations for a defined benefit plan, which are measured at present value.

4. Functional and presentation currency

The financial statements are presented in thousands of Bulgarian Lev (BGN), which is the functional currency of the Bank. All amounts have been rounded to the nearest thousand, unless otherwise indicated.

5. Significant accounting policies

(a) Recognition of interest income and expense

Interest income and expense are recognised in profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the life of the financial asset or liability to the carrying amount of the asset or the liability.

The calculation of the effective interest rate includes all fees and commissions paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or the issue of a financial asset or liability.

The interest income and expense, presented in profit or loss comprise:

- interest on financial assets and liabilities at amortised cost calculated on an effective interest basis;
- interest income on financial assets available-for-sale and financial assets held-to-maturity.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(b) Foreign currency transactions

Transactions in foreign currencies are translated to the functional currency at the exchange rates applicable at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency differences on monetary items is the difference between the amortized cost in the functional currency at the beginning of the period, adjusted for the effective interest and payments during the period, and the amortized cost in foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date when the fair value was determined.

Foreign currency differences arising on retranslation to the functional currency are recognized in profit or loss, except for the differences arising on the retranslation of available-for-sale equity instruments.

Since 1998, the exchange of Bulgarian leva (BGN) is pegged to the Euro (EUR) at a rate of BGN 1.95583 / EUR 1.

(c) Fees and commissions

Fee and commission income and expense that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fee and commission income, including cash operations and cash transfers is recognized as the related services are performed. Fees for guarantees and letters of credits are recognized over the period of the instrument.

Other fee and commission expense relates mainly to account service and other fees, which are expensed as the services are received.

(d) Net trading income

Net trading income comprises gains less losses related to trading assets and liabilities, and includes all realised and unrealised fair value changes, interest, dividends and foreign exchange differences.

(e) Financial instruments

(i) Recognition

The Bank recognizes financial assets held for trading, financial assets held-to-maturity, loans and receivables on settlement date. All other financial assets and liabilities are recognized at their trade date, when the Bank becomes a party in an agreement for financial instruments. From this date, any gains and losses arising from changes in their fair value are recognized by the Bank.

A financial asset or a financial liability is measured initially at fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(e) Financial instruments, continued

(ii) Classification

Financial assets

The Bank classifies its financial assets, as follows:

- Loans and receivables
- Held-to-maturity
- Available-for-sale
- Held for trading

Financial liabilities

The Bank classifies its financial liabilities as measured at amortised cost.

(iii) Derecognition

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

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

The Bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised from the statement of financial position. Transfers of assets with retention of all or substantially all risks and rewards include, for example, securities lending and repurchase transactions.

When assets are sold to a third party with a concurrent total rate of return swap on the transferred assets, the transaction is accounted for as a secured financing transaction similar to repurchase transactions.

In transactions in which the Bank neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset, it derecognises the asset if it does not retain control over the asset. The rights and obligations retained in the transfer are recognised separately as assets and liabilities as appropriate. In transfers in which the control over the asset is retained, the Bank continues to recognise the asset to the extent of its involvement, depending on the extent to which it is exposed to changes in the value of the transferred asset.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(e) Financial instruments, continued

(iii) Derecognition, continued

For certain transactions, the Bank retains its obligation to service the transferred financial asset and to receive payment for this. The transferred asset is written off entirely, if it meets the write-off criteria.

The asset or liability is recognized in the service contract, depending on whether the service charge is more than sufficient (asset) or less than sufficient (liability) in order to perform the service.

(iv) Compensations

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position, when and only when the Bank has a legally enforceable right to offset the recognized amounts and intends to settle the asset and liability on a net basis.

Income and expenses are presented net only in cases when is permitted by the applicable accounting standards or in gains and losses arising from a group of similar transactions such as those resulting from the commercial operations of the Bank.

(v) Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method for any difference between the initial amount recognised and the maturity amount, minus any impairment losses.

(vi) Fair value measurement principles

'Fair value' is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal market of the Bank or, in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the Bank measures the fair value of an instrument using the quoted price in an active market for this instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(e) Financial instruments, continued

(vi) Fair value measurement principles, continued

If there is no quoted price in an active market, then the Bank uses valuation techniques (such as discounted cash flows and comparison with similar instruments) that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is usually the transaction price, i.e. the fair value of the consideration transferred or received. When the Bank determines that the fair value at initial recognition differs from the transaction price and there is no evidence of fair value through stock exchange price of a similar asset or liability, nor is it based on a valuation technique that uses data from observable markets, then the financial instrument initially measured at fair value is adjusted to defer the difference between the fair value at initial recognition and the transaction price. Later this difference is recognized in profit and loss deferred with an appropriate base until the useful life of the instrument but not later than when the valuation is supported wholly by observable market data or the transaction is closed out.

The fair value of a demand deposit is not less than the amount payable on demand, discounted from the initial date on which the amount could be required to be paid. The Bank recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

(vii) Impairment of financial assets

At each reporting date, the Bank assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. Financial assets are 'impaired' when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s) and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

Objective evidence that financial assets are impaired includes:

- adverse changes in the payment status of the borrowers;
- default or delinquency of the contractual terms;
- restructuring measures on terms that the Bank would not consider otherwise;
- indications that a borrower will enter bankruptcy;
- the disappearance of an active market for a security or
- other publicly observable data relating to a group of assets such as adverse changes in the payment status of the borrowers or economic conditions that correlate with defaults of the Bank's assets.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(e) Financial instruments, continued

(vii) Impairment of financial assets, continued

The Bank considers evidence of impairment for risk loan exposures at both a specific and collective level depending on the presence or absence of objective indicators for impairment and taking into account the accepted threshold for individual significance.

Impairment losses on assets accounted for at amortized cost are measured as the difference between the carrying amount of the financial assets and the present value of the estimated future cash flows, discounted at the original effective interest rate of the asset. Losses are recognised in profit or loss and are reflected in an allowance account under loans and advances. For secured assets, when assessing the need for impairment, the discounted current net realisable value of the collateral is taken into account. When a subsequent event causes a reduction of the impairment loss, the decrease in the impairment loss is reversed through profit or loss.

Impairment losses on investment securities available-for-sale are recognised by reclassifying the cumulative loss which is accounted directly in equity to profit or loss. The cumulative loss which is removed from equity and recognised in profit or loss, is the difference between the acquisition cost, a net cost of any interest repayment and amortisation, and the current fair value, less any impairment losses previously accounted for in profit or loss.

If in a subsequent period the fair value of an impaired debt security available-for-sale increases and the increase can be related objectively to an event occurring after the impairment loss has already been recognised in profit or loss, then the impairment loss is reversed with the amount of the reversal recognized in profit or loss. Any subsequent recovery, however, in the fair value of an impaired equity security available-for-sale is recognised directly in equity.

The Bank writes off a loan, either partially or in full, and any related allowance for impairment losses, when the Bank determines that there is no realistic prospect of its recovery.

(f) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, unrestricted cash balances held with the Central bank, deposits in banks with original maturities of or less than three months from the date of acquisition that are subject to an insignificant risk of changes in their fair values, and are used by the Bank in the management of its short-term commitments. The Bank itself calculates the minimal amount of reserves which has to sustain and manage in compliance with ordinance 21 of the Bulgarian National Bank. During the sustain period, the Bank may use without restrictions its compulsory minimum reserves.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(g) Financial assets held for trading

Financial assets at fair value through profit or loss include trading instruments that the Bank holds principally for the purpose of selling or repurchasing in the near term, or holds as part of a portfolio that is managed together for a short-term profit. Financial trading assets are initially recognized at fair value in the statement of financial position with transaction costs taken directly to profit or loss. All changes in fair value are recognized as part of the net trading income in profit or loss.

During the reporting period, the Bank has not reclassified any trading financial assets into other categories.

(h) Financial leasing

Accounting for leases as lessee

Where the Bank is a lessee under an operating lease, the lease payments are recognised in the statement of other comprehensive income on a straight line basis over the period of the contract.

Minimum lease payments under finance leases are allocated between interest expense and reduction of the outstanding liability to the lessor. Interest expense is recognised over the term of the contract so that it represents a constant rate on the outstanding amount.

Assets held by the Bank under leases that transfer to the Bank substantially all of the risks and rewards of ownership are classified as finance leases. The leased asset is initially measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset category.

Assets which the Bank uses following lease agreements that do not transfer substantially all of the rights and rewards from the ownership of an asset are not recognised in the Bank`s statement of financial position.

Accounting for leases as lessor

If the Bank is the lessor in a lease agreement that transfers substantially all of the risks and rewards incidental to ownership of the asset to the lessee, then the arrangement is classified as a finance lease and a receivable equal to the net investment in the lease is recognised and presented within loans and advances.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(i) Loans and advances

Loans and advances are non-derivative financial instruments with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near term.

Loans and advances to banks are classified as loans and receivables.

Loans and advances to customers include:

- those classified as loans and receivables;
- finance lease receivables;
- receivables under factoring contracts;
- receivables under cash pool agreements.

Loans and advances are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method.

When the Bank purchases a financial asset and simultaneously enters into an agreement to resell the asset (or a substantially similar asset) at a fixed price on a future date ("reverse repo"), the arrangement is accounted for as a loan or advance, and the underlying asset is not recognised in the statement of financial position.

(j) Financial assets held-to-maturity

Financial assets held-to-maturity are non-derivative assets with fixed or determinable payments and fixed maturity that the Bank has the intention and ability to hold to maturity, and which are not designated as at fair value through profit or loss or as financial assets available-for-sale.

Financial assets held-to-maturity are carried at amortized cost using the effective interest method less any impairment losses. Any sale or restatement of more than insignificant amount of held-to-maturity investments not close to their maturity would result in the restatement of all held-to-maturity investments as available-for-sale, and prevent the Bank from classifying investment securities as held-to-maturity for the current and the following two financial years.

Examples of sales and restatements which would not result in a restatement of the whole investment portfolio are: sales and restatements shortly before maturity date, when the effective interest rate does not have significant effect on the financial asset's market price; sales and restatements after the Bank has collected substantially all of the asset's principal; and sales and restatements, attributable to non-recurring events beyond the Bank's control, that could not have been reasonably anticipated.

Notes to the Financial statement

5. Significant accounting policies, continued

(j) Financial assets available-for-sale

Available-for-sale financial asstes are non-derivative assets not classified as another category of financial assets. Available-for-sale investments comprise government securities and shares.

Unquoted equity securities whose fair value cannot be reliably measured are carried at cost. All other available-for-sale assets are measured at fair value after their initial recognition.

Interest income is recognised in profit or loss using the effective interest method. Dividend income is recognised in profit or loss when the Bank becomes entitled to the dividend. Foreign exchange gains or losses from revaluation of available-for-sale debt security investments are recognised in profit or loss.

Other fair value changes are recognised in other comprehensive income and presented in the fair value reserve within equity. When the investment is sold or impaired in full, the gain or loss, other than impairment loss, accumulated in equity is reclassified to profit or loss.

A non-derivative financial asset may be reclassified from available-for-sale category into the loans and advances category, if it would otherwise have met the definition of loan and if the Bank has intention and ability to hold the asset for the foreseeable future or to maturity.

(k) Property, plant and equipment

Items of property, plant and equipment are measured in the statement of financial position at their acquisition cost less accumulated depreciation and less any accumulated impairment losses.

Any gain or loss on disposal of an item of property, plant and equipment is recognized in profit or loss.

Depreciation is provided on a straight-line basis at prescribed rates designed to write down the cost of property, plant and equipment over their expected useful lives. The following are approximations of the used annual depreciation rates:

Assets	**%**
Buildings	4
Machines and equipments	20-30
Computers	20-50
Fixtures and fittings	10
Motor vehicles	25

Assets are not depreciated until they are brought into use and/or transferred from expenses for acquisition of fixed assets into the relevant asset category.

Depreciation methods, useful lives and residual values of property, plant and equipment are reviewed at each reporting date and adjusted if appropriate.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(l) Intangible assets

Intangible assets, acquired by the Bank, are measured at cost less accumulated amortization and any accumulated impairment losses.

Expenditure on internally developed intangible assets is recognized as an asset when the Bank is able to demonstrate its ability to complete the development and use the asset in a manner that will generate future economic benefits, and can reliably measure its costs.

Subsequent expenditure on intangible assets is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Amortization is calculated on a straight-line basis over the expected useful life of the asset.

The annual amortization rates are as follows:

Intangible assets	%
Computer software and licences	10-50
Other intangible assets	10

Amortization methods, useful lives and residual values of the intangible assets are reviewed at each reporting date and adjusted if appropriate.

(m) Impairment of non-financial assets

At each reporting date, the Bank reviews the carrying amounts of its non-financial assets to determine whether there is any indication of impairment. If such indication exists, then the asset's recoverable amount is estimated.

For impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that is largely independent of the cash inflows of other assets or cash generated unit (CGUs).

The 'recoverable amount' of an asset or CGU is the greater of its value in use and its fair value less costs to sell. 'Value in use' is based on the estimated future cash flows, discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU.

An impairment loss is recognised if the carrying amount of an asset or CGU exceeds its recoverable amount.

Impairment losses are recognised in profit or loss. They are allocated first to reduce the carrying amount of any goodwill allocated to the CGU, and then to reduce the carrying amounts of the other assets in the CGU.

Notes to the Financial statement

5. Significant accounting policies, continued

(n) Deposits and other borrowings

Deposits from customers and borrowings from public funds are the Bank`s sources of funding for the loans and advances to customers.

When the Bank sells a financial asset and simultaneously enters into an agreement to repurchase the asset (or a similar asset) at a fixed price on a future date ("sale and repurchase agreement"), the arrangement is accounted for as a deposit, and the underlying asset continues to be recognized in the Bank`s financial statements.

Deposits and borrowings are initially measured at fair value plus directly attributable transaction costs, and subsequently measured at their amortized cost using the effective interest method.

(o) Provisions

A provision is recognised in the statement of financial position when the Bank has a present legal or constructive obligation as a result of a past event, which can be estimated reliably, and it is probable that a cash outflow will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

(p) Income tax

Income tax expense comprises current and deferred tax. It is recognized in profit or loss except to the extent that relates to items recognized directly in equity or in other comprehensive income.

Interest income taxes and penalties, including uncertain tax procedures, are reported in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

(i) Current tax

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable or receivable in respect of previous years. The amount of the current tax payable or receivable is the best estimate of the tax amount expected to be paid or received that reflects uncertainty related to income taxes, if any.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(p) Income tax, continued

(ii) Deferred tax

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for:

- temporary differences on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss;
- temporary differences related to investments in subsidiaries and jointly controlled entities to the extent that the Bank is able to control the timing of the reversal of the temporary differences and it is probable that they will not reverse in the foreseeable future.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized; such reductions are reversed when the probability of future taxable profits improves.

In determining the amount of current and deferred tax the Bank takes into account the impact of uncertain tax positions and whether additional taxes and interest may be due. The Bank considers that the tax liabilities estimates are adequate for all open tax years based on an assessment of many factors, incl. the interpretation of tax laws and previous experience. This assessment relies on estimates and assumptions and may involve a series of judgments about future events. New information may become available that causes the Bank to change its judgment regarding the adequacy of existing tax liabilities; such changes to tax liabilities will impact tax expense in the period that such a determination is made.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities related to income taxes, imposed by the same tax authorities.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(q) Employee benefits

(i) Short-term employee benefits

Short-term employee benefits are expensed as the related service is provided. A liability is recognized for the amount expected to be paid if the Bank has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

(ii) Defined contribution plans

Obligations for contributions to defined contribution plans comprise contributions to state-owned institutions and to obligatory pension funds managed by privately-owned management companies, in accordance with legal requirements or individual choice. Obligations for contributions to defined contribution plans are expensed as the related service is provided.

(iii) Defined benefits

The Bank's obligation in respect of defined benefits is restricted to the statutory requirement to pay employees an amount equivalent to two or six monthly salaries upon retirement, depending on their length of service. The amount of future benefits that employees have earned in the current and prior periods is estimated and that amount is discounted at an appropriate discount rate, based on the yield at the reporting date on bonds of acceptable credit rating that have maturity dates approximating the terms of the Bank's obligations and that are denominated in the currency in which the benefits are expected to be paid.

The calculation of the defined benefits obligations is performed annually by a qualified actuary using the projected unit credit method. The Bank determines the net interest rate on the net defined benefit liability for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the net defined benefit liability.

Remeasurements of net defined benefit liability which comprise actuarial gains and losses are recognized in other comprehensive income. Net interest expense and other expenses related to defined benefits plans are recognized in profit or loss.

(r) Repossessed assets from collateral

Repossessed assets from collateral are measured at the lower of cost and net realizable value. Costs include costs of acquiring the asset, state fees for PEAs, etc.

Net realizable value is the estimated selling price less the estimated costs necessary to realize the sale.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted

The following new standards, amendments to standards and interpretations approved by the EC are not mandatory for annual periods beginning on or after 1 January 2017 and have not been applied in the preparation of these financial statements. The Bank does not plan to adopt these standards and interpretations earlier.

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC

- **IFRS 15** ***Revenue from Contracts with Customers***

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including IAS 18 *Revenue*, IAS 11 *Construction Contracts* and IFRIC 13 *Customer Loyalty Programmes*, IFRIC 15 *Agreements for the construction of real estate*, IFRIC 18 *Transfers of assets from customers*, as well as SIC 31 *Revenue- barter transactions, involving advertising services.*

The new standard is based on the principle that revenue is recognized when the control over the good or service is transferred to the customer.

IFRS 15 is only applicable to contracts where the counterparty to the contract is a party that can be identified as a customer in accordance with the requirements of the standard.

Additionally, the new revenue standard gives guidance on accounting of certain costs of obtaining / executing the contract. Under IFRS 15, those costs are capitalized and should be recognized as an asset under contracts with customers only if: a) they are incurred in connection with and relate to a contract with a customer that is the scope of IFRS 15; b) are not covered by another IFRS; and c) are directly related to the contract, help to generate resources for use in the course of the contract itself and are expected to be recovered.

Fee and commission income

The Bank realizes income from fees and commissions that are formed by the management of assets. Fee and commission income arises from:

- Cash operations and cash transfers;
- Letters of guarantee and letters of credit;
- Loans;
- Credit cards;
- Others.

The current accounting policy provides the management fees mentioned above to be recognized when providing the services. Execution fees are recognized as fee income after the end of the relevant reference period.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 15** ***Revenue from Contracts with Customers, continued***

Fee and commission income, continued

Under IFRS 15, revenue will be recognized when (or as) the Bank fulfills the obligation to execute by transferring a service to a client. In addition, revenue will be recognized for these contracts to the extent that it is probable that there will be no significant deviation in the cumulative amount of revenue. On the basis of the analysis made, the time and amount of recognized revenue are similar to those applied at the moment.

The Bank does not expect the applying of IFRS 15 to result in significant differences at the time of recognition and measurement of fee and commission income.

Transition

The Bank plans to adopt IFRS 15 using the cumulative effect method, with the effect of initially applying this standard recognised at the date of initial application (i.e. 1 January 2018). As a result, the Bank will not apply the requirements of IFRS 15 to the comparative period presented.

- **IFRS 9** ***Financial instruments***

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted. It replaces IAS 39 Financial Instruments: Recognition and Measurement.

In October 2017, the IASB issued Prepayment Features with Negative Compensation (Amendments to IFRS 9). The amendments are effective for annual periods beginning on or after 1 January 2019, with early adoption permitted.

The Bank will apply IFRS 9 as issued in July 2014 initially on 1 January 2018 and will early adopt the amendments to IFRS 9 on the same date based on assessments undertaken to date, the total estimated adjustment (net of tax) of the adoption of IFRS 9 on the opening balance of the Bank's equity at 1 January 2018 is approximately BGN 6,425 thousand, representing:

- a reduction of approximately BGN 7,138 thousand, related to impairment requirements;

- an increase of approximately BGN 713 thousand, related to deferred tax impacts.

There are no effects arising from the classification and measurement requirements other than those for impairment.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 9 *Financial instruments, continued***

The table below summarizes the expected impairment effects by type of financial asset as at 1 January 2018:

In thousands of BGN	**Additional impairment**
Loans and advances to customers	3,383
Off-balance sheet commitments	2,865
Loans and advances to banks	12
Investment Securities	731
Cash and cash equivalents	141
Other assets	6
Total	**7,138**

The expected change in equity as at 1 January 2018 is presented in the table below:

In thousands of BGN	**Adjustment in equity**
Change in retained earnings by additional estimates	7,138
Change in retained earnings from deferred tax	(713)
Total change in equity	**6,425**

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 9** ***Financial instruments, continued***

The above assessment is preliminary because not all transition work has been finalised. The actual impact of adopting IFRS 9 on 1 January 2018 may change because:

- IFRS 9 will require the Bank to revise its accounting processes and internal controls and these changes are not yet complete;

- the Bank has not finalised the testing and assessment of controls over its new IT systems and changes to its governance framework;

- the Bank is refining and finalising its models for ECL calculations; and

- the new accounting policies, assumptions, judgements and estimation techniques employed are subject to change until the Bank finalises its first financial statements that include the date of initial application.

(i) Classification – Financial assets

IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics.

IFRS 9 includes three principal classification categories for financial assets: measured at amortised cost, FVOCI and FVTPL. It eliminates the existing IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale.

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and

- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding.

A financial asset is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 9** ***Financial instruments, continued***

(i) Classification – Financial assets, continued

- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity investment that is not held for trading, the Bank may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by investment basis.

All financial assets not classified as measured at amortised cost or FVOCI as described above are measured at FVTPL. In addition, on initial recognition the Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

A financial asset is classified into one of these categories on initial recognition.

Business model assessment

The Bank will make an assessment of the objective of the business model in which a financial asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information that will be considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice, including whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of assets;

- how the performance of the portfolio is evaluated and reported to the Bank's management;

- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;

- how managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 9** ***Financial instruments, continued***

(i) Classification – Financial assets, continued

- the frequency, volume and timing of sales in prior periods, the reasons for such sales and expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Bank's stated objective for managing the financial assets is achieved and how cash flows are realised.

Financial assets that are held for trading and those that are managed and whose performance is evaluated on a fair value basis will be measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

Assessment whether contractual cash flows are solely payments of principal and interest (SPPI)

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as a profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Bank will consider the contractual terms of the instrument. This will include assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Bank will consider:

- contingent events that would change the amount and timing of cash flows;

- leverage features;

- prepayment and extension terms;

- terms that limit the Bank's claim to cash flows from specified assets – e.g. non-recourse asset arrangements; and

- features that modify consideration for the time value of money – e.g. periodic reset of interest rates.

Interest rates on certain retail loans made by the Bank are based on standard variable rates (SVRs) that are set at the discretion of the Bank.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 9** ***Financial instruments, continued***

(i) Classification – Financial assets, continued

Assessment whether contractual cash flows are solely payments of principal and interest (SPPI), continued

The Bank will assess whether the discretionary feature is consistent with the SPPI criterion by considering a number of factors, including whether:

- the borrowers are able to prepay the loans without significant penalties;

- the market competition ensures that interest rates are consistent between banks; and

- any regulatory or customer protection framework is in place that requires banks to treat customers fairly.

All of the Bank's loans contain prepayment features. A prepayment feature is consistent with the SPPI criterion if the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable compensation for early termination of the contract.

In addition, a prepayment feature is treated as consistent with this criterion if a financial asset is acquired or originated at a premium or discount to its contractual par amount, the prepayment amount substantially represents the contractual par amount plus accrued (but unpaid) contractual interest (which may also include reasonable compensation for early termination), and the fair value of the prepayment feature is insignificant on initial recognition.

Impact assessment

The standard will affect the classification and measurement of financial assets held as at 1 January 2018 as follows.

- trading assets measured at FVTPL under IAS 39, will also be measured at FVTPL under IFRS 9;

- loans and advances to banks and to customers that are classified as loans and advances are measured at amortised cost under IAS 39 will in general also be measured at amortised cost under IFRS 9;

- held-to-maturity financial assets measured at amortised cost under IAS 39 will in general also be measured at amortised cost under IFRS 9;

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 9 *Financial instruments, continued***

(i) Classification – Financial assets, continued

Impact assessment, continued

- debt investment securities that are classified as available-for-sale under IAS 39 may, under IFRS 9, be measured at amortised cost, FVOCI or FVTPL, depending on the particular circumstances;

- loans and advances to customers and investment securities that are designated as at FVTPL under IAS 39 will in general continue to be measured at FVTPL under IFRS 9;

- the majority of the equity investment securities that are classified as available-for-sale under IAS 39 will be measured at FVTPL under IFRS 9. However, some of these equity investment securities are held for long-term strategic purposes and will be designated as at FVOCI on 1 January 2018.

The Bank has estimated that, on the adoption of IFRS 9 at 1 January 2018, the impact of these changes will not materially affect the cost of equity.

(ii) Impairment – Financial assets, loan commitments and financial guarantee contracts

IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' model ('ECL'). This will require considerable judgement over how changes in economic factors affect ECLs, which will be determined on a probability-weighted basis.

The new impairment model applies to the following financial assets that are not measured at FVTPL:

- financial assets that are debt instruments;

- lease receivables; and

- loan commitments and financial guarantee contracts issued (previously, impairment was measured under IAS 37 Provisions, Contingent Liabilities and Contingent Assets).

Under IFRS 9, no impairment loss is recognised on equity investments.

IFRS 9 requires a loss allowance to be recognised at an amount equal to either 12-month ECLs or lifetime ECLs. Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument, whereas 12-month ECLs are the portion of ECLs that result from default events that are possible within the 12 months after the reporting date.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 9** ***Financial instruments, continued***

(ii) Impairment – Financial assets, loan commitments and financial guarantee contracts, continued

The Bank will recognise loss allowances at an amount equal to lifetime ECLs, except in the following cases, for which the amount recognised will be 12-month ECLs:

- debt investment securities that are determined to have low credit risk at the reporting date. The Bank considers a debt security to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment-grade'; and

- other financial instruments (other than lease receivables) for which credit risk has not increased significantly since initial recognition.

Loss allowances for lease receivables will always be measured at an amount equal to lifetime ECLs.

The impairment requirements of IFRS 9 are complex and require management judgements, estimates and assumptions, particularly in the following areas, which are discussed in detail below:

- assessing whether the credit risk of an instrument has increased significantly since initial recognition; and

- incorporating forward-looking information into the measurement of ECLs.

Measurement of ECLs

ECLs are a probability-weighted estimate of credit losses and will be measured as follows:

- *financial assets that are not credit-impaired at the reporting date:* the present value of all cash *shortfalls* – the difference between the cash flows due in accordance with the contract and the cash flows that the Bank expects to receive;

- *financial assets that are credit-impaired at the reporting date:* the difference between the gross carrying amount and the present value of estimated future cash flows;

- *undrawn loan commitments:* the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is drawn down and the cash flows that the Bank expects to receive; and

- *financial guarantee contracts:* the present value of the expected payments to reimburse the holder less any amounts that the Bank expects to recover.

Financial assets that are credit-impaired are defined by IFRS 9 in a similar way to financial assets that are impaired under IAS 39.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 9 *Financial instruments, continued***

(ii) Impairment – Financial assets, loan commitments and financial guarantee contracts, continued

Definition of default

Under IFRS 9, the Bank will consider a financial asset to be in default when:

- the borrower is unlikely to pay its credit obligations to the Bank in full, without recourse by the Bank to actions such as realising security (if any is held); or

- the borrower is more than 90 days past due on any credit obligation to the Bank. Overdrafts are considered past due once the customer has breached an advised limit or been advised of a limit that is smaller than the current amount outstanding.

This definition is largely consistent with the definition used for regulatory purposes.

In assessing whether a borrower is in default, the Bank will consider indicators that are:

- qualitative: e.g. breaches of covenant;

- quantitative: e.g. overdue status and non-payment of another obligation of the same issuer to the Bank; and

- based on data developed internally and obtained from external sources.

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances.

Significant increase in credit risk

Under IFRS 9, when determining whether the credit risk (i.e. risk of default) on a financial instrument has increased significantly since initial recognition, the Bank will consider reasonable and supportable information that is relevant and available without undue cost or effort, including both quantitative and qualitative information and analysis based on the Bank's historical experience, expert credit assessment and forward-looking information.

The Bank will primarily identify whether a significant increase in credit risk has occurred for an exposure by comparing:

- the remaining lifetime probability of default (PD) as at the reporting date;

- the remaining lifetime PD for this point in time that was estimated on initial recognition of the exposure.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 9 *Financial instruments, continued***

(ii) Impairment – Financial assets, loan commitments and financial guarantee contracts, continued

Significant increase in credit risk, continued

Assessing whether credit risk has increased significantly since initial recognition of a financial instrument requires identifying the date of initial recognition of the instrument. For certain revolving facilities (e.g. credit cards and overdrafts), the date when the facility has first entered into could be a long time ago. Modifying the contractual terms of a financial instrument may also affect this assessment, which is discussed below.

Credit risk grades

The Bank will allocate each exposure to a credit risk grade based on a variety of data that is determined to be predictive of the risk of default and applying experienced credit judgement. The Bank will use these grades in identifying significant increases in credit risk under IFRS 9. Credit risk grades are defined using qualitative and quantitative factors that are indicative of the risk of default. These factors may vary depending on the nature of the exposure and the type of borrower.

Credit risk grades are defined and calibrated such that the risk of default occurring increases exponentially as the credit risk deteriorates – e.g. the difference in the risk of default between credit risk grades 1 and 2 is smaller than the difference between credit risk grades 2 and 3.

Each exposure will be allocated to a credit risk grade on initial recognition based on available information about the borrower. Exposures will be subject to ongoing monitoring, which may result in an exposure being moved to a different credit risk grade.

Generating the term structure of PD

Credit risk grades will be a primary input into the determination of the term structure of PD for exposures. The Bank will collect performance and default information about its credit risk exposures analysed by jurisdiction, by type of product and borrower and by credit risk grading. For some portfolios, information purchased from external credit reference agencies may also be used.

The Bank will employ statistical models to analyse the data collected and generate estimates of the remaining lifetime PD of exposures and how these are expected to change as a result of the passage of time.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 9** ***Financial instruments, continued***

(ii) Impairment – Financial assets, loan commitments and financial guarantee contracts, continued

This analysis will include the identification and calibration of relationships between changes in default rates and changes in key macro-economic factors, as well as in-depth analysis of the impact of certain other factors (e.g. forbearance experience) on the risk of default. For most exposures, key macro-economic indicators are likely to include:

- CPI – inflation measured by the harmonized index of consumer prices, average annual change (%);

- GDP growth;

- Unemployment – unemployment rate, seasonally adjusted data, monthly;

- 6m SOFIBID – index (SOFIBID: Sofia interbank bid rate) 6m quote.

For exposures to specific industries and/or regions, the analysis may extend to relevant commodity and/or real estate prices. The Bank's approach for the inclusion of forward-looking information in this assessment is described below.

Determining whether credit risk has increased significantly

The Bank has established a framework that incorporates both quantitative and qualitative information to determine whether the credit risk on a particular financial instrument has increased significantly since initial recognition. The framework aligns with the Bank's internal credit risk management process. The criteria for determining whether credit risk has increased significantly will vary by portfolio and will include a backstop based on delinquency.

The Bank will deem the credit risk of a particular exposure to have increased significantly since initial recognition if, based on the Bank's quantitative modelling, the remaining lifetime PD is determined to have increased since initial recognition as per the adopted accounting policy. In measuring increases in credit risk, remaining lifetime ECLs are adjusted for changes in maturity.

In certain instances, using its expert credit judgement and, where possible, relevant historical experience, the Bank may determine that an exposure has undergone a significant increase in credit risk if particular qualitative factors indicate so and those indicators may not be fully captured by its quantitative analysis on a timely basis. As a backstop, and as required by IFRS 9, the Bank will presumptively consider that a significant increase in credit risk occurs no later than when an asset is more than 30 days past due. The Bank will determine days past due by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 9 *Financial instruments, continued***

(ii) Impairment – Financial assets, loan commitments and financial guarantee contracts, continued

Determining whether credit risk has increased significantly, continued

The Bank will monitor the effectiveness of the criteria used to identify significant increases in credit risk by regular reviews to confirm that:

- the criteria are capable of identifying significant increases in credit risk before an exposure is in default;

- the criteria do not align with the point in time when an asset becomes 30 days past due;

- the average time between the identification of a significant increase in credit risk and default appears reasonable;

- exposures are not generally transferred directly from 12-month ECL measurement to credit-impaired; and

- there is no unwarranted volatility in loss allowance from transfers between 12-month ECL and lifetime ECL measurements.

Modified financial assets

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer. An existing loan whose terms have been modified may be derecognised and the renegotiated loan recognised as a new loan at fair value.

Under IFRS 9, when the terms of a financial asset are modified and the modification does not result in derecognition, the determination of whether the asset's credit risk has increased significantly reflects comparison of:

- the remaining lifetime PD at the reporting date based on the modified terms; with

- the remaining lifetime PD estimated based on data on initial recognition and the original contractual terms.

The Bank renegotiates loans to customers in financial difficulties (referred to as 'forbearance activities') to maximise collection opportunities and minimise the risk of default. Under the Bank's forbearance policy, loan forbearance is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 9 *Financial instruments, continued***

(ii) Impairment – Financial assets, loan commitments and financial guarantee contracts, continued

Modified financial assets, continued

The revised terms usually include extending the maturity, changing the timing of interest payments and amending the terms of loan covenants. Both retail and corporate loans are subject to the forbearance policy. The Bank's Credit Committee regularly reviews reports on forbearance activities.

For financial assets modified as part of the Bank's forbearance policy, the estimate of PD will reflect whether the modification has improved or restored the Bank's ability to collect interest and principal and the Bank's previous experience of similar forbearance action. As part of this process, the Bank will evaluate the borrower's payment performance against the modified contractual terms and consider various behavioural indicators.

Generally, forbearance is a qualitative indicator of default and credit impairment and expectations of forbearance are relevant to assessing whether there is a significant increase in credit risk. Following forbearance, a customer needs to demonstrate consistently good payment behaviour over a period of time before the exposure is no longer considered to be in default/credit-impaired or the PD is considered to have decreased such that the loss allowance reverts to being measured at an amount equal to 12-month ECLs.

Inputs into measurement of ECLs

The key inputs into the measurement of ECLs are likely to be the term structures of the following variables:

- probability of default (PD);

- loss given default (LGD); and

- exposure at default (EAD).

These parameters will be derived from internally developed statistical models and other historical data that leverage regulatory models. They will be adjusted to reflect forward-looking information as described below.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 9** ***Financial instruments, continued***

(ii) Impairment – Financial assets, loan commitments and financial guarantee contracts, continued

Inputs into measurement of ECLs, continued

PD estimates are estimates at a certain date, which will be calculated based on statistical rating models and assessed using rating tools tailored to the various categories of counterparties and exposures. These statistical models will be based on internally compiled data comprising both quantitative and qualitative factors. Where it is available, market data may also be used to derive the PD for large corporate counterparties. If a counterparty or exposure migrates between rating classes, then this will lead to a change in the estimate of the associated PD. PDs will be estimated considering the contractual maturities of exposures and estimated prepayment rates.

LGD is the magnitude of the likely loss if there is a default. The Bank will estimate LGD parameters based on the history of recovery rates of claims against defaulted counterparties. The LGD models will consider the structure, collateral, seniority of the claim, counterparty industry and recovery costs of any collateral that is integral to the financial asset. For loans secured by retail property, loan-to-value (LTV) ratios are likely to be a key parameter in determining LGD. LGD estimates will be calibrated for different economic scenarios and, for real estate lending, to reflect possible changes in property prices. They will be calculated on a discounted cash flow basis using the effective interest rate as the discounting factor. EAD represents the expected exposure in the event of a default. The Bank will derive the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract, including amortisation, and prepayments. The EAD of a financial asset will be the gross carrying amount at default. For lending commitments and financial guarantees, the EAD will consider the amount drawn, as well as potential future amounts that may be drawn or repaid under the contract, which will be estimated based on historical observations and forward-looking forecasts. For some financial assets, the Bank will determine EAD by modelling the range of possible exposure outcomes at various points in time using scenario and statistical techniques.

As described above, and subject to using a maximum of a 12-month PD for financial assets for which credit risk has not significantly increased, the Bank will measure ECLs considering the risk of default over the maximum contractual period (including any borrower's extension options) over which it is exposed to credit risk, even if, for risk management purposes, the Bank considers a longer period. The maximum contractual period extends to the date at which the Bank has the right to require repayment of an advance or terminate a loan commitment or guarantee.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 9** ***Financial instruments, continued***

(ii) Impairment – Financial assets, loan commitments and financial guarantee contracts, continued

Inputs into measurement of ECLs, continued

For retail overdrafts and credit card facilities and certain corporate revolving facilities that include both a loan and an undrawn commitment component, the Bank will measure ECLs over a period longer than the maximum contractual period if the Bank's contractual ability to demand repayment and cancel the undrawn commitment does not limit the Bank's exposure to credit losses to the contractual notice period. These facilities do not have a fixed term or repayment structure and are managed on a collective basis. The Bank can cancel them with immediate effect but this contractual right is not enforced in the normal day-to-day management, but only when the Bank becomes aware of an increase in credit risk at the facility level. This longer period will be estimated taking into account the credit risk management actions that the Bank expects to take to mitigate ECLs. These include a reduction in limits and cancellation of the facility.

Where modelling of a parameter is carried out on a collective basis, the financial instruments will be grouped on the basis of shared risk characteristics that include:

- instrument type;
- credit risk gradings;
- collateral type;
- LTV ratio;
- date of initial recognition;
- remaining term to maturity;
- industry; and
- geographic location of the borrower.

The groupings will be subject to regular review to ensure that exposures within a particular group remain appropriately homogeneous.

For portfolios in respect of which the Bank has limited historical data, external benchmark information will be used to supplement the internally available data. The portfolios for which external benchmark information represents a significant input into measurement of ECLs are as follows:

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 9** ***Financial instruments, continued***

(ii) Impairment – Financial assets, loan commitments and financial guarantee contracts, continued

Inputs into measurement of ECLs, continued

		External benchmarks used	
	Exposure	**PD**	**LGD**
Reported at amortized cost (AMORTCOST)	386,155	Studies by Fitch, S & P and other licensed agencies on non-compliance	Studies by Fitch, S & P and other licensed agencies on non-compliance
Reported at fair value through other comprehensive income (FVOCI)	164,971	Studies by Fitch, S & P and other licensed agencies on non-compliance	Studies by Fitch, S & P and other licensed agencies on non-compliance

Forward-looking information

Under IFRS 9, the Bank will incorporate forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since initial recognition and its measurement of ECLs. The Bank will formulate a 'base case' view of the future direction of relevant economic variables and a representative range of other possible forecast scenarios based on advice from the Bank's Market Risk Committee and economic experts and consideration of a variety of external actual and forecast information. This process will involve developing two or more additional economic scenarios and considering the relative probabilities of each outcome. External information may include economic data and forecasts published by governmental bodies and monetary authorities, supranational organisations such as the Organisation for Economic Co-operation and Development and the International Monetary Fund, and selected private sector and academic forecasters.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 9** ***Financial instruments, continued***

(ii) Impairment – Financial assets, loan commitments and financial guarantee contracts, continued

Forward-looking information, continued

The base case will represent a most-likely outcome and be aligned with information used by the Bank for other purposes, such as strategic planning and budgeting. The other scenarios will represent more optimistic and more pessimistic outcomes. The Bank will also periodically carry out stress-testing of more extreme shocks to calibrate its determination of these other representative scenarios.

The Bank has identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments and, using an analysis of historical data, has estimated relationships between macro-economic variables and credit risk and credit losses. These key drivers include interest rates, unemployment rates and GDP forecasts. Predicted relationships between the key indicators and default and loss rates on various portfolios of financial assets have been developed based on analysing historical data over the past 5 years.

The economic scenarios used will be approved by the Management Board of the Bank.

Impact assessment

The most significant impact on the Bank's financial statements from the implementation of IFRS 9 is expected to result from the new impairment requirements. Impairment losses will increase and become more volatile for financial instruments in the scope of the IFRS 9 impairment model.

The Bank has estimated that, on the adoption of IFRS 9 at 1 January 2018, the impact of the increase in loss allowances (before tax) will be approximately BGN 6,425 thousand. Loss allowances on unsecured products with longer expected lives such as overdrafts and credit cards will be most affected by the new impairment requirements.

(iii) Classification – Financial liabilities

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities.

However, under IAS 39 all fair value changes of financial liabilities designated as at FVTPL are recognised in profit or loss, whereas under IFRS 9 these fair value changes will generally be presented as follows:

– the amount of the change in the fair value that is attributable to changes in the credit risk of the liability will be presented in OCI; and

– the remaining amount of the change in the fair value will be presented in profit or loss.

Notes to the Financial statement

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 9** ***Financial instruments, continued***

(iv) Derecognition and contract modification

IFRS 9 incorporates the requirements of IAS 39 for the derecognition of financial assets and financial liabilities without substantive amendments.

However, it contains specific guidance for the accounting when the modification of a financial instrument not measured at FVTPL does not result in derecognition. Under IFRS 9, the Bank will recalculate the gross carrying amount of the financial asset (or the amortised cost of the financial liability) by discounting the modified contractual cash flows at the original effective interest rate and recognise any resulting adjustment as a modification gain or loss. Under IAS 39, the Bank does not recognise any gain or loss in profit or loss on modifications of financial liabilities and non-distressed financial assets that do not lead to their derecognition.

The Bank expects an immaterial impact from adopting these new requirements.

(v) Disclosures

IFRS 9 will require extensive new disclosures, in particular about credit risk and ECLs.

(vi) Impact on capital planning

The Bank`s regulator has issued guidelines on transition requirements for the implementation of IFRS 9. The guidelines allow a choice of two approaches to the recognition of the impact of adoption of the standard on regulatory capital:

1. phasing in the full impact on a straight-line basis over a five-year period; or

2. recognising the full impact on the day of adoption.

The Bank has decided to adopt the second approach.

The principal impact on the Bank`s regulatory capital of the implementation of IFRS 9 will arise from the new impairment requirements.

Under current regulatory requirements, impairment provisions are dealt with differently depending on whether a particular portfolio is under the IRB or the standardised approach.

The Bank applies a standardized approach.The capital requirement is calculated based on the gross exposures net specific provisions – i.e. net exposure. IFRS 9 is expected to increase the loss allowances associated with individual assets, and therefore the resulting net exposure and the capital requirement will fall. However, this reduction in the capital requirement will be outweighed by the increased IFRS 9 loss allowance from capital resources. The Bank`s assessment indicates that the impact on capital resources of the implementation of IFRS 9 for the standardised portfolios will be a reduction in CET1 and total capital of approximately BGN 6,425 thousand.

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 9** ***Financial instruments, continued***

(vii) Transition

Changes in accounting policies resulting from the adoption of IFRS 9 will generally be applied retrospectively, except as described below.

- The Bank will take advantage of the exemption allowing it not to restate comparative information for prior periods with respect to classification and measurement (including impairment) changes. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 will generally be recognised in retained earnings and reserves as at 1 January 2018.

- The following assessments have to be made on the basis of the facts and circumstances that exist at the date of initial application.

- The determination of the business model within which a financial asset is held.

- The designation and revocation of previous designations of certain financial assets and financial liabilities as measured at FVTPL.

- The designation of certain investments in equity instruments not held for trading as at FVOCI.

- For a financial liability designated as at FVTPL, the determination of whether presenting the effects of changes in the financial liability's credit risk in OCI would create or enlarge an accounting mismatch in profit or loss.

- If a debt investment security has low credit risk at 1 January 2018, then the Bank will determine that the credit risk on the asset has not increased significantly since initial recognition.

- **IFRS 16** ***Leases***

IFRS 16 replaces existing leases guidance, including IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases – Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

The standard is effective for annual periods beginning on or after 1 January 2019. Early adoption is permitted for entities that apply IFRS 15 at or before the date of initial application of IFRS 16.

IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are recognition exemptions for short-term leases and leases of low-value items

Notes to the Annual Financial Statements

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- **IFRS 16 *Leases*, continued**

Lessor accounting remains similar to the current standard – i.e. lessors continue to classify leases as finance or operating leases.

Currently, the most significant effect is that the Bank will recognize new assets and liabilities for its operating leases.

In addition, the nature of expenses related to those leases will now change as IFRS 16 replaces the straight-line operating lease expense with a depreciation charge for right-of-use assets and interest expense on lease liabilities.

(i) Determining whether an arrangement contains a lease

Management considers that for the existing contracts as at 31 December 2017 there will be no change in the classification of contracts as containing lease as per IAS 17 and IFRIC 4, and as per the definition in IFRS 16.

(ii) Transition

As a lessee, the Bank can either apply the standard using a:

- retrospective approach; or
- modified retrospective approach with optional practical expedients.

The lessee applies the election consistently to all of its leases.

The Bank plans to apply IFRS 16 initially on 1 January 2019, using the modified retrospective approach. Therefore, the cumulative effect of adopting IFRS 16 will be recognised as an adjustment to the opening balance of retained earnings at 1 January 2019, with no restatement of comparative information.

When applying the modified retrospective approach to leases previously classified as operating leases under IAS 17, the lessee can elect, on a lease-by-lease basis, whether to apply a number of practical expedients on transition. The Bank is assessing the potential impact of using these practical expedients.

For more information on irrevocable minimum lease payments, see note 13.

Notes to the Financial statement

5. Significant accounting policies, continued

(s) New standards and interpretations not yet adopted, continued

Standards, interpretations and amendments to published standards that have not been early adopted – endorsed by the EC, continued

- ***Amendments to IFRS 4: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts***

The Bank is not an insurance provider and therefore does not expect any material impact on its financial statements.

- ***Other amendments***

The following amendments and improvements to standards are not expected to have a material impact on the financial statements of the Bank:

- *Annual Improvements to IFRS 2014-2016 Cycle*

- *Amendments to IFRS 9: Prepayment Features with Negative Compensation*

- *IFRIC 22 Foreign Currency Transactions and Advance Consideration*

Standards and interpretations not yet endorsed by the EC

Management believes that it is appropriate to disclose that the following new or revised standards, new interpretations and amendments to current standards, which are already issued by the International Accounting Standards Board (IASB), are not yet endorsed for adoption by the EC, and therefore are not taken into account in preparing these financial statements. The actual effective dates for them will depend on the endorsement decision by the EC.

- **IFRS 17** ***Insurance Contracts***

The Bank expects that the amendments, when initially applied, will not have a material impact on the presentation of the financial statements of the Bank because the Bank does not issue insurance or reinsurance contracts, does not hold reinsurance contracts and does not issue investment contracts with discretionary participation features

- ***Other amendments***

The following changes are not expected to have a significant impact on the Bank financial statements.

- *IFRIC 23 Uncertainty over Income Tax Treatments*

- *Annual Improvements to IFRS 2015-2017 Cycle*

- *Amendments to IAS 19: Plan Amendment, Curtailment or Settlement*

- *Amendments to References to the Conceptual Framework in IFRS Standards (issued on 29 March 2018)*

Notes to the Annual Financial Statements

6. Financial risk management

(a) Introduction

The Bank is exposed to the following types of risks from its use of financial instruments:

- credit risk;
- liquidity risk;
- market risk;
- compliance with capital adequacy requirements.

This note presents information about the Bank's exposures to the above risks and the Bank's objectives, policies and processes for measuring and managing those risks.

Risk management framework

The Management Board (the Board) has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established the Asset and Liability Committee and the Credit and Operational Risk Committee, which are responsible for developing and monitoring the Bank's risk management policies in their specified areas.

The Bank's risk management policies are established to identify and analyze the risks faced by the Bank, to set appropriate risk limits and controls, and the adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered.

The "Internal Audit" Division is responsible for monitoring compliance with the Bank's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank.

(b) Credit risk

The Bank is subject to credit risk through its trading, lending, and investing activities and in cases where it acts as an intermediary on behalf of customers or other third parties or issues guarantees, Allianz Bank Bulgaria AD has exposure to credit risk.

Concentration of credit risk arises mainly from types of counterparty and the industries in which counterparties operates. Concentrations of credit risk that arise from financial instruments held in contragent banks exist when counterparties have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions.

Notes to the Financial statement

6. Financial risk management, continued

(b) Credit risk, continued

Credit risk management

The Management Board has delegated responsibility for the management of credit risk to the Executive Directors of the Bank, "Credit Risk" Division, "Problem Loans and Collection" Division, "Large Corporate Clients" Division, "Corporate Banking" Division, "Retail Banking" Division, "Sales Controlling" Division and Bank's Credit Council.

- The Management Board of the Bank formulates credit policies in consultation with business units, covering collateral requirements, credit risk, assessment and compliance with regulatory and statutory requirements.
- The Management Board of the Bank sets the competences for the approval and renewal of credit facilities. The "Credit Risk" Division prepares a report for credit risk assessment of all credit exposures in excess of designated limits, prior to facilities being reviewed and approved by the competent Bank's authorities.
- Quality assessment is based on an assessment of indicators such as company history and ownership, management, credit history, experience, sector analysis, environmental assessment and others. In addition to that, the Bank uses specialised software (Litis-POD) to generate a behavioral scoring model based on the borrower's credit history for corporate clients and individuals. The behavioral scoring is carried out clients which have available credit history for at least three months from the date of the rating. As a factor in the speciliased software (Litis-POD), the Bank implements an internal corporate rating model (MicroCap) and application scoring (Critesis).
- The application rating is based on quantitative assessment /financial scoring/ and qualitative assessment of the borrower and its related parties. The financial scoring is calculated based on the latest available annual financial statements and key financial ratios for the reporting period.
- "Strategic Risk and Controlling" Directorate carries out at least once a year "reverse stress tests" of impairment models. The distribution, the significance of the Kolmogorov-Smirnov coefficient and Ginni coefficient are compared as well as the acquired levels of overdue rates with the expected ones (the range of rating intervals). Each change in the structure of the model which leads to a change of the individual ratings of the borrower is approved by the Bank's Credit and Operational Risk Committee.
- The Bank implements specialised PD (ProductDeliverySystem) system which covers the entire work process in the Retail Banking business line, from the application for the loan, the consideration of the request, the decision-making and the signing of the credit agreement, to the utilisation of the loan. The system is designed to operate separate modules for each product (mortgage loans, consumer loans, credit cards, etc.) and each module has a separate system of indicators. The system calculates an assessment rating for assessing credit risk.

Notes to the Annual Financial Statements

6. Financial risk management, continued

(b) Credit risk, continued

Credit risk management, continued

- At the beginning of each calendar year the Management Board of the Bank approves and reviews the concentration of exposures in the credit programmes, industries, sectors, types of customers, loan amounts, maturity, etc., as well as issuers, credit rating, liquidity and country (for investment securities).
- "Credit Monitoring" Department and "Restructuring-Decentralisation" Department are responsible for managing the credit risk of the Bank, regarding review, evaluation and classification of risk exposures of the Bank depending on the period of delayed payments according to the terms stipulated in the banking legislation and the assessment of the financial situation of the debtor and the sources of payment of their obligations, focusing the management's attention on the relevant risk. The above mentioned departments report to the Credit Committee of the Bank.
- "Credit Monitoring" Department periodically reviews for compliance the activity of the Business Centres / Financial Centres with their assigned credit limits to the policies and regulations for the lending activities of the Bank. Periodic reports on the results of the inspections and the quality of local portfolios are provided to the Executive Directors of the Bank. The Bank carries out ongoing monitoring, including analysis of the financial condition of the obligor, depending on the size of the total credit exposure of the borrower and the related parties, as follows: at least once a year for exposures up to BGN 500 thousand and twice a year for the exposures over BGN 500 thousand, and extraordinary monitoring when there is a change in the risk.
- The Bank periodically monitors the value of the real estate accepted as collateral – for commercial real estate at least once a year, and for residential property every three years. The Bank carries out more frequent monitoring where there are significant changes in the market conditions. Collateral accepted on all impaired loans are revalued at least once a year. The collateral is revalued by an independent appraiser, determining net realisable value. For loans exceeding € 3 million or 5% of the equity of the Bank, assessment of the property is subject to review by an appraiser at least once a year.
- The Bank classifies risk exposures according to the degree of credit risk in the following classification groups according to the adopted Impairment policy – serviced exposures and risk positions in default.
- The Credit Committee approves exposures above BGN 0.5m, as well as restructuring of exposures above BGN 0.25m.

Notes to the Annual Financial Statements

6. Financial risk management, continued

(b) Credit risk, continued

Credit risk management, continued

Performing exposures

A risk exposure is classified as performing if the following conditions are all present: principal and interest are continually repaid in accordance with the terms of the contract or are paid overdue up to 90 days, and no event of default is registered.

Risk exposures in default

A default is considered to have occurred with respect to a certain debtor when at least one of the following conditions is met:

a) it is unlikely that the debtor would pay their credit obligations to the Bank without action undertaken by the Bank, such as the realisation of collateral, regardless of the amount of arrears and admitted days overdue;

b) the obligor is overdue for more than 90 days on any material credit obligation to the Bank.

The classification of the risk groups is as follows:

"Standard" are the risk exposures on loans and other receivables which are serviced and for which information on the financial status of debtors gives no ground to doubt that they will repay in full their obligations.

"Watch" are the risk exposures on loans and other receivables where there are minor breaches to their servicing or there is a possibility of deterioration in the debtor's financial situation, which may call into question the full repayment of the debt.

"Non-performing" exposures are the risk exposures on loans and other receivables where there are significant breaches to their servicing, or there is evidence that the financial situation of the debtor is not stable, current and anticipated proceeds are insufficient for the full repayment of their obligations to the Bank and to other creditors, as well as where weaknesses have been found with the distinct possibility that the Bank will sustain losses.

"Loss" exposures are the risk exposures, where due to deterioration in the debtor's financial condition, their obligations are expected to become uncollectible, regardless of their partial recovery value which can be realised in the future.

The risk exposures in default are classified as "non-performing" and "loss".

The Bank assesses and classifies individually all significant risk exposures in default. If the debtor has more than one exposure, the highest risk class is awarded to all of its exposures.

Notes to the Financial statement

6. Financial risk management, continued

(b) Credit risk, continued

Credit quality analysis

The table below set out information about the maximum credit risk exposure.

Maximum exposure to credit risk
In thousands of BGN

	Note	**2017**	**2016** *Restated**
Cash and cash equivalents (excluding cash on hand)	16	775,557	646,662
Financial assets held for trading (excluding equity instruments)	17	34,118	35,590
Loans and advances to banks and other financial institutions	18	38,306	32,122
Financial assets held for sale (excluding equity instruments)	19.1	165,136	166,954
Financial assets, held-to-maturity	19.2	386,720	431,194
Loans and advances to customers	20	1,099,404	1,088,839
Total on-balance-sheet credit risk		**2,499,241**	**2,401,361**
Off-balance sheet commitments			
Undrawn credit commitments	29	109,818	105,007
Guarantees		44,551	44,716
Letters of credit	29	1,580	1,818
Total off-balance sheet commitments		**155,949**	**151,541**
Total credit risk exposure		**2,655,190**	**2,552,902**

** See notes 20 and 24.*

Translation from the original Bulgarian version, in case of divergence the Bulgarian original shall prevail.

Notes to the Annual Financial Statements

6. Financial risk management, continued

(b) Credit risk, continued

Credit quality analysis, continued

Loans and advances to customers, banks and other financial institutions and investment securities are analyzed by risk classification as follows:

In thousands of BGN

	Loans and advances to customers		Loans and advances to banks and other financial institutions		Investment securities (excl. equity instruments)		Off-balance sheet commitments	
	2017	2016 *Restated**	2017	2016	2017	2016	2017	2016
Standard	1,056,693	1,040,571	38,306	32,122	551,856	598,148	155,734	151,527
Watch	12,844	6,169	-	-	-	-	-	-
Non-performing	13,582	29,708	-	-	-	-	431	29
Loss	142,738	146,539	-	-	-	-	278	9
Gross amount	1,225,857	1,222,987	38,306	32,122	551,856	598,148	156,443	151,565
Allowance of impairment	(126,453)	(134,148)	-	-	-	-	(494)	(24)
Carrying amount	**1,099,404**	**1,088,839**	**38,306**	**32,122**	**551,856**	**598,148**	**155,949**	**151,541**
Neither past due nor impaired								
Standard	1,056,693	1,040,571	38,306	32,122	551,856	598,148	155,734	151,527
Watch	12,844	6,169	-	-	-	-	-	-
incl. restructured exposures	*3,220*	*7,945*	-	-	-	-	-	-
	1,069,537	**1,046,740**	**38,306**	**32,122**	**551,856**	**598,148**	**155,734**	**151,527**
Individually impaired								
Non-performing	10,690	21,336	-	-	-	-	431	29
Loss	130,582	138,595	-	-	-	-	278	9
incl. restructured exposures	*44,562*	*47,110*	-	-	-	-	-	-
	141,272	**159,931**	**-**	**-**	**-**	**-**	**709**	**38**
Past due but not impaired								
1≤ 30 days	6,184	7,573	-	-	-	-	-	-
> 30 days ≤ 60 days	1,844	1,384	-	-	-	-	-	-
> 60 days ≤ 90 days	2,180	754	-	-	-	-	-	-
> 90 days ≤ 180 days	1,499	2,572	-	-	-	-	-	-
>180 days	3,341	4,033	-	-	-	-	-	-
incl. restructured exposures	*10,373*	*12,471*	-	-	-	-	-	-
	15,048	**16,316**	**-**	**-**	**-**	**-**	**-**	**-**
Allowance for impairment								
At individual base	(109,810)	(121,840)	-	-	-	-	(494)	(24)
At portfolio base	(16,643)	(12,308)	-	-	-	-	-	-
	(126,453)	**(134,148)**	**-**	**-**	**-**	**-**	**(494)**	**(24)**

* *See notes 20 and 24.*

Translation from the original Bulgarian version, in case of divergence the Bulgarian original shall prevail.

Notes to the Annual Financial Statements

6. Financial risk management, continued

(b) Credit risk, continued

Credit quality analysis, continued

Neither past due, nor impaired

Neither past due, nor impaired, loans are serviced exposures that do not have objective evidence of impairment and for which the Bank allocates collective provisions for incurred but not reported losses allocated to level exposure. For monitoring purposes, the Bank groups risk exposures on a portfolio basis in separate portfolios based on similar characteristics, according to their type, objective and risk profile.

The Bank considers exposures subject to collective impairment for unrated exposures.

Individually impaired loans

Individually impaired loans are loans for which the Bank believes that it is likely it will be unable to collect all principal and interest due according to the contractual terms of the loan.

Past due, but not impaired

Loans where contractual principal and/or interest are overdue but the Bank believes that the allocation of allowances for impairment is not necessary based on the collateral available or the stage of collection of outstanding amounts from the borrower.

Restructured loans

Restructured loans are risk exposures for which the original terms of the agreement are amended by giving concessions from the Bank to the debtor, as a result of the deterioration of their financial situation leading to inability to pay on time the full amount of the debt, such discounts as the Bank would not have given in other circumstances.

Discount means any of the following:

(a) A modification of the previous terms and conditions of the contract, which the debtor is unable to meet due to financial difficulties ("problem debt"), leading to an inability to service the debt and that would not be incurred if the debtor had no financial difficulties;

(b) Full or partial refinancing of troubled debt contract, which would not be granted to the debtor, if they had no financial difficulties.

The discount may result in a loss for the Bank.

Loans are not treated as exposures with renegotiated terms when the Bank has a reason to believe that it will collect principal and interest and there are no circumstances indicating deterioration in the financial situation of the debtor.

Notes to the Financial statement

6. Financial risk management, continued

(b) Credit risk, continued

Credit quality analysis, continued

Set out below is an analysis of the gross and net (of allowances for impairment losses) amounts of individually impaired assets by classification groups.

	Loans and advances to customers		
In thousands of BGN	**Gross**	**Net**	**% of impairment**
2017			
Non-performing	10,690	7,991	25%
Loss	130,582	23,471	82%
Total	**141,272**	**31,462**	**78%**
2016			
Non-performing	21,336	16,388	23%
Loss	138,595	21,703	84%
Total	**159,931**	**38,091**	**76%**

The table below shows the amounts of derecognised loans and advances to customers:

In thousands of BGN	**2017**	**2016**
Written-off loans	31,183	12,576
Impairment losses	(31,183)	(12,576)
Value after impairment	-	-

The table below presents an analysis of restructured loans and advances to customers as at 31 December 2016 and 31 December 2017:

In thousands of BGN	**2017**	**2016**
Restructured loans and advances to customers	**58,155**	**67,526**
Impairment losses	23,596	19,594
Book value	34,559	47,931

Translation from the original Bulgarian version, in case of divergence the Bulgarian original shall prevail.

Notes to the Annual Financial Statements

6. Financial risk management, continued

(b) Credit risk, continued

Credit quality analysis, continued

Concentration of credit risk in respect of economic sectors is presented in the table below:

In thousands of BGN	2017	2016 *Restated**
Concentration by sector		
Government	44,104	43,276
Administrative and support services	18,029	11,755
Real estate	16,818	17,331
Manufacturing	69,735	66,117
Production and distribution of electricity and heat energy	83,691	78,558
Professional and research activities	7,417	6,490
Agriculture, forestry and fishing	58,643	68,835
Construction	48,060	52,297
Creating and distributing information and creative products; telecommunications	1,667	4,155
Transportation, storage and distribution	29,360	42,802
Trade, repair of motor vehicles and motorcycles	136,944	134,382
Financial and insurance services	42,750	52,919
Hotels and restaurants	56,280	51,858
Other	7,173	13,540
	620,671	**644,315**
Individual Loans		
Mortgage	401,615	358,463
Unsecured loans	203,571	220,209
	605,186	**578,672**
Impairment losses	(126,453)	(134,148)
	1,099,404	**1,088,839**

** See notes 20 and 24.*

Notes to the Annual Financial Statements

6. Financial risk management, continued

(b) Credit risk, continued

Credit quality analysis, continued

Collateral and other types of credit relief

The policy of the Bank includes consideration of the need to provide collateral prior to granting the approved loans. The degree of security of any particular risk exposure is set to the amount of the Bank's values of collateral when applying specific collateral margins.

Collateral for loans, guarantees and letters of credit, except for credit cards, include cash, property, machinery and equipment, listed securities, or other ownership, pledge of receivables, commercial enterprise and others.

The Bank holds collateral and other credit facilities against certain of its loan exposures. The table below shows the main types of collateral held agains different types of financial assets.

		Percentage from the exposure subject to an agreement requiring collateral	
Loan exposure type	**Main type of collateral**	**2017**	**2016**
Loans and advances to banks			
Sale and repurchase agreements	Bonds held for trading	100	100
Loans and advances to individuals			
Mortgage lending	Residential properties	100	100
Consumer lending	Guaranty, pledge on receivables with origin salary and other remunerations	-	-
Credit cards	None	-	-
Loans and advances to corporate clients			
Other lending to corporate clients	Commercial properties, rights on commercial assets	100	100

Notes to the Annual Financial Statements

6. Financial risk management, continued

(b) Credit risk, continued

Credit quality analysis, continued

Collateral and other types of credit relief, continued

The Bank requires the appraisers to assess the net realisable value, which represents the sale price of the asset in a liquid market reduced by the additional costs directly related to the disposal (sale) of the asset.

The table below shows the total amount before impairment of the loans and advances to customers, granted by the Bank:

In thousands of BGN	**2017**	**2016** *Restated**
Cash and cash equivalents	**23,027**	**27,595**
Standard	22,817	27,464
Watch	30	20
Non-performing	23	111
Loss	157	-
Secured by mortgage	**527,766**	**507,112**
Standard	474,487	451,736
Watch	8,654	4,003
Non-performing	9,261	21,693
Loss	35,364	29,680
Other collaterals	**296,316**	**352,699**
Standard	294,871	348,858
Watch	618	1,345
Non-performing	681	2,368
Loss	146	128
Secured loans	**847,109**	**887,406**
Unsecured loans	**378,748**	**335,581**
Total loans and advances to customers	**1,225,857**	**1,222,987**

Other collaterals include pledge on current assets – inventories, receivables from third parties, as well as pledges on commercial enterprises.

* See notes 20 and 24.

Notes to the Financial statement

6. Financial risk management, continued

(b) Credit risk, continued

Credit quality analysis, continued

Mortgage Lending (retail and corporate clients)

The tables below present the credit exposures of mortgage loans and advances to customers – individuals and corporate clients – depending on the value of the coefficient loan-to-value (LTV). LTV is calculated as a proportion of the gross value of the loan (or the corresponding amount of the credit commitment) to the value of collateral. The gross value does not include any accumulated impairment losses. The collateral value includes future costs for acquisition and realisation of the collateral. The value of the collateral on mortgage loans is based on the latest assessment carried out by an independent expert appraiser.

In thousands of BGN	**2017**	**2016**
Loan to value (LTV) ratio		
Less than 50%	230,585	180,845
51% to 70%	164,516	149,249
71% to 90%	124,327	150,307
91% to 100%	6,867	7,326
More than 100%	17,420	44,422
Total	**543,715**	**532,149**

As at 31 December 2017, the book value of the assets acquired from collaterals - real estate amounts to BGN 213 thousand (as at 31 December 2016: BGN 227 thousand).

Financial assets, held for trading

The table below sets out the credit quality of financial trading debt securities. The analysis has been based on rating agency Standard & Poor`s:

In thousands of BGN	**2017**	**2016**
Government securities		
BBB-	17,598	-
BB+		35,589
BB	12,426	-
BBB+	4,093	-
Compensatory notes		
Non rated	1	1
	34,118	**35,590**

Translation from the original Bulgarian version, in case of divergence the Bulgarian original shall prevail.

Notes to the Annual Financial Statements

6. Financial risk management, continued

(b) Credit risk, continued

Credit quality analysis, continued

The tables below show a breakdown of Bank`s financial assets by country of issuer`s registration as at 31 December 2017 and 31 December 2016.

2017 *In thousands of BGN*	**Bulgaria**	**Spain**	**Poland**	**Romania**	**France**	**Croatia**	**Sweden**	**Total**
Financial assets held for trading								
Government securities	17,598	-	4,093	-	-	12,426	-	34,117
Compensatory notes	1	-	-	-	-	-	-	1
	17,599	**-**	**4,093**	**-**	**-**	**12,426**	**-**	**34,118**
Financial assets available-for-sale								
Government securities	75,654	29,455	-	23,607	-	-	-	128,716
Compensatory notes	4,363	-	-	-	9,213	-	22,844	36,420
	80,017	**29,455**	**-**	**23,607**	**9,213**	**-**	**22,844**	**165,136**
Financial assets held-to-maturity								
Government securities	337,605	8,602	-	12,875	-	-	-	359,082
Compensatory notes	27,638	-	-	-	-	-	-	27,638
	365,243	**8,602**	**-**	**12,875**	**-**	**-**	**-**	**386,720**
Total	**462,859**	**38,057**	**4,093**	**36,482**	**9,213**	**12,426**	**22,844**	**585,974**

Notes to the Annual Financial Statements

6. Financial risk management, continued

(b) Credit risk, continued

Credit quality analysis, continued

2016

In thousands of BGN	**Bulgaria**	**Spain**	**Poland**	**Romania**	**France**	**Croatia**	**Sweden**	**Total**
Financial assets held for trading								
Government securities	35,589	-	-	-	-	-	-	35,589
Compensatory notes	1	-	-	-	-	-	-	1
	35,590	**-**	**-**	**-**	**-**	**-**	**-**	**35,590**
Financial assets available-for-sale								
Government securities	102,848	29,594	-	24,368	-	-	-	156,810
Compensatory notes	4,152	-	-	-	-	-	5,992	10,144
	107,000	**29,594**	**-**	**24,368**	**-**	**-**	**5,992**	**166,954**
Financial assets held-to-maturity								
Government securities	381,519	8,843	-	13,228	-	-	-	403,590
Compensatory notes	27,604	-	-	-	-	-	-	27,604
	409,123	**8,843**	**-**	**13,228**	**-**	**-**	**-**	**431,194**
Total	**551,713**	**38,437**	**-**	**37,596**	**-**	**-**	**5,992**	**633,738**

Translation from the original Bulgarian version, in case of divergence the Bulgarian original shall prevail.

Notes to the Annual Financial Statements

6. Financial risk management, continued

(c) Liquidity risk

Liquidity risk arises in the general funding of the Bank's activities and in the management of its positions. It includes both the risk for the Bank of being unable to fund liabilities when they become due and the risk of being unable to realize an asset at a reasonable price and in an appropriate time frame.

Liquidity risk management

The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and extraordinary conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

The "Liquidity and Markets" Division receives information from other business units regarding the liquidity profile of financial assets and liabilities and details of other projected cash flows arising from projected future business. "Liquidity and Markets" Division maintains a portfolio of liquid assets, loans and advances to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Bank as a whole.

The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. All liquidity policies and procedures are subject to review and approval by ALCO. Daily reports cover the liquidity position of the Bank. A summary report, including analyses, plans, reports and remedial action taken, is reviewed and approved periodically/monthly/ by ALCO.

Funds are raised using a broad range of instruments including deposits and current accounts, credit lines, other liabilities regulated normatively, and share capital. Funds are raised from different client types, most of them being citizens and households, as well as small and medium enterprises. In addition, there are deposits of non-banking financial institutions and credit lines from development banks. Insignificant amount of the funds is from money market. This enhances the flexibility in financing the activities of the Allianz Bank Bulgaria AD and decreases the dependence on any one source of funds and lowers the cost of acquired funds. The Bank makes its best efforts to maintain a balance between maturity of funding and flexibility through the use of means with a different maturity structure.

The Bank continually assesses liquidity risk by identifying and monitoring changes in funding required to meet targets set in terms of the overall Bank strategy. In addition, the Bank holds and maintains a portfolio of liquid assets as part of its liquidity risk management system.

Notes to the Financial statement

6. Financial risk management, continued

(c) Liquidity risk, continued

Exposure to liquidity risk

For liquidity risk monitoring and management, the Bank calculates various indicators such as the secondary liquidity ratio, liquidity coverage ratio (LCR), net stable funding ratio (NSFR) and survival period. Liquid assets are considered as including cash and cash equivalents, current accounts and deposits with banks up to 7 days, Bulgarian government securities, gold, and debt securities, issued by international banks for development and international organisations. Coefficient calculations are used to measure the Banks`s compliance with the liquidity ratios, recommended by BNB.

Details of the ratios of net liquid assets to deposits from customers at the reporting date and during the reporting period are as follows:

	2017	**2016**
As at 31 December	48.33%	49.23%
Average for the period	49.36%	47.48%
Maximum for the period	51.25%	51.01%
Minimum for the period	46.82%	43.46%

Remaining contractual maturities of financial assets and liabilities

The table shown below presents the undiscounted cash flows of the Bank`s financial assets and liabilities and unrecognised loan commitments on the basis of their earliest possible contractual maturity. The gross nominal inflow/(outflow) is the contractual, undiscounted cash flow on the financial asset and financial liability or commitment. Interest income/expense is included to any financial asset or liability from the date of the last interest payment until maturity.

Notes to the Annual Financial Statements

6. **Financial risk management, continued**

(c) **Liquidity risk, continued**

Remaining contractual maturities of financial assets and liabilities

The imbalance observed in the first period (up to 1 month) is mainly due to the classification of the current accounts from clients in this timing period. The Bank's historical experience shows that demand deposits will maintain steady and increasing pattern, as well as not all unrecognized loan commitments will be utilized immediately.

31 December 2017

In thousands of BGN	**Carrying amount**	**Gross nominal cash inflow/ (outflow)**	**Up to 1 month**	**From 1 to 3 months**	**From 3 months to 1 year**	**From 1 to 5 years**	**More than 5 years**
Cash and cash equivalents	812,888	812,888	812,888	-	-	-	-
Financial assets held for trading	34,132	34,618	16,408	-	14,004	4,191	15
Loans and advances to banks and other financial institutions	38,306	38,394	48	-	38,346	-	-
Investment securities	556,454	621,572	14,520	-	57,368	299,078	250,606
Loans and advances to customers	1,099,404	1,533,422	124,483	54,362	161,153	290,311	903,113
	2,541,184	**3,040,894**	**968,347**	**54,362**	**270,871**	**593,580**	**1,153,734**
Deposits from banks	108	(108)	(108)	-	-	-	-
Deposits from customers	2,272,523	(2,274,644)	(1,553,739)	(114,598)	(418,554)	(187,753)	-
Other borrowings	59,342	(60,156)	(2,439)	(1)	(4,449)	(6,373)	(46,894)
	2,331,973	**(2,334,908)**	**(1,556,286)**	**(114,599)**	**(423,003)**	**(194,126)**	**(46,894)**
Guarantees and letters of credit	46,625	(46,625)	(4,972)	(4,543)	(12,499)	(16,485)	(8,126)
Unrecognised loan commitments	109,818	(109,818)	(7,944)	(12,609)	(82,952)	(5,024)	(1,289)
	2,488,416	**(2,491,351)**	**(1,569,202)**	**(131,751)**	**(518,454)**	**(215,635)**	**(56,309)**
	52,768	549,543	(600,855)	(77,389)	(247,583)	377,945	1,097,425

Notes to the Annual Financial Statements

6. Financial risk management, continued

(c) Liquidity risk, continued

Remaining contractual maturities of financial assets and liabilities, continued

31 December 2016

In thousands of BGN *Restated**	**Carrying amount**	**Gross nominal cash inflow/ (outflow)**	**Up to 1 month**	**From 1 to 3 months**	**From 3 months to 1 year**	**From 1 to 5 years**	**More than 5 years**
Cash and cash equivalents	683,417	683,417	683,417	-	-	-	-
Financial assets held for trading	35,603	35,996	-	11,224	6,258	18,500	14
Loans and advances to banks and other financial institutions	32,122	32,147	22,366	-	9,781	-	-
Investment securities	599,418	685,045	6,389	12,082	54,976	258,039	353,559
Loans and advances to customers	1,088,839	1,511,841	134,994	34,632	180,554	292,989	868,672
	2,439,399	**2,948,446**	**847,166**	**57,938**	**251,569**	**569,528**	**1,222,245**
Deposits from banks	111	(111)	(111)	-	-	-	-
Deposits from customers	2,153,309	(2,158,674)	(1,335,993)	(183,263)	(491,704)	(147,714)	-
Other borrowings	85,971	(87,090)	(4,239)	(46)	(473)	(12,558)	(69,774)
	2,239,391	**(2,245,875)**	**(1,340,343)**	**(183,309)**	**(492,177)**	**(160,272)**	**(69,774)**
Guarantees and letters of credit	46,558	(46,558)	(8,625)	(5,024)	(11,360)	(15,870)	(5,679)
Unrecognised loan commitments	105,007	(105,007)	(39,170)	(4,139)	(37,741)	(23,957)	-
	2,390,956	**(2,397,440)**	**(1,388,138)**	**(192,472)**	**(541,278)**	**(200,099)**	**(75,453)**
	48,443	551,006	(540,972)	(134,534)	(289,709)	369,429	1,146,792

** See notes 20 and 24.*

Notes to the Annual Financial Statements

6. Financial risk management, continued

(d) Market risk

Market risk is the risk that changes in market conditions or parameters, having an impact on the market conditions, such as interest rate, equity prices or foreign exchange rates will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Exposure to market risk – trading portfolio

All trading instruments are subject to market risk as a result of future changes in market conditions. The instruments are recognized at fair value, and all changes in market conditions directly affect net trading income.

Allianz Bank Bulgaria AD manages its use of trading instruments in response to changing market conditions. Exposure to market risk is formally managed in accordance with limits set by exposures, concentrations by type of instruments and VaR limits.

The method used to measure and manage market risk is Value at Risk (VaR). The VaR is the estimated loss that will arise on the trading portfolio over a specified period of time (holding period) with a specified probability (confidence level). The VaR model used by the Bank is based upon a 99 percent confidence level and assumes a 10-day holding period. The VaR model used is based on historical market data from at least 250 days observation period.

Although VaR is an important tool for measuring market risk, the assumptions on which the model is based do give rise to some limitations, including the following:

- A 10-day holding period assumes that it is possible to hedge or dispose of positions within that period. This is considered to be a realistic assumption in almost all cases but may not be the case in situations in which there is severe market illiquidity for a prolonged period.
- A 99 percent confidence level does not reflect losses that may occur beyond this level. Even within the model used there is a one percent probability that losses could exceed the VaR.
- VaR is calculated on an end-of-day basis and does not reflect exposures that may arise on positions during the trading day/trading session.
- VaR is dependent upon the Bank's position and the volatility of market prices. The VaR of an unchanged position by volume reduces if the market price volatility declines and vice versa.

Notes to the Financial statement

6. Financial risk management, continued

(d) Market risk, continued

Exposure to market risk – trading portfolio, continued

A summary of the 10-days VaR positions of the Bank's trading portfolio at 31 December and during the period is as follows:

In thousands of BGN	**As at 31.12**	**Average**	**Max**	**Min**
Financial assets held for trading				
2017				
Currency risk	35.84	38.25	41.50	35.72
Interest risk	2.48	13.91	29.90	2.48
Other price risk	0.11	0.33	0.58	0.11
Correlation	(2.51)	(11.21)	(21.85)	(2.39)
	35.92	41.28	50.13	35.92

In thousands of BGN	**As at 31.12**	**Average**	**Max**	**Min**
Financial assets held for trading				
2016				
Currency risk	36.64	52.92	63.37	36.64
Interest risk	98.91	154.57	249.83	98.91
Other price risk	0.84	1.03	1.47	0.84
Correlation	(29.34)	(44.39)	(57.51)	(29.34)
Total	107.05	164.13	257.15	107.05

The interest rate levels in the current year are gradually decreasing, reaching their minimum values at the end of the reporting period, reflecting declining portfolio duration and low volatility of bond market yields. The share of currency risk in total risk at the end of the reporting period remained relatively unchanged compared to 2016.

1-day VaR of Bank's portfolio on Monte Carlo simulation basis with confidence interval 99% as of 31 December and during the reporting period are as follows:

In thousands of BGN	**2017**	**2016**
As at 31 December	2,096	4,508
Minimum for the period	2,096	4,508

Notes to the Annual Financial Statements

6. Financial risk management, continued

(d) Market risk, continued

Sensitivity analysis to interest rate risk

The management of the interest rate risk and the interest rate changes limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities by applying scenarios for interest rates movements.

The sensitivity analysis is based on scenario of 100 basis point (bp) parallel rise or fall in all yield curves and in all currencies.

In thousands of BGN	**100 b.p. parallel increase**	**100 b.p. parallel decrease**
2017		
As at 31 December	(9,509)	9,509
Average for the period	(10,147)	10,147
2016		
As at 31 December	(11,522)	11,522
Average for the period	(13,364)	13,364

Currency risk

The Bank is exposed to currency risk through making deals with financial instruments, denominated in foreign currency.

As a result of the establishment of Currency Board in the Republic of Bulgaria, the Bulgarian lev is pegged to the Euro. As the currency in which the Bank presents its financial statements is the Bulgarian lev, the Bank's financial statements are affected by movements in the exchange rates between the currencies outside the Euro-zone and the lev.

The Bank's transactional exposures give rise to foreign currency gains and losses that are recognized in the income statement. These exposures comprise the monetary assets and monetary liabilities of the Bank denominated in currency different from the currency in which the financial statements are presented. These exposures in foreign currency are presented in the table below:

Notes to the Financial statement

6. Financial risk management, continued

(d) Market risk, continued

Currency risk, continued

In thousands of BGN

	31 December 2017				
	BGN	**EUR**	**USD**	**Other currencies**	**Total**
Assets					
Cash and cash equivalents	419,829	218,011	161,310	13,738	812,888
Financial assets held for trading	16,410	17,365	357	-	34,132
Loans and advances to banks and other financial institutions	-	37,746	560	-	38,306
Financial assets available-for-sale	33,967	132,646	3,121	-	169,734
Financial assets held-to-maturity	83,061	303,659	-	-	386,720
Loans and advances to customers	747,128	329,266	23,010	-	1,099,404
Total assets	1,300,395	1,038,693	188,358	13,738	2,541,184
Liabilities					
Deposits from banks	88	18	-	2	108
Deposits from customers	1,378,622	694,484	185,273	14,144	2,272,523
Other borrowings	-	59,342	-	-	59,342
Total liabilities	1,378,710	753,844	185,273	14,146	2,331,973
Net currency position	(78,315)	284,849	3,085	(408)	209,211

Notes to the Annual Financial Statements

6. Financial risk management, continued

(d) Market risk, continued

Currency risk, continued

In thousands of BGN

31 December2016, *restated* *

	BGN	EUR	USD	Other currencies	Total
Assets					
Cash and cash equivalents	276,960	273,734	119,284	13,439	683,417
Financial assets held for trading	27,723	7,277	603	-	35,603
Loans and advances to banks and other financial institutions	-	31,488	634	-	32,122
Financial assets available-for-sale	45,260	122,878	86	-	168,224
Financial assets held-to-maturity	90,540	340,654	-	-	431,194
Loans and advances to customers	742,080	317,234	29,525	-	1,088,839
Total assets	1,182,563	1,093,265	150,132	13,439	2,439,399
Liabilities					
Deposits from banks	91	19	-	1	111
Deposits from customers	1,279,239	710,285	150,239	13,546	2,153,309
Other borrowings	-	85,971	-	-	85,971
Total liabilities	1,279,330	796,275	150,239	13,547	2,239,391
Net currency position	(96,767)	296,990	(107)	(108)	200,008

** See notes 20 and 24.*

Notes to the Annual Financial Statements

6. Financial risk management, continued

(e) Compliance with capital adequacy requirements

The Bank prepares quarterly regulatory reports and monthly reports for internal purposes, in accordance with the requirements of Regulation №8 of the Bulgarian National Bank (BNB) from 24 April 2014 on capital buffers of banks. The Bank applies the standardised approach for credit and market risks and the Basic Indicator Approach for operational risk since the beginning of 2007.

According to art.92 of Regulation 575 of the European Parliament and the Council from 26 June 2013, the minimum requirements for the capital adequacy's ratios of Tier I capital and Total capital adequacy are not less than 6% and 8% respectively.

According supervisory statements of the Bank for the purposes of the Bulgarian National Bank in accordance with Regulation 575 of the European Parliament and the Council as of 31 December 2017, the Bank was in compliance with capital adequacy requirements.

Notes to the Financial statement

7. Use of estimates and judgements

The preparation of financial statements in accordance with IFRS requires management to make the best estimates, accruals and reasonable assumptions that have an effect on the reported amounts of assets and liabilities, income and expenses and disclosure of contingent receivables and payables at the reporting date. These estimates, accruals and assumptions are based on the information available at the date of the financial statements, which is why future actual results could be different from them.

Assessments and underlying assumptions are reviewed on an ongoing basis. Revised accounting estimates are recognized in the period in which the measurement is reviewed, as well as in all concerned future periods.

Assumptions and estimation uncertainties

The Bank makes estimates and assumptions about uncertain events, including estimates and assumptions about the future. Such accounting assumptions and estimates are regularly evaluated and are based on historical experience and other factors such as the expected cash flow of future event that can be reasonably assumed in the existing circumstances, but nevertheless necessarily represent sources of estimation uncertainty.

The estimation of impairment losses in the Bank`s credit risk portfolio and, as part of this, the estimation of the realizable value of real estate collateral represents the major source of estimation uncertainty. This and other key sources of estimation uncertainty that have a significant risk to carry a possible material adjustments to the carrying amounts of assets and liabilities in subsequent financial reporting periods, are described below and in the respective notes.

Impairment losses on loans and advances

Assets accounted at amortized cost are evaluated for impairment on a basis described in accounting policy 5 (e) above.

The specific component of collective impairment allowances for a counterparty, applied to financial assets evaluated individually for impairment, are based upon management`s best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgments about counterparty`s financial position and the net realizable value of any underlying loan collateral. Each impaired asset is assessed on its merits, the strategy for recovery of the impaired asset and the estimate of cash flows considered recoverable are independently approved by the Credit Risk Committee of the Bank.

Collectively assessed impairment allowances cover credit losses inherent in portfolios of loans and advances with similar characteristics of credit risks when there is objective evidence to suggest that they contain impaired loans and advances, but the individual impaired items cannot yet be identified. In assessing the need for collective loan loss allowances, management considers factors such as type of credits, portfolio size, concentrations, and economic factors. In order to estimate the required impairment allowance, assumptions are made to define the way inherent losses are modelled based on historical experience and current economic conditions. The accuracy of the allowances depends on the estimated future cash flows for specific counterparty impairment allowances and the model assumptions and parameters used in determining collective allowances losses.

Notes to the Financial statement

7. Use of estimates and judgements, continued

Determination of fair values of financial instruments

The determination of fair value for financial assets and liabilities for which there is no observable market price requires the use of valuation techniques as described in accounting policy 5(e)(vi). For financial instruments that are traded infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgement depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument.

Valuation of financial assets

The Bank measures fair values using the following hierarchy of methods:

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

The fair values of financial assets and financial liabilities which are traded on active markets are based on quoted market prices or closing prices. For all the remaining financial instruments the Bank determined fair value using other valuation techniques.

Other valuation techniques include net present value and discounted cash flow models, comparison with similar instruments for which exist observable market prices, models for assessment of options and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, and equity instruments index prices and expected price volatilities and correlations.

The objective of valuation techniques is to arrive at a fair value measurement that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date.

Notes to the Financial statement

7. Use of estimates and judgements, continued

Valuation of financial instruments, continued

Financial instruments measured at fair value – Fair value hierarchy

The following table analyses financial instruments measured at fair value, by the level in the fair value hierarchy.

In thousands of BGN	Level 1- Reported market price on active markets	Level 2- Evaluation methods using market data	Level 3 - Evaluation methods using non market data	Total
2017				
Financial assets held for trading	34,117	15	-	34,132
Financial assets available-for-sale	166,810	1,548	1,376	169,734
Total:	**200,927**	**1,563**	**1,376**	**203,866**

In thousands of BGN	Level 1- Reported market price on active markets	Level 2- Evaluation methods using market data	Level 3 - Evaluation methods using non market data	Total
2016				
Financial assets held for trading	7,879	27,724	-	35,603
Financial assets available-for-sale	134,988	32,023	-	167,011
Total:	**142,867**	**59,747**	**-**	**202,614**

As at 31 December 2016 the available-for-sale financial assets include equity and debt instruments valued at cost of BGN 1,213 thousand as at that date their fair value could not be measured reliably.

(i) Transfers between level 1 and 2

As of 31 December 2017, domestic issues of Bulgarian government bonds (included in both the trade portfolio and the available-for-sale portfolio) were transferred from Level 2 to Level 1, as for the purpose of their revaluation at the end of the year 2017, the Bank has applied quotes from Bloomberg. As of 31 December 2016, for the same financial assets, the Bank applied theoretical pricing model determined using yield curves from Reuters.

Notes to the Financial statement

7. Use of estimates and judgements, continued

Valuation of financial instruments, continued

Financial instruments measured at fair value – Fair value hierarchy, continued

(ii) Reconciliation of fair value level 3

The following table shows the movement alignment from the opening balance to the final balance of the fair value level 3:

In thousands of BGN	**Equity securities available-for-sale**
Balance as at 1 January 2016	-
Profit included in other comprehensive income	
Net change in fair value (unrealized)	-
Purchases	-
Balance as at 31 December 2016	-
Balance as at 1 January 2017	-
Profit included in other comprehensive income	
Net change in fair value (unrealized)	1,376
Purchases	-
Balance as at 31 December 2017	**1,376**

The fair value movement in level 3 is as a result of valuation of the shares that the Bank owns from the share capital of Borika AD as at 31 December 2017. As at 31 December 2016, the Bank was not able to determine the fair value of the same shares and they were measured at cost.

Notes to the Annual Financial Statements

7. Use of estimates and judgements, continued

Valuation of financial instruments, continued

Financial instruments not measured at fair value - hierarchy, continued

The following tables set out the fair values of financial instruments not measured at fair value and analyses them by the level in the fair value hierarchy into which each fair value measurement is categorized. It does not include fair value information for financial assets and financial liabilities not measured at fair value if the carrying amount is a reasonable approximation of fair value.

31 December 2017 *In thousands of BGN*	**Level 1**	**Level 2**	**Level 3**	**Total fair value**	**Total carrying amount**
Assets					
Cash and cash equivalents	-	812,888	-	812,888	812,888
Loans and advances to banks and other financial institutions	-	38,306	-	38,306	38,306
Financial assets held-to-maturity	431,195	-	-	431,195	386,720
Loans and advances to customers	-	-	1,262,290	1,262,290	1,099,404
Liabilities					
Deposits from banks	-	-	108	108	108
Deposits from customers	-	-	2,269,773	2,269,773	2,272,523
Other borrowings	-	-	59,342	59,342	59,342

Notes to the Annual Financial Statements

7. Use of estimates and judgements, continued

Valuation of financial instruments, continued

Financial instruments not measured at fair value - hierarchy, continued

31 December 2016, *restated** *In thousands of BGN*	**Level 1**	**Level 2**	**Level 3**	**Total fair value**	**Total carrying amount**
Cash and cash equivalents	-	683,417	-	683,417	683,417
Loans and advances to banks and other financial institutions	-	32,122	-	32,122	32,122
Financial assets held-to-maturity	460,005	-	-	460,005	431,194
Loans and advances to customers	-	-	1,208,942	1,208,942	1,088,839
Liabilities					
Deposits from banks	-	-	111	111	111
Deposits from customers	-	-	2,150,543	2,150,543	2,153,309
Other borrowings	-	-	85,971	85,971	85,971

The fair value of cash and cash equivalents, loans and advances to banks and other financial institutions, deposits from banks and other borrowings is approximately equal to their carrying amount because they are short-term.

The fair value of loans and advances to customers is based on observable monetary transactions. In case, no market information is available, the fair value estimate is calculated using discounted cash flow techniques by applying the interest levels offered at reporting date for loans with similar terms and currency and taking in account the accounted impairments.

The fair value of deposits from customers has been calculated using discounted cash flow techniques by applying the interest levels offered at reporting date for deposits in the country with similar maturity and terms.

* *See notes 20 and 24.*

Notes to the Annual Financial Statements

8. Classification of financial assets and financial liabilities

In thousands of BGN	Held for trading	Held to maturity	Loans and advances	Available-for-sale	Liabilities at amortised cost	Total carrying amount
31 December 2017						
Cash and cash equivalents	-	-	812,888	-	-	812,888
Financial assets held for trading	34,132	-	-	-	-	34,132
Loans and advances to banks and other financial institutions	-	-	38,306	-	-	38,306
Investment securities	-	386,720	-	169,734	-	556,454
Loans and advances to customers	-	-	1,099,404	-	-	1,099,404
Total financial assets	**34,132**	**386,720**	**1,950,598**	**169,734**	**-**	**2,541,184**
Deposits from banks	-	-	-	-	108	108
Deposits from customers	-	-	-	-	2,272,523	2,272,523
Other borrowings	-	-	-	-	59,342	59,342
Total financial liabilities	**-**	**-**	**-**	**-**	**2,331,973**	**2,331,973**
31 December 2016, *restated**						
Cash and cash equivalents	-	-	683,417	-	-	683,417
Financial assets held for trading	35,603	-	-	-	-	35,603
Loans and advances to banks and other financial institutions	-	-	32,122	-	-	32,122
Investment securities	-	431,194	-	168,224	-	599,418
Loans and advances to customers	-	-	1,088,839	-	-	1,088,839
Total financial assets	**35,603**	**431,194**	**1,804,378**	**168,224**	**-**	**2,439,399**
Deposits from banks	-	-	-	-	111	111
Deposits from customers	-	-	-	-	2,153,309	2,153,309
Other borrowings	-	-	-	-	85,971	85,971
Total financial liabilities	**-**	**-**	**-**	**-**	**2,239,391**	**2,239,391**

* *See notes 20 and 24.*

Notes to the Annual Financial Statements

9. Net interest income

In thousands of BGN	2017	2016 *Restated**
Net interest income		
Interest income		
Interest income arise from:		
loans and advances to banks	1,634	607
loans and advances to customers	55,555	65,746
borrowings from customers	448	42
investments	14,924	15,472
	72,561	**81,867**
Interest expense		
Interest expense arise from:		
deposits from banks	(4)	(34)
deposits from customers and other borrowings	(4,971)	(12,275)
others	(1,639)	(928)
	(6,614)	**(13,237)**
Net interest income	**65,947**	**68,630**

The recognized interest income from individually impaired loans and advances to customers for 2017 and 2016 amounts to BGN 5,297 thousand and BGN 5,857 thousand respectively.

* In 2017, the Bank reclassified negative interest income from loans and advances to banks for the amount of BGN 928 thousand from interest income to other interest expense.

10. Net income from fees and commissions

In thousands of BGN	2017	2016
Fee and commission income		
Fee and commission income arise from:		
cash operations and cash transfers	12,820	10,532
guarantees and letters of credit	646	768
loans	4,248	4,974
bank cards	5,501	5,171
other	29	32
	23,244	**21,477**
Fee and commission expense		
Fee and commission expense arise from:		
servicing of bank current accounts	(92)	(107)
transaction with bank cards	(2,432)	(2,187)
rings transfers	(171)	(153)
other	(35)	(55)
	(2,730)	**(2,502)**
Net fee and commission income	**20,514**	**18,975**

Notes to the Annual Financial Statements

11 Net trading income

In thousands of BGN	2017	2016
Net trading income arises from:		
financial assets held for trading	(76)	210
foreign exchange trading	3,161	2,566
Net trading income	**3,085**	**2,776**

12. Net investment income

In thousands of BGN	2017	2016
Net investment income arises from:		
dividends	287	115
income from sale of Visa Europe shares	-	4,708
Net investment income	**287**	**4,823**

In June 2016 with the approval of the European Commission, Visa Inc. buys all shares of Visa Europe. The total amount of the transaction is distributed among the members of Visa Europe, depending on the volume of their business over the last three years prior to the transaction. As a result, in late June 2016 Allianz Bank Bulgaria AD receives EUR 2,407 thousand or BGN 4,708 thousand.

13. Administrative and other expenses

In thousands of BGN	2017	2016
Materials	(764)	(825)
External services, including audit	(10,294)	(13,151)
Administration, marketing and other costs	(4,404)	(4,679)
Rental expenses	(3,893)	(3,813)
Depreciation and amortisation	(2,315)	(2,544)
Personnel expenses	(18,141)	(18,166)
Mandatory contributions to the Bank Restructuring Fund	(3,752)	(3,098)
Mandatory contributions to the Bulgarian Deposit Insurance Fund	(3,415)	(3,221)
Total administrative expenses	**(46,978)**	**(49,497)**

The amounts accrued in 2017 for the services provided by the registered auditors for statutory joint independent financial audit are as follows: for KPMG Audit OOD - BGN 108 thousand excluding VAT, for AFA OOD - BGN 42 thousand excluding VAT. The amounts include BGN 43 thousand excluding VAT, relating to the statutory audit of the Bank's financial statements for the year ended 31 December 2016 by KPMG Audit OOD (formerly KPMG Bulgaria OOD).

Notes to the Annual Financial Statements

13. Administrative and other expenses, continued

In 2017 the Bank has charged amounts for other non-statutory audit services provided by the registered auditors or members of the respective network at a total amount of BGN 79 thousand excluding VAT, as follows: for KPMG Audit OOD - BGN 76 thousand excluding VAT, for AFA OOD - BGN 3 thousand excluding VAT.

Personnel expenses for the amount of BGN 18,141 thousand (2016 – BGN 18,166 thousand) include salary expenses and social benefits paid to employees as well as health social security expenses as per the local legislation. At the end of 2017, Allianz Bank Bulgaria AD employs 737 contractual employees (2016: 813 employees).

The Bank has concluded operating lease agreements for buildings, cars and equipment. The agreements are of different duration, depending on the needs of the Bank.

In 2017, the amount of BGN 3,893 thousand was recognized as an expense in profit or loss in respect of operating leases (2016: BGN 3,813 thousand).

The irrevocable payments under operating leases are payable as follows:

In thousands of BGN	**2017**	**2016**
Less than 1 year	3,690	3,662
From 1 to 5 years	4,719	6,285
More than 5 years	836	1,291
	9,245	**11,238**

14. Other operating income, net

In thousands of BGN	**2017**	**2016**
Income from tariff fees, VAT taxable	1,227	1,033
Other income, net	13	169
Other operating income, net	**1,240**	**1,202**

Notes to the Annual Financial Statements

15. Income tax expense

In thousands of BGN	2017	2016
Current tax charge	2,909	3,560
Deferred tax	(15)	29
Total income tax recognised in profit or loss	**2,894**	**3,589**

Reconciliation of effective tax rate

In thousands of BGN	2017	2016
Profit before tax	30,758	33,844
Nominal tax rate	10.00%	10.00%
Supposed tax	3,076	3,384
Taxable permanent differences	(153)	216
Non taxable income from dividends	(29)	(11)
	2,894	**3,589**
Effective tax rate	9.4%	10.6%

16. Cash and cash equivalents

In thousands of BGN	2017	2016
Cash on hand	37,331	36,755
Balances with the Central Bank	601,811	496,567
Current accounts and deposits with banks with original maturity less than 3 months	173,746	150,095
Total cash and cash equivalents	**812,888**	**683,417**

Balances with the Central Bank include current accounts in the Bulgarian National Bank and minimum obligatory reserves. The current account with the Bulgarian National Bank is used for direct participation in money and government securities markets and for settlement purposes. Minimum obligatory reserves at the central bank are interest free and are adjusted on a monthly basis. Daily fluctuations are allowed. Shortage of finance on monthly basis is sanctioned with penalty interest.

Notes to the Annual Financial Statements

17. Financial assets held for trading

In thousands of BGN	2017	2016
Financial assets held for trading:		
Debt government securities	34,117	35,589
Equity securities	14	13
Other	1	1
Total financial assets held for trading	**34,132**	**35,603**

18. Loans and advances to banks and other financial institutions

In thousands of BGN	2017	2016
Loans and advances to local banks	2,565	2,649
Loans and advances to foreign banks	35,741	29,473
Total loans and advances to banks and other financial institutions	**38,306**	**32,122**

19. Investment securities

19.1. *Financial assets available-for-sale*

In thousands of BGN	2017	2016
Government securities, issued or guaranteed by the Republic of Bulgaria	75,654	102,848
Government securities, issued or guaranteed by Spain	29,455	29,594
Government securities, issued or guaranteed by Romania	23,607	24,368
Corporate debt securities	36,420	10,144
Equity securities	4,598	1,270
Total financial assets available-for-sale	**169,734**	**168,224**

19.2. *Financial assets held to maturity*

In thousands of BGN	2017	2016
Government securities, issued or guaranteed by the Republic of Bulgaria	337,605	381,519
Government securities, issued or guaranteed by Spain	8,602	8,843
Government securities, issued or guaranteed by Romania	12,875	13,228
Corporate debt securities	27,638	27,604
Total financial assets held to maturity	**386,720**	**431,194**
Total investment securities	**556,454**	**599,418**

Notes to the Annual Financial Statements

20. Loans and advances to customers

In thousands of BGN	2017	2016 *Restated**
Loans and advances to customers at amortized cost	1,147,183	1,183,351
Factoring receivables	23,364	4,432
Receivables from a cash pool participation	9,779	-
Finance lease receivables	45,531	35,204
Less impairment loss	(126,453)	(134,148)
Total loans and advances to customers	**1,099,404**	**1,088,839**

* In 2017, the Bank increased its portfolio of factoring receivables from BGN 4,432 thousand as at 31 December 2016 to BGN 23,364 thousand as at 31 December 2017. Due to the significant amount of factoring receivables as at the end of 2017, the Bank reclassified them from other assets to loans and advances to customers.

(a) Analysis by product

In thousands of BGN	2017	2016 *Restated**
Retail customers		
Mortgage loans	399,771	377,872
Consumer loans	171,786	169,817
Credit cards	14,823	15,750
Other loans	3,278	3,815
	589,658	567,254
Corporate customers		
Working capital loans	293,300	326,563
Investment loans	262,478	287,595
Credit cards	1,747	1,939
	557,525	616,097
Total loans and advances to customers at amortized cost	**1,147,183**	**1,183,351**
Impairment allowances	(125,563)	(133,741)
Total loans and advances to customers, net of impairment	**1,021,620**	**1,049,610**

Notes to the Annual Financial Statements

20. Loans and advances to customers, continued

(b) Finance lease receivables

Detailed description of the finance lease receivables is shown in the table below.

In thousands of BGN	2017	2016
Gross investments in finance lease receivables		
Less than one year	2,363	1,595
Between one and five years	46,468	36,641
More than five years	233	32
	49,064	38,268
Unearned finance income	(3,533)	(3,064)
Net investments in a finance lease receivables	**45,531**	**35,204**
Less impairment allowance	(890)	(407)
	44,641	**34,797**
Net investments in finance lease receivables		
Less than one year	2,218	1,530
Between one and five years	42,217	33,235
More than five years	206	32
	44,641	**34,797**

(c) Impairment allowance of loans and advances to customers

Individual impairment allowance

In thousands of BGN	2017	2016
Balance at 1 January 2017	121,840	109,882
Charge for the year	23,340	23,446
Recoveries	(16,763)	(9,249)
Write-offs	(18,607)	(2,239)
Balance at 31 December 2017	**109,810**	**121,840**

Collective impairment allowance

In thousands of BGN	2017	2016
Balance at 1 January 2017	12,308	12,774
Charge for the year	8,091	4,423
Recoveries	(3,756)	(4,889)
Write-offs	-	-
Balance at 31 December 2017	**16,643**	**12,308**
Total	**126,453**	**134,148**

Translation from the original Bulgarian version, in case of divergence the Bulgarian original shall prevail.

Notes to the Financial statement

21. Property, plant and equipment

In thousands of BGN	Land and buildings	Machines and equipment	Fixtures and fittings	Motor Vehicles	Expenses for acquisition of fixed assets	Total
Cost						
At 1 January 2016	7,871	13,940	7,767	988	438	31,004
Additions	1	936	118	-	609	1,664
Disposals	-	(544)	(463)	-	-	(1,007)
At 31 December 2016	7,872	14,332	7,422	988	1,047	31,661
At 1 January 2017	7,872	14,332	7,422	988	1,047	31,661
Additions	96	443	205	-	25	769
Disposals	-	(534)	(153)	(57)	-	(744)
Transfers	-	-	-	-	(611)	(611)
At 31 December 2017	7,968	14,241	7,474	931	461	31,075
Depreciation						
At 1 January 2016	(3,087)	(11,741)	(6,436)	(924)	-	(22,188)
Charge for the year	(255)	(899)	(389)	(35)	-	(1,578)
Disposals	-	544	463	-	-	1,007
At 31 December 2016	(3,342)	(12,096)	(6,362)	(959)	-	(22,759)
At 1 January 2017	(3,342)	(12,096)	(6,362)	(959)	-	(22,759)
Charge for the year	(258)	(851)	(329)	(22)	-	(1,460)
Disposals	-	534	153	57	-	744
At 31 December 2017	(3,600)	(12,413)	(6,538)	(924)	-	(23,475)
Net book value						
At 1 January 2016	4,784	2,199	1,331	64	438	8,816
31 December 2016	4,530	2,236	1,060	29	1,047	8,902
31 December 2017	**4,368**	**1,828**	**936**	**7**	**461**	**7,600**

Notes to the Financial statement

22. Intangible assets

In thousands of BGN	Intangible assets	Costs of acquisition of intangible assets	Total
Cost			
At 1 January 2016	16,254	-	16,254
Additions	766	-	766
Disposals	(150)	-	(150)
At 31 December 2016	16,870	-	16,870
At 1 January 2017	16,870	-	16,870
Additions	407	1,286	1,693
Disposals	(234)	(310)	(544)
Transfers	-	611	611
At 31 December 2017	17,043	1,587	18,630
Depreciation			
At 1 January 2016	(12,118)	-	(12,118)
Charge for the year	(966)	-	(966)
Disposals	150	-	150
At 31 December 2016	(12,934)	-	(12,934)
		-	
At 1 January 2017	(12,934)	-	(12,934)
Charge for the year	(855)	-	(855)
Disposals	234	-	234
At 31 December 2017	(13,555)	-	(13,555)
Net book value			
At 1 January 2016	4,136	-	4,136
At 31 December 2016	3,936	-	3,936
At 31 December 2017	3,488	1,587	5,075

Notes to the Annual Financial Statements

23. Deferred tax

Deferred income taxes are calculated on all temporary differences under the liability method using a tax rate of 10% for 2017 (2016: 10%).

Deferred income tax balances are attributable to the following balance positions:

In thousands of BGN	Assets		Liabilities		Net (assets)/liabilities	
	2017	2016	2017	2017	2016	2017
Property, plant and equipment	-	-	286	297	286	297
Other liabilities	(142)	(138)	-	-	(142)	(138)
Net balance of deffered tax (assets)/ liabilities	**(142)**	**(138)**	**286**	**297**	**144**	**159**

Movement in temporary tax differences during the year arises from:

In thousands of BGN	Balance 2016	To profit or loss	Balance 2017
Property, plant and equipment	297	(11)	286
Other liabilities	(138)	(4)	(142)
Net balance of deffered tax (assets)/liabilities	**159**	**(15)**	**144**

In thousands of BGN	Balance 2015	To profit or loss	Balance 2016
Property and equipment	289	8	297
Other liabilities	(159)	21	(138)
Net balance of deffered tax (assets)/liabilities	**130**	**29**	**159**

24. Other assets

In thousands of BGN	2017	2016 *Restated**
Prepaid expenses	2,424	2,180
Inventories	595	429
Receivables from clients	720	576
Fees and commissions receivable	260	2,631
Other assets	2,098	2,419
Total other assets	**6,097**	**8,235**

* In 2017, the Bank increased its portfolio of factoring receivables from BGN 4,432 thousand as at 31 December 2016 to BGN 23,364 thousand as at 31 December 2017. Due to the significant amount of the factoring receivables as at the end of 2017, the Bank reclassified them from other assets to loans and advances to customers (see Note 20) and their carrying amount is included in loans and advances to customers at amortized cost. As of 1 January 2016, the Bank had no receivables under factoring.

Notes to the Annual Financial Statements

25. Deposits from customers

In thousands of BGN	2017	2016
Individuals		
Current accounts	598,412	497,576
Deposits	664,135	740,886
Total	**1,262,547**	**1,238,462**
Private companies		
Current accounts	811,864	683,956
Deposits	159,704	191,863
Total	**971,568**	**875,819**
State owned companies		
Current accounts	35,052	34,655
Deposits	3,356	4,373
Total	**38,408**	**39,028**
Total deposits from customers	**2,272,523**	**2,153,309**

26. Other borrowings

In thousands of BGN	2017	2016
Payables to the European Investment Fund under JEREMIE initiative	21,457	27,308
Payables to the European Investment Bank on received credit line's refinancing	37,885	58,663
Total borrowings	**59,342**	**85,971**

As at 31 December 2017 the attracted funds payable to banks on received credit lines include funds for crediting small and medium-sized enterprises received from the European Investment Bank at the amount of BGN 37,885 thousand.

The Bank has an agreement with the European Investment Fund under the JEREMIE (Joint European Resources for Micro to Medium Enterprises) initiative, part of the Operational Program "Development of the Competitiveness of the Bulgarian Economy 2007-2013", ensuring funding to support small and medium-sized enterprises at the amount of BGN 21,457 thousand.

Notes to the Annual Financial Statements

27. Other liabilities

In thousands of BGN	2017	2016
Liabilities to personnel	886	861
Obligations for defined benefits plans	363	376
Tax and social securities payables	521	552
Payables to suppliers	562	739
Other liabilities	5,028	450
Total other liabilities	**7,360**	**2,978**

Obligations for defined benefits plans

The Bank has an obligation to pay certain amounts to each employee who retires with the Bank in accordance with Art. 222, § 3 of the Labour Code (LC) in Bulgaria. According to these regulations in the LC, when a labour contract of an employee, who has acquired a pension right, is ended, the employer is obliged to pay to the employee compensations for the amount of two gross monthly salaries. In case the employee's length of service in the Bank equals to or is greater than 10 or more years, as at retirement date, then the compensation amounts to six gross monthly salaries.

The estimated amount of the obligation for defined benefits plans as at each reporting date and the expenses recognized in profit and loss are based on an actuarial report (see below information on used parameters and actuarial assumptions).

The defined benefit plan (obligation for compensation upon retirement) is an unfunded plan.

Movements in the present value of the obligations under defined benefits plans

In thousands of BGN	2017	2016
Present value of the obligations at 1 January	376	274
Current service cost	29	32
Interest expenses	6	8
Amounts paid for the year	(77)	(4)
Actuarial (gains)/ losses recognized for the year from change in demographic and financial assumptions	29	66
Present value of the obligations at 31 December	363	376

Notes to the Annual Financial Statements

27. Other liabilities, continued

Obligations for defined benefits plans, continued

Actuarial assumptions

The main actuarial assumptions as of the date of the financial statements (presented as average values) are presented as follows:

	2017	**2016**
Discount rate as of 31 December	1.733%	2.3117%
Average annual salary increase	3.0%	3.0%
Interest rate	2.26%	2.26%

28. Capital and reserves

(a) Share capital

As at 31 December 2017, the share capital of Allianz Bank Bulgaria AD amounts to BGN 69,000 thousand (2016: BGN 69,000 thousand), which comprises the authorized issued capital amounting to BGN 69,000 thousand. The issued share capital comprises 69,000,000 fully paid shares with a par value of BGN 1 each.

The ownership structure of the registered share capital of the Bank as of 31 December 2017 and 31 December 2016 is as follows:

Shareholders	**2017** % of ownership	**2016** % of ownership
Allianz Bulgaria Holding AD	99.891	99.891
Other	0.109	0.109
	100.000	100.000

(b) Retained earnings

As of 31 December 2017, the retained earnings balance amounts to BGN 131,615 thousand, comprising retained earnings of BGN 103,751 thousand (2016 – BGN 133,780 thousand), as well as profit for the year to the amount of BGN 27,864 thousand (2016: BGN 30,255 thousand).

(c) Statutory reserves

Statutory reserves comprise amounts appropriated for purposes defined by the local legislation. Under the Bulgarian Commercial code, the Bank is required to set aside a statutory reserve from its profit in until it reaches 10% of its equity. As of 31 December 2017, the statutory reserve is at the amount of BGN 9,850 thousand (2016: BGN 9,850 thousand).

(d) Fair value reserve

The fair value reserve comprises the accumulated net change in the fair value reserve of available-for-sale financial assets until the investments are written-off or derecognised. The fair value reserve as of 31 December 2017 amounted to BGN 8,623 thousand (2016: BGN 4,480 thousand).

Notes to the Annual Financial Statements

29. Off-balance sheet commitments

Bank letters of guarantee and letters of credit

The Bank provides bank letters of guarantee and letters of credit to guarantee the performance of its customers to third parties. These agreements have fixed limits and generally extend for a period of validity of up to two years.

The contractual amounts of concluded agreements for issue of guarantees and letters of credit are set out in the following table by category. The amounts reflected in the table for commitments are assumed to be fully advanced. The amounts reflected in the table for guarantees and letters of credit represent the maximum accounting loss that would be recognised in the statement of financial position if counterparties failed to fulfil their obligations.

In thousands of BGN	**2017**	**2016**
Undrawn credit commitments	109,818	105,007
Letters of credit	1,580	1,818
Letters of guarantee	45,045	44,740
Total off-balance sheet commitments	156,443	151,565

These commitments and contingent obligations have off-balance sheet credit risk because only commitment fees and accruals for probable losses are recognized in the statement of financial position until the commitments are fulfilled or expire. Many of the contingent obligations will expire without being advanced in whole or in part. Therefore, the amounts do not represent expected future cash flows.

30. Assets pledged as collateral

As at 31 December 2017, the Bank has pledged government securities with nominal value BGN 33,931 thousand (2016: BGN 29,240 thousand) and market value BGN 36,471 thousand (2016: BGN 30,220 thousand) as security for borrowed funds from the State Budget, government securities with nominal value BGN 71,681 thousand (2016: BGN 70,214 thousand) and market value - BGN 81,918 thousand (2016: BGN 76,374 thousand) as security for the loan received by EIB on Programs for refinancing of commercial banks and for refinancing agriculture producers.

31. Trust and fiduciary activities

The Bank provides trust and fiduciary services to the companies in the Allianz Bulgaria Holding Group (the Group), whereby it holds and manages Bulgarian government securities on the behalf of the Bank. The Bank receives fee income for providing these services. Trust assets are not assets of the Bank and are not recognised in the Bank`s statement of financial position. The Bank is not exposed to any credit risk relating to the management of these assets, as it does not guarantee these investments.

Fee and commission income from trust management of Allianz Bulgaria Group amount to BGN 184 thousand for 2017 (2016: BGN 169 thousand).

Notes to the Annual Financial Statements

32. Related parties' transactions

(a) Parent company and ultimate controlling party

Identification of related parties

The Bank considers as a related-party relationship, in accordance with International Accounting Standard 24 Related Party Disclosures ("IAS 24") the following parties:

- The parent – company Allianz Bulgaria Holding AD from which 66.16% are controlled by Allianz SE (ultimate controlling party) and companies from Allianz SE Group;
- Investor with significant influence, owning directly or indirectly (with/or his close family members), 33.84% of the share capital of Allianz Bulgaria Holding AD, companies and non-profit legal entities under his direct or indirect control;
- Key management personnel and companies and non-profit legal entities under their direct or indirect control.

The table below shows the key management personnel compensation:

Compensation for key management personnel *In thousands of BGN*	**2017**	**2016**
Short-term employee benefits	1,529	1,662
Total	1,529	1,622

Related party transactions are summarized below.

Banking services

The Bank provides current accounts to related parties, and takes deposits from them, on which it incurs interest expense, and provides loans to them, on which it earns interest income. The Bank also earns fee and commission income on banking services provided to related parties.

Leasing

The Bank acquires finance leases from a related party. The value of leases acquired during the period was BGN 23,185 thousand (2016: BGN 21,309 thousand). The Bank provides credit risk management services to the related party and in respect of the risk of the lessees of the related party.

Other financial services

The Bank earns fees and commissions, disclosed in the financial statements as other income, from the sale of insurance and pension fund policies on behalf of related parties.

Other transactions with related parties

Other related party transactions includes rent income from and expense to related parties for property occupancy, and costs for services such as staff training, and insurance cost related to Bank's activity.

Notes to the Financial statement

32. Related parties' transactions , continued

(b) Transactions and balances

Related party	Nature of the related party relationship	Type of transaction	Value of the transactions for the year ended		End balances as of 31 December	
In thousands of BGN			**2017**	**2016**	**2017**	**2016**
Allianz Bulgaria Holding	Controls directly or indirectly the business of the Bank	Current accounts	-	-	2,614	748
		Deposits	-	-	-	1,930
		Interest expense	3	3	-	-
		Paid dividends	29,967	10,157		
		Fee and commission income	2	1	-	-
		Other income	1	1	-	-
Allianz Bulgaria Insurance company	Party under common control	Current accounts	-	-	16,255	7,555
		Deposits	-	-	-	5,150
		Receivables	-	-	-	32
		Interest expense	14	11	-	-
		Fee and commission income	115	89	-	-
		Insurance expenses	531	499	-	-
		Rent expenses	419	430	-	-
		Other income	181	181	-	-
		Other expenses	101	21	-	-
		Rental income	3	2	-	-
		Guarantees	-	-	1,173	1,173
Energy Insurance company	Party under common control	Current accounts	-	-	10,468	6,035
		Deposits	-	-	2,143	2,143
		Accrued interest on deposits	-	-	1	5
		Interest expense	21	9	-	-
		Fee and commission income	32	24	-	-
		Rent expenses	5	5	-	-
		Guarantees	-	-	2,073	2,073

Notes to the Annual Financial Statements

32. Related parties' transactions , continued

(b) Transactions and balances, continued

Related party	Nature of the related party relationship	Type of transaction	Value of the transactions for the year ended		End balances as of 31 December	
In thousands of BGN			2017	2016	2017	2016
Allianz Bulgaria Life Insurance company	Party under common control					
		Current accounts	-	-	17,320	6,350
		Interest expense	2	1	-	-
		Fee and commission income	289	269	-	-
		Other income	426	436	-	-
		Rent expenses	296	297	-	-
		Rental income	3	3	-	-
		Insurance expenses	1,475	1,418	-	-
		Payables	-	-	1	-
Allianz Bulgaria Pension company	Party under common control					
		Current accounts	-	-	11,438	11,547
		Deposits	-	-	6	6
		Interest expense	12	-	-	-
		Fee and commission income	22	9	-	-
		Other income	239	168	-	-
		Rental income	3	3	-	-
		Rent expenses	11	13		
		Guarantees	-	-	5	5
Bulgaria Net AD	Party under common control	Current accounts	-	-	-	2,052

Translation from the original Bulgarian version, in case of divergence the Bulgarian original shall prevail.

Notes to the Annual Financial Statements

32. Related parties' transactions , continued

(b) Transactions and balances, continued

Related party	Nature of the related party relationship	Type of transaction	Value of the transactions for the year ended		End balances as of 31 December	
In thousands of BGN			2017	2016	2017	2016
Allianz Leasing Bulgaria company	Party under common control	Current accounts	-	-	6,657	5,623
		Trade loan	-	-	17,602	25,230
		Liabilities to finance lease contract	-	-	7	13
		Interest income	500	675	-	-
		Interest expense	-	2	-	-
		Fee and commission income	5	6	-	-
		Rent expenses	136	114	-	-
		Expenses related to receivable transfer contract	80	80	-	-
		Income related to receivable transfer contract	80	80	-	-
		Cession expenses	1,374	1,179	-	-
		Transferred receivables	23,185	21,309		
		Other income	2	1		
SPOL S.R.O.	Party under the control of Allianz SE	Fee and commission income	-	42	-	-
		Interest income	-	596	-	-
Allianz SE	Ultimate controlling party	Receivables from Cash pool participation	-	-	9,779	-
Shareholders and parties related to shareholders	Party under the control and joint control of investor with significant influence and his close family members					
		Current accounts	-	-	17,106	12,188
		Deposits	-	-	1,677	8,124
		Accrued interest on deposits	-	-	-	1
		Interest receivables	-	-	12	16
		Interest expense	7	26	-	-
		Interest income	500	569	-	-
		Fee and commission income	76	681	-	-
		Loans and credit commitments	-	-	12,598	18,386
		Impairment allowance losses	-	-	106	193
		Guarantees	-	-	20	419
		Rent expenses	760	738	-	-
		Rent receivables	-	-	64	62

Notes to the Financial statement

32. Related parties' transactions , continued

(b) Transactions and balances, continued

As of 31 December 2017, loans and credit commitments are with remaining maturity between 3 months and 11 months. The interest rate varies between 3.1% and 15.75%. Loans and credit commitments are secured in full. Guarantees mature up to 14 years. Deposits and current accounts are not blocked and allow unrestricted payments. Deposits are with remaining maturity of six months. The interest rate on deposits varies between 0.01% and 0.02%.

Key management personnel	**Value of the transactions for the year ended**		**Balances as of 31 December**	
In thousands of BGN	**2017**	**2016**	**2017**	**2016**
Current accounts	-	-	1,319	1,287
Deposits	-	-	3,371	3,942
Accrued interest on deposits	-	-	1	5
Interest expense	25	142	-	-
Interest income	28	21	-	-
Fee and commission income	3	3	-	-
Remuneration	1,529	1,622	-	-
Loans and credit commitments	-	-	740	1,169
Impairment allowance losses	-	-	-	10
Guarantees as per art. 240, (1) from the Trade law	-	-	14	18

As of 31 December 2017 loans and credit commitments to key management personnel are with remaining maturity less than a year and up to 30 years respectively. The interest rate vary between 4.3% and 15.75%. Loans and credit commitments are secured in full. Deposits and current accounts are not blocked and allow unrestricted payments. Deposits are with remaining maturity up to 3 years. The interest rate on deposits varies between 0.02% and 1.5%.

33. Capital commitments

Agreements for purchase of property, plant and equipment are at the amount of BGN 1,397 thousand (2016: BGN – 225 thousand).

34. Subsequent events after the reporting period

There are no events, subsequent to the reporting date, of such a nature that they would require additional disclosures or adjustments to the financial statements.