ProCredit Bank

Part of the ProCredit Group

Consolidated Financial Statements 2018

PROCREDIT BANK (BULGARIA) EAD
CONSOLIDATED FINANCIAL STATEMENTS
31 DECEMBER 2018

The financial statements in English are a translation from the original, which was prepared in Bulgarian. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of the report takes precedence over this translation.

Table of Contents

Independent Auditors' Report

To the Shareholder of ProCredit Bank (Bulgaria) EAD

Report on the audit of the consolidated financial statements

Our opinion

We have audited the consolidated financial statements of ProCredit Bank (Bulgaria) EAD and its subsidiaries (the "Group") which comprise the consolidated statement of financial position as at 31 December 2018, and the consolidated statement of profit or loss, the consolidated statement of other comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and the notes to the consolidated financial statements, which include a summary of significant accounting policies.

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2018, and its financial performance and its cash flows for the year then ended in accordance with the International Financial Reporting Standards (IFRS), as adopted by the European Union (EU).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the consolidated financial statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the ethical requirements of the Independent Financial Audit Act that are relevant to our audit of the consolidated financial statements in Bulgaria. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code and the ethical requirements of the Independent Financial Audit Act.

PricewaterhouseCoopers Audit OOD, 9-11 Maria Louisa Blvd., 1000 Sofia, Bulgaria
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Registered with the Sofia City Court under company file number 13424/1997.

Baker Tilly Kliotu and Partners OOD, 5 Stara Planina Str., 5th and 6th floor, Sofia 1000, Bulgaria
T: +359 2 9580980, F: +359 2 8592139, www.bakertilly.bg
Registered with the Sofia City Court under company file number 131349346.

Our audit approach

Overview

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the consolidated financial statements. In particular, we considered where management made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all our audits, we also addressed the risk of management override of internal controls, including among other matters consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall materiality for the consolidated financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, if any, both individually and in aggregate on the consolidated financial statements as a whole.

Overall materiality	BGN 2,972 thousand
How we determined it	Approximately 7% of profit before tax
Rationale for the materiality benchmark applied	We applied profit before tax as a benchmark because, in our view, it is the benchmark against which the performance of the Group is commonly measured by the users of the consolidated financial statements and it is a generally accepted benchmark.

Key audit matters

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

Key audit matter	*How our audit addressed the key audit matter*
Impairment allowance for loans and advances to customers The impairment allowance for loans and advances to customers has been determined in accordance with IFRS 9 "Financial Instruments". We focus on this area because IFRS 9 is a new and complex accounting standard which requires management's subjective judgement over the interpretation of the requirements applicable to the new expected credit loss model, identification of the exposures with significant increase in credit risk and the estimation of the amount that should be recognized. As described in note 18 to the consolidated financial statements, the Group has recorded as at December 31, 2018 impairment allowances on loans and advances to customers amounting to BGN 39,001 thousand. The identification of significant increase in credit risk and the determination of loans' recoverable amounts are part of the Group's estimations and expected credit loss models including, amongst others, the assessment of objective evidence for impairment, the probability of default, loss given default, exposure at default parameters, the financial condition of the debtors, the expected future cash-flows and the value of collateral. The use of different assumptions could lead to different estimates of impairment charges on loans and advances to customers. Because of the significance of the valuation of loans and advances to customers for the consolidated financial statements, and due to the fact that the assumptions in determining the impairment allowances include significant estimates and application of professional judgment, we identified impairment of loans and advances to customers as a key audit matter.	Our audit approach included assessment of the modelling design, validation and documentation and the Group's expected credit loss methodology for compliance with IFRS 9. We have assessed and tested the design and operating effectiveness of the controls within the lending and provision processes and determined that we could rely on these controls for the purposes of the audit. We involved auditor's experts in the areas which required specific expertise. For individually impaired loans we have performed, for a sample of credit exposures, a detailed review of loans files. We challenged the assumptions related to impairment identification and quantification of expected of future cash-flows (recoverable amounts) determined based on either valuation of underlying collateral or other recoveries. For the loan impairment calculated on a collective basis, we tested the underlying models and the appropriateness of the model parameters such as probability of default, loss given defaults, exposure at default and where available, compared data and assumptions to historical experience. We assessed the completeness, appropriateness and adequacy of the disclosures in the Group's consolidated financial statements with regard to the measurement of loans and advances to customers.

Information other than the separate financial statements and auditors' report thereon

Management is responsible for the other information. The other information comprises *the Separate Annual Activity Report and the Separate Corporate Governance Statement,* prepared by the management in accordance with Chapter Seven of the Accountancy Act but does not include the separate financial statements and our auditors' report thereon.

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

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

We have nothing to report in this regard.

Additional matters to be reported under the Accountancy Act

In addition to our responsibilities and reporting in accordance with ISAs, in relation to the Separate Annual Activity Report and the Separate Corporate Governance Statement, we have also performed the procedures added to those required under ISAs in accordance with the "Guidelines Regarding the New and Enhanced Auditor Reporting and Communication by the Auditor" of the professional organisation of certified public accountants and registered auditors in Bulgaria, i.e. the Institute of Certified Public Accountants (ICPA). These procedures refer to testing the existence, form and content of this other information to assist us in forming an opinion on whether the other information includes the disclosures and reporting provided for in Chapter Seven of the Accountancy Act and art. 100(m) paragraph 8 of Public Offering of Securities Act, applicable in Bulgaria.

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

The management has prepared Separate Annual Activity Report and Separate Corporate Governance Statement as of 31 December 2018 which was presented with the separate financial statements as of 31 December 2018 issued in Bulgarian language only and authorized by the Management on 12 April 2019.

Based on the procedures performed, in our opinion:

a) The information included in the Separate Annual Activity Report referring to the financial year for which the separate financial statements have been prepared is consistent with those separate financial statements.

b) The Separate Annual Activity Report has been prepared in accordance with the requirements of Chapter Seven of the Accountancy Act.

c) The Separate Corporate Governance Statement for the financial year, for which the separate financial statements have been prepared, presents the information required by Chapter Seven of the Accountancy Act and Art. 100(m), paragraph 8 of the Public Offering of Securities Act.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU), and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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

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

Auditors' responsibilities for the audit of the consolidated financial statements

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control. Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

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

We are jointly and severally responsible for the performance of our audit and for the audit opinion expressed by us in accordance with the requirements of the Independent Financial Accounting Act, applicable in Bulgaria. In accepting and performing the engagement for the joint audit, in connection to which we report, we have also been guided by the Guidelines for the Implementation of Joint Audit, issued on 13 June 2017 by the Institute of Certified Public Accountants, Bulgaria and the Commission for Public Oversight of Statutory Auditors in Bulgaria.

Report on other legal and regulatory requirements

Additional reporting on the audit of the consolidated financial statements in connection with art. 10 of Regulation (EU) 537/2014 in connection with the requirements of art. 59 of the Independent Financial Audit Act

In accordance with the requirements of the Independent Financial Audit Act in connection with Art.10 of Regulation (EU) 537/2014, we hereby additionally report the information stated below:

- PricewaterhouseCoopers Audit OOD was appointed as a statutory auditor of the consolidated financial statements of the Group for the year ended 31 December 2018 by the general meeting of shareholders held on 22 October 2018 for a period of one year.
- Baker Tilly Klitou and Partners OOD was appointed as a statutory auditor of the consolidated financial statements of the Group for the year ended 31 December 2018 by the general meeting of shareholders held on 22 October 2018 for a period of one year.
- The audit of the consolidated financial statements of the Group for the year ended 31 December 2018 represents fifth of total uninterrupted statutory audit engagements for that entity carried out by PricewaterhouseCoopers Audit OOD.
- The audit of the consolidated financial statements of the Group for the year ended 31 December 2018 represents second of total uninterrupted statutory audit engagements for that entity carried out by Baker Tilly Klitou and Partners OOD.

- We hereby confirm that the audit opinion expressed by us is consistent with the additional report provided to the Group's audit committee in compliance with the requirements of Art. 60 of the Independent Financial Audit Act.
- We hereby confirm that we have not provided the prohibited non-audit services referred to in Art.64 of the Independent Financial Audit Act.
- We hereby confirm that in conducting the audit we have remained independent of the Group.
- In the period 1 January 2018 – 31 December 2018, PricewaterhouseCoopers Audit OOD have provided to the Group, in addition to the audit, training services for the amount of BGN 450 and interim review for the amount of BGN 50,320.

For PricewaterhouseCoopers Audit OOD:

Jock Nunan

Rositsa Boteva

Registered Auditor responsible for the audit

9-11, Maria Louisa Blvd.
1000 Sofia, Bulgaria

15 April 2019

ОДИТОРСКО ДРУЖЕСТВО
София
Рег. № 085
ПРАЙСУОТЪРХАУСКУПЪРС ОДИТ ООД

For Baker Tilly Klitou and Partners OOD:

Krassimira Radeva

Registered Auditor responsible for the audit

Managing Director

5, Stara Planina Str., 5th floor
1000 Sofia, Bulgaria

15 April 2019

ОДИТОРСКО ДРУЖЕСТВО
София
Рег. № 129
БЕЙКЪР ТИЛИ КЛИТУ И ПАРТНЬОРИ ООД

Consolidated Statement of Profit or Loss

(all amounts expressed in thousands of BGN)	Notes	Year ended 31 December	
		2018	**2017**
Interest and similar income	6	62,510	62,527
Interest and similar expenses	6	(4,965)	(3,231)
Net interest income		**57,545**	**59,296**
Loss allowance	7	(1,656)	(665)
Net interest income after allowances		**55,889**	**58,631**
Fee and commission income	8	24,666	22,008
Fee and commission expenses	8	(2,407)	(1,978)
Net fee and commission income		**22,259**	**20,030**
Result from foreign exchange transactions	9	7,812	7,328
Result from investment securities (2017: available-for-sale financial assets)	10	(321)	(72)
Net other operating income/(loss)	11	2,855	(481)
Operating income		**88,494**	**85,436**
Personnel expenses	12	(16,364)	(17,255)
Administrative expenses	13	(29,676)	(32,178)
Operating expenses		**(46,040)**	**(49,433)**
Profit before tax		42,454	36,003
Income tax expense	14	(4,345)	(3,838)
Profit for the period		**38,109**	**32,165**

These consolidated financial statements on pages 1 to 64 were approved by the Management Board and signed on its behalf by:

Reni Peicheva
Executive Director and
Member of the Management Board
12 April 2019

Ivan Dachev
Executive Director and
Member of the Management Board

Initialled for identification purposes in reference to the auditors' report

For PricewaterhouseCoopers Audit OOD

Jock Nunan
Procurator
15-04-2019

Rositsa Boteva
Registered auditor, responsible for the audit
15-04-2019

For Baker Tilly Klitou and Partners OOD

Krasimira Radeva
Registered auditor, responsible for the audit
Managing Director
15.04.2019

ОДИТОРСКО ДРУЖЕСТВО София Рег. № 129 БЕЙКЪР ТИЛИ КЛИТУ И ПАРТНЬОРИ ООД

The notes set out on pages 6 to 64 form an integral part of these financial statements.

Consolidated Statement of Other Comprehensive Income

(all amounts expressed in thousands of BGN)	Notes	Year ended 31 December	
		2018	**2017**
Profit for the period		38,109	32,165
Items that will not be reclassified to profit or loss			
Change in revaluation reserve from financial assets at fair value through other comprehensive income		641	-
Items that may be reclassified subsequently to profit or loss			
Change in revaluation reserve from financial assets at fair value through other comprehensive income		120	934
Other comprehensive income for the period, net of tax		**761**	**934**
Total comprehensive income for the period		**38,870**	**33,099**

These consolidated financial statements on pages 1 to 64 were approved by the Management Board and signed on its behalf by:

Reni Peicheva
Executive Director and
Member of the Management Board
12 April 2019

Ivan Dachev
Executive Director and
Member of the Management Board

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For PricewaterhouseCoopers Audit OOD

Jock Nunan
Procurator
15-04-2019

Rositsa Boteva
Registered auditor, responsible for the audit
15-04-2019

For Baker Tilly Klitou and Partners OOD

Krasimira Radeva
Registered auditor, responsible for the audit
Managing Director
15.04.2019

The notes set out on pages 6 to 64 form an integral part of these financial statements.

Consolidated Statement of Financial Position

(all amounts expressed in thousands of BGN)	Notes	31.12.2018	IFRS 9 01.01.2018	IAS 39 31.12.2017
ASSETS				
Cash and cash equivalents	15	218,803	191,853	192,077
Loans and advances to banks	16	268,469	288,300	288,320
Investment securities (FVOCI/AFS)	17	33,384	32,592	32,592
Loans and advances to customers	18	1,598,077	1,403,890	1,403,835
Property, plant and equipment	19	39,376	41,295	41,295
Intangible assets	19	5,067	3,780	3,780
Deferred tax assets	20	550	558	558
Other assets	21	11,124	12,908	12,944
Total assets		**2,174,850**	**1,975,176**	**1,975,401**
LIABILITIES				
Liabilities to banks	22	91,164	83,858	83,858
Liabilities to customers	23	1,656,287	1,466,145	1,466,145
Liabilities to financial institutions	24	179,662	200,815	200,815
Other liabilities	25	3,747	6,972	6,972
Provisions	26	959	902	569
Current tax liabilities		515	373	373
Total liabilities		**1,932,334**	**1,759,065**	**1,758,732**
EQUITY				
Share capital and share premium	27	187,264	167,706	167,706
Legal reserve	27	6,461	6,461	6,461
Other reserve	27	6,514	6,514	6,514
Retained earnings		40,544	34,458	35,035
Revaluation reserve		1,733	972	953
Total equity		**242,516**	**216,111**	**216,669**
Total equity and liabilities		**2,174,850**	**1,975,176**	**1,975,401**

These consolidated financial statements on pages 1 to 64 were approved by the Management Board and signed on its behalf by:

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Executive Director and
Member of the Management Board
12 April 2019

Ivan Dachev
Executive Director and
Member of the Management Board

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For PricewaterhouseCoopers Audit OOD

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15-04-2019

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15-04-2019

For Baker Tilly Klitou and Partners OOD

Krasimira Radeva
Registered auditor, responsible for the audit
Managing Director
15.04.2019

The notes set out on pages 6 to 64 form an integral part of these financial statements.

Consolidated Statement of Changes in Equity

(all amounts expressed in thousands of BGN)	Share capital	Share premium	Legal reserve	Other reserve	Retained earnings	Revaluation reserve	Total
Balance as of 1 January 2017	**164,210**	**3,496**	**3,953**	**6,514**	**56,393**	**19**	**234,585**
Comprehensive income for the period							
Revaluation of AFS securities	-	-	-	-	-	934	934
Other increase (decrease) in equity	-	-	2,508		(2,508)	-	-
Profit for the period	-	-	-	-	32,165	-	32,165
Total comprehensive income for the period	-	-	**2,508**	-	**29,657**	**934**	**33,099**
Transactions with owners, recorded directly in equity							
Contributions by and distributions to owners							
Distributed dividends	-	-	-	-	(51,015)	-	(51,015)
Total contributions by and distributions to owners	-	-	-	-	**(51,015)**	-	**(51,015)**
Balance as of 31 December 2017	**164,210**	**3,496**	**6,461**	**6,514**	**35,035**	**953**	**216,669**
Balance as of 1 January 2018	**164,210**	**3,496**	**6,461**	**6,514**	**35,035**	**953**	**216,669**
Change on initial application of IFRS 9	-	-	-	-	(577)	19	(558)
Restated balance as of 1 January 2018	**164,210**	**3,496**	**6,461**	**6,514**	**34,458**	**972**	**216,111**
Comprehensive income for the period							
Change in revaluation reserve, net of taxes	-	-	-	-	-	761	761
Profit for the period	-	-	-	-	38,109	-	38,109
Total comprehensive income for the period	-	-	-	-	**38,109**	**761**	**38,870**
Transactions with owners, recorded directly in equity							
Contributions by and distributions to owners							
Capital increase	19,558	-	-	-	-	-	19,558
Distributed dividends	-	-	-	-	(32,023)	-	(32,023)
Total contributions by and distributions to owners	**19,558**	-	-	-	**(32,023)**	-	**(12,465)**
Balance as of 31 December 2018	**183,768**	**3,496**	**6,461**	**6,514**	**40,544**	**1,733**	**242,516**

These consolidated financial statements on pages 1 to 64 were approved by the Management Board and signed on its behalf by:

Reni Peicheva
Executive Director and
Member of the Management Board
12 April 2019

Ivan Dachev
Executive Director and
Member of the Management Board

Initialled for identification purposes in reference to the auditors' report:

For PricewaterhouseCoopers Audit OOD

Jock Nunan
Procurator
15 -04- 2019

Rositsa Boteva
Registered auditor, responsible for the audit
15 -04- 2019

For Baker Tilly Klitou and Partners OOD

Krasimira Radeva
Registered auditor, responsible for the audit
Managing Director

15. 04. 2019

The notes set out on pages 6 to 64 form an integral part of these financial statements.

ОДИТОРСКО ДРУЖЕСТВО София Рег. № 129 БЕЙКЪР ТИЛИ КЛИТУ И ПАРТНЬОРИ ООД

Consolidated Statement of Cash Flows

(all amounts expressed in thousands of BGN)

	Notes	Year ended 31 December 2018	2017
Profit for the year		38,109	32,165
Non-cash items included in the profit of the period and transition to the cash flow from operating activities			
Loss allowance	7	1,656	665
Result from investment securities	10	321	72
Depreciation	13	5,200	5,143
Unrealised (gains) from currency revaluation	9	(90)	(425)
Net interest income	6	(57,545)	(59,296)
Income tax expense	14	4,345	3,838
Increase/ decrease of assets and liabilities from operating activities after non-cash items			
Required reserve with the central bank		(19,064)	(21,271)
Loans and advances to banks		-	46,940
Loans and advances to customers		(198,746)	(196,552)
Other assets		2,068	4,029
Short term liabilities to banks and financial institutions		7,292	(181,880)
Liabilities to customers		190,351	220,549
Other liabilities		(3,135)	2,166
Interest received		65,204	64,209
Interest paid		(8,900)	(2,882)
Income tax paid		(4,260)	(4,274)
Cash flow from/(used in) operating activities		**22,806**	**(86,804)**
Purchase of/ proceeds from:			
Property, plant and equipment and intangible assets		(4,569)	(190)
Securities purchased		(15,529)	-
Securities matured		14,956	10,181
Cash flow from/(used in) investing activities		**(5,142)**	**9,991**
Cash flow from financing activities			
Dividends paid		(32,023)	(51,015)
Shares issued		19,558	-
Long term liabilities to banks and financial institutions, net		(17,323)	91,194
Cash flow from/(used in) financing activities		**(29,788)**	**40,179**
Net (decrease)/increase in cash and cash equivalents		**(12,124)**	**(36,634)**
Cash and cash equivalents at end of previous year		**348,122**	**384,756**
Cash and cash equivalents at end of year	15	**335,998**	**348,122**

These consolidated financial statements on pages 1 to 64 were approved by the Management Board and signed on its behalf by:

Reni Peicheva
Executive Director and
Member of the Management Board
12 April 2019

Ivan Dachev
Executive Director and
Member of the Management Board

PROCREDIT BANK • SOFIA •

Initialled for identification purposes in reference to the auditors' report

For PricewaterhouseCoopers Audit OOD

Jock Nunan
Procurator
15-04-2019

Rositsa Boteva
Registered auditor, responsible for the audit
15-04-2019

For Baker Tilly Klitou and Partners OOD

Krasimira Radeva
Registered auditor, responsible for the audit
Managing Director
15.04.2019

ОДИТОРСКО ДРУЖЕСТВО София Рег. № 085 ПРАЙСУОТЪРХАУСКУПЪРС ОДИТ ООД

ОДИТОРСКО ДРУЖЕСТВО София Рег. № 129 БЕЙКЪР ТИЛИ КЛИТУ И ПАРТНЬОРИ ООД

The notes set out on pages 6 to 64 form an integral part of these financial statements.

1 Reporting entity

ProCredit Bank (Bulgaria) EAD ("ProCredit Bank", "the bank" or "the institution") was founded in October 2001 by an alliance of international development-oriented investors, many of which are shareholders in ProCredit Holding AG & Co. KGaA („ProCredit Holding") today. Since the beginning of 2013 the sole shareholder of the bank is ProCredit Holding.

The bank is part of the international group of financial institutions owned by ProCredit Holding. ProCredit Holding is the ultimate parent and ultimate controlling party of the ProCredit group of banks ("the ProCredit group"). The bank has two subsidiaries – ProCredit Properties EAD and ProCredit Education EAD (referred to collectively as "the group"), which are wholly owned.

The group is managed through a Supervisory Board consisting of five members and a Management Board consisting of three members as of December 2018 which are elected for a period of three years.

ProCredit Bank is a development oriented full service bank which aims to be a house bank for businesses and private clients. Business clients, serviced by the bank, are companies, agricultural producers and self-employed persons. They are categorised as Small and Medium in accordance to their business potential. Private clients are regular income receivers (salary, pension or other) and business owners. The bank strives to have comprehensive knowledge about its customers and to implement an individual approach and strategy for servicing each client, being based on the client's profile. Strategically, the bank focuses on production companies, agricultural producers, green and energy efficiency financing.

2 Basis of preparation

a Compliance with International Financial Reporting Standards

ProCredit Bank prepares its Consolidated Financial Statements in accordance with International Financial Reporting Standards ("IFRS") and interpretations issued by the IFRS Interpretations Committee ("IFRS IC") as adopted by the European Union ("EU"). IFRSs as adopted by the EU is the commonly accepted name of the general purpose framework – the basis of accounting equivalent to the framework definition introduced by § 1, p. 8 of the Additional Provisions of the Accountancy Act "International Accounting Standards" (IASs). The financial statements were prepared on a consolidated basis according to the Accountancy Act. The consolidated financial statements were approved by the Management Board on 12 April 2019.

The Consolidated Financial Statements comprise the Consolidated Statement of Profit or Loss, the Consolidated Statement of Other Comprehensive Income, the Consolidated Statement of Financial Position, the Consolidated Statement of Changes in Equity, the Consolidated Statement of Cash Flows and the Notes to the Consolidated Financial Statements. The information required by IFRS 7 on the nature and extent of risks arising from financial instruments and their management is presented in the Risk Report section of the Management Report.

The principle accounting policies have been consistently applied to all the years presented, unless otherwise stated. All amounts are presented in thousands of Bulgarian leva (BGN), unless otherwise stated. The fiscal year of the group is the calendar year. For computational reasons, the figures in the tables may exhibit rounding differences of ± one unit (BGN, %, etc.). Reporting and valuation are made on a going concern assumption.

2 Basis of preparation (continued)

b Consolidation

The consolidated financial statements comprise the financial statements of ProCredit Bank (Bulgaria) EAD and its subsidiaries as of 31 December 2018. Subsidiaries are all companies which are controlled by the group, i.e. for which the group can determine the financial and operating policies. The subsidiaries are fully consolidated. The group had two subsidiaries as of end 2018 – ProCredit Properties EAD and ProCredit Education EAD. Intercompany transactions, balances and unrealised gains and losses on transactions between the bank and its subsidiary companies are eliminated. Where necessary, the accounting policies of the subsidiaries have been changed to ensure consistency with the policy adopted by the group. The purchase method of accounting is used to account for the acquisition of subsidiaries by the group.

c Measurement basis

The financial statements have been prepared on a historical cost basis, except for the following:

- certain financial assets and liabilities (including derivative instruments)
- assets held for sale - measured at fair value less costs to sell.

d Use of assumptions and estimates

The group's financial reporting and its financial result are influenced by assumptions, estimates and management judgements which necessarily have to be made in the course of preparation of the Consolidated Financial Statements.

All estimates and assumptions required in conformity with IFRS are best estimates undertaken in accordance with applicable standard. Estimates and judgements are evaluated on continuous basis, and are based on past experience and other factors, including expectations with regard to future events and are considered appropriate under the given circumstances.

Management judgements for certain items are especially critical for the group's results and financial situation due to their materiality in amount. This applies to the following positions:

Impairment of credit exposures
By applying IFRS 9, the Incurred-Loss Model from IAS 39 is replaced by the Expected-Loss Model. Loss allowances are established in an amount equivalent to the expected loss for all financial assets recognised at amortised cost, for all funding instruments recognised at fair value with changes in fair value reported in Other Comprehensive Income (FVOCI), and for off-balance-sheet business. Expected credit losses are recorded in an approach with various stages. ProCredit Bank reports the balance sheet items “Central bank reserves”, “Loans and advances to banks”, “Investment securities”, “Loans and advances to customers” and “Other assets” net (including loss allowances). Further information on the group's accounting policy on loan loss provisioning can be found in Note 3h.

Measurement of deferred tax asset
The group recognises deferred tax assets only to the extent that it is probable that taxable profits will be available against which the tax-reducing effects can be utilised. The profit projection is based on the latest business planning as of December 2018 approved by the Supervisory Board of the group and therefore reflects management's view of future business prospects. The tax planning period of the group is five years. For details on the recognised amounts see notes 14 and 20.

2 Basis of preparation (continued)

e New and amended standards adopted by the group

This note provides a list of the significant accounting policies adopted in the preparation of these financial statements to the extent they have not already been disclosed in the other notes above. These policies have been consistently applied to all the years presented, unless otherwise stated

(i) Standards, amendments and interpretations adopted by the group and effective on or after 1 January 2018

- IFRS 9 "Financial Instruments" has an impact on the classification and measurement of financial instruments and on the recognition of impairment. The impact of the first application is shown under Note 31. Information on the classification and measurement of financial instruments and on the recognition of impairment is shown under Notes 3e and 3h. IFRS 9 is applicable for annual periods beginning on or after 1 January 2018.
- IFRS 15 "Revenue from Contracts with Customers" and Clarifications to IFRS 15 "Revenue from Contracts with Customers" had no effect on financial information reported in the current or comparative periods. In general, the recognition of proceeds from existing contracts with our customers is transaction-based. Both are effective for annual periods beginning on or after 1 January 2018.
- IFRIC Interpretation 22 "Foreign Currency Transactions and Advance Consideration" has a minor impact on the financial statements. The interpretation is effective for annual periods beginning on or after 1 January 2018.
- Amendments to IAS 40 "Transfers of Investment Property" has a minor impact on the financial statements. The amendments are effective for annual periods beginning on or after 1 January 2018.

The following standards, amendments or interpretations were issued by the IASB and endorsed by the EU and had no impact on the group's financial statements: Amendments to IFRS 2: Classification and Measurement of Share-based Payment Transactions, Amendments to IFRS 4: Applying IFRS 9 "Financial Instruments" with IFRS 4 "Insurance contracts", and Annual Improvements to IFRS (2014-2016).

(ii) Standards, amendments and interpretations issued but not yet effective

The following standards, amendments and interpretations were issued by the IASB and will have an impact on the financial statements. These were not applied in preparing these financial statements:

- Amendments to IFRS 9 "Prepayment Features with Negative Compensation" to address concerns about how certain financial instruments with early repayment arrangements are classified under IFRS 9. The amendments are effective for annual periods beginning on or after 1 January 2019.
- IFRS 16 "Leases" will have an impact on the recognition, measurement, presentation and disclosure of existing contracts as lessees. The group intends to apply the simplified transition approach (modified retrospective approach) and will not restate comparative amounts for the year prior to first adoption. From 2019 on, existing leases will be reported as "right-of-use" assets under "Property, Plant and Equipment and Investment Property". The standard will affect primarily the accounting for the group's operating leases. Finance lease activities are not material and hence the group does not expect any significant impact on the financial statements. The standard is applicable for annual periods beginning on or after 1 January 2019.

2 Basis of preparation (continued)

e New and amended standards adopted by the group (continued)

The group develops models and processes to implement IFRS 16. The impact from initially applying IFRS 16 will be to recognise rights of use assets in respect of office properties leased by the group under contracts classified as operating leases under IAS 17. Other contracts are related to lease of low value items. The group will

- ✓ apply IFRS 16 to contracts previously identified as leases by IAS 17
- ✓ use the incremental borrowing rate as the discount rate
- ✓ not apply IFRS 16 to short-term operating leases (with a remaining term of less than 12 months) or leases of low-value assets

The opening statement of financial position at 1 January 2019 will be adjusted to create a right of use asset of approximately BGN 6.6 million. A lease liability will also be recognised of BGN 6.6 million. This will have an estimated impact of 10 basis points on the CET 1 ratio.

- Annual Improvements to IFRS Standards (2015-2017) will have a minor impact on the financial statements. The amendments are effective for annual periods beginning on or after 1 January 2019.
- Amendments to References to the Conceptual Framework in IFRS Standards will have a minor impact on the financial statements. The amendments are effective for annual periods beginning on or after 1 January 2020.
- Amendments to IAS 1 and IAS 8: Definition of material will have a minor impact on the financial statements. The amendments are effective for annual periods beginning on or after 1 January 2020.

The following standards, amendments or interpretations were issued by the IASB but will not have an impact on the group's financial statements: IFRS 17 “Insurance Contracts”, IFRIC 23 “Uncertainty over Income Tax Treatments”, amendments to IAS 19 “Plan amendments, curtailments, and settlements”, amendments to IAS 28 “Long-term Interests in Associates and Joint Ventures”, and amendment to IFRS 3 “Business Combinations”.

There was no early adoption of any standards, amendments or interpretations not yet effective.

3 Summary of significant accounting policies

This note provides a list of the significant accounting policies adopted in the preparation of these financial statements to the extent they have not already been disclosed in the other notes above. These policies have been consistently applied to all the years presented, unless otherwise stated.

a Foreign currency translation

(a) Functional and presentation currency
Items included in the financial statements are measured using the currency with which the entity operates in its primary economic environment ("the functional currency"). The financial statements are presented in Bulgarian leva, which is the group's functional and presentation currency. All amounts stated within the financial statements are presented in thousands of Bulgarian leva unless otherwise specified.

(b) Transactions and balances
Foreign currency assets and liabilities are translated into the functional currency using the closing exchange rates, and items of income and expenses are translated at the monthly average rate of exchange when these approximate actual rates. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the Consolidated Statement of Profit or Loss (result from foreign exchange transactions).

In the case of changes in the fair value of financial assets at fair value through other comprehensive income denominated in foreign currency a distinction is made between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security. Translation differences on financial assets at fair value through other comprehensive income in the Consolidated Statement of Profit or Loss.

Non-monetary items measured at historical cost denominated in foreign currency are translated with the historical exchange rate as of the date of the transaction.

As of 31 December 2018, monetary assets and liabilities denominated in foreign currency were translated into Bulgarian leva at the official central bank exchange rate: BGN 1.95583 for EUR 1 and BGN 1.70815 for USD 1 (2017: BGN 1.95583 for EUR 1 and BGN 1.63081 for USD 1).

b Interest income and expenses

Interest income and expenses for all interest-bearing financial instruments are recognised within "Interest income" and "Interest expense" in the Consolidated Statement of Profit or Loss using the effective interest rate method in the period in which they arise.

Payments received in respect of written-off loans are not recognised in net interest income, but rather under "Loss allowances".

c Fee and commission income and expenses

Fees and commissions consist mainly of fees for Bulgarian leva and foreign currency transactions, and are generally recognised on an accrual basis. Fee and commission expenses concern fees incurred by the group in dealings with other banks and are recognised on the date of the transaction.

3 Summary of significant accounting policies (continued)

d Result from foreign exchange transactions

"Result from foreign exchange transactions" refers primarily to the results of foreign exchange dealings with and for customers. The group does not engage in any foreign currency trading on its own account. This position also includes unrealised foreign currency revaluation effects. The group does not apply hedge accounting as defined by IFRS 9.

e Financial instruments

From 1 January 2018, ProCredit Bank classifies its financial assets both according to their underlying business model and also their contractual cash flows.

Differentiation is made between the following business models: "hold to collect", "hold to collect and sell" and "other". Financial assets are assigned to the "hold to collect" business model if their objective is to collect contractual cash flows through interest and principal payments (Solely Payments of Principal and Interest ("SPPI") conform). The balance sheet items allocated to this business model are: "Central bank reserves", "Loans and advances to banks", "Loans and advances to customers" and "Other assets". "Investment securities" (which are debt securities) are allocated to the "hold to collect and sell" business model; these financial assets are generally held (SPPI conform) in order to collect contractual cash flows but can be sold as needed. Furthermore, a small amount of shares are allocated to the "hold to collect and sell" business model, included under "Investment securities". "Cash in hand" and "derivative financial assets" are allocated to the "other" business model.

Subsequent recognition of financial liabilities is generally performed at amortised cost. Only derivative financial liabilities are recognised at fair value.

(a) Financial assets and financial liabilities at fair value through profit or loss

Financial assets held for trading or which are not classified in the "hold to collect" or "hold to collect and sell" business models are allocated to the "other" business model and recognised at fair value through profit or loss. This includes "cash and cash equivalents" and "derivative financial assets". Only "derivative financial liabilities" are recognised as financial liabilities at fair value through profit or loss.

The group does not apply hedge accounting. Derivatives with a positive fair value at the balance sheet date are carried as financial assets and reported under "Derivative financial assets". Derivatives with a negative fair value are carried as financial liabilities and are reported under "Derivative financial liabilities".

Derivative financial instruments are initially recognised at fair value, and transaction costs are expensed in the Consolidated Statement of Profit or Loss. Purchases and sales of derivative financial instruments are recognised on the trade date – the date on which the group commits to purchase or sell the instrument. Subsequently, the financial instruments are also carried at fair value. Gains and losses arising from changes in their fair value are immediately recognised in the Consolidated Statement of Profit or Loss of the period.

Derivative financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the group has transferred legal rights and substantially all risks and rewards of ownership. Derivative financial liabilities are derecognised when they are extinguished – that is, when the obligation is discharged, cancelled or expired.

3 Summary of significant accounting policies (continued)

e Financial instruments (continued)

(b) Financial assets at amortised costs

A financial asset is classified as “at amortised costs” if the financial asset is allocated to the “hold to collect” business model and the contractual cash flows meet the SPPI criterion. Financial assets at amortised costs are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the group provides capital directly to a contracting party with no intention of trading the receivable.

Financial assets are recognised when the principal is advanced to the borrowers. These assets are initially recognised at fair value plus transaction costs; subsequently they are measured at amortised cost using the effective interest method. Amortised premiums and discounts are accounted for over the respective terms in the Consolidated Statement of Profit or Loss under “net interest income”. At each balance sheet date and whenever there is evidence of potential impairment, the group assesses the value of its financial assets. As a consequence, their carrying amount may be reduced through the use of an allowance account (see note 3h for the accounting policy for impairment of credit exposures, as well as notes 7 and 18). If the amount of the impairment loss decreases, the impairment allowance is reduced accordingly, and the amount of the reduction is recognised in the Consolidated Statement of Profit or Loss. The upper limit on the reduction of the impairment is equal to the amortised costs which would have been incurred as of the valuation date if there had not been any impairment. Loans and receivables are derecognised when the rights to receive cash flows from the financial assets have expired or where the group has transferred substantially all risks and rewards of ownership. In addition, when loans and receivables are restructured with substantially different terms and conditions, the original financial asset is derecognised and replaced with the new financial asset.

(c) Financial assets at fair value with changes in fair value recognised in Other Comprehensive Income

A financial asset is classified and recognised as “at fair value with changes in fair value recognised in Other Comprehensive Income” (“FVOCI financial instrument”), if the financial asset is allocated to a “hold to collect or sell” business model.

Most of the “investment securities” allocated to this business model are those financial assets that are generally held “SPPI conform” in order to collect contractual cash flows but can be sold as needed. Furthermore, a small amount of shares (also included under the position “Investment securities”) are allocated to this business model.

At initial recognition, the FVOCI financial instruments are recorded at fair value plus transaction costs that are directly attributable to the acquisition of the financial asset. Subsequently they are carried at fair value. Gains and losses arising from changes in fair value are recognised in the Consolidated Statement of Other Comprehensive Income under “Revaluation reserve”. If the financial asset is derecognised or impaired (for details on impairment, see note 3h), the cumulative gain or loss previously recognised in the “Revaluation reserve” is recognised in the Consolidated Statement of Profit or Loss in the position “Net result from investment securities”. Interest calculated using the effective interest rate method and foreign currency gains and losses on monetary assets classified as FVOCI financial instruments are recognised in the Consolidated Statement of Profit or Loss. For the FVOCI capital instruments, any dividend payments are recognised in the Consolidated Statement of Profit or Loss, but not the accumulated value change on derecognition (no recycling).

3 Summary of significant accounting policies (continued)

e Financial instruments (continued)

Purchases and sales of FVOCI financial instruments are recorded as of the trade date. They are derecognised when the rights to receive cash flows from the financial assets have expired or when the group has transferred substantially all risks and rewards of ownership.

(d) Other financial liabilities at amortised cost

Other financial liabilities at amortised cost are recognised initially at fair value net of transaction costs incurred. They are subsequently measured at amortised cost using the effective interest method. Any difference between proceeds net of transaction costs and the redemption value is recognised in the Consolidated Statement of Profit or Loss over the period of the debt instrument. Financial liabilities at amortised cost are derecognised when they are extinguished – that is, when the obligation is discharged, cancelled or expired.

Fair value measurement principles

Upon acquisition, financial instruments are measured at fair value. In principle, this is the transaction price at the time they are acquired. Depending on their respective category, financial instruments are subsequently recognised either at fair value or at (amortised) cost. In general, financial instruments at fair value are measured on a recurring basis in the financial statements.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market between market participants at the measurement date.

ProCredit Bank applies the IFRS hierarchy to measure fair value. The hierarchy categorises the inputs used in the valuation techniques to measure fair value into three levels:

Level 1 Inputs
Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date. A market is regarded as active if market transactions with the asset or liability occur there sufficiently frequently and in sufficient volumes to ensure the ongoing availability of pricing information.

Level 2 Inputs
Other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation techniques applied are approximations of the current fair value of similar instruments and discounted cash flow analysis using observable market parameters.

Level 3 Inputs
Unobservable inputs for the asset or liability. If observable market interest rates are not available, internal rates are used as an input for a discounted cash flow model. These internal rates reflect the cost of funds, taking into account foreign currency effects and maturities as well as a risk margin. Internal rates are regularly compared to those applied for third-party transactions and are consistent with the parameters of an orderly transaction between market participants under market conditions at the measurement date.

3 Summary of significant accounting policies (continued)

f Financial instruments(accounting policies applied until 31 Dec 2017)

Until 31 December 2017, the group's accounting policy, concerning the financial instruments, was in compliance with the requirements of IAS 39. As a result, the comparative information provided (for the period ended on 31 Dec 2017) continues to be accounted for in accordance with the group's previous accounting policy.

Until 31 December 2017, the group classified its financial assets in the following categories:

- available-for-sale financial assets
- loans and receivables

The classification depended on the purpose for which the investments were acquired. Management determined the classification of its investments at initial recognition.

(a) Available-for-sale financial assets

Available-for-sale assets were those intended to be held for an indefinite period of time, which might be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

At initial recognition, available-for-sale financial assets were recorded at fair value. Subsequently they were carried at fair value. In exceptional cases, in which fair value information cannot otherwise be measured reliably, they were measured at cost. Gains and losses arising from changes in fair value of available-for-sale financial assets were recognised in the Consolidated Statement of Profit or Loss and Other Comprehensive Income in the position "Revaluation reserve from available-for-sale financial asset", until the financial asset was derecognised. At this time, the cumulative gain or loss previously recognised in equity was recognised in profit or loss as "Net result from available-for-sale financial assets". Interest calculated using the effective interest rate method and foreign currency gains and losses on monetary assets classified as available-for-sale were recognised in the Consolidated Statement of Profit or Loss.

(b) Loans and receivables

Loans and receivables were defined as non-derivative financial assets with fixed or determinable payments not quoted in an active market. All loans and advances to banks as well as loans and advances to customers fell under the category "Loans and receivables". Loans were recognised when the principal is advanced to the borrowers. Loans and receivables were derecognised when the rights to receive cash flows from the financial assets expired or where the group has transferred substantially all risks and rewards of ownership.

Loans and receivables were initially recognised at fair value including transaction costs; subsequently they were measured at amortised cost using the effective interest method. Amortised premiums and discounts were accounted for over the respective terms in the Consolidated Statement of Profit or Loss under "net interest income". At each balance sheet date and whenever there was an evidence of potential impairment, the group assessed the value of its loans and receivables if impairment occurred (see note 3i for more details about the previously applied accounting policy for impairment of credit exposures).

g Cash and cash equivalents

For the purposes of the Consolidated Statement of Financial Position, cash and cash equivalents comprise cash and balances with Bulgarian National Bank ("BNB"). Generally, all cash and cash equivalent items are recognised at their nominal value.

3 Summary of significant accounting policies (continued)

g Cash and cash equivalents (continued)

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity including: cash, balances with the BNB excluding the minimum required reserve, and amounts due from other banks.

h Loss allowances

ProCredit Bank sets aside loss allowances for the balance sheet items "Central bank reserves", "Loans and advances to banks", "Loans and advances to customers", "Investment securities" and for the financial assets under "Other assets". These are generally recognised at net value within the corresponding balance sheet positions, except for the item "Investment securities", which are reported at fair value. The respective loss allowances are recognised in shareholders' equity under "Revaluation reserve".

Increase of loss allowances
For the recognition of loss allowances, a three-stage model is used based on expected credit losses.

- Stage 1: All financial assets are generally classified as "Stage 1" at initial recognition. ProCredit Bank establishes loss allowances in an amount equivalent to the 12 month expected credit losses, insofar as there has not been a significant increase in credit risk since initial recognition.
- Stage 2: If the credit risk increases significantly, then "Stage 2" classification is assigned, and loss allowances are established in an amount equivalent to the lifetime expected credit losses.
- Stage 3: Defaulted financial assets are assigned to "Stage 3" and loss allowances are likewise established in an amount equivalent to the lifetime expected credit losses. For significant exposures, risk provisioning is determined on the basis of recoverable cash flows. For insignificant exposures, loss allowances are determined on the basis of portfolio-based parameters. Interest income is recognised at net book value (less loss allowances). Stage 3 also includes financial assets which are already impaired at initial recognition (purchased or originated credit-impaired ("POCI") assets). These are measured initially at fair value and without loss allowances. Regardless of future changes in the credit risk, POCI assets remain in Stage 3 until their disposal.

Release of loss allowances
In the event of a decrease of credit risk, the already recognised loss allowance is reduced accordingly.

Write-offs, recoveries and direct write-offs
When a loan is uncollectible, it is written off against the related loss allowance set aside. Such write-offs occur after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recognised in the Consolidated Statement of Profit or Loss under "Loss allowances". Uncollectible loans for which no loss allowances have been set aside in full are recognised as direct write-offs.

3 Summary of significant accounting policies (continued)

h Loss allowances (continued)

Restructured credit exposures
Restructuring is defined as any modification of the terms and conditions of a credit exposure by agreement between the group and the client to modify the payment plan of a credit exposure agreement in response to an increase in the current or future credit default risk associated with the client. Restructured credit exposures are assigned to Stage 3 at the moment of restructuring if either of the following conditions are met: the exposures is in arrears by more than 90 days, and/or cannot be expected to be repaid in full due to serious payment problems faced by the client. Otherwise, restructured loans are assigned to Stage 2.

Non-substantial modification
Non-substantial modification is a modification event that does not result in derecognition of the original asset. The effect is recognised through profit or loss as a modification gain or modification loss. The modification gain or loss is calculated as the difference between the original gross carrying amount and the present value of the modified contractual cash flows discounted at the original effective interest rate.

Assets acquired in exchange for loans (repossessed property)
Repossessed properties are non-financial assets acquired in exchange for loans as part of an orderly realisation and are reported as “Other assets”. The asset acquired is recorded at the lower of its fair value less costs to sell and the carrying amount of the loan at the date of exchange. Repossessed properties are held for sale and no depreciation is charged for the respective assets. Any subsequent write-down of the acquired asset to fair value less costs to sell is recognised in the Consolidated Statement of Profit or Loss in “Net other operating income”. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative write-down, is also recognised in “Net other operating income”, together with any realised gains or losses on disposal.

i Loss allowances (accounting policies applied until 31 Dec 2017)

Until 31 December 2017, the group’s accounting policy, concerning the loss allowances, was in compliance with the requirements of IAS 39. As a result, the comparative information provided (for the period ended on 31 Dec 2017) continues to be accounted for in accordance with the group’s previous accounting policy.

(a) Impairment of loans and advances

The group assessed at each balance sheet date whether there was an objective evidence that a financial asset or group of financial assets was impaired. If there was an objective evidence that impairment of a credit exposure or a portfolio of credit exposures occurred which influenced the future cash flow of the financial asset(s), the respective losses were immediately recognised. Depending on the size of the exposure, such losses were either calculated on an individual credit exposure basis or were collectively assessed for a portfolio of credit exposures. Collective assessment was carried out if on an individual basis objective evidence of impairment did not exist. The carrying amount of the exposure was reduced through the use of an allowance account and the amount of the loss was recognised in the statement of profit or loss. The group did not recognise losses from expected future loss events.

3 Summary of significant accounting policies (continued)

i Loss allowances (accounting policies applied until 31 Dec 2017) (continued)

Individually assessed loans and advances

Credit exposures were considered individually significant if they exceeded EUR 30,000. For such exposures, it was assessed whether any signs of impairment existed that could lead to an impairment loss, i.e. any factors which might influence a customer's ability to fulfil his contractual payment obligations towards the group as follows:

- delinquencies in contractual payments of interest or principal, in particular being more that 30 days in arrears;
- breach of contractual covenants or conditions
- initiation of bankruptcy proceedings or financial reorganisation;
- initiation of court procedures by the group;
- all or part of the off-balance sheet exposure of a client showed signs of impairment;
- credit exposures in the highest risk class;
- any specific information on the customer's business or changes in the customer's market environment that were expected to have a negative impact on the future cash flow;

When determining the allowance for impairment, the aggregate exposure to the customer and the claimable amount of collateral held were taken into account. If there was an objective evidence that an impairment loss had been incurred, the amount of the loss was measured as the difference between the asset's carrying amount and the present value of its estimated future cash flows discounted at the financial asset's original effective interest rate (specific impairment). The calculation of the present value of the estimated future cash flow of a collateralised financial asset reflected the cash flow that may result from foreclosure less costs for obtaining and selling the collateral.

Collectively assessed loans and advances

There were two cases in which exposures are collectively assessed for impairment:

- individually insignificant exposures that showed objective evidence of impairment;
- a group of loans that did not show signs of impairment, in order to cover all losses which had already been incurred but not detected on an individual loan basis.

For the purposes of the evaluation of impairment of individually insignificant credit exposures, the credit exposures were grouped on the basis of similar credit risk characteristics, i.e. according to the number of days they are in arrears. Arrears of 30 or more days were considered to be a sign of impairment. This characteristic was relevant for the estimation of future cash flows for the so defined groups of such assets, based on historical loss experiences with loans that showed similar characteristics.

If the group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether individually significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment (impairment for collectively assessed exposures).

The collective assessment of impairment for individually insignificant credit exposures (allowance for individually insignificant impaired loans) and for unimpaired credit exposures (allowance for collectively assessed loans) was based on a quantitative analysis of default rates for loan portfolios with similar risk characteristics (migration analysis).

3 Summary of significant accounting policies (continued)

j Intangible assets

Software and licences
Acquired or developed computer software is capitalised on the basis of the costs incurred to acquire or develop and bring to use the specific software. These costs are amortised on the basis of the expected useful lives. Software has an expected useful lifetime of 5 years and is tested for impairment if there are indications that impairment may have occurred. Computer software is carried at cost less accumulated amortisation less impairment losses. Depreciation is calculated as follows:

Licences	7 years
Software	5 years

k Property, plant and equipment and Investment property

Property, plant and equipment are stated at historical cost less scheduled depreciation and impairment losses, as decided by the management. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Component parts of an asset are recognised separately if they have different useful lives or provide benefits to the enterprise in a different pattern.

Subsequent purchase or production costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the Consolidated Statement of Profit or Loss during the financial period in which they are incurred.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate the depreciable amount of the asset over its useful live, as follows:

Buildings	40 years
Furniture	10 years
Leasehold improvements	10 years
Computers	5 years
Motor vehicles	5 years
Other fixed assets	7 years

The assets' residual carrying values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

In addition, all assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount exceeds its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use. The impairment is recognised within "Other administrative expenses".

Gains and losses on disposals are determined by comparing the proceeds with carrying amount and are recognised within "Net other operating income" in the Consolidated Statement of Profit or Loss.

3 Summary of significant accounting policies (continued)

l Leases

Operating leases when the group is the lessee
Operating leases are all lease agreements in which a significant portion of the risks and rewards of ownership are retained by the lessor. The total payments made under operating leases are charged to the Consolidated Statement of Profit or Loss under "Administrative expenses" on a straight-line basis over the period of the lease. Operating lease commitments result primarily from non-cancellable rental agreements for properties. The leasing objects are recognised by the lessor.

m Income taxes

Taxation has been provided for in the consolidated financial statements in accordance with Bulgarian legislation.

(a) Current income tax
Current tax is calculated on the basis of the taxable profit for the year, using the tax rates enacted at the reporting date and is recognised as an expense in the period in which taxable profits arise. Taxes other than on income are recorded under "Other administrative expenses".

(b) Deferred income tax
Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Consolidated Financial Statements prepared in conformity with IFRS, as adopted by the EU. Deferred tax assets and liabilities are determined using Bulgarian tax rates (and laws) that have been enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled. The tax planning period is five years.

Changes of deferred taxes related to financial instruments carried at fair value are charged to the Consolidated Statement of Other Comprehensive Income. The presentation in the Consolidated Statement of Other Comprehensive Income is made on a gross basis. At the time of sale, the respective deferred taxes are transferred to current income tax.

n Provisions

Provisions are recognised if:
- there is a present legal or constructive obligation resulting from past events;
- it is more likely than not that an outflow of resources will be required to settle the obligation;
- and the amount can be reliably estimated.

Where there are a number of similar obligations, the likelihood that an outflow of resources will be required in a settlement is determined by considering the class of obligations as a whole.

Provisions for which the timing of the outflow of resources is known are measured at the present value of the expenditures, if the outflow will not be earlier than in one year's time. The increase in the present value of the obligation due to the passage of time is recognised as an interest expense. For the provisions for imminent losses from off-balance sheet items and for untaken vacation, the outflow of economic benefits is expected during the next one or two years.

3 Summary of significant accounting policies (continued)

n Provisions (continued)

Contingent liabilities, which mainly consist of certain guarantees and letters of credit issued for customers, are possible obligations that arise from past events. As their occurrence, or non-occurrence, depends on uncertain future events not wholly within the control of the group, they are not recognised in the financial statements but are disclosed in the notes to the financial statements (see note 29).

Employee entitlements to annual leave are recognised when they are accrued to employees. A provision is made for the estimated annual leave as a result of services rendered by employees up to reporting date.

o Financial guarantee contracts

Financial guarantees are initially recognised in the financial statements at fair value on the date the guarantee was given. Subsequent to initial recognition, the group's liabilities under such guarantees are measured at the higher of the initial measurement, less amortisation calculated to recognise in the Statement of Profit or Loss the fee income earned on a straight line basis over the life of the guarantee and the best estimate of the expenditure required to settle any financial obligation arising at the reporting date. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgement of the Management.

p Employee benefits

Defined benefit plans

The group has an obligation to pay certain amounts to each employee who retires with the group in accordance with Art. 222, § 3 of the Labour Code ("LC"). According to the regulations in the LC, when a labour contract of a bank employee, who has acquired a pension right, is ended, the group is obliged to pay the employee compensation equivalent to two gross monthly salaries. In the event that the employee's length of service in the group is equal to or exceeds 10 years, as of the date of retirement, then the compensation shall amount to six gross monthly salary payments. As of reporting date, the Management of the group estimates the approximate amount of the potential expenditures for every employee based on a calculation performed by a qualified actuary using the projected unit credit method. The group recognises all actuarial gains and losses arising from defined benefit plans in personnel expenses for the period.

4 Risk management

a Business model and business strategy

ProCredit Bank aims at being a leading partner providing a complete range of financial services for small and medium enterprises in Bulgaria, since these businesses have vital significance for the economic development and the creation of new jobs. The group functions in a responsible and transparent way, focusing on building long-term relationships with its clients and providing an inclusive range of professional and flexible business solutions, both for the businesses and for their owners and staff. The main competitive advantages of ProCredit Bank are the personal approach to the individual needs of the clients and the high quality of the services provided.

By offering simple and accessible deposit facilities the group promotes a culture of savings, which contributes to greater security and stability of households. At the same time ProCredit Bank does not offer complex financial products or asset management services. ProCredit Bank takes an individual approach to its clients, aiming to know their needs in order to develop a strategy for serving them effectively. The group adheres to its concept of “Know your Customer”, which is based on the assumption that if clients and their businesses are accurately identified, the group will be able to provide them with the most suitable banking services. A strategic focus of the work with clients is on funding projects leading to improving energy efficiency and environmental protection as well as funding production companies and agricultural producers. To achieve more efficient, effective and better-quality service, the group provides 24-hour access to self-service as well as easily accessible Internet banking operations (ProBanking).

The ProCredit Bank business strategy has two main purposes – to have a positive effect on the development of the economic and social environment, and to earn a commercial profit. The business model is straightforward, with asset-side operations dominated by credit issued to clients, while the liabilities basically comprise attracted funds from clients.

The business strategy is based on a focused approach to staff development. The group carefully recruits and trains its staff to work responsibly and professionally with clients. ProCredit Bank is an institution based on professionalism, communication and trust and it aims at a high level of satisfaction both for the staff and the clients. To this effect, the group makes significant investments in training its personnel.

Since November 2015 the group operates a branch in Thessaloniki, Greece offering full range of banking services to the local businesses and providing professional service and advice. All locations in Thessaloniki are equipped with modern self-service areas, which are available to customers 24 hours and 7 days a week.

b Risk management strategy

ProCredit Bank is exposed to risks in the course of its business activities. An informed and transparent approach to risk management is a central component of our socially responsible business model. This is also reflected in our risk culture, resulting in decision-making processes that are well-balanced from a risk point of view. The overall risk profile of the group is appropriate and stable. This is based on an overall assessment of the individual risks, as presented in this risk report.

4 Risk management (continued)

b Risk management strategy (continued)

In accordance with our simple, transparent and sustainable business strategy, our risk strategy is a conservative one. By following a consistent group-wide approach to managing risks, the aim is to ensure that the liquidity and capital adequacy of the group continues to be appropriate at all times, as well as to achieve steady results. While the business strategy lists the objectives of the group for all material business activities and regions of operation and presents the measures to be taken to achieve them, the group's risk strategy addresses the material risks arising from the implementation of the business strategy and defines the objectives and measures of risk management. The risk strategy is broken down into strategies for all material risks in the group. The strategies are updated annually and are approved by the Management of ProCredit Bank following discussions with the group's Supervisory Board.

The principles of our business activity, as listed below, provide the foundation for our risk management. The consistent application of these principles significantly reduces the risks to which the group is exposed.

- **Focus on core business**

ProCredit Bank focuses on the provision of financial services to small and medium businesses as well as to private clients. Accordingly, income is generated primarily in the form of interest income on customer loans and fee income from account operations and payments. All of the group's other operations are performed mainly in support of the core business. ProCredit Bank assumes mainly credit risk, interest rate risk and liquidity risk in the course of its day-to-day operations. At the same time, ProCredit avoids or very strictly limits all other risks involved in banking operations.

- **High degree of transparency, simplicity and diversification**

ProCredit's focus on small and medium-sized businesses entails a very high degree of diversification in both customer loans and customer deposits. Geographically, this diversification spans the main business areas of Bulgaria and the Thessaloniki region in Greece. In terms of client groups, this diversification spans economic sectors, client groups (SMEs and private clients) and income groups. The diversification of the loan portfolio is a central pillar of the group's credit risk management policy. A further characteristic of our approach is that we seek to provide our clients with simple, easily understandable services. This leads to a high degree of transparency not only for the respective client, but also from a risk management point of view. Both the high degree of diversification and our simple, transparent services and processes result in a significant reduction of the group's risk profile.

- **Careful staff selection and intensive training**

Responsible banking is characterised by long-term relationships not only with clients, but also with staff. This is why we select our staff very carefully and have made significant investments in training our employees for many years. Our intensive training efforts not only produce a high level of professional competence, but also and above all, they promote an open and transparent communication culture. From a risk perspective, well-trained employees who are accustomed to voicing their opinions openly are an important factor for managing and reducing risk, specifically operational risk and fraud risk.

4 Risk management (continued)

b Risk management strategy (continued)

Key elements of risk management

Risk management comprises identifying, quantifying, managing, monitoring, controlling and reporting risks. In managing risks, the group takes account of the German supervisory "Minimum Requirements for Risk Management" (MaRisk), of relevant publications by national and international regulatory authorities and of our knowledge of the markets acquired over many years. The mechanisms designed to hedge and mitigate risks are monitored regularly to ensure their effectiveness, and the procedures and methods used to manage risks are subject to ongoing further development. The key elements of risk management in ProCredit are presented below.

- All ProCredit institutions apply a single common risk management framework, which defines group-wide minimum standards. The risk management policies and standards are approved by the Management of ProCredit Bank and are updated at least annually. These specify the responsibilities at bank and establish minimum requirements for managing, monitoring and reporting.
- All risks assumed are managed by ensuring at all times an adequate level of regulatory and internal capital of the group.
- The annually conducted risk inventory ensures that all material and non-material risks are identified and, if necessary, considered in the strategies and risk management processes.
- Monitoring and control of risks and possible risk concentrations is carried out using comprehensive analysis tools for all material risks.
- Early warning indicators (reporting triggers) and limits are set and monitored for all material risks.
- Regular stress tests are performed for all material risks; stress tests are carried out for each individual risk category as well as across all risk categories.
- Regular and ad-hoc reporting is carried out on the risk profile, including detailed descriptions and commentaries.
- The effectiveness of the chosen measures, limits and methods is continuously monitored and controlled.
- Suitable processes and procedures for an effective internal control system are in place. This is built around the principles of segregation of duties, dual control and, for all risk-relevant operations, the separation of front and back office up to the management level; this ensures that risk management and risk control are performed independently of front-office functions.
- All new or significantly changed products undergo a thorough analysis before being used for the first time (New Risk Approval process). This ensures that new risks are assessed and all necessary preparations and tests are completed prior to the introduction of a new or significantly changed product for the first time.

Organisation of the risk management function and risk reporting

The overall responsibility for risk management is assumed by the Management Board of the group, which regularly analyses the risk profile and decides on the measures to be taken. The risk controlling function required by MaRisk is headed by a member of the Management Board. Risk management is supported conceptually and implemented operationally by the Risk Management Department and various risk management and finance functions. Various committees support and advise the Management in the performance of the risk management function.

4 Risk management (continued)

b Risk management strategy (continued)

The rules regulating risk management at the group are part of the Internal Regulations and determine:

- The process and the purposes of risk management at the group.
- The structure, composition and powers of the competent internal bodies of the group, their activities and the measures they undertake.
- The employees' duties related to monitoring, reporting, management and analysis of various risks.
- The establishment and functioning of internal control systems and the competences of the relevant management levels and of the regular staff for taking part in risk management.

The group has an effective compliance management system supported by our Code of Conduct, which is binding for all staff, and by our approach to staff selection and training. The group's Compliance Officer bears responsibility for the implementation of a group-wide system to ensure fulfilment of all regulatory requirements. ProCredit Bank has a compliance function, which bears responsibility for adhering to national banking regulations and reports regularly and on an ad-hoc basis to the Management of the group and to ProCredit Holding. Any conduct, which is inconsistent with the established rules, can be reported anonymously both to an e-mail address established for the ProCredit group, or to an e-mail address on a local level.

Internal Audit is an independent functional area within ProCredit Bank. It provides support in determining what constitutes appropriate risk management and an appropriate internal control system within the institution. Additionally, the Internal Audit Department is supported and monitored by ProCredit Group Audit. Once per year, the Internal Audit Department carries out risk assessments of all of the group's activities in order to arrive at a risk-based annual audit plan. This comprises risk management and risk control processes, including the identification, assessment, control, monitoring and communication of material risks. The risk management system is reviewed accordingly. The Internal Audit Department reports to the Audit Committee of the group, which generally meets on a quarterly basis. The ProCredit Group Audit team monitors the quality of the audits conducted in ProCredit Bank and provides technical guidance.

The Management of the group bears responsibility for risk management within the institution. The General Risk Management Committee, Credit Risk Management Committee and Operational Risk Management Committee develop the framework for risk management and monitor the risk profile of the group and the individual risks. This includes the monitoring of individual risk positions and limit compliance. The Asset and Liability Committee (ALCO) is responsible for monitoring the liquidity reserve and liquidity management and the internal and regulatory capital adequacy of the group, coordinating measures aimed at securing funding for ProCredit bank.

Risk positions are analysed regularly, discussed intensively and documented in standardised reports. The Risk Management Department reports regularly to the different risk functions at ProCredit Holding, and the respective supervisory board is informed on at least a quarterly basis about all risk-relevant developments. Monitoring of the group's risk situation is carried out through a review of these reports and of additional information generated. If necessary, additional ad-hoc reporting occurs for specific topics. The aim is to achieve transparency on the material risks and to be aware at an early stage if potential problems might be arising.

Regular regional and group-wide meetings and training events support the exchange of best practices and the development and enhancement of the risk management functions.

4 Risk management (continued)

b Risk management strategy (continued)

The management of material risks in the ProCredit group is described in greater detail in the following section. This includes: credit risk, foreign currency risk, interest rate risk, liquidity and funding risk, operational risk, business risk and model risk, and risks arising from money laundering, terrorist financing and other acts punishable by law.

c Credit risk

The group defines credit risk as the risk that losses will be incurred if the party to a transaction cannot fulfil its contractual obligations at all, not in full or not on time. Within overall credit risk we distinguish between customer credit risk, counterparty risk (including issuer risk) and country risk. Credit risk is the most significant risk facing ProCredit Bank, and customer credit exposures account for the largest share of that risk.

Maximum exposure to credit risk

Exposure types	31 Dec 2018	31 Dec 2017
Loans and advances to banks	**268,469**	**288,320**
Investment securities (2017: available-for-sale financial assets)	**28,666**	**28,729**
Fixed interest rate securities	28,666	28,729
Loans and advances to customers	**1,598,077**	**1,403,835**
Loans and advances to customers	1,598,077	1,403,835
Contingent liabilities and commitments	**291,252**	**268,355**
Guarantees	35,801	34,536
Letters of credit	1,033	2,754
Credit commitments (revocable loan commitments)	254,418	231,065

Customer credit risk

The key objectives of credit risk management are to achieve high loan portfolio quality, low risk concentrations within the loan portfolio and appropriate coverage of credit risks with loan loss provisions. Thanks to the diversification of operations across and to the experience that ProCredit Bank has gained over the past years, the group has extensive expertise with which to limit customer credit risk effectively.

ProCredit Banks serves a broad spectrum of clients, ranging from relatively small business clients with increasingly formalised structures to larger SMEs. For our lending operations, we apply the following principles, among others:

- Intensive analysis of the debt and payment capacity of our loan clients, including an assessment of future cash flows.
- Careful compliance with the standards on serving business clients combined with group-wide application of a uniform risk classification approach supports the systematic collection and analysis of risk-relevant data, thus enabling the identification of risks.
- Carefully documenting credit risk analyses and processes conducted during lending operations, ensuring that the analyses performed can be understood by knowledgeable third parties.
- Rigorously avoiding overindebtedness among our loan clients.

4 Risk management (continued)

c Credit risk (continued)

- Building a long-term relationship with the client, maintaining regular contact and documenting the development of the exposure within the regular monitoring reports.
- Strictly monitoring the repayment of credit exposures.
- Applying closely customer-oriented, intensified loan management in the event of arrears.
- Collecting collateral in the event of insolvency.

The framework for managing customer credit risk is presented in the relevant policies and standards. The policies specify, among other things, the responsibilities for managing credit risk, the principles for the organisation of the lending business, the principles involved in lending operations, and the framework for the valuation of collateral for credit exposures. The standards contain detailed explanations of the group’s lending operations with business clients and private clients and of the range of credit offered. They also set forth the rules governing restructuring, risk provisioning and write-offs. Thus, the policies and standards define risk-mitigating measures for the pre-disbursement phase (credit risk assessment) and the post-disbursement phase (e.g. regular monitoring of the financial situation, review of early warning indicators, and both intensified and problem loan management).

The group divides its credit exposures into three categories: small and medium-sized business credit exposures and credit exposures to private clients. Small exposures are between EUR 30k and EUR 500k; medium exposures are above EUR 500k. Depending on the client category to which the respective credit exposure is assigned, different credit risk assessment processes are applied. These processes differ from one another in terms of the following attributes: The degree of segregation of duties, type of information that provides the basis for the credit analysis, criteria for credit decisions, and collateral requirements. A strict separation of front and back office functions up to the management level is applied for risk-relevant operations (over EUR 50k).

The experience of the group has shown that a thorough creditworthiness assessment constitutes the most effective form of credit risk management. The credit decisions are therefore based predominantly on an analysis of the client’s financial situation and creditworthiness. Regular on-site visits are performed for all clients to ensure an adequate consideration of their specific features and needs.

All credit decisions are taken by a credit committee. Its members have approval limits that reflect their expertise and experience. All decisions on small and medium credit exposures are taken by credit committees at the groups’ head offices. If the exposures are particularly significant on account of their size, the decision is taken by the Supervisory Board of the group, usually following a positive vote issued by the responsible Group Credit Risk Management team at ProCredit Holding.

The most important basis for decision-making within the credit committee is the proposal for the financing and collateral structure, which is tailored to the customer's needs and dependent on his risk profile. In this context, the following general principles apply: the lower the loan amount, the more detailed the documentation provided by the client, the shorter the loan period, the longer the client’s history with the group, and the higher the client’s account turnover with the group, then the lower the collateral requirements will be.

4 Risk management (continued)

c Credit risk (continued)

The credit risk management policies limit the possibility for unsecured credit operations. Depending on the risk profile and the term of the exposure, loans may also be issued without being fully collateralised. As a general rule, credit exposures with a higher risk profile are covered with solid collateral, mostly through mortgages.

The valuation of immovable collateral is conducted on the basis of opinions prepared by external, independent experts. In order to ensure that a reduction in the value of the collateral is detected at an early stage and appropriate measures can be taken, plausibility checks of collateral value are a fixed component of the annual review process of our borrowers. The appraisals must be updated at regular intervals, with plausibility checks being carried out by specialised bank's staff.

Based on our collateralisation requirements, securing loans with mortgages is among the most important instruments for limiting credit risk. The distribution of the loans and advances to customers by type of collateral is presented in the table below:

Collateral held	31 Dec 2018	31 Dec 2017
Mortgage	53%	54%
Guaranties from the EIF	24%	20%
Machines and vehicles	7%	9%
Cash collateral	4%	3%
Other types of collateral	12%	14%
Total	**100%**	**100%**

The group has disbursed loans to small and medium enterprises under the auspices of JEREMIE program (Joint European Resources for Micro to Medium Enterprises), which is a joint initiative launched by the European Commission and the European Investment Bank ("EIB") to improve access to finance for Micro, Small and Medium-sized Enterprises in the EU within the Structural Funds framework for the period 2007 – 2013. The loans are disbursed under more beneficial conditions in comparison to the standard bank's terms and are partially guaranteed by the European Investment Fund ("the EIF"). Two new programs for financing of SMEs were launched in 2016 jointly with the EIF – InnovFin SME Guarantee Facility and SME Initiative Guarantee Facility providing partial guarantee for the subloans disbursed under both programs. The total customers loan portfolio outstanding under the programs, in which the group is a partner with the EIF, were BGN 388,957 thousand as of end 2018 (2017: BGN 282,131 thousand).

The early detection of increases in credit risk at the borrower level is incorporated into all lending-related processes, resulting in prompt identification and timely assessment of the financial difficulties faced by clients. Moreover, the group has developed and implemented indicators for the early identification of risks based on quantitative and qualitative risk features. These include, but are not limited to, declining account turnover or volume, high usage of granted credit lines and overdrafts over a longer period of time, and arrears. Regular recording and analysis of these early warning indicators helps to manage the performing portfolio, identify potential default risks at an early stage and take the required measures to avoid a significant increase in credit risk. Reports on the affected portfolio are regularly given to the branch manager, the group's head office and in aggregated form to ProCredit Holding. Additionally, on a quarterly basis, the Risk Management Department prepares a report examining the group's loan portfolio for concentration by economic sectors / sub-sectors and geographic regions as well as the portfolio quality trends in these economic sectors / sub-sectors. Also the group regularly monitors changes in the external environment to assess their potential impact on its loan portfolio.

4 Risk management (continued)

c Credit risk (continued)

Events which could have an impact on a significant part of the loan portfolio (common risk factors) are analysed and discussed at group and bank level. This can lead to the imposition of limits on risk exposures towards certain groups of clients, e.g. in specific sectors of the economy or geographical regions.

In addition, asset quality indicators were implemented, on the basis of which the loan portfolio is divided into the categories: performing, underperforming and defaulted. Exposures are assigned to these categories based on a risk classification and other risk characteristics of the borrower. Of particular importance here are the risk classification, overdue contractual payments (especially those over 90 days overdue), initiation of bankruptcy proceedings or similar court procedures, restructurings or collateral liquidations by other banks, as well as other factors indicating a significant deterioration of the economic situation of the client. The indicators allow for a clear overview of the quality of the group's portfolio, and represent one of the most important tools for the credit risk management process. The categories are as follows:

- **The performing loan portfolio** shows no signs of a potential risk increase. Although some exposures show early warning signals, these may not necessarily result in a risk increase being determined.
- **The underperforming loan portfolio** comprises exposures showing increased credit risk. This can be caused by temporary payment difficulties (30-90 days), restructuring or other factors. Nevertheless, the group still assesses full repayment of the exposure to be possible, e.g. after restructuring.
- **The defaulted loan portfolio** comprises all exposures in default, most of which have shown lasting payment difficulties (over 90 days) or other negative factors, e.g. initiation of bankruptcy proceedings. Further details are provided below.

Once a higher risk of default is detected for a credit exposure, it is placed under intensified management. This centres around close communication with the client, identification of the source of higher credit default risk and close monitoring of their business activities. Decisions on measures to reduce the credit default risk are taken by the authorised decision-making bodies (e.g. Credit Committee on Restructuring). In addition, specialised recovery officers may be called in to support the intensified management of the credit exposure.

One of the first steps in managing such loans is to determine the economic and financial situation of the client, as this is the most important basis for decisions on whether or not the exposure can be restructured. The aim is to take such decisions at an early stage, while the chances of stabilisation are high and before the exposure enters an advanced phase of payment delay.

When a credit exposure is classified as defaulted, it is passed on to officers responsible for customer service. These officers are supported by specialists in settlement and liquidation (legal unit). Collateral is sold through liquidation to a third party at the highest possible price, typically via public auction. The majority of the collateral sold consists of tangible assets such as land or buildings.

4 Risk management (continued)

c Credit risk (continued)

Loss allowances

Loss allowances are established in line with the defined group standards, which are based on IFRS 9. The forward-looking expected credit loss (ECL) model is the central element of the approach to quantifying loss allowances. Accordingly, all credit exposures to customers are allocated among the three stages listed below, with a distinct provisioning methodology applied to each group. These stages are analogous to the performing, underperforming and defaulted categories described above.

- **Stage 1** comprises exposures for which credit risk has not significantly increased since initial recognition as well as those showing low credit risk as of the reporting date. For these exposures, the expected credit losses arising from possible default events within the 12 months following the reporting date are recognised as expenses.
- **Stage 2** comprises exposures for which credit risk has significantly increased since initial recognition, but for which there are no objective indications of impairment. This assessment takes account for appropriate and plausible information. Loss allowances are established in an amount equivalent to the expected credit losses over the entire remaining term of the loan.
- **Stage 3** includes defaulted financial instruments, i.e. as of the reporting date, there is both a significant increase in credit risk and objective indications of impairment. The respective calculation of loss allowances is performed based on the expected credit losses considering 100% probability of default.

When determining whether or not a significant increase in credit risk has occurred, both quantitative and qualitative information derived from the group's experience is used.

Accordingly, a transfer from Stage 1 to Stage 2 is made, for instance, when one of the following criteria applies:

- contractual payments are past due by more than 30 days but less than 90 days
- risk classification downgraded below a certain threshold
- adjustment of the originally agreed contractual conditions due to temporary liquidity difficulties for the client that could lead to higher credit default

A financial asset is transferred to Stage 3 when the following, or similar, characteristics apply:

- contractual payments are more than 90 days past due
- risk classification has been downgraded to a level viewed as defaulted
- adjustment of the originally agreed contractual conditions due to liquidity difficulties for the client that lead to significantly higher credit risk
- loan impairment (i.e. repayment cannot be guaranteed without realisation of collateral)

The group views an exposure as defaulted when one or more of the above items applies and negatively impacts the expected cash flows of a financial asset to the extent that it can be assumed the borrower will not fulfil his credit obligations.

As part of the exposures allocated to Stage 3, the group has introduced special treatment of POCI (Purchased or Originated Credit Impaired) exposures in accordance with IFRS 9 requirements concerning modified financial assets. Within our business model, the acquisition of on initial recognition credit-impaired assets is not permitted. On this basis, a POCI loan can arise as a consequence of new negotiations or substantial modification of the contractually agreed cash flows. In order to recognise POCI loans, it is necessary to determine the fair value of the POCI credit exposure as of initial recognition, taking into account the expected losses from these agreements.

4 Risk management (continued)

c Credit risk (continued)

The process for returning to the performing portfolio and thus to stage 1 has two steps. Once the economic situation of the borrower has improved (usually through a successful restructuring), such that he can fulfil his payment obligations in full and without recourse to collateral and there are no indications of impairment, there is a one-year rehabilitation period before the exposure can be classified as performing again. During the subsequent probationary period, which lasts two years, the exposure will continue to be classified as “restructured” and thus still recognised as stage 2. Upon compliance with various criteria – e.g. no past-due payments; repayment of a significant portion of the obligation, including deferral agreements; and no indications of impairment – the exposure can be classified under stage 1 at the end of the probationary period.

In the following, additional details are provided on the model for quantifying credit risk and the data used therein.

The input data are based on multi-year data histories for all borrowers in the group. This includes outstanding amounts from past reporting dates, various data on default events, such as date and amount of default, any repayment amounts or proceeds from the sale of collateral since the default, and information about the risk characteristics of the clients.

Expected credit losses are based on estimates of the main risk parameters, probability of default and loss given default. These parameters are estimated empirically based on the input data histories. Regression models are used here to quantify the impact of a series of factors, which include client risk characteristics and macroeconomic factors. Estimates are made for subgroups of borrowers; the defined groups are largely homogeneous in terms of their risk characteristics.

Additionally, the group performed calculation that an increase or decrease of 6.8% of realised losses in comparison with estimated future discounted cash flows from individually significant exposures, which may arise from differences in the amounts and timing of cash flows, would result in an increase or decrease of the impairment allowance for BGN 811 thousand as of end-2018. The rate of change of the realised losses was derived from the complex stress test, that the group produced within the internal capital adequacy assessment process.

The riskiness of a client is determined using a range of indicators, including the risk classification, restructuring status and fulfilment of contractual payment obligations. Changes in these indicators reflect an increase or decrease in the credit risk associated with a client. Furthermore, these indicators are used to identify defaulted clients.

The group has established a process for determining of a risk classification of small and medium client credit exposures. If an exposure is assessed to be in on of the three worst risk classification groups, than it is immediately transferred out from the performing portfolio (Stage 1). If the assessment shows that the worst risk classification has to be assigned to an exposures, than it is immediately transferred to the defaulted loan portfolio (Stage 3). Evidence for assigning one of the three worst risk classifications to an exposure would be such as: poor financial performance and indicators; poor management and organisation quality; high dependency on customers and/or suppliers; high business sector risk; poor credit payment history.

4 Risk management (continued)

c Credit risk (continued)

When determining loss allowances the group applies ECL model, using preliminary set parameters. Within the model, certain management overlays are applied, which results in higher loss allowances accrued for default exposures in arrears more than 180 days and for non-restructured exposures classified at Stage 2.

In general, exposures are only written off when no further recoveries are expected. The direct and indirect costs of managing credit exposures that have not been written off must also be in proportion to the size of the outstanding exposure. Bearing these points in mind, the group generally writes off insignificant credit exposures (<EUR 30,000) earlier than significant ones.

Decisions to write off an exposure do not automatically apply to the entire client relationship. The group may write off parts of a credit exposure (e.g. through a restructuring decision), in order to increase the likelihood of total repayment of the client's remaining debt. In such cases, loss allowances for the remaining exposure are established using the rules for POCI assets.

When determining loss allowances a distinction is drawn between individually significant and individually insignificant credit exposures; the threshold is EUR 150,000. For significant exposures with indications of impairment, an individual assessment is performed to determine allowances, taking account for the expected inflows, including collateral liquidation. Here, the group places great emphasis on a careful approach to estimating costs and expected earnings and also with respect to assumptions about the timeframe for liquidation. Regardless of the amount of loss allowance, a loan is classified as impaired as soon as the expected cash flows take account for liquidation of collateral.

The following table provides an overview of the respective gross and net exposure amounts and loss allowances for financial assets, broken down by stages:

	Stage1	Stage 2		Stage 3			POCI	Total
As of 31 Dec 2018	**12 month ECL**	**Lifetime ECL**		**Lifetime ECL**				
		0-30 days	31-90 days	0-30 days	31-90 days	over 90 days	0-30 days	
Gross outstanding amount	1,557,546	30,777	1,145	18,543	2,184	25,943	940	**1,637,078**
Loss allowances	(7,394)	(4,493)	(175)	(7,253)	(955)	(18,668)	(63)	**(39,001)**
Carrying amount	**1,550,152**	**26,284**	**970**	**11,290**	**1,229**	**7,275**	**877**	**1,598,077**

	Stage1	Stage 2		Stage 3			POCI	Total
As of 01 Jan 2018	**12 month ECL**	**Lifetime ECL**		**Lifetime ECL**				
		0-30 days	31-90 days	0-30 days	31-90 days	over 90 days	0-30 days	
Gross outstanding amount	1,344,814	44,329	3,539	19,554	3,275	28,102	1,017	**1,444,630**
Loss allowances	(7,002)	(7,393)	(628)	(6,203)	(1,182)	(18,332)	-	**(40,740)**
Carrying amount	**1,337,812**	**36,936**	**2,911**	**13,351**	**2,093**	**9,770**	**1,017**	**1,403,890**

4 Risk management (continued)

c Credit risk (continued)

The following table presents gross and net exposures, broken down according to economic sector and by stage.

As of December 31, 2018	Business loans					Private loans			Total
	Wholesale and retail trade	Agriculture, forestry and fishing	Production	Transportation and storage	Other economic activities	Housing	Investment loans and OVDs	Other	
Stage 1									
Gross outstanding amount	338,709	347,749	334,886	105,643	256,070	158,434	13,388	2,667	**1,557,546**
Loss allowances	(1,510)	(1,965)	(1,599)	(504)	(1,269)	(504)	(36)	(7)	**(7,394)**
Carrying amount	**337,199**	**345,784**	**333,287**	**105,139**	**254,801**	**157,930**	**13,352**	**2,660**	**1,550,152**
Stage 2									
Gross outstanding amount	7,121	9,106	4,775	1,082	6,649	2,809	295	85	**31,922**
Loss allowances	(954)	(965)	(892)	(85)	(1,047)	(679)	(41)	(5)	**(4,668)**
Carrying amount	**6,167**	**8,141**	**3,883**	**997**	**5,602**	**2,130**	**254**	**80**	**27,254**
Stage 3									
Gross outstanding amount	12,268	6,227	6,812	3,329	14,957	2,923	111	43	**46,670**
Loss allowances	(6,944)	(2,564)	(4,983)	(1,790)	(8,558)	(1,988)	(27)	(22)	**(26,876)**
Carrying amount	**5,324**	**3,663**	**1,829**	**1,539**	**6,399**	**935**	**84**	**21**	**19,794**
POCI									
Gross outstanding amount	-	-	-	-	940	-	-	-	**940**
Loss allowances	-	-	-	-	(63)	-	-	-	**(63)**
Carrying amount	**-**	**-**	**-**	**-**	**877**	**-**	**-**	**-**	**877**

As of January 1, 2018	Business loans					Private loans			Total
	Wholesale and retail trade	Agriculture, forestry and fishing	Production	Transportation and storage	Other economic activities	Housing	Investment loans and OVDs	Other	
Stage 1									
Gross outstanding amount	290,641	332,331	260,529	95,621	212,050	140,996	10,449	2,197	**1,344,814**
Loss allowances	(1,461)	(2,029)	(1,317)	(511)	(1,134)	(512)	(31)	(7)	**(7,002)**
Carrying amount	**289,180**	**330,302**	**259,212**	**95,110**	**210,916**	**140,484**	**10,418**	**2,190**	**1,337,812**
Stage 2									
Gross outstanding amount	9,687	11,966	10,747	2,888	8,795	3,545	177	63	**47,868**
Loss allowances	(1,600)	(1,565)	(1,362)	(525)	(2,089)	(851)	(22)	(7)	**(8,021)**
Carrying amount	**8,087**	**10,401**	**9,385**	**2,363**	**6,706**	**2,694**	**155**	**56**	**39,847**
Stage 3									
Gross outstanding amount	15,486	5,276	7,155	1,000	19,442	2,450	68	54	**50,931**
Loss allowances	(7,921)	(1,806)	(3,993)	(627)	(9,810)	(1,484)	(49)	(27)	**(25,717)**
Carrying amount	**7,565**	**3,470**	**3,162**	**373**	**9,632**	**966**	**19**	**27**	**25,214**
POCI									
Gross outstanding amount	-	-	-	-	1,017	-	-	-	**1,017**
Loss allowances	-	-	-	-	-	-	-	-	**-**
Carrying amount	**-**	**-**	**-**	**-**	**1,017**	**-**	**-**	**-**	**1,017**

Credit risk at the portfolio level is assessed on a quarterly basis and, if necessary, more frequently. This includes an analysis of portfolio structure and quality, restructured exposures, write offs, the coverage ratio (risk provisions in relation to past-due portfolio) and concentration risk.

Concentration risk in the customer loan portfolio is effectively limited by a high degree of diversification. This diversification is a consequence of lending to small and medium businesses in various economic sectors. Geographically, the loans and advances to customers are predominantly disbursed to clients, which are Bulgarian or Greek residents.

4 Risk management (continued)

c Credit risk (continued)

In addition, the ProCredit bank limits the concentration risk of its portfolios by means of the following requirements: Large credit exposures (those exceeding 10% of regulatory capital) require the approval of the ProCredit Group Risk Management Committee and of the Supervisory Board of the group. No large credit exposure may exceed 25% of regulatory capital, and the sum of all large credit exposures may not exceed 150% of its regulatory capital. The largest credit exposure of the group was 5% of the regulatory capital as of end 2018 (2017: 4%).

As of 31 December 2018	<= 50,000 EUR	>50,000 <= 250,000 EUR	> 250,000 EUR	Total
Business loans	**118,643**	**572,224**	**765,456**	**1,456,323**
Wholesale and retail trade	27,740	139,674	190,684	358,098
Agriculture, forestry and fishing	44,482	193,414	125,186	363,082
Production	14,404	103,582	228,487	346,473
Transportation and storage	14,061	54,346	41,647	110,054
Other economic activities	17,956	81,208	179,452	278,616
Private loans	**71,101**	**100,944**	**8,710**	**180,755**
Housing	55,194	100,262	8,710	164,166
Investment loans and OVDs	13,112	682	0	13,794
Others	2,795	0	0	2,795
Customer loan portfolio (gross)	**189,744**	**673,168**	**774,166**	**1,637,078**

As of 1 January 2018	<= 50,000 EUR	>50,000 <= 250,000 EUR	> 250,000 EUR	Total
Business loans	**149,302**	**580,163**	**555,166**	**1,284,631**
Wholesale and retail trade	36,885	141,767	137,164	315,816
Agriculture, forestry and fishing	56,550	199,139	93,884	349,573
Production	17,812	104,239	156,379	278,430
Transportation and storage	15,870	51,385	32,254	99,509
Other economic activities	22,185	83,633	135,485	241,303
Private loans	**74,508**	**78,783**	**6,708**	**159,999**
Housing	61,690	78,594	6,708	146,992
Investment loans and OVDs	10,505	189	0	10,694
Others	2,313	0	0	2,313
Customer loan portfolio (gross)	**223,810**	**658,946**	**561,874**	**1,444,630**

Business loans include loans for business purposes (working capital or investments) disbursed to Small and Medium clients. Business loans include agricultural loans as well as business overdrafts and revolving loans. Loans to Private clients include consumer and housing loans as well as consumer overdrafts and credit card receivables.

Continuous training of the staff ensures that credit risk is properly evaluated whenever a loan is issued, and that credit exposures are closely observed throughout their lifetime and, if necessary, that appropriate measures are taken in a timely manner. That is why the quality of the ProCredit Bank's loan portfolios is significantly higher than the sector average.

The group's client credit risk is regularly quantified in the risk-bearing capacity calculation using a credit risk model. Relevant stress scenarios are also used to determine the economic capital needed by the group to cover client credit risk in extremely negative circumstances.

4 Risk management (continued)

c Credit risk (continued)

Credit related commitments
The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees, which represent irrevocable assurance that the group will make the payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans and guarantees. With respect to credit risk on commitments to extend credit, the group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total commitments since commitments to extend credit are contingent upon customers maintaining specific credit standards.

d Counterparty risk, including issuer risk

The group defines counterparty risk, including issuer risk, as the risk that a counterparty/issuer cannot fulfil its contractual obligations at all, not in full or not on time. Counterparty risk in the group mainly arises from keeping highly liquid assets for the purpose of managing liquidity. There are also structural exposures towards the BNB in the form of mandatory minimum reserves.

The framework for managing the counterparty risk is approved by the Management of the group and is specified in the respective policies and standards. These define counterparty risk, specify the responsibilities at bank level, and establish minimum requirements for managing, monitoring and reporting. Both the ALCO and the General Risk Assessment Committee are involved in decisions made with regard to counterparty risk.

Counterparty risk is managed according to the principle that our liquidity must be placed securely and, to the greatest extent possible, in a diversified manner. While the group tries to generate some income from these assets, the overriding objective is to ensure secure placement and timely availability, i.e. risk considerations predominate. For this reason, we only work with carefully selected reliable banks that have a high credit rating, typically place our money for short terms (up to three months, but typically shorter) and use only a very limited number of simple financial instruments.

Issuer risk is likewise managed according to these principles. The group is prohibited from engaging in speculative trading. As a matter of principle, only highly liquid securities are bought, typically with a maximum maturity of three years at fixed-interest rates. BGN liquidity is predominantly invested in the BNB or Bulgarian sovereign bonds. EUR or USD, on the other hand, are generally invested in ProCredit Bank Germany or securities issued by multilaterals internationally rated at least AA-. The impact of market price changes on the group is limited. The reasons are that the volume of securities is rather low, their maturities are short and issuers are carefully selected based on conservative risk criteria.

Typically, our counterparties are the BNB, Bulgarian Governments and commercial banks. The main types of exposure are account balances, short-term TDAs, highly liquid securities, and, on a very limited scale, simple derivative instruments for liquidity management and hedging purposes (mostly foreign currency forwards and swaps). We effectively limit counterparty and issuer risk within through our conservative investment strategy. Due to mandatory minimum reserves, a concentration exists with regard to exposure towards the BNB.

4 Risk management (continued)

d Counterparty risk, including issuer risk (continued)

The group's exposure to counterparty and issuer risk did not change significantly in 2018 compared to the end of 2017. The liquid assets other than physical cash of the group were placed as follows:

Counterparty	31 Dec 2018	in %	31 Dec 2017	in %
BNB	179,630	38%	147,312	32%
Mandatory reserves	151,341	32%	132,277	29%
Others	28,289	6%	15,035	3%
Banking groups	268,469	56%	288,320	62%
OECD banks	268,469	56%	288,320	62%
local banks	-	-	-	-
Securities issued by Bulgarian Govt	28,666	6%	28,729	6%
Total	**476,765**	**100%**	**464,361**	**100%**

The table below presents an analysis of debt securities and banks placements by rating agency designation, based on the credit assessments of nominated External Credit Assessment Institutions:

As of 31 Dec 2018

Rating	Debt instruments	Loans and advances to banks	Total
AA- to AA+	-	2	2
A- to A+	-	-	-
BBB- to BBB+	28,666	268,467	297,133
Total	**28,666**	**268,469**	**297,135**

As of 31 Dec 2017

Rating	Debt instruments	Loans and advances to banks	Total
AA- to AA+	-	3	3
A- to A+	-	-	-
BBB- to BBB+	28,729	-	28,729
Unrated	-	288,317	288,317
Total	**28,729**	**288,320**	**317,049**

For counterparty risk, the same definitions for "past due" and "non-performing" apply in principle as for customer credit risk. Due to the careful selection of the counterparties, none of positions shown was past due nor showed any signs of impairment as of 31 December 2018. In accordance with IFRS 9 requirements, allowances were established for counterparty risk for the first time in the 2018 financial year.

The exposure towards counterparties and issuers is managed on the basis of a limit system, as is the case for customer credit risk. ProCredit Bank concludes transactions only with counterparties that have previously been carefully analysed and for which a limit has been approved. The total limit for banks or banking groups is also set, with a distinction being made between banks and banking groups based in an OECD country and those outside of the OECD. The typical maximum maturity of our term deposits is three months; longer maturities must be approved. In general, approval is required before any investments in securities. The group's counterparty risk is quantified and analysed regularly as part of the internal capital adequacy calculation. When calculating the risk- and term-adjusted exposure, all exposures towards counterparties are taken into account.

4 Risk management (continued)

e Market risk

Market risks comprise the risk of potential losses from shifts in market prices, such as exchange rates or other parameters which influence prices. Relevant market risks for the ProCredit group are foreign currency risk and interest rate risk in the banking book. The group manages market risks in such a way that their impact is as limited as possible from an overall risk perspective. In accordance with the group risk strategy, foreign currency risk and interest rate risk may not be incurred for speculative purposes. Foreign currency and interest rate derivatives are used exclusively for hedging or liquidity purposes. ProCredit Bank is non-trading book institution.

Foreign currency risk

We define foreign currency risk as the risk that the group incurs losses due to exchange rate fluctuations. Foreign currency risk can have adverse effects on income and can lead to a decline in regulatory capital ratios.

The framework for managing the foreign currency risk is approved by the Management of the group and is specified in the respective policies and standards. These define foreign currency risk, specify the responsibilities at bank level, and establish minimum requirements for managing, monitoring and reporting. Both the ALCO and the General Risk Assessment Committee are involved in decisions made with regard to currency risk.

Results are impacted negatively when the volume of the assets and liabilities denominated in foreign currencies do not match and the exchange rates move unfavourably. The key risk indicator that captures the balance sheet discrepancy for each currency is the open currency position (OCP). Limits for OCP are set at bank level. The total OCP is calculated as the sum of the absolute values of the individual currency positions and is limited to 10% of the group's capital, unless deviation from this limit has been approved by the ProCredit Group ALCO or ProCredit Group Risk Management Committee. A threshold of 7.5% of the ProCredit Bank's capital has been defined as an early warning indicator for the total OCP, and ±5% for each individual currency OCP.

ProCredit Bank operates in an environment, where the local currency is stable because of the currency board in Bulgaria. It guarantees that in a mid-term no fluctuations of the local currency to the EUR exchange rate are expected. As almost all of the assets and liabilities are denominated either in local currency or in EUR, the exposure of the group toward foreign currency risk is insignificant. In order to protect from the effects of a devaluation of the local currency to the EUR, the group maintains a long OCP in EUR close to 100% of the shareholder capital, which could offset the negative effect from eventual devaluation and protect the shareholder's equity.

Since ProCredit Bank is a non-trading book institution and has no commodity positions, foreign currency risk is the only risk of those classified as market price risks according to article 351 of Regulation No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on the prudential requirements for credit institutions and investment firms and amending EU regulation no 648/2012 (Regulation 575/2013) that is relevant for regulatory capital requirements.

The P&L effect arising from OCPs is also measured regularly when calculating the risk-bearing capacity of ProCredit bank. The calculation is based on a Value at Risk (VaR)-type analysis of the OCPs considering historically extreme exchange rate volatilities during the past seven years. In addition, regular stress tests are conducted for the risk arising from OCPs. The table below summarizes the group's exposure to foreign currency exchange rate risk.

4 Risk management (continued)

e Market risk (continued)

As of 31 December 2018	BGN	EUR	USD	Other	Total
Assets					
Cash and cash equivalents	145,573	71,606	1,568	56	218,803
Loans and advances to banks	-	221,862	33,314	13,293	268,469
Investment securities	19,248	10,407	3,729	-	33,384
Loans and advances to customers	813,433	782,765	1,879	-	1,598,077
Property, plant and equipment	39,376	-	-	-	39,376
Intangible assets	5,067	-	-	-	5,067
Deferred tax assets	550	-	-	-	550
Other assets	9,504	1,620	-	-	11,124
Total assets	**1,032,751**	**1,088,260**	**40,490**	**13,349**	**2,174,850**
Liabilities					
Liabilities to banks	37,858	53,306	-	-	91,164
Liabilities to customers	995,302	604,377	43,134	13,474	1,656,287
Liabilities to institutions	-	179,662	-	-	179,662
Other liabilities	2,264	1,446	36	1	3,747
Provisions	959	-	-	-	959
Current tax liabilities	515	-	-	-	515
Total liabilities	**1,036,898**	**838,791**	**43,170**	**13,475**	**1,932,334**
Net balance sheet position	**(4,147)**	**249,469**	**(2,680)**	**(126)**	**242,516**
Credit commitments (note 29)	204,140	85,598	1,514	-	291,252
Open spot transactions	1,956	528	(2,349)	(138)	(3)

As of 31 December 2017	BGN	EUR	USD	Other	Total
Total assets	987,555	935,194	46,705	5,947	1,975,401
Total liabilities	984,906	718,024	49,482	6,320	1,758,732
Net balance sheet position	**2,649**	**217,170**	**(2,777)**	**(373)**	**216,669**
Credit commitments (note 29)	193,961	73,415	979	-	268,355
Open spot transactions	3,325	132	(3,153)	(294)	10

Interest rate risk in the banking book

Interest rate risk is the risk of incurring losses due to changes in market interest rates and primarily arises from differences between the repricing maturities of assets and liabilities.

The framework for managing the interest rate risk is approved by the Management of the group and is specified in the respective policies and standards. These define interest rate risk, specify the responsibilities at bank level, and establish minimum requirements for managing, monitoring and reporting. General Risk Assessment Committee is responsible for all key decisions regarding interest rate risk management, and this committee analyses, at least quarterly, the interest rate risk profile of the group.

In order to manage interest rate risk, ProCredit Bank primarily issues variable-rate loans. In this way, the repricing maturities of assets can be better matched to the repricing maturity of liabilities, even when liabilities have shorter maturities than loans. In order to grant variable-rate loans in a transparent manner, the group uses a publicly available interest rate as a benchmark when adjusting the interest rates.

4 Risk management (continued)

e Market risk (continued)

The measuring, monitoring and limiting of interest rate risk is based on repricing gap analyses. The assets and liabilities are distributed across time buckets according to the terms of the underlying contracts. Sight deposits are included in the gap analyses as non-interest bearing whereas saving accounts are presented in the time bucket up to one month. Included in the table are the group's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates. Loans to customers that are non-interest bearing comprise exposures with worsened credit quality.

As of 31 December 2018	**Up to 1 month**	**1 – 3 months**	**3 – 12 months**	**1 – 5 years**	**Over 5 years**	**Non-interest bearing**	**Total**
Assets							
Cash and cash equivalents	27,202	-	-	-	-	191,601	218,803
Loans and advances to banks	221,289	41,066	-	-	-	6,114	268,469
Investment securities	9,069	4,307	-	15,290	-	4,718	33,384
Loans and advances to customers	67,735	134,918	526,903	611,310	257,211	-	1,598,077
Property, plant and equipment	-	-	-	-	-	39,376	39,376
Intangible assets	-	-	-	-	-	5,067	5,067
Deferred tax assets	-	-	-	-	-	550	550
Other assets	-	-	-	-	-	11,124	11,124
Total assets	**325,295**	**180,291**	**526,903**	**626,600**	**257,211**	**258,550**	**2,174,850**
Liabilities							
Liabilities to banks	45	17,500	53,585	19,558	-	476	91,164
Liabilities to customers	554,963	89,602	212,129	18,886	-	780,707	1,656,287
Liabilities to institutions	-	53,251	53,756	72,655	-	-	179,662
Other liabilities	-	-	-	-	-	3,747	3,747
Provisions	-	-	-	-	-	959	959
Current tax liabilities	-	-	-	-	-	515	515
Total liabilities	**555,008**	**160,353**	**319,470**	**111,099**	**-**	**786,404**	**1,932,334**
Interest sensitivity gap	**(229,713)**	**19,938**	**207,433**	**515,501**	**257,211**	**(527,854)**	**242,516**

As of 31 December 2017	**Up to 1 month**	**1 – 3 months**	**3 – 12 months**	**1 – 5 years**	**Over 5 years**	**Non-interest bearing**	**Total**
Total assets	462,593	448,713	713,321	56,457	23,122	271,195	1,975,401
Total liabilities	364,352	180,404	311,407	119,357	-	783,212	1,758,732
Interest sensitivity gap	**98,241**	**268,309**	**401,914**	**(62,900)**	**23,122**	**(512,017)**	**216,669**

In relation to the interest rate risk management, we assume a parallel shift of the interest rate curve. For EUR and USD the interest rate shock is ± 200 basis points, whereas for domestic currencies the magnitude of the shock is derived on the basis of a historical analysis. Sight deposits and savings accounts are included in the gap analyses according to their expected repricing maturities. These maturities are derived from a group-wide analysis of historical developments. Limits are set in relation to regulatory capital (non-netted in each case) for the economic value impact when simulating a simultaneous detrimental (upward or downward) interest rate shock across all currencies as well as for the P&L effect.

4 Risk management (continued)

e Market risk (continued)

The potential economic value impact when simulating a simultaneous detrimental (upward or downward) interest rate shock across all currencies must not exceed 15% of the group's capital, unless approved by the ProCredit Group Risk Management Committee; the early warning indicator for each currency is set at 10%.

A second key indicator measures the potential impact of interest rate shocks on the expected earnings of the group (P&L effect) over a period of twelve months. This risk measure indicates how the income statement may be influenced by interest rate risk under a short-term perspective. An upper limit of 10% of the group's CRR capital is set for the non-netted, total 12 months interest earnings impact and an early warning indicator is set above 5% of the group's CRR capital. Whenever the early warning indictor is reached, the group's risk management department must analyse the situation and explain it to the group's ALCO or General Risk Committee. If deemed necessary, appropriate measures must be taken.

Currency	31 Dec 2018		31 Dec 2017	
	Economic value impact	12 month P&L effect	Economic value impact	12 month P&L effect
BGN	(4,578)	(145)	(9,716)	(575)
EUR	(4,359)	(3,927)	(7,403)	7,024
USD	92	(503)	93	637
Total amount	**(8,845)**	**(4,575)**	**(17,026)**	**7,086**

The group exposure to interest rate risk is quantified and analysed quarterly in the context of the risk bearing capacity calculation.

f Liquidity and funding risk

Liquidity and funding risk addresses the ProCredit group's short- and long-term ability to meet its financial obligations in a complete and timely manner, even in stress situations.

The framework for managing ProCredit Bank's liquidity and funding risk is approved by the Management of the group and is specified in the respective policies and standards. These define liquidity risk, specify the responsibilities at bank level, and establish minimum requirements for managing, monitoring and reporting. The ALCO is responsible for all key operational decisions regarding liquidity management. Selected liquidity risk indicators are reported and presented each month in detail to the ProCredit Group Risk Management Committee.

We measure our short-term liquidity risk using a liquidity gap analysis, among other instruments, and monitor this risk based on a 30-day liquidity indicator (Sufficient Liquidity Indicator, SLI), as well as in accordance with the minimum liquidity ratio stipulated by CRR (Liquidity Coverage Ratio, LCR). The SLI measures whether the institutions has sufficient liquidity for the expected inflows and outflows of funds in the next 30 days. The calculation applies outflows derived from historical analyses of deposit movements in the group. LCR indicates whether the group has sufficient liquidity to cover the net outflows expected in the next 30 days, even in the event of a specified severe economic shock scenario.

Additional indicator was included within the liquidity risk management framework in 2018 – survival period above 90 days. The survival period is the time during which the group can meet all its payments due without needing to generate additional (i.e. still not contracted) funds, i.e. the period within which the group does not have negative liquidity gaps in any of the time-buckets. The survival period is estimated based on risk scenario assumptions. The defined minimum survival period limits is at least 90 days on total currency level. Early warning indicators are also defined and monitored

4 Risk management (continued)

f Liquidity and funding risk (continued)

Market-related, institution-specific, combined and longer-term stress tests are conducted monthly and ad hoc to make sure that the group keeps sufficient liquid funds to meet its obligations, even in difficult times. Moreover, the group has a contingency plan. If unexpected circumstances arise and an individual bank from ProCredit Group proves not to have sufficient liquid funds, the ProCredit group has also developed a liquidity contingency plan and ProCredit Holding would step in as a “lender of last resort”. ProCredit Holding keeps an adequate liquidity reserve available for this purpose. The amount of the liquidity reserve is determined on the basis of group stress tests and monitored on a regular basis.

The liquidity of the group is managed on a daily basis by the respective responsible units (i.e. treasury), based on the ALCO-approved cash flow projections, and is monitored by risk management and ALCO.

The following tables show the cash flows of the financial assets and financial liabilities of the group according to their remaining contractual maturities. The remaining contractual maturity is defined as the period between the balance sheet date and the contractually agreed due date of the asset or liability, or the due date of a partial payment under the contract for an asset or liability.

Maturities of assets and liabilities

As of 31 December 2018	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Total
Assets						
Cash and cash equivalents	218,803	-	-	-	-	218,803
Loans and advances to banks	227,403	41,066	-	-	-	268,469
Investment securities	9,068	4,307	-	15,291	4,718	33,384
Loans and advances to customers	64,830	126,248	526,385	621,823	258,791	1,598,077
Property, plant and equipment	-	-	-	-	39,376	39,376
Intangible assets	-	-	-	-	5,067	5,067
Deferred income tax assets	-	-	550	-	-	550
Other assets	-	5,775	-	5,349	-	11,124
Total assets	**520,104**	**177,396**	**526,935**	**642,463**	**307,952**	**2,174,850**
Liabilities						
Liabilities to banks	567	17,587	45,816	21,718	5,476	91,164
Liabilities to customers	1,309,041	96,418	232,097	18,731	-	1,656,287
Liabilities to institutions	-	13,145	65,260	96,560	4,697	179,662
Other liabilities	-	3,747	-	-	-	3,747
Provisions	647	25	72	86	129	959
Current tax liabilities	-	515	-	-	-	515
Total liabilities	**1,310,255**	**131,437**	**343,245**	**137,095**	**10,302**	**1,932,334**
Net liquidity gap	**(790,151)**	**45,959**	**183,690**	**505,368**	**297,650**	**242,516**
As of 31 December 2017						
Total assets	510,462	74,580	315,889	735,373	339,097	1,975,401
Total liabilities	1,146,501	89,529	279,607	226,450	16,645	1,758,732
Net liquidity gap	**(636,039)**	**(14,949)**	**36,282**	**508,923**	**322,452**	**216,669**

4 Risk management (continued)

f Liquidity and funding risk (continued)

Liabilities to customers with maturity up to 1 month include all sight and saving deposits amounting to BGN 1,267,046 thousand (2017: BGN 1,053,175 thousand). The group's management expects that these funds will not be withdrawn at the same time or within the period in which they are reflected. Additionally, an analysis of depositors' behaviour revealed that 58% of term deposits at maturity date were not withdrawn but automatically renegotiated under the similar terms and conditions.

The following table shows the undiscounted cash flows of the financial assets and financial liabilities of the group according to their remaining contractual maturities.

Maturity analysis for financial assets and financial liabilities

As of 31 December 2018	**Up to 1 month**	**1 – 3 months**	**3 – 12 months**	**1 – 5 years**	**Over 5 years**	**Total**	**Total gross amount**
Cash and cash equivalents	218,911	-	-	-	-	218,911	218,911
Loans and advances to banks	227,451	41,049	-	-	-	268,500	268,484
Investment securities	9,098	4,325	212	15,562	4,718	33,915	33,384
Loans and advances to customers	64,272	135,914	565,504	703,120	291,468	1,760,278	1,637,078
Total financial assets	**519,732**	**181,288**	**565,716**	**718,682**	**296,186**	**2,281,604**	**2,157,857**
Liabilities to banks	559	17,608	46,390	22,248	5,521	92,326	91,164
Liabilities to customers	1,309,338	96,608	232,861	18,956	-	1,657,763	1,656,287
Other borrowed funds	-	53,367	54,666	74,036	-	182,069	179,662
Total financial liabilities	**1,309,897**	**167,583**	**333,917**	**115,240**	**5,521**	**1,932,158**	**1,927,113**

As of 31 December 2017	**Up to 1 month**	**1 – 3 months**	**3 – 12 months**	**1 – 5 years**	**Over 5 years**	**Total**	**Total gross amount**
Cash and cash equivalents	192,077	-	-	-	-	192,077	192,077
Loans and advances to banks	268,763	19,553	-	-	-	288,316	288,320
AFS securities	13,310	11	2,318	13,531	3,863	33,033	32,592
Loans and advances to customers	33,624	62,346	344,577	797,753	325,474	1,563,774	1,444,808
Total financial assets	**507,774**	**81,910**	**346,895**	**811,284**	**329,337**	**2,077,200**	**1,957,797**
Liabilities to banks	30,261	113	1,017	48,291	6,207	85,889	83,858
Liabilities to customers	1,103,418	88,944	267,928	6,007	635	1,466,932	1,466,145
Other borrowed funds	5,880	205	73,264	114,388	9,517	203,254	200,815
Total financial liabilities	**1,139,559**	**89,262**	**342,209**	**168,686**	**16,359**	**1,756,075**	**1,750,818**

Funding risk is the danger that additional funding cannot be obtained, or can only be obtained at higher costs. It therefore covers parts of the non-systemic effect of interest rate changes. This risk is mitigated by the fact that we finance our lending operations primarily through retail customer deposits; nonetheless, our deposit-taking operations focus on our target group of business clients and private clients/savers, with whom we establish strong relationships. These are supplemented by long-term credit lines from international financial institutions (IFIs). We make little use of the interbank market. In addition, we primarily issue instalment loans with monthly repayments. The funding of the group has proven to be resilient even in times of stress.

4 Risk management (continued)

f Liquidity and funding risk (continued)

The group manages, measures and limits funding risk through business planning, maturity gap analysis and several indicators. The funding needs of the group, identified in the business planning process, are monitored and regularly reviewed. ALCO monitors the progress of all individually significant transactions with external funding providers, especially international financial institutions. ProCredit Holding and the ProCredit Bank in Germany also offer bridge financing in the event that a funding project is delayed. A key indicator for limiting funding risk is the deposit concentration indicator which should not exceed 7% (it stood at 3.6% as of end 2018). Two more indicators additionally restrict the level of funding from the interbank market to a low level.

g Operational risk management

In line with CRR, we define operational risk as the risk of loss resulting from inadequate or failed internal processes, people or systems or from external events. This definition includes in particular fraud risk, IT risk, legal risk, reputational risk and outsourcing risk. The principles set forth in the group operational risk management policies are in compliance with the requirements for the standardised approach for operational risk pursuant to CRR.

The group has an assigned operational risk management role to ensure the effective implementation of the operational and fraud risk management framework within the institution. In addition, the Operational Risk Management Committee (“ORAC”) serves as decision-making body for operational risk matters A centralised and decentralised reporting procedure ensures that the Management as well as other members of the ORAC receive regular comprehensive reports on operational risks to serve as a basis for their decisions.

The aim of operational risk management is to detect risks at an early stage and to avoid recurrence. The main tools utilised to manage operational risks are the group-wide Risk Event Database (RED), the Annual Risk Assessments, established Key Risk Indicators (KRI) and the analysis of all new services and processes in a structured procedure, the New Risk Approval (NRA) process.

The Risk Event Database was developed to ensure that all operational risk events identified in the group are documented, analysed and communicated effectively. All ProCredit banks and ProCredit Holding document risk events using the provided framework, which ensures that adequate attention is paid to the implementation of necessary corrective or preventive measures for reducing or avoiding operational and fraud risk.

In contrast to the ex-post analysis of risk events as recorded in the Risk Event Database, annual risk assessments are systematically performed in order to identify and evaluate key risks and assess the adequacy of the control processes. These two tools complement each other and provide an overall picture of the operational risk profile for the group.

Risk indicators are also used to identify elevated fraud risk in specific areas of banking operations. These indicators are analysed regularly and where needed preventive measures are agreed on.

To complete the management of operational risk, all new products need to be analysed to identify and manage potential risks before implementation (NRA process).

4 Risk management (continued)

g Operational risk management (continued)

In order to limit IT risks, the group has defined standards for IT infrastructure, business continuity and information security. Regular controls of information security and business continuity are part of existing processes and procedures. The group carries out a classification of the information assets and conduct an annual risk assessment on the critical information assets. The business continuity framework implemented in the group ensures that these risks are understood by all members of staff, that critical processes are identified and that resources are allocated to restore operations, in line with the prioritisation of processes.

A key element of the risk assessment is the evaluation of outsourcing. The group conducts evaluation of risk on each outsourced process and well as on the insourcing company. Key performance indicators are tracked for the quality of services of the outsourced activities, and on annual basis is performed monitoring of all of them.

h Risks arising from money laundering, terrorist financing and other acts punishable by law

Ethical behaviour is an integral part of the values-oriented business model of all ProCredit banks. The prevention of money laundering, terrorist financing and fraud is a key component of our self-perception. The group does not tolerate any fraudulent activity or other questionable transactions, either by clients or employees.

The group is in full compliance with all regulatory requirements concerning the prevention of money laundering and terrorist financing. Moreover, the group has implemented the ProCredit group-wide guidelines on the prevention of money laundering and terrorist financing, which in many respects are stricter than the legal requirements prevailing in the individual countries of operation of the ProCredit group. As the ProCredit group is supervised by the German financial supervisory authorities, we implement the requirements stipulated by the German Money Laundering Act, as well as the requirements applicable at the European level.

Our ethical responsibility is documented in the form of our Code of Conduct and Exclusion List, which contain the core rules and regulations that all employees of ProCredit banks are obliged to observe. The group-wide guidelines on the prevention of money laundering, terrorist financing and fraudulent activities, together with their subordinate directives, specify how these basic rules are to be implemented in practice.

Besides identifying all contracting parties and clarifying the purpose of the business relationship, the collection of client data always also entails identifying the beneficial owner of all funds that are managed in customer accounts. Beneficial owners are natural persons who substantially profit from a business structure, even if they are not personally in evidence during our business relationship with a client. The group identifies and screens, without exception, all persons who could prove to be beneficial owners.

ProCredit Bank uses specialized software to identify payments that give cause for suspicion of money laundering, terrorist financing or fraud. Anti-money laundering officers work closely with the responsible law enforcement authorities and report regularly to the ProCredit Group Anti-Money Laundering (AML) Officer at ProCredit Holding, who in turn is the main contact for supervisory and law enforcement authorities in Germany and other countries.

4 Risk management (continued)

i Capital management

Capital management in the group is guided by the principle that the institution may at any time incur greater risks than they are able to bear. This principle is monitored using different indicators for which early warning indicators and limits have been established. The indicators include, in addition to regulatory standards in the country an internal capital adequacy assessment process (ICAAP).

The capital management framework of the group has the following objectives:
- compliance with regulatory capital requirements
- ensuring internal capital adequacy
- compliance with the internally defined capital requirements and creation of a sufficient capital buffer to ensure that the group is able to act
- support for the group in implementing the plans for continued growth

The capital management of ProCredit bank is governed by specific policies and monitored on a monthly basis by the Management.

Internal Capital Adequacy Assessment Process

Ensuring that the group has sufficient internal capital at all times is a key element the group's risk management and internal capital adequacy assessment process. In the context of the internal capital adequacy assessment, the capital needs arising from our specific risk profile are compared with the available capital resources to assure that the institution's capitalisation is at all times sufficient to match the risk profile. It is an ongoing process that raises awareness of our capital requirements and exposure to risks.

The methods we use to calculate the amount of economic capital required to cover the different risks the group is exposed to are based on statistical models, provided that appropriate models are available. The guiding principle for our internal capital adequacy assessment is that the group is able to withstand strong shock scenarios. In our view, the crisis years 2009 and 2010 underscored the necessity for a conservative approach to managing risks and capital, and the developments during that time proved the strength of the group in dealing with a difficult economic environment. Throughout this period, the group showed strong levels of capital.

The group applies a gone concern approach in managing and monitoring internal capital adequacy. We are committed to being able to meet our non-subordinated obligations at all times in the event of unexpected losses in the gone-concern approach, both in normal and in stress scenarios. The internal capital adequacy of the group was sufficient at all times during 2018.

When calculating the economic capital required to cover risk exposures we apply a one-year risk assessment horizon. The included material risks and the limits set for each risk reflect the specific risk profile of the group and are based on the annually conducted risk inventory. The following risks are included in the internal capital adequacy calculation:

Material risk	Quantification/treatment
Credit risk, comprising:	Portfolio model based on a Monte Carlo simulation (VaR)
• customer credit risk	
• counterparty risk	
• Foreign currency risk	Monte Carlo simulation (VaR)
Interest rate risk	Historical simulation (VaR)
Operational risk	Quantitative model based on a Monte Carlo simulation

4 Risk management (continued)

i Capital management (continued)

The group's risk-taking potential (RTP) in the gone concern approach, defined as the consolidated equity (net of intangibles and deferred tax assets), amounted to BGN 237 million as of the end of December 2018. The resources available to cover risks (RAtCR) are calculated as 60% of the RTP. Only RAtCR are considered when setting the limits for each risk category. Thus, a buffer of 40% of the RTP is available to cover possible shortcomings of the applied models and unfavourable effects, which can be associated with risks which have not been explicitly included in the ICAAP calculation. The RAtCR is then, on the basis of the risk appetite, distributed among the individually quantifiable risks, and the economic capital required to cover the risks is compared with the available capital.

The table below shows the distribution of RAtCR among the different risks and the limit utilisation as of end-December 2018. In the standard scenario, ProCredit Bank needs 60.4% of its RAtCR and 36.2% of its RTP to cover its risk profile.

As of 31 Dec 2018

Material risks	Limit (% of the RTP)	Limit (amount)	Limit used (amount)	Limit used (%)
Credit risk	38.0%	90,028	70,865	29.9%
FX risk	2.0%	4,738	97	0.0%
Interest rate risk	10.0%	23,692	4,575	1.9%
Operational risk	10.0%	23,692	10,387	4.4%
Resources available to cover risks (RAtCR) (limited at 60% of RTP)	**60.0%**	**142,150**	**85,924**	**36.2%**
Risk-taking potential (RTP)	**-**	**236,915**	**-**	**-**

Regulatory capital adequacy

Since 1 January 2014, the Basel III requirements, implemented in Bulgaria through Capital Requirements Directive IV and Regulation 575/2013 CRR, have been binding for the group. As per Art. 92 of Regulation 575/2013, the minimum capital requirement for the overall capital adequacy ratio is 8% of the total risk exposure. Added to this requirement are the capital buffers, which the BNB demands that the groups maintain as per Regulation No. 8 on the capital buffers of banks. They are:

- capital conservation buffer in the form of Common Equity Tier 1 equal to 2.5% of total risk exposure;
- systemic risk buffer in the form of Common Equity Tier 1 capital equal to 3.0% of the total risk exposure.
-

After adding the capital buffers to the capital requirements, the minimum requirement amounts to 13.5%. The group's internal capital management policy sets a stricter limit for the total capital adequacy ratio with a reporting trigger of 15.5% and a limit of 14.5%.

During the reporting period, all regulatory capital requirements were met at all times.

4 Risk management (continued)

i Capital management (continued)

When defining the capital requirements for the purposes of calculation of capital adequacy as per Regulation 575/2013, the group adheres to the following:

- capital requirements for credit risk and counterparty risk – Standardised approach as per Part Three, Section II, Chapter 2 of Regulation 575/2013 is used for exposure classes. Credit risk mitigation techniques are applied in the calculation of capital requirements for credit risk. Risk amounts arising from credit risk are reduced in part through the recognition of guarantees from the European Investment Fund (EIF), cash collaterals and mortgages on immovable property.
- capital requirements for operational risk – Standardized approach as per part Three, Section III, Chapter 3 of Regulation 575/2013. Compared to the regulatory capital requirements for operational risk, which amount to BGN 17.6 million, the average annual loss according to data recorded in the Risk Event Database in the last three years amounted to BGN 128 thousand.

As ProCredit Bank is a non-trading book institution, which moreover does not engage in transactions involving commodities, foreign currency risk is the only market risk to be considered. However, ProCredit Bank does not calculate a capital requirement for currency risk, as the overall net foreign currency position (excluding EUR) is virtually kept very close to 0% of the capital (as of 31.12.2018 the absolute value was 0.18%, which is less than minimum threshold of 2% according to Regulation 575/2013).

The regulatory capital ratios are calculated by dividing the capital by the amount of the risk-weighted assets; when calculating each ratio, only the respective capital components are considered (of the Common Equity Tier 1 capital, of the Tier 1 capital and of the overall capital adequacy). The group's regulatory capital ratios are presented below:

	2018	2017
Regulatory capital		
Common Equity Tier 1 capital	177,567	177,552
Total regulatory capital	**177,567**	**177,552**
Risk Weighted Assets		
Risk Weighted Assets for Credit Risk	967,480	870,962
Risk Weighted Assets for Operational Risk	129,837	132,789
Total Risk Weighted Assets	**1,097,317**	**1,003,751**
Capital ratios		
Common Equity Tier 1 capital	16.2%	17.7%
Tier 1 capital	16.2%	17.7%
Total capital	16.2%	17.7%

The capital ratios of the group decreased in the 2018 financial year. This was due to growth of the loan portfolio. Nevertheless, it must be taken into account that ProCredit Bank increased its subscribed capital by BGN 19,558 thousand. The newly paid capital was registered in the Bulgarian Trade Register in November 2018 but was recognised as a Common Equity Tier 1 capital by the BNB in February 2019. If the amount was added to the regulatory capital of the group, the total capital ratio would be 18.0% as of December 2018. The level of capitalisation in the group is thus significantly higher than the current regulatory requirements.

The Common Equity Tier 1 capital of the group is composed of subscribed capital and reserves. Deductions are made for intangible assets, additional valuation adjustments for balance sheet items recognised at market value, investment in non-financial subsidiary undertakings and other deductions related to credit risk corrections.

4 Risk management (continued)

i Capital management (continued)

The total volume of risk-weighted assets in the group increased by BGN 93 million in 2018. This change was due largely to the growth of the customer loan portfolio.

With the implementation of CRR, an additional leverage ratio was introduced which is not risk-based. This is defined as the ratio of Tier 1 capital to unweighted on- and off-balance sheet risk exposures. A binding minimum requirement for the leverage ratio has yet to take effect; however, in future it will be 3%. As of year-end 2018 ProCredit Bank reported a very comfortable leverage ratio of 8.0%.

j Internal control system and risk management system in the financial reporting process

The internal control system and risk management system in ProCredit Bank's financial reporting process comprises the principles, procedures and measures for the effective, cost-efficient and rule-compliant application of financial reporting requirements. The main risks in due and proper financial reporting are the improper representation of financial position and financial performance or delayed publication. The internal control system in the financial reporting process is subject to the general principles of our risk management approach and is thus an integral component of the risk management system.

Primary responsibility for the internal control system and risk management system in the financial reporting process, and thus for its effectiveness and monitoring, lies with the Management. The Management establishes the general principles and defines areas of responsibility. Finance function implements the requirements of the Management and defines the specific parameters within the framework provided. Operational Risk Management identifies and assesses risks on a regular basis. Risk assessment comprises an evaluation of operational and fraud risks as well as a review of the effectiveness of the respective controls. If necessary, appropriate measures are defined and implemented in order to limit the risks identified.

The financial reporting process aims to standardise, to the greatest extent possible, the application of the main international financial reporting standards and related processes. The Procredit group Accounting & Taxes function establishes the accounting manual, which applies throughout the group, and defines the material processes in the respective policies, taking account for the principle of dual control. The processes for report preparation are largely automated and the functionalities of the key IT applications have been defined on a centralised basis. IT permissions are defined and regularly monitored in accordance with the respective policies.

The financial reporting process is supported by a multi-step control system. This ensures compliance with legal requirements and the implementation of internal policies. The units in the group prepare information relevant for financial reporting with the support of IT applications which are uniform throughout the group. The information packages from units in the group are reviewed, taking account for the dual control principle, and then subject to standardised quality checks.

In addition, Internal Audit supports the Management and the Supervisory Board in their control functions through independent and objective risk-oriented audits. Regular audits are performed on the financial reporting processes to determine whether they are effective, orderly and cost efficient.

5 Fair values of financial assets and liabilities

The following table summarises the carrying amounts and fair values the financial assets and liabilities in the group's statement of financial position, distributed in the respective hierarchical levels in accordance to the methods used for determining of the fair value.

As of 31 December 2018				**Fair value hierarchy**		
Financial assets	**Category***	**Gross outstanding amount**	**Fair value**	**Level 1**	**Level 2**	**Level 3**
Cash	FV	39,281	39,281	39,281	-	-
Central bank balances	AC	179,630	179,630	-	179,630	-
Loans and advances to banks	AC	268,484	268,484	-	268,484	-
Investment securities (Bonds)	FVOCI	28,666	28,666	28,666	-	-
Investment securities (Shares)	FV	4,718	4,718	3,729	-	989
Loans and advances to customers	AC	1,637,078	1,671,726	-	-	1,671,726
Total		**2,157,857**	**2,192,505**	**71,676**	**448,114**	**1,672,715**

Financial liabilities	**Category***	**Gross outstanding amount**	**Fair value**	**Level 1**	**Level 2**	**Level 3**
Liabilities to banks	AC	91,164	91,210	-	37,993	53,217
Liabilities to customers	AC	1,656,287	1,656,178	-	1,289,079	367,099
Liabilities to institutions	AC	179,662	179,274	-	-	179,274
Total		**1,927,113**	**1,926,662**	**-**	**1,327,072**	**599,590**

As of 31 December 2017				**Fair value hierarchy**		
Financial assets	**Category***	**Gross outstanding amount**	**Fair value**	**Level 1**	**Level 2**	**Level 3**
Cash and cash equivalents	FV	192,077	192,077	44,765	147,312	-
Loans and advances to banks	LaR	288,320	288,320	-	288,320	-
Loans and advances to customers	LaR	1,444,808	1,483,090	-	-	1,483,090
AFS financial assets	AFS	32,592	32,592	31,826	-	766
Total		**1,957,797**	**1,996,079**	**76,591**	**435,632**	**1,483,856**

Financial liabilities	**Category***	**Gross outstanding amount**	**Fair value**	**Level 1**	**Level 2**	**Level 3**
Liabilities to banks	AC	83,858	83,982	-	30,174	53,808
Liabilities to customers	AC	1,466,145	1,466,126	-	1,073,612	392,514
Liabilities to institutions	AC	200,815	201,190	-	-	201,190
Total		**1,750,818**	**1,751,298**	**-**	**1,103,786**	**647,512**

* categories: FV - At Fair value; LaR - Loans and Receivables, AFS - Available-for-sale; AC - Amortised cost; FVOCI - fair value through other comprehensive income

(i) Cash and cash equivalents

The item "cash and cash equivalents" includes cash at hand and balances at central banks including mandatory reserve disclosed under note 15. The fair value of these assets matches their carrying amount.

(ii) Loans and advances to banks

Loans and advances to banks include inter-bank placements. The fair value of floating rate placements and overnight deposits is their carrying amount. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and remaining maturity.

5 Fair values of financial assets and liabilities (continued)

(iii) Investment securities

The group's portfolio of government securities is carried at fair value using the Level 1 inputs that are quoted market prices (unadjusted) in active markets for identical instruments. A small part of the investment securities includes equity securities where observable market prices are not available (SWIFT and Borika-Bankservice shares). These instruments are carried at cost.

(iv) Loans and advances to customers

Loans and advances are net of provision for impairment. The fair value of loans and advances represents the discounted amount of estimated future cash flows using the interest rates currently offered by the group for similar risk and maturity. Difference in fair values and carrying amounts represents the changes in the current market interest rates. Fair value incorporates expected future losses, while amortised cost and related impairment include only incurred losses at the statement of financial position date.

(v) Financial liabilities

The fair value of deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest-bearing deposits and other borrowings without quoted market price is based on discounted cash flows using interest rates for similar risk and maturity.

If observable market rates are not available to determine the fair value of financial liabilities measured at amortised cost, ProCredit Group Treasury rates are used as an input for a discounted cash flow model. These are presented as level 3 input factors. ProCredit Group Treasury rates are determined taking into consideration the cost of capital depending on currencies and maturities plus a risk margin that depends on an internal risk rating for each institution within the ProCredit group (incl. ProCredit Bank (Bulgaria) EAD). Internal rates are regularly compared to those applied for third party transactions and are therefore in compliance with an orderly transaction between market participants at the measurement date under current market conditions.

Fair values of repossessed and investment properties (note 21) are established on the basis of internal calculations. The group considers the following valuation techniques:

- Cost approach. It considers the current replacement costs of building the property, including the cost of transportation, installation and start-up.
- Income approach. It considers the present value of the net cash flows expected to be generated from the facility, taking into account the planned EBITDA growth rate and budgeted capital expenditure growth rate; the expected net cash flows are discounted using a risk-adjusted discount rate.
- Sales comparison approach. It considers direct comparison with the offered prices of similar properties.

6 Net interest income

	2018	2017
Interest and similar income		
Loans and advances to customers	62,451	62,065
Investment securities	124	181
Loans and advances to banks	(65)	281
Total interest and similar income	**62,510**	**62,527**
Interest and similar expenses		
Liabilities to customers	2,565	1,399
Liabilities to banks and international financial institutions	2,321	1,832
Other interest expenses	79	-
Total interest and similar expenses	**4,965**	**3,231**
Net interest income	**57,545**	**59,296**

Included in "Interest income from loans and advances to customers" for 2018 is BGN 1,255 thousand of accrued interest on impaired loans (2017: BGN 1,000 thousand).

7 Loss allowance

	2018	2017
Increase of impairment charge	18,801	18,723
Release of impairment charge	(16,469)	(16,135)
Recovery of written-off loans	(1,904)	(2,049)
Direct write-offs	589	126
Non-significant modification	639	-
Loss allowance	**1,656**	**665**

8 Net fee and commission income

	2018	2017
Fee and commission income		
Opening and account maintenance fees	12,006	10,372
Payment services	5,280	4,622
Debit/credit cards	3,223	3,280
Cash operations on machines	1,523	750
Insurance fees	944	1,237
Loan management	841	1,138
Letters of credit and guarantees	497	463
Others	352	146
Total fee and commission income	**24,666**	**22,008**
Fee and commission expense		
Debit/credit cards	924	955
Correspondent accounts	747	706
Guarantees for EIF programs	726	310
Others	10	7
Total fee and commission expense	**2,407**	**1,978**
Net fee and commission income	**22,259**	**20,030**

9	**Result from foreign exchange transactions**	**2018**	**2017**
	Currency transactions	7,722	6,903
	Net gains from revaluation	90	425
	Total result from foreign exchange transactions	**7,812**	**7,328**

10	**Result from investment securities (2017: available-for-sale financial assets)**	**2018**	**2017**
	Losses from investment securities	(321)	(72)
	Total result from investment securities	**(321)**	**(72)**

11	**Net other operating income**	**2018**	**2017**
	Other operating income		
	Income/(loss) from sale of own property	(112)	(14)
	Income from sale of repossessed property	258	182
	Dividends from investment securities	23	222
	Fee for keeping of funds of closed inactive accounts	1,499	1,433
	Income from non-financial services	486	642
	Other operating income	2,347	285
	Total other operating income	**4,501**	**2,750**
	Other operating expenses		
	Impairment of repossessed property	1,170	2,970
	Other expenses related to repossessed property	187	224
	Result from derivative financial instruments	181	-
	Other operating expenses	108	37
	Total other operating expenses	**1,646**	**3,231**
	Net other operating income	**2,855**	**(481)**

"Dividends from investment securities" includes the dividend received by entities in which the group has non-controlling interest.

12	**Personnel expenses**	**2018**	**2017**
	Salary expenses	14,135	14,949
	Pension costs	981	970
	Other social security costs	1,181	1,305
	Other employee costs	67	31
	Total personnel expenses	**16,364**	**17,255**

13 Administrative expenses

	2018	**2017**
Payments to Deposit Insurance Fund and Bank Restructuring Fund	5,614	5,279
Depreciation fixed and intangible assets	5,200	5,143
Consultancy, legal and audit services	2,982	2,427
Communication and transport costs	2,906	2,784
Other professional services	2,749	3,260
Non-profit tax	2,593	2,477
Training	1,662	2,040
Operating lease rentals	1,417	1,987
IT expenses	1,132	1,121
Maintenance and utilities	900	1,035
Security services	885	1,127
Marketing, advertising and representation	681	548
Other administrative expenses	955	2,950
Total administrative expenses	**29,676**	**32,178**

Total fees incurred for the services provided by the external auditors were BGN 230 thousand (2017: BGN 174 thousand).

14 Income tax expense

	2018	**2017**
Current income tax	4,337	4,093
Deferred income tax (note 20)	8	(255)
Total income tax expenses	**4,345**	**3,838**

The tax on the operating profit differs from the theoretical amount that would arise using the basic tax rate as follows:

	2018	**2017**
Profit before income tax	**42,454**	**36,003**
Theoretical tax at a tax rate of 10 % (2017: 10 %)	4,245	3,600
Tax effect from non-taxable income	(1,838)	(21)
Tax effect of expenses not deductible for tax purposes	1,938	259
Total income tax expense	**4,345**	**3,838**

The effective tax rate for 2018 is: 10.2% (2017: 10.7%).

15 Cash and cash equivalents

	2018	2017
Cash in hand	39,281	44,765
Central bank balances (excl. mandatory reserve)	28,289	15,035
Loss allowances for cash and central bank balances	(108)	-
Mandatory reserve deposits	151,341	132,277
Total cash and cash equivalents	**218,803**	**192,077**
Loans and advances to banks with a maturity up to 3 months	268,536	288,322
Minimum reserve with central bank, which does not qualify as cash for the statement of cash flows	(151,341)	(132,277)
Cash and cash equivalents for the statement of cash flows	**335,998**	**348,122**

The following table discloses the central bank balances by three stages for the purpose of expected credit losses measurement as of 31 December 2018.

Central bank balances

	Stage 1	Stage 2	Stage 3	POCI	Total
Gross outstanding amount as at 1 Jan 2018	147,312	-	-	-	**147,312**
Derecognition	(990)	-	-	-	**(990)**
Other movements	33,308	-	-	-	**33,308**
As at end of period	**179,630**	**-**	**-**	**-**	**179,630**

Loss allowances for cash and central bank balances

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at 1 Jan 2018	(224)	-	-	-	**(224)**
Release due to derecognition	124	-	-	-	**124**
Increase/Decrease in credit risk	(8)	-	-	-	**(8)**
As at end of period	**(108)**	**-**	**-**	**-**	**(108)**

16 Loans and advances to banks

	2018	2017
Current accounts	202,981	258,984
Up to three months	65,503	29,336
Loss allowances for loans and advances to banks	(15)	-
Total loans and advances to banks	**268,469**	**288,320**

The following table discloses the loans and advances to banks balances by three stages for the purpose of expected credit losses measurement as of 31 December 2018.

16 Loans and advances to banks (continued)

Loans and advances to banks

	Stage 1	Stage 2	Stage 3	POCI	Total
Gross outstanding amount as at 1 Jan 2018	288,320	-	-	-	**288,320**
Derecognition	(20,265)	-	-	-	**(20,265)**
Other movements	429	-	-	-	**429**
As at end of period	**268,484**	**-**	**-**	**-**	**268,484**

Loss allowances for loans and advances to banks

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at 1 Jan 2018	(20)	-	-	-	**(20)**
Release due to derecognition	5	-	-	-	**5**
As at end of period	**(15)**	**-**	**-**	**-**	**(15)**

17 Investment securities

	2017	2017
Bulgarian Government debt securities	28,666	28,729
Shares	4,718	3,863
Total investment securities	**33,384**	**32,592**

The shares represent investments in local and foreign financial intermediary institutions.

The following table discloses the debt securities by three stages for the purpose of expected credit losses measurement as of 31 December 2018.

Investment securities

	Stage 1	Stage 2	Stage 3	POCI	Total
Gross outstanding amount as at 1 Jan 2018	28,729	-	-	-	**28,729**
New financial assets originated	15,477	-	-	-	**15,477**
Derecognition	(15,540)	-	-	-	**(15,540)**
As at end of period	**28,666**	**-**	**-**	**-**	**28,666**

Loss allowances for investment securities

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at 1 Jan 2018	(19)	-	-	-	**(19)**
New financial assets originated	(9)	-	-	-	**(9**
Release due to derecognition	9	-	-	-	**9**
Increase/Decrease in credit risk	3	-	-	-	**3**
As at end of period	**(16)**	**-**	**-**	**-**	**(16)**

The movement of the shares are presented in the table below:

	2018	2017
Opening balance	**3,863**	**3,180**
Gains / (losses) from changes in FV	713	981
Foreign currency revaluation	142	(298)
Closing balance	**4,718**	**3,863**

18 Loans and advances to customers

	31.12.2018	01.01.2018	31.12.2017
Total gross loans and advances	1,637,078	1,444,630	1,444,808
Less provision for impairment	(39,001)	(40,740)	(40,973)
Total net loans and advances	**1,598,077**	**1,403,890**	**1,403,835**

The following table discloses the changes in the gross carrying amount and credit loss allowance for loans and advances to customers carried at amortised cost between the beginning and the end of the reporting period

Loans and advances to customers

	Stage 1	Stage 2	Stage 3	POCI	Total
Gross outstanding amount as at 1 January 2018	1,344,814	47,868	50,931	1,017	**1,444,630**
New financial assets originated	687,648	4,061	2,049	-	**693,758**
Modification of contractual cash flows of financial assets	-	1,048	329	-	**1,377**
Derecognitions (including write-offs)	(273,357)	(13,605)	(10,781)	-	**(297,743)**
Changes in interest accrual	(431)	(24)	230	1	**(224)**
Changes in the principal and disbursement fee amount	(191,348)	(5,578)	(7,716)	(78)	**(204,720)**
Transfer from Stage 1 to Stage 2	(13,319)	13,319	-	-	**-**
Transfer from Stage 1 to Stage 3	(4,514)	-	4,514	-	**-**
Transfer from Stage 2 to Stage 1	7,344	(7,344)	-	-	**-**
Transfer from Stage 2 to Stage 3	-	(8,343)	8,343	-	**-**
Transfer from Stage 3 to Stage 2	-	520	(520)	-	**-**
Transfer from Stage 3 to Stage 1	709	-	(709)	-	**-**
Gross outstanding amount as at end of period	**1,557,546**	**31,922**	**46,670**	**940**	**1,637,078**

Loss allowances for loans and advances to customers

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at 1 January 2018	(7,002)	(8,021)	(25,717)	-	**(40,740)**
New financial assets originated	(3,240)	(441)	(828)	-	**(4,509)**
Release due to derecognition	1,571	1,091	1,823	-	**4,485**
Transfer from Stage 1 to Stage 2	72	(72)	-	-	**-**
Transfer from Stage 1 to Stage 3	25	-	(25)	-	**-**
Transfer from Stage 2 to Stage 1	(1,769)	1,769	-	-	**-**
Transfer from Stage 2 to Stage 3	-	1,450	(1,450)	-	**-**
Transfer from Stage 3 to Stage 2	-	(21)	21	-	**-**
Transfer from Stage 3 to Stage 1	(40)	-	40	-	**-**
Increase in credit risk	(314)	(1,573)	(8,931)	(69)	**(10,887)**
Decrease in credit risk	3,303	915	3,902	6	**8,126**
Usage of allowance	-	-	4,202	-	**4,202**
Increase due to restructuring	-	(482)	(767)	-	**(1,249)**
Decrease due to restructuring	-	717	12	-	**729**
Unwinding effects	-	-	842	-	**842**
As at end of period	**(7,394)**	**(4,668)**	**(26,876)**	**(63)**	**(39,001)**

19 Property, plant and equipment and Intangible assets

	Land and buildings	Furniture and fixtures	IT and other equipment	Leasehold improve-ments	Intangible assets	Total
Cost						
Balance as of 1 Jan 2017	33,590	2,519	32,450	4,380	11,270	84,209
Acquisitions	135	208	222	88	1,536	2,189
Disposals	-	(503)	(3,901)	-2,276	0	-6,680
Balance as of 31 Dec 2017	**33,725**	**2,224**	**28,771**	2,192	12,806	79,718
Depreciation						
Balance as of 1 Jan 2017	5,226	1,164	18,166	1,611	8,013	34,180
Depreciation for the period	807	207	2,840	276	1,013	5,143
Accumulated depreciation of disposal	-	(257)	(3,552)	-871	0	-4,680
Balance as of 31 Dec 2017	**6,033**	**1,114**	**17,454**	1,016	9,026	34,643
Carrying amounts						
Balance as of 1 Jan 2017	28,364	1,355	14,284	2,769	3,257	50,029
Balance as of 31 Dec 2017	27,692	1,110	11,317	1,176	3,780	45,075
Cost						
Balance as of 1 Jan 2018	33,725	2,224	28,771	2,192	12,806	79,718
Acquisitions	1,984	146	1,413	262	2,479	6,284
Disposals	(738)	(426)	(2,584)	(231)	(16)	(3,995)
Balance as of 31 Dec 2018	**34,971**	**1,944**	**27,600**	**2,223**	**15,269**	**82,007**
Depreciation						
Balance as of 1 Jan 2018	6,033	1,114	17,454	1,016	9,026	34,643
Depreciation for the period	810	199	2,735	264	1,192	5,200
Accumulated depreciation of disposal	-	(317)	(1,890)	(56)	(16)	(2,279)
Balance as of 31 Dec 2018	**6,843**	**996**	**18,299**	**1,224**	**10,202**	**37,564**
Carrying amounts						
Balance as of 1 Jan 2018	27,692	1,110	11,317	1,176	3,780	45,075
Balance as of 31 Dec 2018	28,128	948	9,301	999	5,067	44,443

20 Deferred tax assets

The deferred income taxes relate to the following temporary differences:

	2018	2017
Deferred tax assets		
Repossessed properties	987	1,012
Unused staff holiday time	66	59
Other temporary differences	48	45
Total deferred tax assets	**1,101**	**1,116**
Deferred tax liabilities		
Property, plant and equipment	505	512
Other temporary differences	46	46
Total deferred tax liabilities	**551**	**558**
Net deferred tax assets	**550**	**558**

The following table analyses the change in deferred taxes:

	2018	2017
Unused staff holiday time	7	(16)
Repossessed properties	(24)	247
Property, plant and equipment	6	37
Other temporary differences	3	(13)
Total change in deferred taxes (note 14)	**(8)**	**255**

21 Other assets

	2018	2017
Repossessed properties	5,349	8,993
Accounts receivable	3,776	3,041
Receivables from clients	1,083	-
Prepayments	865	787
Tax receivables	80	123
Loss allowance for account receivables	(29)	-
Total other assets	**11,124**	**12,944**

Repossessed properties shown in the above table include real estates, agricultural and regulated land, etc. They are carried at the lower of the previous carrying amount of the written-off loan and the expected selling price less cost to sell. Reconciliation of the carrying amount of repossessed property is presented in the following table:

Repossessed property	**2018**	**2017**
Balance as of 1 January	**8,993**	**13,062**
Additions	1,108	578
Disposals (sales)	(3,582)	(1,677)
Impairment of repossessed property	(1,170)	(2,970)
Balance as of 31 December	**5,349**	**8,993**

21 Other assets (continued)

The following table discloses the other financial assets balances by three stages for the purpose of expected credit losses measurement as of 31 December 2018.

Other financial assets

	Stage 1	Stage 2	Stage 3	POCI	Total
Gross outstanding amount as at 1 Jan 2018	3,951	-	-	-	**3,951**
New financial assets originated	5,634	-	-	-	**5,634**
Derecognition	(3,781)	-	-	-	**(3,781)**
As at end of period	**5,804**	**-**	**-**	**-**	**5,804**

Loss allowances for other assets

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at 1 January 2018	(35)	-	-	-	**(35)**
New financial assets originated	(28)	-	-	-	**(28)**
Release due to derecognition	34	-	-	-	**34**
As at end of period	**(29)**	**-**	**-**	**-**	**(29)**

22 Liabilities to banks

	2018	2017
Current accounts	493	175
Term deposits	37,500	30,000
Loans	53,171	53,683
Total liabilities to banks	**91,164**	**83,858**

The current accounts include liabilities to ProCredit Bank Germany and liabilities to other banks of the ProCredit Holding group in the amount of BGN 109 thousand (2017: BGN 92 thousand). Term deposits comprise money market liabilities to local banks with maturity less than 6 months. The loans include liabilities to ProCredit Bank Germany in the amount of BGN 53,171 thousand (2017: BGN 53,683 thousand) with maturity 2019 and 2020.

23 Liabilities to customers

	2018	2017
Current accounts		
- private individuals	91,230	104,437
- legal entities	614,117	656,703
Total current accounts	**705,347**	**761,140**
Saving accounts		
- private individuals	142,498	111,659
- legal entities	425,065	184,543
Total saving accounts	**567,563**	**296,202**
Term deposit accounts		
- private individuals	111,905	172,321
- legal entities	255,302	220,211
Total term deposit accounts	**367,207**	**392,532**
Payments in transit	16,170	16,271
Total liabilities to customers	**1,656,287**	**1,466,145**

24 Liabilities to financial institutions

Institution	Final year of maturity	2018	2017
ProCredit Holding	2020	68,599	68,601
European Investment Fund (EIF)	2026	53,079	72,136
Black See Trade and Development Bank (BSTDB)	2020	39,086	39,083
European Bank for Reconstruction and Development (EBRD)	2023	18,898	-
KfW	2018	-	20,995
Total liabilities to institutions		**179,662**	**200,815**

The loan agreement with the European Investment Fund is under the JEREMIE program aimed towards co-financing of small and medium enterprises. The group was in compliance with the covenants included in the respective loan agreements in 2018.

25 Other liabilities

	2018	2017
Creditors	2,677	5,822
Non-income taxes payable	778	666
Derivative financial liabilities	181	-
Deferred income	2	465
Other due payments	109	19
Total other liabilities	**3,747**	**6,972**

Derivative financial liabilities represent the net position of accrued interest from interest rate SWAP with ProCredit Bank (Germany) with contractual amount BGN 10,270 thousand. The amount as of 31 December 2018 was BGN 9,784 thousand.

26 Provisions

	2018	2017
Provisions for post-employment benefits (see below)	126	101
Provisions for losses from off-balance sheet items	553	220
Provisions for unused staff holiday time	280	248
Total provisions	**959**	**569**

Obligations for defined benefit retirement compensation

The estimated amount of the obligation as at each reporting date and the expenses for retirement compensation recognised are based on an actuarial report (see below information on actuarial assumptions). The defined benefit plan (obligation for compensation upon retirement) is an unfunded plan.

26 Provisions (continued)

Movement in the present value of the defined benefit obligations

	2018	2017
Defined benefit obligations as of 1 January	**101**	**111**
Current service costs	17	16
Interest cost	1	2
Actuarial (gains) losses from changes in financial and demographic assumptions	7	(28)
Defined benefit obligations as of 31 December	**126**	**101**

Actuarial assumptions

The following are the principal actuarial assumptions at the reporting date (expressed as weighted averages).

	2018	2017
Discount rate as of 31 December	1.25%	2.00%
Future salary increases	5.00%	5.00%
Interest rate increase/decrease	5.00%	5.00%

27 Equity

Share capital and share premium

As of end 2018 the capital of the group consisted of registered capital and share premium. In November 2018 the share capital of the bank was increased with BGN 19,558 thousand. The increase was registered in the Trade Register and fully paid in cash. The registered capital of BGN 183,768 thousand is divided into 183,768 thousand shares (2017: 164,210 thousand shares) with a nominal value of BGN 1 each. All shares confer equal voting power and are fully paid. The sole owner of the group's capital is ProCredit Holding. The share premium is BGN 3,496 thousand (2017: BGN 3,496 thousand).

Retained earnings and reserves

Legal and other reserves – the reserves have been distributed from the net profit of the group in compliance with the Commercial Law, article 246. The funds in these reserves could only be used for covering of current loss and loss from previous years.

Revaluation reserve – comprise accumulated revaluation by fair value of financial assets at fair value through other comprehensive income (2017: available-for-sale financial assets).

Retained earnings – comprise the retained profits of the group. The group paid dividends for BGN 32,023 thousand in 2018 from its retained earnings from 2017.

28 Reconciliation of movements of liabilities to cash flows arising from financing activities

	Liabilities to		Equity			
	Banks	Institutions	Share capital	Reserves	Retained earnings	Total
Balance at 1 Jan 2018	83,858	200,815	167,706	13,947	34,458	500,784
Proceeds from liabilities to	-	58,674	-	-	-	58,674
Repayment of liabilities to banks and institutions	-	(75,997)	-	-	-	(75,997)
Dividend paid	-	-	-	-	(32,023)	(32,023)
Total changes from financing cash flows	**-**	**(17,323)**	**-**	**-**	**(32,023)**	**(49,346)**
Other changes						
Liability-related						
Short term liabilities to banks and institutions	7,292	-	-	-	-	7,292
Interest expense	763	1,637	-	-	-	2,400
Interest paid	(749)	(5,467)	-	-	-	(6,216)
Total liability-related other changes	**7,306**	**(3,830)**	**-**	**-**	**-**	**3,476**
Equity-related						
Revaluation of afs securities, net of taxes	-	-	-	761	-	761
Capital increase	-	-	19,558	-	-	19,558
Profit for the year	-	-	-	-	38,109	38,109
Total equity-related other changes	**-**	**-**	**19,558**	**761**	**38,109**	**58,428**
Balance at 31 Dec 2018	**91,164**	**179,662**	**187,264**	**14,708**	**40,544**	**513,342**

29 Contingent liabilities and commitments

Off-balance sheet commitments

The following table indicates the contractual amounts of the group's off-balance sheet financial instruments that commit it to extend credit to customers:

	2018	2017
Commitments to extend credit	254,418	231,065
Letters of credit and letters of guarantee	36,834	37,290
Total contingencies and commitments	**291,252**	**268,355**

Operating lease commitments

The group leases a number of branch premises under operating leases. The leases typically run for a period of up to ten years. The leases are cancellable with prior notification up to six months. As a lessee under operating leases, the group has committed to make the following minimum rental payments:

	2018	2017
Not later than 1 year	555	597
Total contingencies and commitments	**555**	**597**

30 Related party transactions

ProCredit Holding is the sole shareholder, the ultimate parent and ultimate controlling party of the group. ProCredit Bank has stand-by line agreement with ProCredit Holding, directed towards liquidity management, which is not utilized at the end of 2018. The group has received loans from ProCredit Holding and ProCredit Bank Germany (fully owned subsidiary of ProCredit Holding) under loan agreements. Banks from ProCredit Holding group keep current accounts placements with the group, which are disclosed in note 22.

30 Related party transactions (continued)

The related party transactions were carried out on commercial terms and at market rates. The volumes of related party transactions outstanding at year end, and associated expenses and income for the year are as follows:

Transactions/balances with ProCredit Holding	**2018**	**2017**
Other income earned	61	48
Liabilities at the end of the period	68,599	68,601
Interest expense incurred	962	699
Other expenses incurred	2,266	1,932

Transactions/balances with other ProCredit group entities	**2018**	**2017**
Loans and advances at the end of the period	269,653	288,318
Interest income earned	88	386
Other income earned	62	184
Liabilities at the end of the period	53,444	53,775
Interest expense incurred	856	631
Other expenses incurred	2,249	1,851

In 2018 the total compensation of key management personnel was BGN 839 thousand (2017: BGN 545 thousand).

31 Transition to IFRS 9 "Financial instruments"

The following tables present the reconciliation of financial assets, liabilities and equity according to IAS 39 with their book values according to IFRS 9.

Financial assets	**IAS 39 carrying amount 31.12.2017**	**Reclassi-fications**	**Remeasu-rements**	**IFRS 9 carrying amount 01.01.2018**
Cash and cash equivalents (IAS 39)	**192,077**			
Remeasurement: ECL allowance			(224)	
Cash and cash equivalents (IFRS 9)				**191,853**
Loans and advances to banks (IAS 39)	**288,320**			
Remeasurement: ECL allowance			(20)	
Loans and advances to banks (IFRS 9)				**288,300**
Available-for-sale financial assets				
Opening balance under IAS 39	**32,592**			
Reclassification to Investment securities (IFRS 9)		(32,592)		
Closing balance under IFRS 9				**n/a**
Investment securities				
Opening balance under IAS 39	**n/a**			
Reclassification from available for sale financial assets (IAS 39)		32,592		
Closing balance under IFRS 9				**32,592**
Loans and advances to customers (*IAS 39)*	**1,444,808**			
Reclassification from Allowance for losses on loans and advances (IAS 39)		(40,973)		
Remeasurement: Loans and advances to customers (POCI)			(178)	
Remeasurement: ECL allowance (net)			233	
Loans and advances to customers (*net incl. LLP* IFRS 9)				**1,403,890**
Allowance for losses on loans and advances				
Opening balance under IAS 39	(40,973)			
Reclassification to Loans and advances to customers (ECL allowance)		40,973		
Closing balance under IFRS 9				**n/a**
Other assets (IAS 39)	**12,944**			
Remeasurement: ECL allowance (net)			(36)	
Other assets (IFRS 9)				**12,908**
Total financial assets	**1,929,768**	**-**	**(225)**	**1,929,543**

Financial liabilities	**IAS 39 carrying amount 31.12.2017**	**Reclassi-fications**	**Remeasu-rements**	**IFRS 9 carrying amount 01.01.2018**
Liabilities				
Provisions (IAS 39)	**569**			
Remeasurement			333	
Provisions (IFRS 9)				**902**
Equity				
Revaluation reserve (IAS 39)	**953**			
Remeasurement: ECL allowance			19	
Revaluation reserve (IFRS 9)				**972**
Total changed equity and financial liabilities	**1,522**		**352**	**1,874**

31 Transition to IFRS 9 "Financial instruments" (continued)

The following table shows the measurement basis of financial assets and financial liabilities according to IAS 39 and according to IFRS 9:

	Measurement basis under IAS 39	Measurement basis under IFRS 9
Financial assets		
Central bank balances	amortised cost	amortised cost
Available-for-sale financial assets	FVOCI	n/a
Investment securities	n/a	FVOCI
Loans and advances to banks	amortised cost	amortised cost
Loans and advances to customers	amortised cost	amortised cost
Financial liabilities		
Liabilities to banks	amortised cost	amortised cost
Liabilities to customers	amortised cost	amortised cost
Liabilities to financial institutions	amortised cost	amortised cost

The following table shows the transition of loss allowances:

	IAS 39 loss allowance 31.12.2017	Remeasurement: ECL allowance	IFRS 9 loss allowance 01.01.2018	Stage 1	Stage 2	Stage 3	POCI
Loss allowance for central banks	**n/a**	(224)	**(224)**	224	-	-	-
Loss allowance for loans to banks	**n/a**	(20)	**(20)**	20	-	-	-
Loss allowance for investment securities	**n/a**	(19)	**(19)**	19	-	-	-
Loss allowance for loans to customers	**(40,973)**	233	**(40,740)**	7,002	8,021	25,717	-
Loss allowance for other assets (Financial Instruments)	**n/a**	(36)	**(36)**	36	-	-	-
Loss allowance for contingent liabilities	**(220)**	(333)	**(553)**	553	-	-	-

The following table shows the impact of the initial application of IFRS 9 on the group's equity:

	Effect on AfS revaluation reserve	Effect on FVOCI revaluation reserve	Effect on retained earnings
Opening balance – IAS 39	**953**	**-**	**35,035**
Reclassification of financial instruments from available-for-sale to FVOCI	(953)	953	-
Remeasurement: ECL allowance	-	19	(577)
Opening balance - IFRS 9	**-**	**972**	**34,458**

32 Events after the reporting period

There have been no events after the reporting period that may have a material effect on the consolidated financial statements for 2018.

ProCredit Bank

Part of the ProCredit Group

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