



ProCredit Bank

 Part of the
ProCredit Group



*Consolidated
Financial Statements
2016*

**PROCREDIT BANK (BULGARIA) EAD
CONSOLIDATED FINANCIAL STATEMENTS
31 DECEMBER 2016**

Financial statements in English are translation from the original in Bulgarian. This version of the financial statements is 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.

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Independent Auditor's Report

To the Shareholder of ProCredit Bank (Bulgaria) EAD

Our Opinion

We have audited the consolidated financial statements of ProCredit Bank (Bulgaria) EAD and its subsidiaries (together - the "Group"), which comprise the consolidated statement of financial position as at 31 December 2016, 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 cash flow statement 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 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the 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.

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

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

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Registered with the Sofia City Court under company file number 13424/1997.

This version of our report/the accompanying documents is 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 our report takes precedence over this translation.



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

We have nothing to report in this regard.

Additional Matters to Be Reported under the Accountancy Act

In addition to our responsibilities and reporting in accordance with ISAs, in relation to the consolidated Annual Activity Report and the Corporate Governance Statement, we have also performed the procedures added to those required under ISAs in accordance with the Guidelines of the professional organisation of certified public accountants and registered auditors in Bulgaria, i.e. the Institute of Certified Public Accountants (ICPA), issued on 29 November 2016 and approved by its Management Board on 29 November 2016. 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 the Public Offering of Securities Act (Art. 100(m) of POSA, if applicable), applicable in Bulgaria.

Opinion in Connection with Art. 37, Paragraph 6 of the Accountancy Act

Management has prepared consolidated Annual Activity Report and Corporate Governance Statement as of 31 December 2016 which were presented with the consolidated financial statements as of 31 December 2016 issued in Bulgarian language and authorised by the Management on 31 March 2017.

Based on the procedures performed, our opinion is that:

- a) The information included in the consolidated Annual Activity Report referring to the financial year for which the consolidated financial statements have been prepared is consistent with those consolidated financial statements.
- b) The consolidated Annual Activity Report has been prepared in accordance with the requirements of Chapter Seven of the Accountancy Act.
- c) The Corporate Governance Statement referring to the financial year, for which the consolidated 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.

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

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

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional 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 auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.



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

A handwritten signature in blue ink, appearing to read "R. Boteva", positioned above a horizontal line.

Rositsa Boteva
Registered Auditor

A handwritten signature in blue ink, appearing to read "Stefan Weiblen", positioned above a horizontal line.

Stefan Weiblen
PricewaterhouseCoopers Audit OOD

11 April 2017
Sofia, Bulgaria

Consolidated Statement of Profit or Loss

(all amounts expressed in thousands of BGN)

	Notes	Year ended 31 December	
		2016	2015
Interest and similar income	6	69,987	81,113
Interest and similar expenses	6	(3,903)	(12,393)
Net interest income		66,084	68,720
Allowances for impairment losses on loans and advances	7,19	(3,346)	(6,180)
Net interest income after allowances		62,738	62,540
Fee and commission income	8	19,099	21,261
Fee and commission expenses	8	(1,568)	(1,575)
Net fee and commission income		17,531	19,686
Result from foreign exchange transactions	9	6,227	5,841
Net result from available-for-sale financial assets	10	7,292	(741)
Net other operating income	11	(2,263)	(2,082)
Operating income		91,525	85,244
Personnel expenses	12	(18,020)	(19,784)
Administrative expenses	13	(31,126)	(33,410)
Operating expenses		(49,146)	(53,194)
Profit before tax		42,379	32,050
Income tax expense	14	(4,547)	(3,381)
Profit for the period		37,832	28,669

These consolidated financial statements on pages 10 to 53 were approved by the Management Board and signed on its behalf by:

Rumyana Todorova
Executive Director and
Member of the Management Board
31 March 2017

Reni Peycheva
Executive Director and
Member of the Management Board

Initialled for identification purposes in reference to the auditor's report

Rositsa Boteva
Registered Auditor
Date: 11 April 2017

Stefan Weiblen
PricewaterhouseCoopers Audit OOD
Date: 11 April 2017

The following notes set out on pages 6 to 53 form an integral part of these financial statements

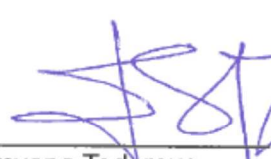


Consolidated Statement of Other Comprehensive Income

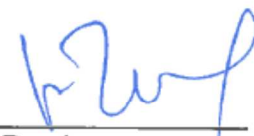
(all amounts expressed in thousands of BGN)

	Notes	Year ended 31 December	
		2016	2015
Profit for the period		37,832	28,669
Items that will not be reclassified to profit or loss			
Remeasurements of post-employment benefits		(112)	15
Items that may be reclassified subsequently to profit or loss			
Change in revaluation reserve from available-for-sale financial assets		(5,866)	6,857
Other comprehensive income for the period, net of tax		(5,978)	6,872
Total comprehensive income for the period		31,854	35,541

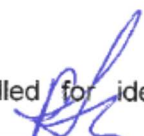
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 Executive Director and
 Member of the Management Board
 31 March 2017




 Reni Peycheva
 Executive Director and
 Member of the Management Board

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 Rositsa Boteva
 Registered Auditor
 Date: 11 April 2017


 Stefan Weiblen
 PricewaterhouseCoopers Audit OOD
 Date: 11 April 2017

The following notes set out on pages 6 to 53 form an integral part of these financial statements.



Consolidated Statement of Financial Position

(all amounts expressed in thousands of BGN)

	Notes	As of 31 December	
		2016	2015
ASSETS			
Cash and cash equivalents	15	211,268	199,210
Loans and advances to banks	16	331,511	102,571
Available-for-sale financial assets	17	42,835	28,012
Loans and advances to customers	18	1,251,556	1,172,167
Allowance for losses on loans and advances to customers	19	(42,165)	(38,616)
Property, plant and equipment	20	46,772	47,531
Intangible assets	20	3,256	2,921
Deferred tax assets	21	303	133
Other assets	22	16,879	22,717
Total assets		1,862,215	1,536,646
LIABILITIES			
Liabilities to banks	23	61,943	53,897
Liabilities to customers	24	1,245,779	1,116,585
Liabilities to financial institutions	25	313,212	156,928
Other liabilities	26	5,512	5,023
Provisions	27	725	496
Current tax liabilities		459	1,016
Total liabilities		1,627,630	1,333,945
EQUITY			
Share capital and share premium	28	167,706	139,130
Legal reserve		3,953	3,953
Other reserve		6,514	6,626
Retained earnings		56,393	47,107
Revaluation reserve		19	5,885
Total equity		234,585	202,701
Total equity and liabilities		1,862,215	1,536,646

These consolidated financial statements on pages 1 to 53 were approved by the Management Board and signed on its behalf by:

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31 March 2017

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Rositsa Boteva
Registered Auditor
Date: 11 April 2017

Stefan Weiblen
PricewaterhouseCoopers Audit OOD
Date: 11 April 2017

The following notes set out on pages 6 to 53 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 reserves	Retained earnings	Revalu- ation reserve	Total
Balance as of 1 January 2015	135,634	3,496	3,953	6,611	26,940	(972)	175,662
Comprehensive income for the period							
Revaluation of AFS securities	-	-	-	-	-	6,857	6,857
Revaluation of actuarial gains and losses	-	-	-	15	-	-	15
Profit for the period	-	-	-	-	28,669	-	28,669
Total comprehensive income for the period	-	-	-	15	28,669	6,857	35,541
Transactions with owners, recorded directly in equity							
Contributions by and distributions to owners							
Distributed dividends	-	-	-	-	(8,502)	-	(8,502)
Total contributions by and distributions to owners	-	-	-	-	(8,502)	-	(8,502)
Balance as of 31 December 2015	135,634	3,496	3,953	6,626	47,107	5,885	202,701
Comprehensive income for the period							
Revaluation of AFS securities	-	-	-	-	-	(5,866)	(5,866)
Revaluation of actuarial gains and losses	-	-	-	(112)	112	-	-
Other increase (decrease) in equity	-	-	-	-	(82)	-	(82)
Profit for the period	-	-	-	-	37,832	-	37,832
Total comprehensive income for the period	-	-	-	(112)	37,862	(5,866)	31,884
Transactions with owners, recorded directly in equity							
Contributions by and distributions to owners							
Capital increase	28,576	-	-	-	-	-	28,576
Distributed dividends	-	-	-	-	(28,576)	-	(28,576)
Total contributions by and distributions to owners	28,576	-	-	-	(28,576)	-	-
Balance as of 31 December 2016	164,210	3,496	3,953	6,514	56,393	19	234,585

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The following notes set out on pages 6 to 53 form an integral part of these financial statements.

Consolidated Statement of Cash Flows

(all amounts expressed in thousands of BGN)

	Notes	Year ended 31 December	
		2016	2015
Profit for the period		37,832	28,669
Non-cash items included in the profit of the period and transition to the cash flow from operating activities			
Allowances for impairment losses on loans and advances	7, 19	3,346	6,180
Net (income)/loss from available-for-sale financial assets	10	(7,292)	741
Depreciation	13	5,514	5,452
Unrealised gains/ losses from currency revaluation	9	(171)	(190)
Interests and dividends	6	(66,085)	(68,721)
Income tax expense	14	4,547	3,381
Increase/ decrease of assets and liabilities from operating activities after non-cash items			
Required reserve with the central bank		(18,210)	(15,479)
Loans and advances to banks		(37,161)	(9,779)
Loans and advances to customers		(84,994)	(154,168)
Other assets		5,179	7,692
Liabilities to banks and other short term borrowings		189,953	(33,292)
Liabilities to customers		131,639	160,482
Other liabilities		2,065	1,624
Interest received		76,143	83,840
Interest paid		(6,694)	(16,378)
Income tax paid		(4,616)	(3,517)
Cash flow from operating activities		230,995	(3,463)
Purchase of/ proceeds from sale of:			
Property, plant and equipment and intangible assets		(5,088)	(7,196)
Securities purchased		(37,974)	-
Securities sold		23,426	8,353
Cash flow from investing activities		(19,636)	1,157
Cash flow from financing activities			
Dividends paid		(28,576)	(8,502)
Shares issued		28,576	-
Long term borrowings		(25,807)	(52,035)
Cash flow from financing activities		(25,807)	(60,537)
Net increase in cash and cash equivalents		185,552	(62,843)
Cash and cash equivalents at end of previous year		199,204	262,047
Cash and cash equivalents at end of period	15	384,756	199,204

These consolidated financial statements on pages 1 to 53 were approved by the Management Board and signed on its behalf by:

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Executive Director and
Member of the Management Board
31 March 2017

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Rositsa Boteva
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Date: 11 April 2017



Reni Peycheva
Executive Director and
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Stefan Weiblen
PricewaterhouseCoopers Audit OOD
Date: 11 April 2017

The following notes set out on pages 6 to 53 form an integral part of these financial statements.

1 Reporting entity

ProCredit Bank (Bulgaria) EAD ("ProCredit Bank" or "the bank") was founded in June 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 one subsidiary – ProCredit Properties EAD (referred to collectively as "the group"), which is wholly owned.

The group is managed through a Supervisory Board consisting of five members and a Management Board consisting of four members as of December 2016 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), students 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 31 March 2017.

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. 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 subsidiary as of 31 December 2016. Subsidiaries are all companies which are controlled by the group, i.e. for which the group can determine the financial and operating policies. The subsidiary is fully consolidated. The group had one subsidiary as of end 2016 – ProCredit Properties 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 subsidiary 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

These consolidated financial statements were prepared under the amortised cost convention, unless IFRS require recognition at fair value. Financial instruments measured at fair value for accounting purposes on an ongoing basis include all financial instruments classified as available-for-sale. Details on the applied measurement techniques for the balance sheet positions are part of the accounting policies listed below.

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

The group reviews its loan portfolios to assess impairment at least once per month. In determining whether an impairment loss should be recorded in the Statement of Profit or Loss, the group makes judgements as to whether there are any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national economic conditions that correlate with defaults on assets in the group of borrowers. The group's management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

2 Basis of preparation (continued)

d Use of assumptions and estimates (continued)

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 (for the group's accounting policy for income taxes see note 14). The profit projection is based on the latest business planning as of December 2016 approved by the Supervisory Board of the respective entity 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 21.

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) Compliance with IFRS

The financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations issued by the IFRS Interpretations Committee (IFRS IC) as adopted by the European Union.

(ii) Historical cost convention

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

- available-for-sale financial assets, financial assets and liabilities (including derivative instruments) certain classes of property, plant and equipment and investment property – measured at fair value;
- assets held for sale – measured at fair value less cost of disposal, and
- defined benefit pension plans – plan assets measured at fair value.

(iii) Standards, amendments and interpretations effective on or after 1 January 2016

The bank has applied the following standards and amendments for the first time for their annual reporting period commencing on or after 1 January 2016:

- Annual Improvements to IFRSs 2010-2012 Cycle will have a minor impact on the financial statements of the bank. The improvements are applicable for annual periods beginning on or after 1 February 2015.
- Amendments to IAS 1 "Disclosure Initiative" will have a minor impact on the financial statements. The amendments are effective for annual periods beginning on or after 1 January 2016.
- Annual Improvements to IFRSs 2012-2014 Cycle will have a minor impact on the financial statements of the bank. The improvements are effective for annual periods beginning on or after 1 January 2016.

2 Basis of preparation (continued)

e New standards, amendments and interpretations adopted by the group (continued)

(iii) Standards, amendments and interpretations effective on or after 1 January 2016 (continued)

The following standards, amendments or interpretations were issued by the International Accounting Standard Board ("IASB") and endorsed by the EU and have no impact on the bank's financial statements:

- Amendments to IAS 19 "Defined Benefit Plans: Employee Contributions", Amendments to IFRS 10, IFRS 12 and IAS 28 "Investment Entities: Applying the Consolidation Exception", Amendments to IFRS 11 "Accounting for Acquisitions of Interests in Joint Operations", IFRS 14 "Regulatory Deferral Accounts", Amendments to IAS 16 and IAS 38 "Clarification of Acceptable Methods of Depreciation and Amortisation", Amendments to IAS 16 and IAS 41 "Bearer plants", Amendments to IAS 27 "Equity Method in Separate Financial Statements".

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

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

- Amendments to IAS 7 "Disclosure Initiative" will have a minor impact on the financial statements. The amendments are effective for annual periods beginning on or after 1 January 2017.
- Amendments to IAS 12 "Recognition of Deferred Tax Assets for Unrealised Losses" will have a minor impact on the financial statements. The amendments are effective for annual periods beginning on or after 1 January 2017.
- IFRS 9 "Financial Instruments" will have an impact on the recognition and measurement, the impairment as well as on the disclosure requirements of financial instruments. The bank does not expect that the new classification requirements will have a material impact. Based on the preliminary assessment, the application of IFRS 9 impairment requirements is expected to result in an increase in loss allowance at the moment of transition and moderate increases for expenses for allowance for losses on loans and advances. The new hedge accounting requirements will not affect the financial statements as the bank does not apply hedge accounting. IFRS 9 is applicable for annual periods beginning on or after 1 January 2018. The overall impact of this standard is currently being investigated as a project for the assessment and implementation of the standard has been launched on ProCredit group level.
- IFRS 15 "Revenue from Contracts with Customers" and amendments to IFRS 15 "Clarifications to IFRS 15" will have a minor impact on the financial statements. Both are effective for annual periods beginning on or after 1 January 2018.
- IFRIC Interpretation 22 "Foreign Currency Transactions and Advance Consideration" will have a minor impact on the financial statements. The consideration is effective for annual periods beginning on or after 1 January 2018.
- Amendments to IAS 40 "Transfers of Investment Property" will have a minor impact on the financial statements. The amendments are effective for annual periods beginning on or after 1 January 2018.
- IFRS 16 "Leases" will have an impact on the recognition, measurement, presentation and disclosure of leases. The overall impact of the standard is currently being assessed. The standard is applicable for annual periods beginning on or after 1 January 2019.

2 Basis of preparation (continued)

e New standards, amendments and interpretations adopted by the group (continued)

(iv) New standards and interpretations not yet adopted (continued)

The following standards, amendments or interpretations were issued by the IASB but will not have an impact on the bank's financial statements:

- Annual Improvements to IFRS Standards 2014-2016 Cycle", 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, Amendments to IFRS 10 and IAS 28 "Sale or Contribution of Assets between an Investor and its Associate or Joint Venture".

There was no early adoption of any standards, amendments and 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 available-for-sale assets 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 monetary items are recognised 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 2016, 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 1.85545 for USD 1 (2015: BGN 1.95583 for EUR 1 and BGN 1.79007 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 Statement of Profit or Loss using the effective interest rate method. Interest income and expense are recognised in the Statement of Profit or Loss in the period in which they arise.

For loans where there is objective evidence that an impairment loss has been incurred, the accrual of interest income is terminated not later than 90 days after the last payment. Payments received with respect to written-off loans are not recognised in "Net interest income".

3 Summary of significant accounting policies (continued)

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. Asset management fees related to the servicing of loans, originated by the group and transferred to other companies are recognised over the period to which they relate.

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. In addition, this position includes the result from foreign currency hedging operations and unrealised foreign currency revaluation effects. The group does not apply hedge accounting as defined by IAS 39.

e Financial assets

The group classifies its financial assets as available-for-sale financial assets or loans and receivables. The group holds no financial assets at fair value through profit or loss or held-to-maturity instruments. Management determines the classification of financial assets at the time of initial recognition.

(i) Available-for-sale financial assets

Available-for-sale assets are those intended to be held for an indefinite amount of time, which may 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 are recorded at fair value. Subsequently they are carried at fair value. In exceptional cases, in which fair value information cannot otherwise be measured reliably, they are measured at cost. The fair values reported are either observable market prices in active markets or values calculated with a valuation technique based on currently observable market data. Gains and losses arising from changes in fair value of available-for-sale financial assets are 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 is derecognised or impaired (for details on impairment, see note 3g). At this time, the cumulative gain or loss previously recognised in equity in other comprehensive income is 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 are recognised in the Consolidated Statement of Profit or Loss. Dividends on available-for-sale equity instruments are recognised in the Consolidated Statement of Profit or Loss when the entity’s right to receive the payment is established.

Purchases and sales of available-for-sale financial assets are recorded on the trade date. The available-for-sale financial assets 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.

3 Summary of significant accounting policies (continued)

e Financial assets (continued)

(ii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. All loans and advances to banks as well as loans and advances to customers fall under the category "Loans and receivables". They arise when the group provides money, goods or services directly to a debtor with no intention of trading the receivable.

Loans and receivables are initially recognised at fair value including 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 loans and receivables. As a consequence, their carrying amount may be reduced through the use of an allowance account (see note 3g for the accounting policy for impairment of credit exposures, as well as note 4c and note 19). 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 cost which would have been incurred as of the valuation date if there had not been any impairment.

Loans are recognised when the principal is advanced to the borrowers. 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.

For the purposes of the cash flow statement, claims to banks with a remaining maturity of less than three months from the date of acquisition are recognised under "Cash and cash equivalents" (see note 15).

Fair value measurement principles

On initial recognition 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 recognised in the statement of financial position subsequently either at (amortised) cost or fair value.

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. The fair value of a liability reflects its non-performance risk.

If an asset or a liability measured at fair value has a bid price and an ask price, then the Group measures assets and long positions at a bid price and liabilities and short positions at an ask price.

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

3 Summary of significant accounting policies (continued)

e Financial assets (continued)

(ii) Loans and receivables (continued)

The group applies the IFRS fair value, with a three-level categorisation of the inputs used in valuation techniques to measure fair value.

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 quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

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 refer to 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 rates are not available, internal rates are used as an input for a discounted cash flow model. Internal rates are determined taking into consideration the cost of capital depending on currencies and maturities plus 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.

f Cash and cash equivalents

For the purposes of the balance sheet, 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.

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.

g Allowance for losses on loans and advances

(i) Impairment of loans and advances

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

3 Summary of significant accounting policies (continued)

g Allowance for losses on loans and advances (continued)

Individually assessed loans and advances

Credit exposures are considered individually significant if they exceed EUR 30,000. For such exposures, it is assessed whether any signs of impairment exist 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:

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

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is 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 reflects the cash flow that may result from foreclosure less costs for obtaining and selling the collateral.

Collectively assessed loans and advances

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

- individually insignificant exposures that show objective evidence of impairment;
- a group of loans that does not show signs of impairment, in order to cover all losses which have 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 are 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 are considered to be a sign of impairment. This characteristic is 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.

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) is based on a quantitative analysis of default rates for loan portfolios with similar risk characteristics (migration analysis).

3 Summary of significant accounting policies (continued)

g Allowance for losses on loans and advances (continued)

Future cash flows in a group of financial assets that are collectively assessed for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the group to reduce any differences between loss estimates and actual loss experience.

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).

(ii) Reversal of impairment

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the Consolidated Statement of Profit or Loss.

(iii) Writing off loans and advances

When an exposure is uncollectible, it is written off against the related allowance for loan impairment. Such loans are written off after all the necessary legal 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 as part of the allowance for impairment losses on loans and advances.

(iv) Restructured credit exposures

Restructured credit exposures which would otherwise be past due or impaired and which are considered to be individually significant are provisioned on an individual basis. The amount of the loss is measured as the difference between the restructured loan's carrying amount and the present value of its estimated future cash flows discounted at the loan's original effective interest rate (specific impairment). Restructured loans which would otherwise be past due or impaired and which are individually insignificant are collectively assessed for impairment. The same applies to individually significant loans, where on an individual basis it has been determined that no impairment loss would occur.

(v) 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 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.

3 Summary of significant accounting policies (continued)

h 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

i 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 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 their depreciable amount of the asset over its useful life, 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)

j 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. The leasing objects are recognised by the lessor.

k 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. 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 fair value re-measurement of available-for-sale financial instruments 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 recognised in the Consolidated Statement of Profit or Loss together with the deferred gain or loss.

l Liabilities to banks, customers and institutions

All liabilities 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.

m 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.

3 Summary of significant accounting policies (continued)

m Provisions (continued)

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 respective provision will be discounted. The increase in the present value of the obligation due to the passage of time is recognised as an interest expense.

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.

n 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.

o Employee benefits

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 Group 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/other comprehensive income.

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 bank 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 Bank 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 bank adheres to its concept of “Know your Customer”, which is based on the assumption that if clients and their businesses are accurately identified, the bank 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 bank provides 24-hour access to self-service areas 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 retail deposits.

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 bank makes significant investments in training its personnel.

In November 2015 the Group opened a branch in Thessaloniki, Greece with the aim to offer full range of banking services to the representatives of the local business and provide 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

In accordance with the simple, transparent and sustainable business strategy, the risk strategy is a conservative one. The aim is to achieve steady results, despite volatile external conditions, by following a consistent approach to managing risks. The principles of the business activity, as listed below, provide the foundation for the risk management. The consistent application of these principles significantly reduces the risks to which the group is exposed.

4 Risk management (continued)

b Risk management strategy (continued)

- **Focus on core business**

ProCredit Bank focuses on the provision of financial services to small and medium-sized 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 banking transactions. All of the bank's other operations are performed mainly in support of the core business. ProCredit Bank assumes mainly customer credit risk and operational risk in the course of the day-to-day operations. At the same time, the group avoids or strictly limits all other risks involved in banking operations even at the expense of forgone income opportunities.

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

The focus on small and medium enterprises results in a high degree of diversification, both in the credit portfolio and in the deposit base. This is achieved on the levels of client groups, business sectors and avoidance of concentration. The simple and easily understandable products both aid transparency and facilitate risk management.

- **Careful staff selection and intensive training**

Responsible banking means long-term relationships not only with clients, but with the employees of the Bank. The basic elements of the personnel management approach at the Bank are: recruitment, involving a six-month intensive training programme for all candidates (the Young Bankers Programme), regular trainings for current employees, intensive managerial training at the ProCredit Academies and applying a universal remuneration structure across the ProCredit group, based on fixed monthly salaries.

Other elements of the risk management approach include mechanisms designed to hedge and mitigate risks, and processes for monitoring the continuing effectiveness of these hedging and mitigating mechanisms. Specifically:

- The group applies a risk management framework, which is binding for all ProCredit institutions and defines group-wide minimum standards for risk management. The risk management policies and standards are approved by the Management of the group and are updated at least annually. These policies and standards are based on the "Minimum Requirements for Risk Management" (MaRisk) and are compliant with the specifics of the bank's activities, the regulatory requirements of the Bulgarian National Bank and the situation in the country.
- All risks incurred by the group are managed by ensuring at all times an adequate level of capital and risk bearing capacity.
- Early warning indicators (reporting triggers) and limits are set and monitored for all material risks.
- Regular stress tests are performed for all material risks.
- Regular and ad hoc reporting on the risk profile, including detailed descriptions and commentaries, is carried out.
- Monitoring and control of risks and possible risk concentrations is carried out using comprehensive analysis tools for all material risks.
- The effectiveness of the chosen measures, limits and methods is continuously monitored and controlled. This also includes back testing of the models used.
- All new or significantly changed business processes, products or instruments undergo a "New Risk Approval" (NRA) process before being used for the first time. This ensures that new risks are assessed and all necessary preparations and tests are completed prior to implementation.

4 Risk management (continued)

b Risk management strategy (continued)

While the business strategy lists the objectives of the group for all material business activities and presents measures to be taken to achieve them, the group risk strategy addresses the material risks arising from the implementation of business strategy and defines the objectives and measures of risk management. The risk strategy is broken down into strategies for all material risks and business activities in the group. The annually conducted risk inventory ensures that all material and non-material risks are identified and, if necessary, considered in the strategies.

Organisation of the risk management function

The overall responsibility for risk management is assumed by the Management Board of the group. The group has an Assets and Liabilities Committee ("ALCO"), which comprises Management Board members and it is convened at least once per month, Risk Management Department, as well as specialised committees that address individual risks. In addition, the risk departments of the group report regularly to the different risk functions at ProCredit Holding, and the Supervisory Board is informed on at least a quarterly basis on all risk-relevant developments. Furthermore, the Management of the group is advised and supported by the compliance function, ensuring the implementation of legal regulations and requirements and avoiding the risks associated with non-compliance.

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 Bank;
- The structure, composition and powers of the competent internal bodies of the Bank, 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 control of risks is operationally exercised by the responsible departments with the risk management function being actively supported by Finance and Risk Management Department. The responsibilities include monitoring risk positions and compliance with limits, performing the group's capital planning and monitoring risk-bearing capacity. Risk positions are analysed regularly, discussed intensively and documented in standardised reports. Monitoring of the risk profile is carried out through a review of these reports and of additionally generated information. If necessary, additional topic-specific ad hoc reporting occurs. The aim is to achieve transparency on the material risks and to be aware at an early stage if potential problems might be arising. On the basis of these risk reports, ProCredit Holding prepares an aggregate risk report on a ProCredit Group level.

Adequate processes and procedures for an effective internal control system are in place. The system 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.

Internal audit is managed as an independent functional area within ProCredit Bank. The Internal Audit Department carries out the auditing procedures established by the ProCredit Holding's Group Audit. Once per year, the Internal Audit Departments carries out risk assessments of all of the bank's activities in order to arrive at a risk-based annual audit plan. The Internal Audit Department reports to an Audit Committee, which generally meets on a quarterly basis.

4 Risk management (continued)

b Risk management strategy (continued)

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

c Credit risk

The group defines credit risk as the risk that the party to a transaction fails to meet its contractual obligations, or fails to meet them in full or on time. It comprises the risk arising from customer credit exposures as well as counterparty risk (including issuer risk) and country risk. As a consequence of the business model, credit exposures to customers dominate the balance sheet and thus being the most significant risk facing the group, and customer credit exposures account for the largest share of that risk.

Maximum exposure to credit risk

Exposure types	31 Dec 2016	31 Dec 2015
Loans and advances to banks	331,511	102,571
Available-for-sale financial assets	39,655	19,750
Fixed interest rate securities	39,655	19,750
Loans and advances to customers	1,209,391	1,133,551
Loans and advances to customers	1,251,556	1,172,167
Allowance for losses on loans and advances to customers	(42,165)	(38,616)
Contingent liabilities and commitments	269,256	206,808
Guarantees	32,303	22,252
Letters of credit	173	810
Credit commitments (revocable loan commitments)	236,780	183,746

The group has developed procedures to effectively manage the credit risk posed by its clients. The thorough knowledge of the risks associated with the target clients has been the basis for drafting the policies that stipulate the requirements for risk management. For the lending operations the following principles are applied:

- intensive analysis of the debt capacity of the banks' clients
- 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 over-indebtedness among the banks' customers
- building a personal and long-term relationship with the client, maintaining regular contact
- strictly monitoring credit exposure repayment
- closely customer-oriented, intensified loan management in the event of arrears
- collateral collection in the event of insolvency

4 Risk management (continued)

c Credit risk (continued)

The framework for managing customer credit risk is approved by the Management of both the group and ProCredit Holding and set forth in policies and standards. The policies define, among other things, the responsibilities for managing credit risk, the principles for the organisation of lending business, the principles involved in lending operations, and the framework for the valuation of collateral for credit exposures. The standards define in more detail the group's lending operations with business clients and private clients and the range of credit products offered. They also set forth the rules governing restructuring, loan loss 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 (regular monitoring of the financial situation and problem loan management). The credit risk profile of the group is assessed both on a local and ProCredit Holding level at least on a monthly basis, and more comprehensively on a quarterly basis.

The group divides its credit exposures into three client categories: small and medium business credit exposures and credit exposures to private clients. Small exposures are between EUR 50k and EUR 250k; medium exposures are above EUR 250k. The majority of medium exposures are for amounts below EUR 1 million. 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: 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 division of front and back office functions up to the management level is applied for risk-relevant credit exposures (over EUR 50k).

The experience of the group has shown that an appropriate credit risk assessment constitutes the most effective form of credit risk management. Credit decisions are based on an analysis of the financial situation of the client and an assessment of the creditworthiness of the client. All clients are regularly visited on-site to ensure an adequate consideration of their specific features and needs.

The credit decisions are all taken by a credit committee. Its members have approval limits that reflect their expertise and experience. All decisions on medium credit exposures are taken by credit committees at the bank's head office.

The group applies various instruments available to reduce the risk on individual transactions related to loans and advances to customers, including security in the form of physical assets and guarantees. The most frequently provided forms of collateral are mortgage of real estate property and movables such as vehicles, goods and machines. Collateral generally is not held over other financial assets. The distribution of the loans and advances to customers by type of collateral is presented in the table below:

Collateral held	31 Dec 2016	31 Dec 2015
Mortgage	66%	65%
Cash collateral	2%	2%
Bank guarantee	0%	0%
Other types of collateral	32%	33%
Total	100%	100%

4 Risk management (continued)

c Credit risk (continued)

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") Group 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. 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 bank is partner with the EIF, were BGN 213,611 thousand as of end 2016 (2015: 207,933 thousand).

The loan portfolio of ProCredit Bank is composed of exposures with regular monthly payments. This is why payment delays are a reliable indicator of increased credit risk. Consequently, the key indicator employed by ProCredit Bank to assess the level of credit risk in the group is the portfolio at risk (PAR 30 and PAR 90). This is defined as the outstanding volume of credit exposures with one or more payments of interest or principal overdue by more than 30 or 90 days, respectively. When calculating this indicator, the total outstanding exposure towards a client is taken into consideration. Deductions for available collateral are not applied. The indicator is expressed as a percentage of the total gross loan portfolio. The quality of the loan portfolio is monitored based on this key indicator on an ongoing basis. At the end of 2016, PAR 30 stood at 2.7%, lower than the level reported for the end of 2015 (3.3%).

Once a higher risk of default is detected for a credit exposure, it is placed under intensified management. This centres on close communication with the client, identification of the source of higher credit default risk and close monitoring of the client's business activities. Decisions on the measures to reduce the credit default risk for individual credit exposures are taken by specialised Credit Committee on Restructuring. In addition, specialised recovery officers may be called in to support the intensified management of the credit exposure.

When a credit exposure reaches problem credit exposure status, recovery officers take over full responsibility for dealings with this client. The handover is based on factors such as insolvency and occurs after the loan has been in arrears for 90 days at the latest. Generally speaking, problem credit exposures are characterised as such if the bank has significant doubts about the ability of the client to comply with the contractual terms and conditions. If necessary, recovery officers are supported by litigation officers (legal department) and/or specialists in the sale of assets or collateral. Collateral is always liquidated through sales to third parties. Repossessed property is sold at the highest possible price, typically via public auction.

As a principle, ProCredit Bank does not write off receivables from clients until it no longer expects to receive any further payments. As a rule, the more days that the client's payments are past due and the more doubtful the recoverability of the collateral, the lower the probability of further payments is. Additionally, the direct and indirect costs of managing credit exposures that have not been written off must be in proportion to the size of the outstanding exposure. Bearing these points in mind, the group writes off insignificant credit exposures (up to EUR 30k) earlier than significant ones

4 Risk management (continued)

c Credit risk (continued)

The group views the adequate provisioning of credit risk as a key strategic objective, which is achieved by making allowance for losses and impairment. In this context, a distinction is drawn between individually significant and individually insignificant credit exposures; the threshold is EUR 30,000.

	Loan portfolio (LP)	Allowance for impairment	PAR (> 30 days)	PAR as % of LP	PAR coverage ratio	Net write- offs	Net write- offs as % of LP
31 Dec 2016	1,251,556	(42,165)	34,262	2.7%	123.1%	(203)	0.0%
31 Dec 2015	1,172,167	(38,616)	38,211	3.3%	101.1%	3,903	0.3%

For all credit exposures that currently show no signs of impairment (standard exposures, including restructured exposures which do not show signs of impairment), portfolio-based allowances for impairment are made based on historical loss experience. This applies to both individually significant and individually insignificant credit exposures.

ProCredit Bank calculates lump-sum specific provisions for individually insignificant credit exposures in arrears more than 30 days. Respective provisioning rates are based on historic default rates. The amount of such provisions is determined on the basis of the number of days that the client's payments have been overdue.

Individually significant credit exposures are subject to individual monitoring. For such credit exposures, the bank performs an impairment test (specific provisions) once objective evidence exists that their quality has deteriorated. The main indicator of this is that the receivable is more than 30 days past due (PAR 30). However, credit exposures can show other signs of impairment as well. Typical examples are:

- breach of covenants or conditions, unless waived or modified by the bank
- initiation of legal proceedings by the bank
- initiation of bankruptcy proceedings
- any information on the customer's business or changes in the client's market environment that are having or will have a negative impact on the client's payment capacity

Based on signs of deterioration in the quality of the credit exposure, an impairment test is performed, applying the discounted cash flow method. In this context, expected future cash flows from realised collateral items as well as other realisable cash flows are taken into account. The level of loan loss provisions is determined by the difference between the book value of the credit exposure and the net present value of the expected future cash flows.

4 Risk management (continued)

c Credit risk (continued)

Loans and advances to customers by LLP types	31 Dec 2016	31 Dec 2015
Collectively assessed impaired exposures (below EUR 30,000)		
no arrears	1,024	1,378
1-30 days in arrears	297	672
31-90 days in arrears	2,675	2,355
91-180 days in arrears	843	1,037
over 180 days in arrears	748	974
Provision for impairment	(2,536)	(2,999)
Carrying amount	3,051	3,417
Individually assessed impaired exposure (above EUR 30,000)		
no arrears	23,298	26,428
1-30 days in arrears	4,780	7,216
31-90 days in arrears	2,353	3,927
91-180 days in arrears	1,231	905
over 180 days in arrears	26,412	29,013
Provision for impairment	(19,644)	(17,328)
Carrying amount	38,430	50,161
Collectively assessed exposures which are not impaired below EUR 30,000		
no arrears	92,540	110,421
1-30 days in arrears	3,772	4,739
Provision for collectively assessed exposures	(2,019)	(2,419)
Carrying amount	94,293	112,741
Including with renegotiated terms	5,953	8,171
Collectively assessed exposures which are not impaired above EUR 30,000		
no arrears	1,084,985	976,192
1-30 days in arrears	6,598	6,910
Provision for collectively assessed exposures	(17,966)	(15,870)
Carrying amount	1,073,617	967,232
Including with renegotiated terms	15,838	16,205
Total gross amount of loans and advances to customers	1,251,556	1,172,167
Total provision for impairment	(42,165)	(38,616)
Total carrying amount of loans and advances to customers	1,209,391	1,133,551

The loan portfolio is monitored continuously for possible risk-relevant developments with the aid of "reporting triggers". These include past due credit exposures (PAR 30 and PAR 90), restructured credit exposures, written-off credit exposures and allowances for impairment on the loan portfolio. These indicators are analysed in the group's Risk Report and discussed by the Credit Risk Assessment Committee. In addition, exceptional events which could have an impact on large areas of the loan portfolio (common risk factors) are analysed. Limits could be imposed on risk exposures towards certain groups of clients, e.g. in specific sectors of the economy or geographical regions.

Concentration risk in the group is primarily minimised through the high degree of diversification stemming from lending to the core client groups (small and medium businesses) in various economic sectors. Geographically, the loans and advances to customers are predominantly disbursed to clients, which are Bulgarian residents.

4 Risk management (continued)

c Credit risk (continued)

Economic sector risk concentrations within the customer loan portfolio were as follows:

Loan and advances to customers by business sectors	31 Dec 2016	in %	31 Dec 2015	in %
Agriculture	330,259	26%	327,244	28%
Trade	313,612	25%	315,174	27%
Industry and other production	226,817	18%	187,709	16%
Services	119,390	10%	104,501	9%
Transport	91,498	7%	76,319	7%
Construction	57,029	5%	61,013	5%
Accommodation and restaurants	42,834	3%	51,123	4%
Households	70,117	6%	49,084	4%
Total gross loans and advances	1,251,556	100%	1,172,167	100%

Loans to households include housing improvement loans in the amount of BGN 59,548 thousand (2015: BGN 38,781 thousand).

ProCredit Group also limits the concentration risk in its portfolio as the disbursement of any large credit exposure (exceeding 10% of the regulatory capital) requires the approval of the ProCredit Holding Group Risk Management Committee. The largest credit exposure of the bank was 4% of the regulatory capital as of end 2016 (2015: 4%).

Loan and advances to customers by outstanding exposure amount	Business clients	Private clients	Total gross loan portfolio
As of 31 December 2016			
<= 50,000 EUR	135,773	39,028	174,801
>50,000 <= 250,000 EUR	412,097	11,793	423,890
> 250,000 EUR	652,415	450	652,865
Total	1,200,285	51,271	1,251,556

Loan and advances to customers by outstanding exposure amount	Business clients	Private clients	Total gross loan portfolio
As of 31 December 2015			
<= 50,000 EUR	174,997	30,628	205,625
>50,000 <= 250,000 EUR	416,571	6,913	423,484
> 250,000 EUR	543,058	-	543,058
Total gross loans and advances	1,134,626	37,541	1,172,167

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.

The quality of credit operations in all client categories is monitored by credit controlling unit. Its experts assess the quality of the credit analysis, verify compliance with internal procedures and identify signs of fraudulent activity. The unit employs experienced credit staff who not only conducts on-site visits to customers in order to monitor the lending process but also systematically screen the portfolio.

4 Risk management (continued)

c Credit risk (continued)

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 appropriate measures are taken in a timely manner. That is why the quality of the ProCredit Bank's loan portfolio 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.

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 is unwilling or unable to fulfil its obligations on time or in full. Counterparty risk in the group mainly arises from keeping highly liquid assets for the purpose of mitigating liquidity risk. There is also structural exposure 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.

The overarching counterparty risk management strategy is to invest the group's liquid assets safely and in a diversified manner. While ProCredit Bank tries to generate some income from these assets, the overriding objective is to ensure secure placement and timely availability – consequently risk considerations predominate. For this reason, the group only works with carefully selected reliable banks with high credit quality, performs placements 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 or proprietary trading. The impact of market price changes on the group is limited. The reasons are that the volume of securities is rather low and issuers are carefully selected based on conservative risk criteria.

4 Risk management (continued)

d Counterparty risk (including issuer risk) (continued)

Typically, counterparties are BNB, Bulgarian Government and commercial banks. The main types of exposure are account balances, short-maturity term deposits, highly liquid securities, and, on a very limited scale, simple derivative instruments for liquidity management and hedging purposes (particularly foreign currency forwards and swaps). The group's exposure to counterparty and issuer risk has been influenced in 2016 by placements in other ProCredit banks (particularly ProCredit Bank Germany and ProCredit Bank Serbia). The securities portfolio increased as an alternative option for liquidity storage other than placements in the BNB or commercial banks. The risk-adjusted exposure of the bank increased in comparison to end 2015. The liquid assets other than physical cash of the bank were placed as follows:

Counterparty	31 Dec 2016	in %	31 Dec 2015	in %
BNB	155,812	30%	147,255	55%
Mandatory reserves	111,006	21%	92,797	35%
Others	44,806	9%	54,458	20%
Banking groups	331,511	63%	102,571	38%
OECD banks	331,511	63%	96,475	36%
local banks	-	-	6,096	2%
Securities issued by Bulgarian Gmnt	39,655	7%	19,750	7%
Total	526,978	100%	269,576	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 December 2016

Rating	Debt securities, available for sale	Loans and advances to banks	Total
AA- to AA+	9,323	3	9,326
A- to A+	-	5	5
BBB- to BBB+	30,332	48,745	79,077
Unrated	-	282,758	282,758
Total	39,655	331,511	371,166

As of December 2015

Rating	Debt securities, available for sale	Loans and advances to banks	Total
AA- to AA+	-	-	-
A- to A+	-	653	653
BBB- to BBB+	19,750	13,070	32,820
Unrated	-	88,848	88,848
Total	19,750	102,571	122,321

For counterparty risk, the same definitions for "in arrears" and "impaired" apply in principle as for customer credit risk. Due to the careful selection of the counterparties, none of positions shown was in arrears nor showed any signs of impairment as of 31 December 2016. Accordingly, no allowance for impairment was set aside for them in 2016.

4 Risk management (continued)

d Counterparty risk (including issuer risk) (continued)

As with customer credit risk, the exposure towards counterparties/issuers is managed by a limit system. ProCredit Bank conclude transactions only with counterparties that have previously been carefully analysed and for which a limit has been approved. The total limit towards a non-OECD bank or banking group cannot exceed 10% of the ProCredit Bank's capital without prior additional approval from ProCredit Group ALCO or the ProCredit Group Risk Management Committee. For an OECD bank, the threshold is 25%. The typical maximum maturity of the term deposits is up to three months; longer maturities must be approved by ProCredit Group ALCO or the ProCredit Group Risk Management Committee. Approval is likewise required before any investments in securities. The group's counterparty risk is quantified and analysed regularly as part of the risk-bearing capacity calculation. When calculating the risk- and term-adjusted exposure, all exposures towards counterparties are taken into account. The bank received an approval from ProCredit Group ALCO to place additional funds in ProCredit Bank Germany as of end-2016.

e Market risk

Relevant market risks for the group are currency and interest rate risk. In accordance with the ProCredit group risk strategy, foreign currency risk and interest rate risk may not be incurred for the purposes of speculative or proprietary trading. Therefore, ProCredit Bank is strictly non-trading book credit institution within the terms of the Basel Capital Accord. The group closes currency positions to the extent possible. Interest rate risk positions are always only taken within established limits. Foreign currency and interest rate derivatives are used exclusively for hedging or liquidity purposes. The group does not apply hedge accounting as defined by IAS 39.

Foreign currency risk

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 foreign currency risk is defined as the risk that the institution incurs losses or is negatively affected by exchange rate fluctuations.

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 counterparty risk.

The P&L effect of foreign currency risk occurs when the volumes of its 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). The total OCP is calculated as the sum of the absolute values of the individual currency positions and is limited to 10% of the bank'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 $\pm 5\%$ for each individual currency OCP.

4 Risk management (continued)

e Market risk (continued)

The P&L effect arising from OCPs is also measured regularly when calculating the risk-bearing capacity of each individual 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 bank's exposure to foreign currency exchange rate risk.

As of 31 December 2016	BGN	EUR	USD	Other	Total
Assets					
Cash and cash equivalents	158,268	51,884	1,048	68	211,268
Loans and advances to banks	-	291,590	30,421	9,500	331,511
Available-for-sale financial assets	28,849	2,250	11,736	-	42,835
Loans and advances to customers	588,816	660,490	2,250	-	1,251,556
Allowance for losses on loans and advances to customers	(15,811)	(26,313)	(41)	-	(42,165)
Property, plant and equipment	46,772	-	-	-	46,772
Intangible assets	3,256	-	-	-	3,256
Deferred income tax assets	303	-	-	-	303
Other assets	14,758	2,107	10	4	16,879
Total assets	825,211	982,008	45,424	9,572	1,862,215
Liabilities					
Liabilities to banks	35,909	26,034	-	-	61,943
Liabilities to customers	783,926	406,021	46,357	9,475	1,245,779
Liabilities to institutions	-	313,212	-	-	313,212
Other liabilities	3,615	1,719	174	4	5,512
Provisions	725	-	-	-	725
Current tax liabilities	459	-	-	-	459
Total liabilities	824,634	746,986	46,531	9,479	1,627,630
Net balance sheet position	577	235,022	(1,107)	93	234,585
Credit commitments (note 29)	200,727	62,617	5,912	-	269,256
Open spot and derivative transactions	1,956	(645)	(1,362)	59	8
As of 31 December 2015	BGN	EUR	USD	Other	Total
Total assets	675,584	805,232	48,750	7,080	1,536,646
Total liabilities	727,433	551,323	48,044	7,145	1,333,945
Net balance sheet position	(51,849)	253,909	706	(65)	202,701
Credit commitments (note 29)	154,133	51,123	1,552	-	206,808
Open spot and derivative transactions	9,779	(10,244)	537	(72)	-

4 Risk management (continued)

e Market risk (continued)

Interest rate risk in the banking book

Interest rate risk is the risk of incurring losses driven by changes in market interest rates and arises from structural 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 addition, each ALCO reviews any interest rate-sensitive transaction with a notional amount exceeding 5% of the bank's capital, and which has a maturity to the next repricing longer than six months. This is designed to avoid the conclusion of transactions that could have a negative impact on the interest rate risk of the institution.

In order to maintain an acceptable level of interest rate risk even when loans are disbursed with longer maturities ProCredit Bank offers its clients variable-rate loans, and also issues loans with shorter terms. In this way, the repricing maturities of assets can be 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 bank uses a publicly available interest rate as a benchmark when adjusting the interest rates and communicates this clearly to the client at the time of disbursement.

The group's approach used to measure, monitor and limit 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.

4 Risk management (continued)

e Market risk (continued)

As of 31 December 2016	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	39,126	-	-	-	-	172,142	211,268
Loans and advances to banks	233,292	39,117	47,018	-	-	12,084	331,511
Available-for-sale financial assets	1,275	9,331	26	29,022	-	3,181	42,835
Loans and advances to customers	169,385	345,755	640,114	47,179	19,570	29,553	1,251,556
Allowance for losses on loans and advances to customers	(3,308)	(6,823)	(13,554)	(2,416)	(525)	(15,539)	(42,165)
Property, plant and equipment	-	-	-	-	-	46,772	46,772
Intangible assets	-	-	-	-	-	3,256	3,256
Deferred income tax assets	-	-	-	-	-	303	303
Other assets	-	-	-	-	-	16,879	16,879
Total assets	439,770	387,380	673,604	73,785	19,045	268,631	1,862,215
Liabilities							
Liabilities to banks	15,800	20,000	15,057	10,757	-	329	61,943
Liabilities to customers	192,655	66,226	255,434	-	-	731,464	1,245,779
Liabilities to institutions	176,025	137,187	-	-	-	-	313,212
Other liabilities	-	-	-	-	-	5,512	5,512
Provisions	-	-	-	-	-	725	725
Current tax liabilities	-	-	-	-	-	459	459
Total liabilities	384,480	223,413	270,491	10,757	-	738,489	1,627,630
Interest sensitivity gap	55,290	163,967	403,113	63,028	19,045	(469,858)	234,585
As of 31 December 2015							
	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Non- interest bearing	Total
Total assets	200,474	340,041	555,682	64,980	20,269	355,200	1,536,646
Total liabilities	204,563	225,691	301,653	14,997	558	586,483	1,333,945
Interest sensitivity gap	(4,089)	114,350	254,029	49,983	19,711	(231,283)	202,701

The economic value impact is a key indicator for managing interest rate risk, and measures the potential economic value change on all assets and liabilities determined by a sudden detrimental change in interest rates. For EUR or USD it is assumed a parallel shift of the interest rate curve by +/- 200 basis points in line with the Basel Capital Accord. For local currencies the magnitude of the shocks is derived using a VaR-type methodology taking into consideration interest rate volatilities over the past seven years.

The potential economic impact when simulating a simultaneous detrimental (upward or downward) interest rate shock across all currencies must not exceed 10% of its capital, unless approved by the ProCredit Group Risk Management Committee; the early warning indicator for each currency is set at 5%.

4 Risk management (continued)

e Market risk (continued)

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 three months. This risk measure indicates how the income statement may be influenced by interest rate risk under a short-term perspective and is deemed significant if it exceeds 1% of the bank's capital. In addition, the P&L effect is monitored over 12 months.

Currency	31 Dec 2016		31 Dec 2015	
	12-month interest earnings	Interest rate shock Basis points	12-month interest earnings	Interest rate shock Basis points
BGN	324	+0.10%	384	+0.14%
EUR	266	+0.10%	326	+0.14%
USD	590	+0.10%	710	+0.24%
Total amount	1,180		1,420	

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 Bank's short- and long-term ability to meet its financial obligations in a complete and timely manner.

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.

Liquidity risk is limited by the fact that the group primarily issues loans which feature monthly repayments and are financed largely by local deposits. The deposit-taking operations focus on our target group of business clients and savers, with whom strong relationships are established.

Liquidity risk is measured using, among other instruments, a liquidity gap analysis, and limit the risk based on the liquidity indicator "Expected assets in time bucket up to 30 days / expected liabilities in time bucket up to 30 days ≥ 1 ", which requires the institution to hold sufficient liquidity for the next 30 days. In addition, early warning indicators are defined and are monitored using reporting triggers. If the indicators go above or, as the case may be, fall below the reporting triggers, the reasons must be explained, and if appropriate, mitigating measures must be decided by the bank's ALCO and communicated to ProCredit Group Financial Risk Management. A key indicator is the highly liquid assets indicator, which determines that the banks must always hold sufficient highly liquid assets to be able to pay out at least 20% of all customer deposits at all times. The indicator stood at 26.4% as of end 2016 (2015: 32.6%).

4 Risk management (continued)

f Liquidity and funding risk (continued)

In addition, as part of risk management, market-related and combined 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, ProCredit Bank has a liquidity contingency plan. If unexpected circumstances arise and an individual institution from ProCredit group proves not to have sufficient liquid funds, ProCredit Holding would step in as a "lender of last resort". ProCredit Holding keeps an adequate liquidity reserve available for this purpose.

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 which take account of planned business developments and liquidity indicators, and is monitored by risk management and ALCO.

The following table shows the cash flows of the balance sheet assets and 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 2016	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Total
Assets						
Cash and cash equivalents	211,268	-	-	-	-	211,268
Loans and advances to banks	245,455	39,116	46,940	-	-	331,511
Available-for-sale financial assets	1,275	9,331	26	29,023	3,180	42,835
Loans and advances to customers	30,043	59,163	266,200	651,211	244,939	1,251,556
Allowance for losses on loans and advances to customers	(803)	(1,248)	(6,085)	(12,868)	(21,161)	(42,165)
Property, plant and equipment	-	-	-	-	46,772	46,772
Intangible assets	-	-	-	-	3,256	3,256
Deferred income tax assets	-	-	303	-	-	303
Other assets	3,050	-	-	-	13,829	16,879
Total assets	490,288	106,362	307,384	667,366	290,815	1,862,215
Liabilities						
Liabilities to banks	16,174	20,077	6,243	12,729	6,720	61,943
Liabilities to customers	921,746	65,416	257,861	73	683	1,245,779
Liabilities to institutions	181,926	19,587	15,186	81,310	15,203	313,212
Other liabilities	5,040	-	-	-	472	5,512
Provisions	725	-	-	-	-	725
Current tax liabilities	-	459	-	-	-	459
Total liabilities	1,125,611	105,539	279,290	94,112	23,078	1,627,630
Net liquidity gap	(635,323)	823	28,094	573,254	267,737	234,585
As of 31 December 2015	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Total
Total assets	321,874	95,180	231,931	594,923	292,738	1,536,646
Total liabilities	789,219	77,141	310,489	127,383	29,713	1,333,945
Net liquidity gap	(467,345)	18,039	(78,558)	467,540	263,025	202,701

4 Risk management (continued)

f Liquidity and funding risk (continued)

Liabilities to customers with maturity up to 1 month include all sight deposits amounting to BGN 724,986 thousand (2015: BGN 569,347 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 95% of term deposits at maturity date were not withdrawn but automatically renegotiated under the same 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 2016	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Total	Total carrying amount
Cash and cash equivalents	211,268	-	-	-	-	211,268	211,268
Loans and advances to banks	245,377	39,117	47,177	-	-	331,671	331,511
Financial assets available for sale	1,314	9,347	420	29,753	-	40,834	42,835
Loans and advances to customers	29,481	65,795	293,026	716,780	264,507	1,369,589	1,251,556
Total financial assets	487,440	114,259	340,623	746,533	264,507	1,953,362	1,837,170
Liabilities to banks	15,862	20,108	6,562	13,788	7,028	63,348	61,943
Liabilities to customers	921,876	65,561	258,195	73	669	1,246,374	1,245,779
Other borrowed funds	176,025	19,615	21,087	82,025	15,203	313,955	313,212
Total financial liabilities	1,113,763	105,284	285,844	95,886	22,900	1,623,677	1,620,934
As of 31 December 2015	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Total	Total carrying amount
Cash and cash equivalents	199,210	-	-	-	-	199,210	199,210
Loans and advances to banks	102,571	-	-	-	-	102,571	102,571
Financial assets available for sale	6,055	10,464	174	3,533	-	20,226	28,012
Loans and advances to customers	41,297	74,155	258,366	676,658	255,188	1,305,664	1,172,167
Total financial assets	349,133	84,619	258,540	680,191	255,188	1,627,671	1,501,960
Liabilities to banks	21,807	108	6,631	19,972	7,707	56,225	53,897
Liabilities to customers	762,336	74,281	279,467	1,942	574	1,118,600	1,116,585
Other borrowed funds	821	2,352	25,494	108,753	21,432	158,852	156,928
Total financial liabilities	784,964	76,741	311,592	130,667	29,713	1,333,677	1,327,410

Funding risk is the danger that additional funding cannot be obtained, or can only be obtained at significantly higher costs. It therefore covers parts of the non-systemic effect of interest rate changes. This risk is mitigated by the fact that the group finances its lending operations primarily through retail customer deposits, supplemented by long-term credit lines from international financial institutions or other ProCredit group entities. ProCredit Bank makes little use of interbank and financial markets.

The group manages measures and limits funding risk through business planning, maturity gap analysis and several indicators. The funding needs, identified in the business planning process, are monitored and regularly reviewed. ALCO monitors the progress of all significant individual transactions with external funding providers, especially international financial institutions (IFIs). An important indicator for limiting funding risk is the deposit concentration indicator. This is defined as the share of the ten largest depositors relative to the bank's total deposit base, which should not exceed 20% (it stood at 4% as of end 2016). Additionally, the level of funding from the interbank market is restricted to a low level.

4 Risk management (continued)

g Operational risk management

The group defines operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems and/or external events. This definition includes legal risk as well as reputational risk. Dedicated policies on operational risk management, fraud prevention, information security and outsourcing have been implemented, following approval by the Management and are reviewed annually. The principles outlined in these documents have been designed to effectively manage the group's operational and fraud risk exposure and they are in compliance with the Basel Capital Accord requirements for the "standardised approach" for operational risk.

The bank has an assigned operational risk manager 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 the 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 operational risk management process consists of the identification, evaluation, treatment, monitoring, communication and documentation, and follow-up of operational and fraud risks. The main tools utilised to manage these risks are the Risk Event Database, Annual Risk Assessments, Key Risk Indicators and New Risk Approvals.

The Risk Event Database ("RED") is a tool developed to ensure that all operational risk events identified in the group are documented, analysed and communicated effectively. As opposed to ex-post analysis of risk events from RED, the Annual Risk Assessments are a systematic way of identifying and evaluating material risks in order to confirm the adequacy of the control environment. Key Risk Indicators ("KRI") are used as indicators of elevated fraud risk in specific areas of banking operations or specific branch locations that could be used by a potential fraudster. These indicators are analysed regularly and where needed preventive measures are agreed on. To complete the picture of operational risk, new products, processes and instruments need to be analysed to identify and manage potential risks before implementation. This is ensured by the New Risk Approval (NRA) process.

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 are a key component of the bank's self-perception. ProCredit Bank does not tolerate any fraudulent activity or any other questionable behaviour from either their clients or their own employees.

The group is in full compliance with all national regulatory requirements concerning the prevention of money laundering and terrorist financing. As the ProCredit group is supervised by the German Federal Financial Supervisory Authority (BaFin), ProCredit Bank has also implemented the requirements stipulated by the German Money Laundering Act. The Code of Conduct and Exclusion List constitute the core rules and regulations that all employees of the group are obliged to observe. Certain guidelines (e.g. AML Policy and Fraud Prevention Policy) specify how these basic rules are to be implemented in practice.

4 Risk management (continued)

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

Besides identifying all contracting parties and clarifying the purpose of the business relationship, “knowing the customer” for ProCredit Bank 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. Without exception, the group identifies and screens all persons who could prove to be beneficial owners. In addition, the group uses specialised 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 AML Officer at ProCredit Holding.

i Capital management

At no time may ProCredit bank incurs greater risks than it is able to bear. This principle is implemented using different indicators for which early warning indicators and limits have been established. The indicators include capital adequacy calculations in accordance to the applicable legislation (i.e. Regulation 575/2013 of the European Parliament and the Council) and a risk-bearing capacity calculation.

The capital management of the group has the following objectives:

- compliance with external capital requirements
- compliance with the internally defined minimum capital adequacy requirements
- support for the group in implementing its plans for continued growth while following its business strategy as a house bank for small and medium-sized businesses.

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

Risk-bearing capacity

The risk-bearing capacity concept is a key element of risk management and of the Internal Capital Adequacy Assessment Process (ICAAP). The adequacy of internal capital assessment entails defining the risk-bearing capacity of the group. The current capital resources are compared to the capital needs, which are derived from the risk profile and risk exposure, in order to guarantee the sufficiency of the capital resources at any moment. This is a continuous process which provides clarity on capital requirements and exposure to material risks.

The methods used 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. Extreme scenarios, some of them historically observed in individual countries of operation, are applied to the group in its entirety to test its ability to withstand such shocks, both in individual risk areas and in combination. The guiding principle for the risk-bearing capacity calculations is that the group is able to withstand shock scenarios without endangering depositors and other providers of funding. The crisis years 2009 and 2010 underscored, firstly, the necessity for a conservative approach towards capital management, and secondly, the developments during that time proved the strength of the group in dealing with a very difficult economic environment.

4 Risk management (continued)

i Capital management (continued)

The approach adopted for management and monitoring of the risk-bearing capacity is the “gone concern” approach. Assessment is made of the outcomes from the occurrence of an extreme operational environment, including situations which have not occurred as historical data and outcomes of various stress scenarios. Under the “gone concern” approach, a sufficient buffer is included to cover risk positions which are either not considered essential, or cannot be measured and have the potential for loss.

The material risks, as well as the applicable limits for each risk, for which the required capital is calculated, reflect the risk profile of ProCredit Bank, and are subject to annual revisions. These risks are: credit risk, counterparty risk (including issuer risk), interest rate risk, FX risk and operational risk.

Within ICAAP ProCredit Bank compares the calculated economic capital needed for the various risks to the available capital. For the purposes of ICAAP, the available capital is considered as risk-taking potential (RTP) and comprises the equity as per the financial statements, minus the intangible assets and the deferred tax assets plus Tier 2 capital. The resources available to cover risks (RA_tCR) are calculated as 60% of the RTP. Only RA_tCR 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 risk-bearing capacity calculation. The table below gives more details on the calculated internal capital within the ICAAP as well as on the risk taking potential:

As of 31 Dec 2016

Material risks	Limit (% of the RTP)	Limit (amount)	Limit used (amount)	Limit used (%)
Credit risk	33.0%	77,418	28,119	12.0%
Counterparty risk	5.0%	11,730	2,933	1.3%
FX risk	2.0%	4,692	39	0.0%
Interest rate risk	10.0%	23,460	3,558	1.5%
Operational risk	10.0%	23,460	10,860	4.6%
Resources available to cover risks (RA_tCR) (limited at 60% of RTP)	60.0%	140,761	45,509	19.4%
Risk-taking potential (RTP)	-	234,601	-	-

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 banks 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.

4 Risk management (continued)

i Capital management (continued)

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

When defining the capital requirements for the purposes of calculation of capital adequacy as per Regulation 575/2013, the Bank 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.
- 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 18.9 million, the average annual loss according to data recorded in the Risk Event Database in the last three years amounted to BGN 95 thousand.

As ProCredit Bank is non-trading book institutions, which moreover do 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 31.12.2016 the values was 0.17%, 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 table below shows information about the regulatory capital ratios:

	2016	2015
Regulatory capital		
Common Equity Tier 1 capital	174,661	146,654
Total regulatory capital	174,661	146,654
Risk Weighted Assets		
Risk Weighted Assets for Credit Risk	819,715	729,693
Risk Weighted Assets for Operational Risk	135,754	140,023
Total Risk Weighted Assets	955,469	869,716
Capital ratios		
Common Equity Tier 1 capital		
Tier 1 capital	18.3%	16.9%
Total capital	18.3%	16.9%

The Common Equity Tier 1 capital of the group is composed of subscribed capital and reserves, whereas deductions are made for intangible assets. ProCredit Bank plans growth of risk-weighted assets to be accompanied solely by an increase in Tier 1 capital.

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 2016				Fair value hierarchy		
Financial assets	Category	Carrying value	Fair value	Level 1	Level 2	Level 3
Cash and cash equivalents	AFV	211,268	211,268	55,455	155,813	-
Loans and advances to banks	LaR	331,511	331,511	-	331,511	-
Loans and advances to customers	LaR	1,251,556	1,289,838	-	-	1,289,838
AFS financial assets	AFS	42,835	42,835	42,069	-	766
Total		1,837,170	1,875,452	97,524	487,324	1,290,604
Financial liabilities	Category	Carrying value	Fair value	Level 1	Level 2	Level 3
Liabilities to banks	AC	61,943	61,986	-	45,197	16,789
Liabilities to customers	AC	1,245,779	1,245,946	-	877,731	368,215
Liabilities to institutions	AC	313,212	313,706	-	-	313,706
Total		1,620,934	1,621,638		922,928	698,710
As of 31 December 2015				Fair value hierarchy		
Financial assets	Category	Carrying value	Fair value	Level 1	Level 2	Level 3
Cash and cash equivalents	AFV	199,210	199,210	51,955	147,255	-
Loans and advances to banks	LaR	102,571	102,571	-	102,571	-
Loans and advances to customers	LaR	1,172,167	1,207,682	-	-	1,207,682
AFS financial assets	AFS	28,012	28,012	19,750	-	8,262
Total		1,501,960	1,537,475	71,705	249,826	1,215,944
Financial liabilities	Category	Carrying value	Fair value	Level 1	Level 2	Level 3
Liabilities to banks	AC	53,897	52,662	-	21,645	31,017
Liabilities to customers	AC	1,116,585	1,117,458	-	709,200	408,258
Liabilities to institutions	AC	156,928	156,354	-	-	156,354
Total		1,327,410	1,326,474		730,845	595,629

* categories: AFV - At Fair value; LaR - Loans and Receivables, AFS - Available-for-sale; AC - Amortised cost

(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.

(iii) Available-for-sale financial assets

The bank'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 AfS assets includes equity securities where observable market prices are not available (SWIFT and Borika-Bankservice shares). These instruments are carried at cost.

5 Fair values of financial assets and liabilities (continued)

(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 bank 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 amortized 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 22) are established on the basis of internal calculations. The group considers the following valuation techniques:

- Cost technique. It considers the current replacement costs of replicating the property, including the cost of transportation, installation and start-up.
- Discounted cash flows model. 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.

Markets analogues methods. It considers direct comparison with the offered prices of

6	Net interest income	2016	2015
	Interest and similar income		
	Loans and advances to customers	69,601	80,317
	Available-for-sale financial assets	341	723
	Loans and advances to banks	45	73
	Total interest and similar income	69,987	81,113
	Interest and similar expenses		
	Liabilities to customers	2,213	7,273
	Liabilities to banks and international financial institutions	1,690	4,444
	Subordinated debt	-	676
	Total interest and similar expenses	3,903	12,393
	Net interest income	66,084	68,720

Included in "Interest income from loans and advances to customers" for 2016 is BGN 1,331 thousand of accrued interest on impaired loans (2015: BGN 1,489 thousand).

7	Allowance for impairment losses on loans and advances	2016	2015
	Increase of impairment charge	22,087	23,118
	Release of impairment charge	(12,757)	(10,982)
	Recovery of written-off loans	(5,984)	(5,956)
	Allowance for impairment losses on loans and advances	3,346	6,180

The total increase of impairment charge comprises the following entries:

	2016	2015
Specific impairment	8,247	7,730
Allowance for individually insignificant impaired loans	3,160	3,963
Allowance for collectively assessed loans	10,680	11,425
Increase of impairment charge	22,087	23,118

There is no risk provisioning on loans and advances to banks, as historically no defaults have been recorded and there is currently no objective evidence of impairment.

8	Net fee and commission income	2016	2015
	Fee and commission income		
	Debit/credit cards	6,916	6,102
	Payment transfers and transactions	5,681	6,078
	Opening and account maintenance fees	2,183	3,369
	Loan management	1,483	1,234
	Cash operations	946	1,960
	Insurance fees	934	1,496
	Letters of credit and guarantees	636	652
	Others	320	370
	Total fee and commission income	19,099	21,261

8	Net fee and commission income (continued)	2016	2015
	Fee and commission expense		
	Debit/credit cards	896	1,058
	Correspondent accounts	643	508
	Others	29	9
	Total fee and commission expense	1,568	1,575
	Net fee and commission income	17,531	19,686
9	Result from foreign exchange transactions	2016	2015
	Currency transactions	6,056	5,651
	Net gains and losses from revaluation	171	190
	Total result from foreign exchange transactions	6,227	5,841
10	Net result from available-for-sale financial assets	2016	2015
	Gains/(losses) from disposal of afs securities	7,292	(741)
	Total net result from available-for-sale financial assets through profit and loss	7,292	(741)
11	Net other operating income	2016	2015
	Other operating income		
	Income from sale of own property	117	202
	Income from sale of repossessed property	224	430
	Dividends from AFS securities	90	48
	Other operating income	1,090	1,262
	Total other operating income	1,521	1,942
	Other operating expenses		
	Impairment of repossessed property	2,982	2,721
	Other expenses related to repossessed property	405	370
	Other operating expenses	397	933
	Total other operating expenses	3,784	4,024
	Net other operating income	(2,263)	(2,082)
“Dividends from available-for-sale financial assets” includes the dividend received by entities in which the bank has non-controlling interest.			
12	Personnel expenses	2016	2015
	Salary expenses	15,556	17,109
	Pension costs	998	939
	Other social security costs	1,457	1,583
	Other employee costs	9	153
	Total personnel expenses	18,020	19,784

13 Administrative expenses	2016	2015
Payments to Deposit Insurance Fund and Bank Restructuring Fund	4,038	6,236
Depreciation fixed and intangible assets incl. impairment	5,514	5,452
Operating lease rentals	4,003	4,003
Communication and transport costs	3,373	3,235
Other professional services	3,336	3,461
Consultancy, legal and audit services	3,040	1,761
Training	1,845	1,697
Security services	1,439	1,611
Maintenance and utilities	1,224	1,244
IT expenses	1,166	1,001
Marketing, advertising and representation	668	1,429
Non-profit tax	191	282
Other administrative expenses	1,289	1,998
Total administrative expenses	31,126	33,410

Total fees incurred for the services provided by the group auditor were BGN 124 thousand (2015: BGN 113 thousand).

14 Income tax expense	2016	2015
Current income tax	4,717	3,505
Deferred income tax (note 21)	(170)	(124)
Total income tax expenses	4,547	3,381

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

	2016	2015
Profit before income tax	42,379	32,050
Theoretical tax at a tax rate of 10 % (2015: 10 %)	4,238	3,205
Tax effect from non-taxable income	(8)	(14)
Tax effect of expenses not deductible for tax purposes	317	190
Total income tax expense	4,547	3,381

The effective tax rate for 2016 is: 10.7% (2015: 10.5%).

15 Cash and cash equivalents	2016	2015
Cash in hand	55,456	51,955
Balances with the central bank (excl. mandatory reserve)	44,806	54,458
Mandatory reserve deposits	111,006	92,797
Total cash and cash equivalents	211,268	199,210
Loans and advances to banks with a maturity up to 3 months	284,494	92,791
Minimum reserve with central bank, which does not qualify as cash for the statement of cash flows	(111,006)	(92,797)
Cash and cash equivalents for the statement of cash flows	384,756	199,204
16 Loans and advances to banks	2016	2015
Current accounts	225,818	67,137
Up to three months	58,675	35,434
Above three months	47,018	-
Total loans and advances to banks	331,511	102,571
17 Available-for-sale financial assets	2016	2015
Bulgarian Government bonds	39,655	19,750
Shares	3,180	8,262
Total available-for-sale financial assets	42,835	28,012
The shares represent investments in local and foreign financial intermediary institutions.		
	2016	2015
Opening balance	28,012	29,450
Additions	37,974	-
Disposals	(23,426)	(8,353)
Gains / (losses) from changes in FV	(215)	6,885
Premium amortization	(354)	-
Change in accrued interest	144	(306)
Foreign currency revaluation	700	336
Closing balance	42,835	28,012
18 Loans and advances to customers	2016	2015
Total gross loans and advances	1,251,556	1,172,167
Less provision for impairment	(42,165)	(38,616)
Total net loans and advances	1,209,391	1,133,551

19 Allowance for losses on loans and advances to customers

Movement in provisions was as follows:	2016	2015
Balance as of 1 January	38,616	36,339
Increase in provisions for loan impairment	9,330	12,136
Loans written off	(5,781)	(9,859)
Balance as of 31 December	42,165	38,616
Allowance for impairment on loans and advances to customers was formed as follows:		
	2016	2015
Increase in provisions for loan impairment	9,330	12,136
Less recoveries on loans previously written off	(5,984)	(5,956)
Recognised in the Statement of Profit or Loss	3,346	6,180

20 Property, plant and equipment and Intangible assets

	Land and buildings	Furniture and fixtures	IT and other equipment	Leasehold improvements	Intangible assets	Total
Cost						
Balance as of 1 Jan 2015	33,506	2,189	32,045	7,300	9,415	84,455
Acquisitions	58	936	5,688	1,423	766	8,871
Disposals	-	(776)	(3,402)	(2,152)	(1)	(6,331)
Balance as of 31 Dec 2015	33,564	2,349	34,331	6,571	10,180	86,995
Depreciation						
Balance as of 1 Jan 2015	3,628	859	21,525	3,621	6,113	35,746
Depreciation for the period	798	198	2,830	480	1,146	5,452
Accumulated depreciation of disposal	-	(101)	(3,160)	(1,394)	-	(4,655)
Balance as of 31 Dec 2015	4,426	956	21,195	2,707	7,259	36,543
Carrying amounts						
Balance as of 1 Jan 2015	29,878	1,330	10,520	3,679	3,302	48,709
Balance as of 31 Dec 2015	29,138	1,393	13,136	3,864	2,921	50,452
Cost						
Balance as of 1 Jan 2016	33,564	2,349	34,331	6,571	10,180	86,995
Acquisitions	26	481	4,614	803	1,251	7,175
Disposals	-	(311)	(6,495)	(2,994)	(162)	(9,962)
Balance as of 31 Dec 2016	33,590	2,519	32,450	4,380	11,269	84,208
Depreciation						
Balance as of 1 Jan 2016	4,426	956	21,195	2,707	7,259	36,543
Depreciation for the period	800	229	3,079	491	915	5,514
Accumulated depreciation of disposal	-	(21)	(6,108)	(1,587)	(161)	(7,877)
Balance as of 31 Dec 2016	5,226	1,164	18,166	1,611	8,013	34,180
Carrying amounts						
Balance as of 1 Jan 2016	29,138	1,393	13,136	3,864	2,921	50,452
Balance as of 31 Dec 2016	28,364	1,355	14,284	2,769	3,256	50,028

21 Deferred income tax assets

The deferred income tax charge in the Statement of Profit or Loss and related deferred income tax assets include the following temporary differences:

	2016	2015
Deferred income tax assets		
Reposessed properties	765	554
Unused staff holiday time from previous years	75	60
Other temporary differences	58	100
Total deferred income tax assets	898	714
Deferred income tax liabilities		
Property, plant and equipment	549	535
Other temporary differences	46	46
Total deferred income tax liabilities	595	581

The following table shows the income/(charges) to which the profit and loss from deferred taxes is related:

	2016	2015
Unused staff's holidays from previous years	15	4
Reposessed properties	211	215
Property, plant and equipment	(14)	47
Other temporary differences	(42)	(142)
Total change in deferred income tax for the year	170	124

22 Other assets

	2016	2015
Reposessed properties	13,062	19,727
Accounts receivable	3,049	2,280
Prepayments	767	634
Tax receivables	1	76
Total other assets	16,879	22,717

Reposessed 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 reposessed property is presented in the following table:

Reposessed property	2016	2015
Balance as of 1 January	19,727	23,662
Additions	1,518	4,199
Disposals (sales)	(5,201)	(5,413)
Change in fair value	(2,982)	(2,721)
Balance as of 31 December	13,062	19,727

23 Liabilities to banks	2016	2015
Current accounts	329	1,645
Term deposits	35,700	20,000
Loans	25,914	32,252
Total liabilities to banks	61,943	53,897

Liabilities to ProCredit Bank (Germany) in the amount of BGN 25,794 thousand (2015: BGN 22,628 thousand) and liabilities to other sister banks from ProCredit group in the amount of BGN 90 thousand (2015: BGN 1,574 thousand) are reported under the current position.

24 Liabilities to customers	2016	2015
Current accounts		
- private individuals	121,599	100,137
- legal entities	606,839	473,396
Total current accounts	728,438	573,533
Saving accounts		
- private individuals	102,792	87,826
- legal entities	38,953	35,860
Total saving accounts	141,745	123,686
Term deposit accounts		
- private individuals	230,123	263,959
- legal entities	137,925	143,428
Total term deposit accounts	368,048	407,387
Payments in transit	7,548	11,979
Liabilities to customers	1,245,779	1,116,585

25 Liabilities to financial institutions

Institution	Final year of maturity	2016	2015
ProCredit Holding		176,025	-
European Investment Fund (EIF)	2026	96,816	103,716
European Investment Bank (EIB)	2017	19,587	27,430
KfW	2018	20,784	20,559
State Fund Agriculture	2016	-	5,223
Total liabilities to institutions		313,212	156,928

The liabilities towards ProCredit Holding represent received short term placement for the purposes of the ProCredit group's liquidity management. The loan agreement with the European Investment Fund is under the JEREMIE program aimed towards co-financing of small and medium enterprises.

26 Other liabilities	2016	2015
Creditors	4,325	3,717
Non-income taxes payable	699	734
Deferred income	472	480
Banks	-	71
Other due payments	16	21
Total other liabilities	5,512	5,023
27 Provisions	2016	2015
Provisions for post-employment benefits (see below)	111	110
Provisions for losses from off-balance sheet items	220	138
Provisions for untaken vacation	394	248
Total provisions	725	496

Obligations for defined benefit retirement compensations

The estimated amount of the obligation as at each reporting date and the expenses for retirement compensations recognized 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.

Movement in the present value of the defined benefit obligations

	2016	2015
Defined benefit obligations as of 1 January	110	108
Benefits paid by the plan	-	-
Current service costs	17	15
Interest cost	3	4
Past service cost - non-vested benefits	(9)	-
Actuarial (gains) losses from changes in financial and demographic assumptions	(10)	(17)
Defined benefit obligations as of 31 December	111	110

Actuarial assumptions

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

	2016	2015
Discount rate as of 31 December	2.5%	3%
Future salary increases	5.0%	5%
Interest rate increase/decrease	5.0%	5%

28 Equity

Share capital and share premium

As of end 2016 the capital of the bank consists of registered capital and share premium. The registered capital of was divided into 164,210 thousand shares (2015: 135,634 thousand shares) with a nominal value of BGN 1 each. All shares confer equal voting power and are fully paid. The bank's share capital was increased by BGN 28,576 thousand in 2016 in order to further strengthen its common equity tier 1 position. The sole owner of the bank's capital is ProCredit Holding. The share premium was BGN 3,496 thousand (2015: BGN 3,496 thousand).

Retained earnings and reserves

Legal and other reserves – these have been distributed from the net profit of the bank in compliance with the Commercial Law, article 246. The position "Other reserves" also comprises the amount accumulated as a result by remeasurement of post-employment benefits. The funds in these reserves could be only used for covering of current loss and loss from previous years or payments towards employees under defined benefit plan obligation.

Revaluation reserve – comprise accumulated revaluation by fair value of available-for-sale financial assets as well as changes in the actuarial gains or losses related to the calculation of provisions for post-employment benefits

Retained earnings – comprise the accumulated profit of the bank from previous years. The bank paid dividends BGN 28,576 thousand in 2016 from its retained earnings from 2015.

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:

	2016	2015
Commitments to extend credit	236,780	183,746
Letters of credit and letters of guarantee	32,476	23,062
Total contingencies and commitments	269,256	206,808

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:

	2016	2015
Up to 1 year	913	904

30 Related party transactions

ProCredit Holding is the sole shareholder of ProCredit Bank. ProCredit Holding is the ultimate parent and ultimate controlling party of the bank. ProCredit Bank has stand-by line agreement with ProCredit Holding, directed towards liquidity management, which is not utilized as of end 2016. The bank has received loans from ProCredit Bank (Germany) (fully owned subsidiary of ProCredit Holding) under loan agreements. Other sister banks keep current accounts placements as the bank provides the functioning of a payment system within the ProCredit group (ProPay) (note 23).

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 with shareholders	2016	2015
Other income earned	101	99
Liabilities at the end of the period	-	-
Interest expense incurred	159	198
Other expenses incurred	1,551	1,529
Transactions with other ProCredit group entities	2016	2015
Loans and advances at the end of the period	329,783	88,857
Interest income earned	212	174
Other income earned	200	158
Liabilities at the end of the period	26,009	33,840
Interest expense incurred	592	930
Other expenses incurred	1,519	1,092

In 2016, the total compensation of key management personnel was BGN 488 thousand (2015: BGN 682 thousand).

31 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 2016.



ProCredit Bank

 Part of the
ProCredit Group

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