Head Office

Strategy, Finance and Data Management Division

YEAR END DISCLOSURE

DSK Bank Group

According to

Regulation 575/2013 on prudential requirements for

credit institutions and investment firms

2022

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**Please note, all tables containing quantitative information have been exported in a separate Excel file: *DSK Group\_Disclosures\_2022\_EN* for better readability.**

DSK Bank AD (“The Bank”, “DSK Bank”) was incorporated on 2 March 1951 in Bulgaria as a centralised deposit accepting institution under the name State Savings Bank. In 1998 the Bank was transformed into a commercial bank through the Act on DSK transformation and is allowed to conduct all the transactions stated in art. 1. par.2 from the Banking Law. Later the Bank receives a full banking license to operate as a commercial bank (by order No. 220882 of 26 September 2002 issued by the Bulgarian National Bank).

On 26 January 1999 Sofia City Court registered the State Savings Bank as a solely owned joint stock company "DSK Bank", 100% owned by the state. In 2001 pursuant to a court decision the Bank has been transformed to a joint stock company with its capital divided between the Council of Ministers -75%, and the Bank Consolidation Company AD - 25 %.

On 29 November 2002 following a decision of the Sofia City Court the Bank Consolidation Company acquired 100% of the share capital of DSK Bank EAD.

On 29 October 2003 following a decision of the Sofia City Court OTP Bank, incorporated in Hungary, acquired 100% of the share capital of DSK Bank EAD.

In 2020 the subsidiaries Expressbank AD and Express Factoring EOOD merged into DSK Bank based on agreements for transformation through merger registered in the Commercial Register on 30 April 2020 and 30 September 2020, respectively. The transformations have been undertaken with the aim to optimise the structure, enhance effectiveness of processes, decrease expenses and improve customer service.

On 30 April 2020 DSK Bank issued new shares in favour of the non-controlling shareholders of the transforming bank Expressbank AD. As a result, the Bank was re-registered from a solely owned joint stock company (EAD) to a joint stock company (AD) as of the same date.

The share capital of DSK Bank is BGN 1 329 m, distributed in 132 865 992 common registered shares with a nominal value of BGN 10 each.

In 2022 DSK Bank strengthened its position in the banking market by maintaining its leading position in the portfolio of loans and deposits in retail banking and managed to maintain its stability in terms of liquidity and capital position. The Bank ranks first in the credit market in terms of exposure to customers (excluding exposures to credit institutions) with a market share of 20.3% compared to 20.2% at the end of 2021. In terms of customer deposits (excluding those of credit institutions), the Bank also leads position in the banking system of the country with a market share of 19.0% which improved compared to a year ago, when the share was 18.4%.

DSK Bank has the largest branch network in the country with 294 branches as of 31 December 2022, which accounts for a share of 15.82% in the banking system.

For 2022 DSK Banking Group reports a profit after tax of the amount of BGN 563.7 million.

1. Capital and Risk Management and Capital Requirements of DSK Bank Group

This consolidated disclosure is published according to part eight of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013on prudential requirements for credit institutions and investment firms (the Regulation). According to Art. 434 of the Regulation an equivalent disclosure of non-disclosed here parts is made in the Financial Statements of the Bank published on official web page.

The Management board of DSK Bank allocates the capital amongst various banking activities by maintaining a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position. The Bank Asset and Liabilities Committee reviews the level and trend of credit, market and operational risks and their effects on capital levels on a regular basis. In cooperation with OTP Bank Hungary the Bank's risk profile is assessed in order to determine whether the Bank Group allocates sufficient capital against the various risks and to assess future capital requirement either for regulatory purposes or from the internal understanding for its risk profile coverage according to its strategy.

1. **Policy and rules for risk management**

The Risk Strategy of the Bank Group is, by its nature, an instrument of the senior management that ensures the control, monitoring and mitigation of risks inherent in normal banking activities to guarantee their adequate management regarding the Group’s goals.

The risk management is a process that investigates, analyses and tracks the development of existing risks in order to avoid them or to reduce the negative effect of their eventual occurrence. Risk management aims to be proactive in order to minimise potential negative consequences.

The Group’s control and risk management has the following main goals:

* Achievement of the strategic goals of the Bank Group in a way that ensures a reasonable balance between taken risks and realised earnings;
* The potential losses should be limited to an amount which the Bank Group is capable of bearing without endangering its long-term development. This goal is realised by regularly measuring expected losses, applying impairments to cover the expected losses, and inclusion of the expected losses in product pricing so that the latter reflects the risks and guarantees lasting returns;
* DSK Bank Group and OTP banking group are developing processes for risk management which correspond to the applicable regulatory requirements and follow the good banking practices;
* DSK Bank Group and OTP banking group follow a common and consistent risk management policy, which corresponds to the risk profile of the banking group and is consistent with its size.

To guarantee the achievement of the main goals of the Bank Group, systems and processes for risk identification, measurement, monitoring, and reporting have been developed. The existent risks are subject to ongoing control in order to ensure they are limited to expected and acceptable amounts.

Bank Group has stress test methodology for estimation and analysis of Bank Group readiness to meet negative effect from significant adverse changes in risk components that can appear outside from expected in normal course of business. Stress Tests are performed under the significant risks arising from activities of the Bank Group. Available stress test scenarios based on potential effect of factors which increase risk in case of possible future events instead of particular economic forecast grants the opportunity for comprehensive research of different adverse or even opposite feature of events under particular risk categories and entirely for the Bank Group. Scenarios are determined for every performed test from competent bodies responsible for performance of the test in dependency of market and economic circumstances under which Bank Group operates as of particular moment of time and ordinary three scenarios are executed: quick economic recovery, quick macroeconomic shock and long lasting crisis. Results from performed stress tests are presented to the management of the Bank Group. In case result from relevant analysis indicates deterioration of financial stability of the Bank Group as per methodology stands process of decision making for implementation of adequate measures.

* 1. **Types of risk**

The risk identification process is performed on an annual basis or ad-hoc in case of significant change in the operating environment. It is an integral building block from the annual business and risk management framework. The risk identification is crucial for understanding the threats to the business model sustainability and the need for proper governance application.

Within the risk identification DSK Bank AD and all its subsidiaries are covered.

The risk identification process follows the so called “gross approach” which considers the initial expected impact from risk without taking into account any specific techniques designed to mitigate the underlying risks.

For the purpose of identification and assessment of risk types, the internal definition of materiality is also considered. It is based on several elements:

(1) If the risk is typical or applicable to the Bank’s business model;

(2) The frequency and the potential impact which the risk could have on the overall performance and

(3) The scope of impacted clients or products.

The types of risk are divided into the following categories:

* Risks – from mandatory regulatory requirements (Pillar 1);
* Risks – specific for the banking sector;
* Risks – embedded in DSK business model & strategy;
* Risks from operating environment.

The main output from the risk identification process is the risk taxonomy of the Bank which covers the following main risk categories:

* Credit risk;
* Market risk;
* Operational risk;
* Liquidity risk;
* Interest rate risk of non-trading book activities (IRRBB);
* Credit spread risk of non-trading book activities (CSRBB);
* Reputational risk (incl. step-in risk);
* Business and strategic risks
* Environmental risk.

* 1. **Structures for the management of the various risk types**

The structure of the management of the various risk types is determined in the Risk Assumption Regulation of DSK Bank. The main part of the management of risks is concentrated in the Risk Management Division, which plays a key role in risk management as a second line of defence. This is an independent from the business units division lead by a Head, who is a member of the Management Board of DSK Bank and a chairman of the Credits and limits Council, Corporate credit risk Committee and the Assets and Liabilities Committee. The mission of this division is to мanage the credit, market and operational risk through adequate controls and methodologies, delivery of the regulatory reporting regarding the assumed risk and improvement of the risk management and risk reporting practices on an ongoing as well as a project basis.

The Functions of the Risk Management Division include:

* Maintains an adequate risk assumption policy and risk assessment methodologies in accordance with the risk appetite and with the adopted risk management strategy.
* Efficient management of the operational risk in order to minimise losses caused by non-adequate or not well functioning processes, systems, human errors or external operational event.
* Establishes an adequate system for the measurement, reporting and management of the market risks (currency and interest rate risks with regard to the trading portfolio of the Bank), as well as country and counterparty risk.
* Plans and manages the implementation of risk management related projects.
* Provides regulatory and operational reporting with respect to the management of the credit, market and operational risk.

The Collection Division reporting to the CEO manages problem loans in the entire process from day past due 1 until the full resolving or healing of the exposure, ensuring full dedication and expertise and a faster and more flexible proactive reaction to changes in the environment. The Head of the division is member of the Management Board of DSK Bank and Chairmen of the Work Out Committee of the Bank.

Analysis, Reporting and Third Party Relations Directorate within the Collection Division supports the operational processes and management with data provision, analysis, internal and external reporting.

Loan packages write-off and sale activity is separated from the workout process in order to streamline the process of selection, third party relations, proposals and realisation of write-offs and sales of problem loan packages.

The management of the various risk types is supported also by some collective decision taking bodies. These are:

* Credits and Limits Council
* Assets and Liabilities Committee
* Product Development, Pricing and Sales Committee
* Workout Committee
* Risk Committee
* Retail Credit risk Committee
* Corporate Credit risk Committee
* Data Analytics Committee

The participants in these bodies and their functions are detailed in the Governance Rules of DSK Bank as well as in the relevant committee rules for its activity.

* 1. **Bank Group Strategy and Risk Management Policy**

The strategy of DSK Bank Group and OTP Group regarding the control and management of risk has the following main goals:

* Achievement of the strategic goals of the Group in a way which ensures the balance between risks and realised earnings;
* The potential losses should be limited to an amount which the Bank Group is capable of bearing without endangering its long-term development. This goal is realised through considering of expected losses related to events which have occured, allocation of impairments to cover the expected losses, and considering expected losses in product pricing so that the latter reflects the risks and guarantees lasting returns. Correspondingly, the capital of the Bank Group has to be sufficient to provide protection against unexpected losses and at the same time generate the planned return on capital;
* DSK Bank Group and OTP Group have developed processes for risk management which correspond to the applicable regulatory requirements and follow the best banking practices;
* DSK Bank Group and OTP Group follow a common and consistent risk management policy, which corresponds to the level of development of the Bank Group and is consistent with its size.
* To guarantee the achievement of the main goals of the Bank Group, systems and processes for risk identification, measurement, monitoring, and reporting have been developed. The existent risks are subject to ongoing control in order to ensure they are limited to expected and acceptable amounts.

**Risk Appetite Framework**

The risks identified within the annual or ad-hock Risk Identification Process are reflected in the Risk Appetite Framework on a granular basis.

The Risk Appetite Framework (RAF) sets the Bank’s and the Banking Group’s Risk Profile. It is part of the overall process of development and implementation of the Risk Strategy. It determines the appetite to undertake risks in relation to the Risk Capacity. The Risk Appetite Framework defines the boundaries within which management is expected to operate when pursuing the Bank’s and the Banking Group’s business strategy. It expresses the general principles of risk appetite that the Bank considers acceptable to undertake and is aimed at guaranteeing that risk assumption activities remain in line with the expectations of the various stakeholders. It is defined considering the risk position of the Bank and the current and expected economic trend.

The Bank's Risk Capacity is evaluated on the basis of both the regulation in place and the planned regulatory changes that are relevant in terms of the plan and/or budget time horizon. The Risk Profile of the Bank is evaluated with reference to both the Overall Risk Profile (best expressed through the capital and liquidity position), and the main specific risks.

In 2022 review of the Risk Appetite Framework DSK Bank did mainly technical changes. Some new concepts and texts are introduced as follows:

Risk Tolerance: Maximum negative impact (loss amount) the Banking Group or the Banking Group Members are willing to accept from a specific risk event or series of risk events, where normally the risk appetite is considered to be zero. Such risks are normally operational or compliance risks.

Risk Triggers: Early warning levels indicating that the utilisation is getting close to the Risk Limits (in case the utilisation reaches or exceeds the Risk Trigger, setting up of an action plan is not needed, but recommended). DSK Bank uses the term "early warning signal" in its table of monitored indicators;

Recovery Plan: OTP’s Group Recovery Plan (it contains the single-point-of-entry recovery strategy concerning DSK Bank);

Stress testing: Covers quantitative and qualitative techniques and risk management methodologies, which financial institutions can employ to analyse their exposure or vulnerability to the impacts of exceptional but possible events that may occur due to rare risk events that can have severe consequences.

* + 1. **Credit risk**

The credit risk policy of DSK Bank Group is aiming at developing of a diversified portfolio with a stable profitability. The constant monitoring of the portfolio and related risks create the basis on which processes are built aiming to ensure an environment, where the undertaken risk is constantly subject of a preventive and reactive control.

Having in mind the business model of DSK Bank Group being mainly retail the management of the risk is done on a portfolio basis, which is supported through rules, regulations and procedures as well as by appropriate limits subject to a review and approval on an annual basis within the framework of the Credit policy document for the respective year.

With the aim to establish a well-diversified portfolio of business clients, which additionally strengthens the retail position of the bank, through the comprehensive servicing of the business clients and their employees, non-standardised exposures (due to the size of the exposure, the client`s business or the structure of the deal) the decision has to be taken on a case-by-case basis for each client/ client group, whereby the delegated authorities in accordance with the Governance rules of DSK Bank apply. The monitoring and the administration of these credits is set in an appropriate manner in the Credit Control and Administration of Business Clients Regulation and the Credit Monitoring of Business Clients of DSK Bank.

The Risk Management Division consists of the following units engaged in the management of risks:

* General Policy and Risk Management Directorate with the following functions:
	+ Maintains an adequate risk assumption policy and risk assessment methodologies in accordance with the risk appetite and with the adopted risk management strategy.
	+ Efficient management of the operational risk in order to minimise losses caused by non-adequate or not well functioning processes, systems, human errors or external operational event.
	+ Establishes an adequate system for the measurement, reporting and management of the market risks (currency and interest rate risks with regard to the trading portfolio of the Bank), as well as country and counterparty risk.
	+ Plans and manages the implementation of risk management related projects.
	+ Provides regulatory and operational reporting with respect to the management of the credit, market and operational risk.
* Credit Risk - Corporate Clients Directorate with the following functions:
	+ Provides methodological assistance as regards company loans to the managers engaged with customer relations and to the credit analysts.
	+ Independent assessment of the credit risk regarding the proposed credits of business clients and approves/ proposes for approval the ones with acceptable risk level. The employee and links of the Directorate take decisions on credits according to the provided powers according to it. 3 of Section ІV of these Rules.
	+ Prepares the meetings of the Credits and Limits Council, by submitting also own proposals.
	+ Responsible for the movement of the loan files and administrates the approval process of credits to business clients within their own or higher level of competence.
* Retail Credit Risk Directorate with the following functions:
	+ Develops, maintains and implements models and analytical system for credit risk assessment;
	+ Develops, implements and maintain of credit risk assessment processes and systems;
	+ Performs monitoring and provides internal reporting on the loan portfolio quality. Develops early warning mechanisms for increased credit risk;
	+ Performs verification and independent credit risk assessment of the proposals for private individuals and micro enterprises financing according to the provided competences.
* Credit Control and Administration Department with the following functions:
	+ Execute independent centralised credit control and centralised credit administration of business clients in order to minimise the credit and operational risk;
	+ Develop and apply the Bank’s policy in respect to credit control and administration of the business clients;
	+ Centralised preparation of the loans contracts for the companies in SME segment.
	+ Create and support the internal bank regulations which treat the activities of credit control and credit administration to business clients;
	+ Make suggestions for reducing the client’s, the product’s and the portfolio credit bank risk on the grounds of findings on the loans of business clients;
	+ Execute effective control for collection of the initially due fees for credit deals to business clients.

* Credit Monitoring to Corporate Clients Department with the following functions:
	+ Implements and updates the Bank's policy regarding the processes and systems for performing of credit monitoring on corporate clients.
	+ Creates and maintains the internal bank regulatory framework, which regulates the credit monitoring activities for corporate clients;
	+ Optimizes the credit risk in the management of corporate clients’ loans and helps to maintain an adequate quality of the corporate credit portfolio in terms of risk;
	+ Performs centralized monitoring on corporate clients, for which there are early warning signals for deterioration in order to be minimized the credit risk.

* Risk Management аnd Leasing Sales Section with the following functions:
* Provides methodological assistance and advises business units on leasing transactions;
* Performs independent credit risk assessment on proposed leasing transactions with individuals and / or legal entities, approves / proposes for approval those with an acceptable level of credit risk. The employees of the Department shall make decisions in accordance with the powers granted to them under Section V. Decision making mechanism of the Governance Rules;
* Prepares proposals for the meetings of the Credit and Limits Committee, as for clients / client groups to which the group of DSK Bank has exposure both in the form of leasing and other type of credit exposure gives an opinion / proposal, in coordination with the unit that assesses non-leasing credit exposures;
* Administers the decision-making process of its own and higher competence
* Sustainability Development Section with the following functions:
* Ensures sustainable development through implementation and update of the Bank’s strategy regarding the environmental, social and governance (ESG) issues and management of the related ESG risks.
* Prepares and updates of the ESG Strategy of DSK Bank in line with the adopted standards of the OTP Group;
* Maintains and updates the Roadmap with the steps and deadlines for implementing recommendations of the European Central Bank;
* Provides methodological support and interaction with units within DSK Bank functionally involved in implementation of ESG-related actions;
* Assists units within DSK Bank to identify and manage the ESG-related risks;
* Performs independent assessment of the compliance of credit exposures with established international taxonomies;

The Collection Division consists of the following units engaged in the management, healing and collection of problem loans:

* Retail Collection Directorate - Performs operational and methodological functions establishing and ensuring application of processes, rules and procedures in order to effectively collect overdues and improving the quality of the portfolio.
	+ Central Collection Department - Processes and manages loans to individuals and business clients in early delinquency phase with the main task for full payment of overdue amounts and restoring loan exposures to regularity.
	+ Network Collection Department - Organises, manages and controls the activity of management of overdue and problem loans to individuals after the period of early delinquency, aiming effective collection and/or restructuring of the overdue exposures and improvement of the quality of the portfolio of loans to individuals by coordinating and supporting the work of all participants in the process.
	+ Legal Collection Department - Manages, coordinates and controls the centralised and decentralised (units of the bank's branch network) processes of initiating and enforcement of court executive actions on collection of receivables from individuals.
	+ Centralised Collection Processes Department - Manages, coordinates and controls the centralised receivables collection processes, including approvals of financial solutions, administrative handling (back office activities) of overdue loans, actions for data update/retrieval about the debtors (skip tracing actions) in order to accelerate and optimise the process of collecting overdue loans at each stage of their management.
	+ Colletion Methodology Department - Performs methodological functions in outlining processes, elaborating rules and procedures, training/coaching/mentoring of the employees in the Directorate; in optimising the processes while aiming at efficient collection of the overdue loans, fulfillment of the set targets, and improvement of the portfolio quality
* Business Clients and Leasing Collection Directorate - Performs operational and methodological functions for the management of overdue and problem loans of business clients. Monitors and coordinates the implementation of group standards and strategy in order to optimally organise the collection of loan and lease receivables.
	+ Management of Problem Loans of Business Clients Department - Organises, coordinates and controls the overall activity of managing problem loans of business clients in the Bank.
	+ Management of Judicial Loans of Business Clients Department - Manages the process of collecting problem loans to business clients, transferred for centralised collection by decision of the Monitoring Committee.
	+ Legal Servicing of Business Problem Loans Department - Ensures the compliant collection and management of centralised problem exposures of business clients
* Analysis, Reporting and 3rd Party Relations Directorate - Through analysis and reporting, monitors and controls the process of managing overdue and problem loans and supports the operational process. Manages the relationship with external counterparties regarding the collection or sale of packages of problem loans. Responsible for the coordination and preparation of an Operational Plan for the implementation of the strategy for reducing problem loans in the banking group.
	+ Management and Regulatory Reporting Section
	+ Operational Reporting Section
	+ Data Analytics Section
	+ Third-party Relations Section
* Real Estate Department - Organises, assists and performs actions for the implementation of the Bank's policy on sale of real estate used as collateral of problem loans. Manages acquired real estate collateral and performs other functions in the Bank related to real estate.

**Credit risk assumption appetite**

The definition of credit risk appetite is intended to support the achievement of growth objectives in such a way that prevents the accumulated portfolio from jeopardising capital even across cycles. Accordingly, credit risk appetite is a framework that encompasses all risk management tools, methods and processes that ensure – provided that the business plans are implemented as scheduled – that the risks associated with the accumulated portfolio do not jeopardise the strategic goals.

**Risk appetite at the strategic level**

Strategic-level credit risk appetite reflects shareholder and management objectives regarding the utilisation of the capacities available, as well as the basic attitude to credit risk, on the basis of which DSK Bank Group:

* strives to preserve and reinforce its market position and satisfy demand in dynamically growing segments while pursuing a prudent credit policy;
* carries out its activities in full compliance with legal regulations and supervisory requirements;
* pursues a positively conservative risk assumption practice;
* ensures risk-aware operations by consciously assuming risks instead of avoiding them and by building up and maintaining portfolios that generate stable profits, besides the appropriate identification, assessment and management of risks;
* does not undertake any reputation risk during its activity;
* holds a sufficient level of regulatory capital to maintain its solvency at all times.

**Risk appetite at the operative level (Operative Lending Limits and Principles)**

By defining operative-level credit risk appetite DSK Bank Group:

* ensures the incorporation of strategic directions and expectations into day-to-day risk management activity;
* considers profitability aspects by analysing the income-generation potential of individual customer segments and product groups in the context of specific risk factors;
* assesses the risk indicators that can best ensure the fulfilment of growth objectives in the context of a prudent, conservative risk assumption practice. Such indicators include:
	+ expected PD as an indicator ensuring the identification of the customer base that is desirable / eligible subject to certain conditions / to be avoided;
	+ product / segment-level risk indicators indicating the quality of the portfolio: cost of risk, NPL portfolio, vintage indicators;
	+ LGD indicators in relation to the definition and back-testing of collateralisation requirements.

Determining and adhering to the tolerance levels and the desirable values of the indicators listed above may ensure the formation of a desirable risk profile. The annual Operative Lending Limits and Principles – as the manifestation of the operative-level credit risk appetite – summarises the behaviour required for the desirable loan portfolio, defining:

* the limits and target numbers reflecting the willingness to take risks;
* the level, proportion and concentration of the assumed risks comprising the portfolio and the expectations about the quality of the portfolio;
* preferences and business orientation, potential tightening or exclusions regarding the customer base, the sectors, collateral, products and product types and the maturity structure.

In order to monitor the credit risk appetite defined at the operative level, DSK Bank Group operates a control system that covers:

* policy framework;
* the risk parameters of products;
* the reporting system, and
* additional, secondary controls (e.g. ex post audits of the compliance of specific transactions within the local competence level).

At the operative level the necessary tools for the monitoring of the assumed risk in the context of the pre-defined risk appetite are ensured through a comprehensive system of regulations, product parameters, IT systems supporting the compliance with the regulations and the product parameters and the Operative Lending Limits and Principles limits. The frame and the limits at the operative level are detailed in the Operative Lending Limits and Principles and the applicable regulations. These documents are available to all concerned staff in the Bank’s intranet. The compliance with the limits and the monitoring of the overrides are regularly communicated to the business units. Taking the necessary measures, whenever needed for ensuring compliance, is a common task of the risk management function and the respective business unit. In the Credit policy of the bank are presented the applicable credit limits for each month of the year and the document is annually approved by the Management Board of the bank and consented by OTP Bank. The compliance with the retail credit limits are reported to the parent bank on a monthly basis and discussed quarterly by the risk function and the respective business unit. A detailed report for the performance of each main product in each month of the past year is presented to the Management Board upon the review of the proposal for next year’s Operative Lending Limits and Principles. This is the basis for estimating the efficiency of the strategy of the risk management at operative level.

The compliance with the sector limits is monitored monthly by the General Policy and Risk Management Directorate and reported quarterly to the Credits and Limits Council .

**Lending guidelines**

The objective of DSK Bank Group is to develop a diversified portfolio, the performance of which does not excessively depend on the changes in the position of any particular sector, geographical region or debtor group. It is a basic requirement regarding the enforcement of the lending criteria that:

* the primary repayment sources of lending should be the cash flows generated from the enterprise’s activity or, in the case of private individuals, long-term, regular income;
* when developing the conditions of new products and upon the review of existing schemes, risk parameters should comply with group standards, reflecting country-specific differences;
* identical risks within the Group should be managed along the lines of the same principles, aligned with the degree and nature of the risk exposure.

The definitions of “delinquent”, “impaired” and “forborne” applied in the regulatory reporting, are fully compliant with the EBA definitions. Respectively exposures overdue more than 90 days are considered default (as determined in the Risk Assumption Regulation) and have to be impaired in compliance with the Impairment Policy of the DSK Group as per the IFRS requirements. The policy details also the application of individually and collectively assessed impairment.

* + 1. **Operational risk**

A primary ambition of the Bank Group is to minimise the losses arising from any inadequately defined or erroneously executed business processes, errors caused by people or non-compliant operation of systems, or losses originating from the external environment.

* + 1. **Market risk and liquidity management**

The main goal of market risk management is to protect from potential losses due to changes in foreign exchange rates, prices of investments, and interest rates. The market risk and the liquidity risk are managed in accordance with the limits agreed with the sole owner, OTP Bank, and through continuous monitoring and control over the data completeness and quality.

* + 1. **Business and Strategic risks**

The business and strategic risks are the risks that the Bank would not to be able to deliver the results expected by different stakeholders. During the identification process, we have assessed four main risks grouped into two main sub-categories:

1. Business model risks – these are risks which are embedded in our business model and could impact the mid and long-term performance of the Bank.

2. Strategic risks – these are risks related to the proper definition and execution of the strategic objectives of the organisation.

* + 1. **Reputation risk**

The main goal of reputation risk management is not to allow unfavorable perceived image of the Bank Group, loss of trust of clients, counterparties, shareholders, investors, regulatory bodies, rating agencies and employees as a result of Bank Group activity or the activities of the Bank Group employees. That could therefore lead to lower sales and market share, deteriorated relations with contractors and customers, as well as weakened financial indicators, losses imposed by negative public attitude, publications and statements in the mass media and e-media and other affecting the institution events which lead to a reduction in the client base or income or to court procedures.

In addition, DSK assesses the risk related to the need for providing financial support to connected unconsolidated entities in order to prevent possible adverse reputational impact on the Bank Group (step-in risk).

* 1. **Description of the operational risk management**

Operational risk management control is performed through identification, analysis, monitoring and limitation of the operational risk in DSK Bank Group and its subsidiaries.

Operational risk management is performed through identification, analysis, monitoring and limitation of the operational risk in DSK Bank and its subsidiaries.

DSK Bank has adopted the following categorisation of operational risk events:

|  |  |
| --- | --- |
| **Event-Type Category** | **Definition** |
| Internal fraud | Any intentional act or omission, most often related to non-compliance with or circumvention of laws, regulations or internal prescriptions, in which at least one employee of DSK Group participates and which aims at the perpetrator or another person receiving undue benefits, at the expense of loss or damage suffered by the victim. |
| External fraud | Any intentional act or omission, most often related to non-compliance with or circumvention of laws, regulations or internal prescriptions, in which no employee of DSK Group participates and which aims at the perpetrator or another person receiving undue benefits, at the expense of loss or damage suffered by the victim. |
| Employment Practices and Workplace Safety | Operational events related to non-compliance with labor legislation or serious violation of the ethical rules as per the Code of Ethics of DSK Bank, whether unintentionally, due to negligence or intentionally. |
| Clients, Products & Business Practices | Operational events due to non-fulfillment of the Bank's obligations to its clients or non-compliance with main regulatory and legal requirements for the Bank's activities (market abuse in relation to trading with financial instruments, violation of anti-money laundering measures and financing of terrorism, unfair competition, misuse of confidential information, etc.) as well as all types of unfair commercial practices - misleading advertising, aggressive commercial practices such as persistent and unsolicited messages to customers and others. |
| Damage to Physical Assets | Operational risk events causing destruction or damage of the Bank's physical assets, besides normal wear and tear, waste and depreciation, most often caused by natural disasters or human actions, even intentionally. |
| Business disruption and system failures | Operational risk events that disrupt the business continuity, interrupt some of the activities of the Bank, cause difficulties in the functioning or failure of the information and communication systems and services, used in the Bank for executing its activity and providing services. |
| Execution, Delivery & Process Management | Operational events due to unintentional or negligent errors in the execution of processes, omissions in the activity, poor management of business processes and relationships with business partners, suppliers and external vendors. |

The Bank uses the following methods for managing operational risk:

* Internal operational risk events data collection and analysis - starting from 2010, all operational risk events are registered in a single electronic register of OTP Bank – SAS. Each operational event includes the following basic information: date, description, business line, taxonomy (type of event) related to credit/ market risk, geography, gross loss amount, recovery amount (including from insurances). The internal data is used for the capital calculation according to the Advanced Measurement Approach (AMA) at OTP Banking Group level;Data collection and analysis of the operational risks inherent for the particular business processes, conducted within the regular process of risk-control self-assessment and definition of appropriate measures to mitigate the identified high risks. Data is used for the capital calculation according to the Advanced Measurement Approach (AMA) at OTP Banking Group level;
* Data collection and analysis of the potential impact of significant operational risk events with catastrophic consequences, conducted within the scenario analysis process. Data is used for the capital calculation according to the Advanced Measurement Approach (AMA) at OTP Banking Group level;
* Maintaining and up-dating the Key Risk Indicators system, regular monitoring and reporting of their values, undertaking the adequate measures in cases of deviations and increase of the risk;
* Regular model risk assessment;
* Regular business impact analysis;
* Regular risk assessment the locations where DSK Bank and its subsidiaries operate;
* Regular conduct risk assessment;
* Regular control testing of the efficiency of some of the controls implemented in the business processes to mitigate operational risks;
* Maintaining an up-to-date system for risk tolerance and regular monitoring of the risk tolerance level in relation to the actual internal losses from operational risk events;
* Root cause analysis, implementation of mitigating measures and monitoring of an action plan in case of an extraordinary event;
* Regular risk assessment of the outsourced critical or important functions in accordance with the Outsourcing Policy;
* Regular assessment of the reputational risk that may arise from the usage of information and communication technologies;
* Regular identification of positions having a material impact on the risk profile of DSK Bank Group, and on the assessment procedure;
* Regular assessment of the adequacy of the allocated capital for operational risk, calculated by OTP Group on the Advanced Approach (AMA approach) the purpose of which is to assess the adequacy of capital for operational risk for internal purposes and thus verify whether the capital set aside by the Group adequately covers the unexpected loss from operational events. The components used in the calculation are the following: internal loss data, external loss data, scenario analyzes and risk control self-assessment.

The hierarchy reporting of occurred operational events is based on the "bottom-up" approach. Responsibility for identifying and managing risk lies upon the so-called Process owners, which are employees of a managerial positions in the Head Office of the Bank, the Regional Centers or the subsidiaries, appointed by the Heads of the Divisions to be responsible for the organisation and the execution of the business process, as well as upon the senior management. For this purpose, Internal Rules for Operational Risk Management have been developed and are in force.

An independent unit has been created - the Operational Risk Management Section at the General Policy and Risk Management Directorate, part of the Risk Management Division, which carries out methodological and operational control over the operational risk management in DSK Bank and supports the execution of the above activities, the results of which are regularly reported to the Operational Risk Management Committee, the Bank's Management Board and OTP Bank.

Every year the bank performs a stress test for operational risk. Its main purpose is to provide a forward-looking, quantitative assessment of the operational risk losses that the Bank may suffer in case of certain unfavorable changes in the macroeconomic conditions or other factors in the operating environment. A key component of the stress testing is to estimate weather and to what extend various economic, political, geopolitical, environmental, social or other changes affect the materialisation of the operational risk. For that reason the Operational Risk Stress Testing process covers all possible different types of events according the classification above with realistic scenarios for possible aggravation of both their severity and/or frequency. The purpose is to analyse whether the Bank has sufficient capital in hypothetical adverse operational risk scenarios. The Stress Testing program includes analysis of the main pillar of those involved in AMA modelling for the purpose of the calculation of the operational risk capital requirement – the Internal operational loss data.

DSK Bank has concluded several insurance policies that cover losses arising from operational risk (e.g. material damage, theft of valuables) detailed in the insurance policy. The need to insure a new risk or change the parameters of an insurance contract for already covered risk can be identified as a result of: analysis of data from annual processes of self-assessment of operational risk and scenario analysis, analysis of occurred operational events, the results of key risk indicators, the analysis of the insurance claims and the received or refused insurance indemnities, normative or regulatory requirement that require the Bank to insure against the occurrence of a certain risk, another change in the circumstances and environment in which the Bank operates. This need to insure a new risk or change the parameters of an insurance contract for already covered risk can be identified by the Operational Risk Management Section, the unit managing (owner of) the insurance contract and the owners of business processes in the Bank.

The process of identifying, measuring and managing the risks related to the outsourcing of banking activities to external providers is also within the scope of operational risk management and reflects the current requirements of the European and national legislation. The classification of the outsourced activities and the determination of the critical or important ones for the Bank, the established mechanisms for control and surveillance on the external providers by the Bank and the supervisory bodies, the defined minimum obligatory contractual conditions, the risk assessments and the due diligence of the external providers and the developed exit strategies aim to limit the risks from the execution of activities by external providers, to avoid the risk of concentration and strong dependence on external contractors as well as to ensure the business continuity in case of unforeseen circumstances related to the ability of the vendor to perform the assigned activity.

As a part of the Bank's operational risk management framework, the management of model risks arising from the used internal models is included. The model risk management aims to build an environment with proper controls by identifying the used models, their categorisation and evaluation, as well as compliance with the requirements of the implemented controls.

Another method of assessing operational risk is the valuation of potential reputational losses arising from the use of information and communication technologies (ICT risk) and in particular from disruptions in the availability and expected functioning of information and communication services and systems used in the Bank.

The framework for assessing operational risk includes another emerging risk - environmental, social or governance risk - ESG (risk to sustainability). It represents an environmental, social or governance event or condition that, if it occurs, could cause a negative material impact on the value of the investment and/or assets, financial and earnings situation, or reputation of the Bank. This risk is taken into account in the annual self-assessments of the business processes, as well as in the process of collecting information on operational events.

An inventory of the products provided by the Bank is carried out annually. The purpose of the process is to assess the incurrence of reputational risk resulting from incorrect sales practices and to minimise the risk of financial loss and loss of customers’ trust. The Rules for coordination of credit, payment and deposit products of DSK Bank AD stipulates that when the development of products requires the implementation of a new process, system or activity, or the implementation of significant changes in existing ones, they must be analysed and assessed in terms of all risks associated with them, including the various categories of operational risk in order to determine their impact on the risk profile of the Bank and to ensure the introduction of appropriate measures for their management and control.

The Bank also has a Business Continuity Strategy on the basis of which a detailed Business Continuity Plan has been developed, aimed at ensuring the recovery of the most important business processes to levels predetermined by its business needs. In accordance with it and the Procedures for restoration of the business processes in the bank, a BCP test is performed annually to certify the readiness of the Bank to restore its processes in case of unforeseen circumstances and crisis scenarios.

Operational risk is subject to periodic review by DSK Bank's Internal and Audit Directorate, which performs a regular annually inspections in accordance with the annual audit plan. Additionally, in order to ensure a regular and systematic review of the operational risk management strategies, a review of the Operational Risk Management Rules and activities, related to Operations Risk Management is performed once a year. The current trends in the development of risk regarding major Bank activities are analysed and measures are proposed for its elimination or limitation. The residual risk is reported to the Management Board.

1. **Regulatory Capital Requirements**

As of 31.12.2022 the Bank Group has to maintain the minimum amount of or above the sum total of the capital requirements for:

* Capital requirements for:
* credit and dilution risk in the banking book;
* position risk in the trading book;
* counterparty and settlement risk from the entire activity;
* exchange rate and commodity risk from the entire activity and
* operational risk from the entire activity.
* Pillar 2 Capital requirement (P2R) of 1.8%. If applied to Tier 1 the Pillar 2 Requirements is 1.35% and if applied to the Common Equity Tier 1 the P2R is 1.01% .
* Capital buffers, required from the Bulgarian National Bank according to the Regulation:
* Capital conservation buffer - 2.5 % of total risk exposure;
* Systemic risk buffer - 3 % of total risk exposure;
* Institution-specific Countercyclical capital buffer – 0.95 %;
* Other Systematically Important institution buffer – 1 % of total risk weighted exposure.
* Pillar 2 Capital Guidance of 2%.
	1. **Regulatory capital**

Total own funds are the sum of common equity Tier 1 capital, additional Tier 1 capital and Tier 2 capital, reduced by specific deductions according to provisions of Regulation 575/2013.

The scope of regulatory consolidation of DSK Bank Grоup is provided in the following attached Excel table: ***EU LI3: Outline of the differences in the scopes of consolidation (entity by entity)*.**

Quantitative information on total own funds and capital ratios is provided in the following attached Excel table: *Capital:* *Total own funds*.

Total own funds and capital ratios

The Bank Group calculates the total capital adequacy (the “Basel ratio”) as a ratio between total own funds for solvency purposes and the total of the risk-weighted assets for credit, market and operational risks. The Tier 1 capital adequacy is assessed by the division of the Tier 1 capital by the total risk weighted assets and it shall excced the regulatory minimum level of 16.80% incl. combined capital buffer and P2G. The CET 1 capital adequacy reported by the Bank should be higher than 14.96%. The total capital adequacy, according to the regulatory framework, ratio should be higher than 19.25% incl. capital buffers and P2G.

Quantitative information showing the reconciliation between balance sheet items used to calculate own funds and regulatory own funds is provided in the following attached Excel table with the same name: *EU CC2 : Reconciliation of regulatory own funds to balance sheet in the audited financial statements .*

 Capital instruments’ main features are presented in the following attached Excel table: *EU CCA: Main features of regulatory own funds instruments and eligible liabilities instruments.*

 The completed own funds disclosure template for 2022 can be provided in the following attached Excel table: *EU CC1: Composition of regulatory own funds*. Note: There is an impact on DSK’s CET1 capital in Q4 2022 stemming from the temporary treatment of unrealised gains and losses measured at fair value through other comprehensive income in view of the COVID-19 - per Art. 468 of the Regulation.

 Quantitative information covering available own funds, risk-weighted exposure amounts, combined buffers, leverage ratio, Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) is provided in the following attached Excel table: **EU KM1: Key metrics template.**

There is no difference between accounting and regulatory scopes of consolidation. The respective quantitative information is provided in the following attached Excel table: ***EU LI1: Differences between accounting and regulatory scopes of consolidation and the mapping of financial statement categories with regulatory risk categories.***

Quantitative information on the main sources of regulatory exposure amounts and carrying values in financial statements is provided in the following attached Excel table: ***EU LI2: Main sources of differences between regulatory exposure amounts and carrying values in financial statements.***

* 1. **Capital requirements**
		1. **Capital requirements for credit risk**

DSK Bank Group applies the standardised approach for calculating its risk-weighted assets for credit risk. For this purpose the Bank Group multiplies its Banking book positions by risk weights fixed from the Regulation or BNB when there is possibility for local regulator’s discretion, based on the external credit assessment of each asset issuer. The risk-weighted assets should consist of: risk-weighted on-balance sheet assets, risk-weighted off-balance sheet equivalents, OTC derivative instruments weighted for counter party risk and Trading portfolio positions weighted for counterparty risk.

For risk weighted calculation of rated exposures the Bank Group uses external credit assessments of the following credit agencies: Standard & Poor's, Moody's and Fitch Ratings with strict observation of the requirements of the Regulation. ECAIs assessments are used for the next exposure classes: central governments or central banks, multilateral banks and institutions.

Quantitative information regarding the amounts of risk weighted assets and capital requirements is provided in the following attached table: ***EU OV1: Overview of RWAs***.

CCR related mainly to OTC derivatives, REPO-transactions, lending/borrowing of securities or commodities, margin transactions and transaction with prolonged settlement. It is originated by adverse movements in market prices deteriorating credit quality of the counterparty and reveal the risk of counterparty to fall under default before final settlement of transaction.

Bank Group reduces the CCR by using different technics – system of limits and/or via accepting of high liquidity callaterals which are approved as per rules and procedures

The Bank Group manages CCR which are undertaken through the deals by strict rules based on preliminary approved limits of maximum risk exposure (counterparty limit) to counterparty group and/or counterparty.

The Bank Group has approved rules concerning detailed rights and responsibilities of different units of Bank DSK and OTP Bank, Hungary, related to preparation, monitoring and control of counterpary limits set. Approved counterparty limits are obligatory before conclusion of deals with financial institutions. The Council of Credits and Limits (CCL) approves counterpary limits under the competences of Management Rules of the Bank.

The Bank Group acts through policy of CCR reducement by mandatory observation of procedures for margin call, assessment of collateral’s market prices as guarantee of deals fulfilment by counterparties which do not have approved limits. For this purpose the Bank Group uses the approved relative risk weights as per type of transactions and counterparties. If there is no approved counterparty limit as a rule the Bank Group accepts as collateral in transactions with financial institutions cash freezed on account.

In accordance with Regulation 575 No. 575/2013 since 1Q 2021 DSK Bank Group has started applying the derivatives’ exposure value following the Original Exposure Method in accordance with article 282, paragraph 2. For the purpose of the application of this method the Bank Group complies with the requirement of article 273a, paragraph 2, namely - the size of its on- and off-balance-sheet derivative business is equal to or less than both 5% of the group's total assets or EUR 100 m.

Quantitative information analysing the CCR exposure by approach and the exposures to CCPs is provided in the following attached Excel tables, respectively: ***EU CCR1: Analysis of CCR exposure by approach*** and ***EU CCR8: Exposures to CCPs*.**

For the purposes of credit risk mitigation the Bank Group applies Financial Collateral Simple Method. During the process of credit risk mitigation for the purposes of capital calculation the Bank Group recognises collaterals as follows: financial collaterals - debt securities and cash on deposits; guarantees; secured by first line mortgage residential property insured in favour of the Bank Group and commercial property.

Quantitative information on the credit risk mitigation techniques is provided in the following attached Excel table: ***EU CR3: CRM techniques overview: Disclosure of the use of credit risk mitigation techniques*.**

Quantitative information on the credit risk exposure following the Standardised approach, as well as the credit risk mitigation effects is provided in the following attached Excel table: ***EU CR4: Standardised approach – Credit risk exposure and CRM effects*.**

 **Capital requirements for market risk**

Market risk is the risk arising from unexpected and adverse changes in market factors that affect the Bank Group's performance or the value of its financial instruments. These may be changes in interest rates, securities prices, exchange rates, negative information, political and economic crises.

Interest rate risk (IRR) is a potential loss from adverse changes in fair value of interest rate sensitivity positions after change of market interest rates. IRR originates form available interest bearing exposures in interest sensitivity instruments as the vast majority of potential loss is a result of adverse market movements of interest rates. Such a movement affects open interest bearing positions and requires special regulation.

Foreign exchange risk (FXR) is the risk of negative changes in value of foreign currency exposures, originated by changes in foreign exchange rate. Positions in foreign currencies /including gold/ bears FXR and have immediate effect on current and potential cash flows of the Bank Group in currency different from local one as the assets and liabilities are every day revaluated.

The policy of the Bank Group regarding management of FXR aims bearing of currency exposures which do not generate losses endangering income of the Bank Group or its safety under observation of all regulatory boundaries. The Bank Group determines its aims of income from foreign currencies exposures based on preliminary approved business plan and strategy.

Concerning the bearing of market risk the strategy of the Bank Group as a part of Bank OTP is in compliance with strategic aims adopted by the Group, local Risk appetite and characterises as a conservative one. Market Risk is observed and contolled through strict build limits system, composed of limits for FXR and IRR. The system of market risk limits are defined in manner which requires on time close-outs of positions with minimum losses. With this purpose there are approved limits for positions by financial instruments, currencies and maturities, turnover rate for bonds and maturity limits, stop-loss limit and triggers, VaR and BPV limits.

All limits of market risk is approved by ALCO of the Bank, after reconciliation and approvement by OTP Bank. These limits are subject of review and actualisation every year taking in account new business targets, possible changes in determinated risk apetite or business strategy.

FXR of the trading portfolio is controlled by position limits set on open currency total position and positions by every single currency (intraday and daily) as well as limit of total open currency position. Utilisation of open currency position limits is observed daily from Market risk Management Section and releated report is sent to the management of the Bank. Every breach of limits is analysed on time and relevant communication is made for the reasons of limits breach and measures undertaken for elimination.

The interest risk of the trading portfolio is controlled daily by unit “Market risk Management” section based on limits of maximum exposures divided by categories as per issuer of securities and maturities; BPV limits as per time bands and currency through permited currencies BGN, EUR and USD; VaR and ES limits and stop loss limits and triggers.

For the purpose of market risk management historical stress test model is used for calculating VaR. Assesment of market risk of portfolio is detrmined by VaR calculation which indicates loss in value within confidence level of probability for time horizon that won’t be exceeded. At present moment historical models are used for determination of Value at Risk for period 252 days, 1 day maintenance period, confidence level 99 % and standard deviation 2.33.

Organisation structure of the companies from the Bank Group related to process of market risk undertaking is built to ensure independency of the units responsible for control of business units.

Risk-weighted assets for position risk on the Trading book and risk-weighted assets for exchange rate risk on both the Trading and the Banking books compile the risk-weighted assets for market risk.

* *Capital requirements for position risk*

Capital requirements for both general and specific risk in each currency are calculated applying standardised approach for the Bank Group's debt securities in the Trading portfolio.

To calculate the capital requirements for general position risk, the Bank Group uses maturity approach where the net position in each debt instrument is assigned a risk weight depending on its residual term to maturity. Fixed-rate instruments shall be assigned on the basis of residual maturity, and variable-rate instruments - on the basis of the period until the next interest rate change.

To calculate the capital requirements for specific risk, the net position in each debt instrument is assigned a risk weight related to the instrument issuer, its external credit assessment and its residual term to maturity.

Quantitative information on the risk-weighted assets for market risk under the standardised approach iss provided in the following attached Excel table: *EU MR1: Market risk under the standardised approach.*

* *Capital requirements for exchange rate risk*

A capital charge for exchange rate risk for the positions in both the Trading and the Banking book is applied only when the net open currency position exceeds 2% of the regulatory capital. Quantitative information regarding the FX risk capital requirements is provided in the following attached Excel table: ***FX risk: Capital requirements for foreigh exchange risk as at 31 December 2022***.

* *As of December 31, 2022 the Bank Group does not calculate capital for settlement risk.*
	+ 1. **Capital requirements for operational risk**

From the beginning of 2014 a Joint Decision of the National Bank of Hungary and the Bulgarian National Bank which approved DSK Bank to apply the Advance Measurement Approach for the capital calculation purposes on the individual and also on the consolidated base is in force.

The capital requirement as of 31.12.2022 is BGN 50 212 thousand.

Quantitative information on the operational risk own fund requirements and risk-weighted exposure is provided in the following attached Excel table: ***EU OR1: Operational risk own funds requirements and risk-weighted exposure amounts*.**

* + 1. **Detailed disclosure for exposure classes allocation according to criterion defined in Regulation 575**

Relevant quantitative information is provided in the following attached Excel tables:

* ***EU CR1-A: Maturity of exposures***
* ***EU CR1: Performing and non-performing exposures and related provisions***
* ***EU CQ1: Credit quality of forborne exposures***
* ***EU CQ2: Quality of forbearance***
* ***EU CQ3: Credit quality of performing and non-performing exposures by past due days***

А significant change, as compared to 2021, is being observed in a decreasing direction by the non-performing exposures, which is strongly influenced by a large volume of partial write-offs, based on statistical methodology

The statistical methodology represents the process for determination of the amount subject to a partial write-off based on statistical analysis of the maximum recovery expected for a group of exposures with similar characteristics whenever the Bank has no reasonable expectation of a full recovery of the exposures.

The main aim of the partial write-off is to present the maximum expected recovery of the exposure as the gross book value of the exposure in the balance sheet and is in compliance with the applicable IFRS and the relevant OTP Group guidelines.

Due to the implementation of the methodology, a one-off effect based on the evaluation of the entire NPL unsecured retail portfolio is booked in 4Q 2022 to the amount of BGN 250 m, whereas the rest of the effect booked in 4Q 2022 is related to the regular quarterly write-off which will be performed also in future for the NPL unsecured retail loans which migrate to DPD 180+.

The main part of written-off loans is in household sector - credit for consumption.

Relevant quantity information is provided in the following attached Excel tables:

* ***EU CQ4: Quality of non-performing exposures by geography***
* ***EU CQ5: Credit quality of loans and advances by industry***
* ***EU CQ6: Collateral valuation - loans and advances***
* ***EU CQ7: Collateral obtained by taking possession and execution processes***
* ***EU CQ8: Collateral obtained by taking possession and execution processes – vintage breakdown***
* ***EU CR2: Changes in the stock of non-performing loans and advances***
* ***EU CR2-A: Changes in the stock of non-performing loans and advances and related net accumulated recoveries***
* ***EU CR5: Standardised approach –*** Note: Since 3Q 2021 onwards DSK Banking Group has applied the alternative approach with risk weight of 1 250% for the calculation of the risk weighted exposures for investments and shares in collective investment undertakings.
* ***EU CCR3: Standardised approach – CCR exposures by regulatory portfolio and risk***
* ***EU CCR5-A: Impact of netting and collateral held on exposure values –*** Note: DSK Group has no netting agreements.
* ***EU CCR5: Composition of collateral for CCR exposures*** – Not applicable. DSK Bank Group does not have such type of activity.
* ***EU CCR6: Credit derivatives exposures*** - Not applicable. DSK Bank Group does not have such type of activity

* 1. **COVID-19**

On 11 March 2020 the World Health Organisation declared a COVID-19 pandemic, and on 13 March 2020 the Bulgarian Parliament imposed a state of emergency in Bulgaria, as a result of which a number of restrictive measures were taken.

On 24 March 2020, the State of Emergency Act was promulgated, imposing measures for the period of the pandemic state of emergency in various areas – employment relations and social security, taxation and annual financial closure, default and forced execution, terms and deadlines, etc.

On 10 April 2020 the Bulgarian National Bank approved a “Procedure for deferral and settlement of liabilities payable to banks and their subsidiaries – financial institutions, in relation to the state of emergency imposed by Parliament on 13 March 2020” (the “Procedure”), resulting from the COVID-19 pandemic and consequences thereof. The Procedure allowed borrowers affected by the restrictive measures applied to defer the repayment of their debts to financial institutions. The Procedure initially provided for deferral possibility for up to 6 months, not later than 31 December 2020. Consequently, the Procedure was amended and the period was extended to 31 March 2021. Pursuant to a new BNB decision, dated 10 December 2020, the Procedure’s effect was extended until 31 December 2021, and borrowers were allowed to defer repayments to financial institutions for a period of 9 months.

After 31 March 2021 no borrowers could take advantage of moratorium agreements. For this reason as of 31 December 2022 in the loan portfolio of DSK Bank there are no loans under moratorium.

On the 17.01.2022 EBA confirms the continued application of COVID-19 related reporting and disclosure requirements until further notice.

Uncertainty of COVID 19 situation persists, and so the need to monitor exposures and the credit quality of loans with public support measures in those Member States, where those are still relevant.

The EBA will continue to monitor developments and will further reassess the application of the Guidelines on the reporting and disclosure of exposures subject to measures applied in response to the COVID-19 crisis in the future.

EBA publishes its closure report of Covid-19 measures on the 16.12. 2022 and repeals its Guidelines on Covid-19 reporting and disclosure from 01.01.2023.Relevant quantitative information is provided in the following attached Excel tables:

* ***CVD-19-1: Information on loans and advances subject to legislative and non-legislative moratoria*** – Note: COVID-19 template 1 does not contain any values as of the reporting dates 31 December 2022 and 30 June 2022 because the morations have expired. For this reason, this template is no longer disclosed.
* ***CVD-19-2: Breakdown of loans and advances subject to legislative and non-legislative moratoria by residual maturity of moratoria***
* ***CVD-19-3: Information on newly originated loans and advances provided under newly applicable public guarantee schemes introduced in response to COVID-19 crisis***
1. **Liquidity risk**

DSK Bank manages its exposure to liquidity risk by:

* accumulating an adequate level of high-quality liquid assets (HQLA);
* developing a modern system for liquidity risk management covering exposures in adequate manner;
* applying a transparent management process;
* performing monitoring and preparing regular and well-grounded analyses and reports to the management body.

The Bank has set in place a Liquidity Risk Management policy (LRMP). The policy sets out a robust liquidity management framework which is well integrated into the Bank risk management process. It clearly defines the internal liquidity governance and the liquidity risk measurement and control practices.

The main body for liquidity management is the Asset and Liabilities Management Committee (ALCO). ALCO reports its activity to the Management board quarterly or on demand if needed. Balance Sheet Management Department (BSM) within Assets and Liabilities Management Directorate (ALM) is the unit that performs constant monitoring and prepares a regular information and proposals to the ALCO concerning management of liquidity in short and long term (Market risk section is a second line of defence as well).

DSK Bank uses information from various sources to monitor the liquidity position on daily and monthly base. In case of deviations from the strategy or significant changes in liquidity, they are reported to the Group and Local ALCO in order corrective measures to be undertaken.

DSK Bank maintains adequate level of liquidity buffer, so that it can fulfil its obligations in different currencies, when they come due.

Once a year DSK Bank carries out an internal liquidity adequacy assessment process (ILAAP). The final ILAAP report is submitted and approved by the Management Board prior to being sent to the supervisory authority.

DSK Bank has large and well-diversified deposit base. The prevailing part of attracted funds is from retail clients. For that reason, there is not concentration to any client or group of clients.

Exposures in derivatives is not significant. Derivatives are used mainly for servicing corporate and financial clients.

Liquidity coverage ratios (LCR) and Net Stable Funding Ratio (NSFR) areabove the regulatory and internal limits for the whole year.

Liquidity management in foreign currencies is to a large extent coordinated with OTP Group. Irrespective of the level of centralisation of the liquidity management function, the Bank applies group methods and standards for measurement and reporting of liquidity.

There are no significant positions in terms of liquidity that are not considered in the LCR and NSFR.

LCR disclosure template on quantitative information of LCR which complements Article 435(1)(f) of Regulation (EU) No 575/2013 is provided in the following attached Excel table: ***EU LIQ1: Quantitative information of LCR.***

NSFR disclosure template on quantitative information in accordance with Article 451a(3) CRR is provided in the following attached Excel table: ***EU LIQ2: Net Stable Funding Ratio***

1. **Interest rate risk arising from non-trading book activities (IRRBB)**

Exposure and management of interest rate risk of non-trading book activities

1. Interest rate risk of non-trading book activities relates to the current or prospective risk to both the earnings and the economic value of an institution arising from adverse movements in interest rates that affect interest rate sensitive instruments from non-trading book activities. Management of the interest rate risk seeks to maintain the level of interest rate risk exposure according to the risk strategy and predefined limits. The Bank uses two core indicators:
	1. Change in Net Interest Income (∆NII) - Earnings-based measure
	2. Change in Economic Value of Equity (∆EVE) - Economic value measure
2. DSK Bank manages interest rate risk of non-trading book activities in accordance with the regulatory guidelines and OTP Group rules. DSK Bank controls its exposure to interest rate risk of non-trading book activities by determining acceptable thresholds for risk levels. These acceptable thresholds are defined by limits that reflect the overall strategy and risk appetite of the Bank for this risk type. The risk appetite is expressed in terms of acceptable level of impact of interest rates on both the earnings capacity and economic value of the Bank.

The Management board is ultimately responsible for the management of the interest rate risk of non-trading book activities. Assets and Liabilities Committee (ALCO) develops the interest rate risk strategy and develops the interest rate risk management framework in accordance with the defined interest rate risk appetite. ALCO ensures that the appropriate controls, procedures and information flows are in place to support implementation of the Bank’s strategy and follow-up. DSK Bank Risk Committee monitors and oversees the current and future risk appetite and strategy of the Bank, considering all types of risks as well as the implementation of the strategy for capital and liquidity management, in order to assess its adequacy against the approved risk appetite and strategy.

The Bank uses models and calculation tools developed by the group which are independently confirmed by an independent unit. Management of the interest rate risk seeks to maintain the level of interest rate risk exposure according to the risk strategy and predefined limits. Interest rate risk exposure is managed by minimizing discrepancies between repricing volumes and repricing dates of interest-bearing assets, liabilities and off-balance sheet items.

1. Interest rate risk of non-trading book activities is monitored on an ongoing basis. The change in Net Interest Income (∆NII) and change in Economic Value of Equity (∆EVE) indicators are calculated on a quarterly basis. Ad-hoc analyses are performed when circumstances mandate it. The main sources of risk are:
	1. Gap risk – Risk resulting from the term structure of interest rate sensitive instruments that arises from differences in the timing of their rate changes, covering changes to the term structure of interest rates occurring consistently across the yield curve (parallel risk) or differentially by period (non-parallel risk).
	2. Basis risk – Risk arising from the impact of relative changes in interest rates on interest rate sensitive instruments that have similar tenors but are priced using different interest rate indices. It arises from the imperfect correlation between the interest rate indices used as a base for interest rates earned and paid on different instruments with otherwise similar repricing characteristics.
	3. Option interest rate risk – a type of interest rate risk that arises from interest rate option derivative positions or from optional elements embedded in bank’s assets, liabilities or off-balance sheet items, where the bank or customer can alter the level and timing of cash flows on contracts.
2. Quarterly stress test and scenario analysis are performed to assess the magnitude of interest rate risk. For regulatory purposes DSK Bank reports NII and EVE measures for the 6 interest rate shock scenarios defined by EBA:
	1. Parallel shock up – A constant parallel shock up across all time buckets
	2. Parallel shock down – A constant parallel shock down across all time buckets
	3. Steepener shock – Involving rotations to the term structure of the interest rates, whereby both the long and short rates are shocked (short rates down and long rates up)
	4. Flattener shock – Involving rotations to the term structure of the interest rates, whereby both the long and short rates are shocked (short rates up and long rates down)
	5. Short rates shock up – Shock up that is greatest at the shortest tenor midpoint
	6. Short rates shock down – Shock down that is greatest at the shortest tenor midpoint
3. The primary means of hedging the interest rate risk of non-trading book activities exposure are government bond purchases and interest rate derivative contracts. Further, long-term organic adjustment is initiated via the fund transfer pricing system. The interest rate risk of non-trading book activities exposure is managed on a currency basis. The exposure related to the core deposit portfolio in the respective currencies is managed directly while the rest of the balance sheet is managed on a portfolio level. Interest rate derivatives accounting treatment is based on fair value.
4. Assumptions are necessary to address on the one hand the circumstantial modelling parameters which are not covered by contractual attributes of the deals (business and other assumptions) and on the other hand the factors that modify the contractual repricing characteristics (behavioural assumptions). In order to address this the Bank uses prepayment and withdrawing modelling. The elasticity of adjustment of product rates to changes in market rates is assessed and migration of balances between product types dependent on the interest rate environment is considered. Non-maturing accounts are separated to core and non-core depending on their interest rate sensitivity.
5. The variations in Net Interest Income (∆NII) and Change in Economic Value of Equity (∆EVE) between 31.12.2021 and 31.12.2022 are due to the increased balance sheet of the Bank and the increased market interest rates expectations after most central banks started to increase their interest rates.
6. The average repricing maturity assigned to non-maturity deposits from retail and non-financial wholesale counterparties is 2.5 years.
7. The longest repricing maturity assigned to non-maturity deposits from retail and non-financial wholesale counterparties is 15 years.

Relevant quantitative information is provided in the following attached Excel table: ***EU IRRBB1: Interest rate risks of non-trading book activities***.

1. **Leverage**

DSK Bank Group estimates the leverage ratio according to Regulation (EC) 575/2013, art. 429 and the following improvements as a proportion between CET 1 and the total leverage exposure in percentage.

As of December 31, 2022 the leverage ratio is 10.49 %.

Quantitative information connected with the fulfilment of Regulation (EC) 575/2013, art. 451 and Commission implementing regulation – EU 2016/200 is provided in the following attached Excel tables:

* ***EU LR1 - LRSum: Summary reconciliation of accounting assets and leverage ratio exposures***
* ***EU LR2: LRCom - Leverage ratio common disclosure***
* ***EU LR3 - LRSpl: Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures).***
1. **Countercyclical Capital Buffer (CCyB)**

According to Directive 2013/36/EC, Part VII, Chapter 4 the Bank Group have to keep CCyB which purpose is to protect against potential losses, resulting from accumulated system cyclical risk in period of exess credit growth.

The CCyB is regulated with Ordinance No. 8 of the Bulgarian National Bank for capital Buffrs of the banks. BNB discloses information for the fixed level of CCyB and ups to date it quarterly. The level of CCyB for the period until the end of the first quarter of 2022 is 0.5% and from 1 October 2022 the Regulator increases the countercyclical capital buffer applicable to local credit risk exposures to 1.0%.

The specific for the Bank Group CCyB is also 0.95%.

Relavent quantitative information is provided in the following attached Excel tables:

* **EU CCyB1: Geographical distribution of credit exposures relevant for the calculation of the countercyclical buffer**
* **EU CCyB2: Amount of institution-specific countercyclical capital buffer**
1. **Pillar 2 Requirement (P2R)**

The Pillar 2 requirement (P2R) is a bank-specific capital requirement which is determined on the basis of the Supervisory Review and Evaluation Process (SREP).

Under Articles 431(1), 433a(1) and 438(b) of the Capital Requirements Regulation (CRR), large institutions (as defined in Article 4(1)(146) of the CRR) are required to disclose their P2Rs on an annual basis.

As a result of the performed in 2022 Supervisory Review and Evaluation Process (SREP) the Joint Supervisory Team (JST) determined for DSK Bank microprudential capital requirement of 1.8% for 2022 as Pillar 2 Requirement on consolidated and individual level of DSK Bank to be held in the form of:

* 56.25% of Common Equity Tier 1 (CET1) capital /1.01% as CET 1/;
* 75% of Tier 1 (T1) capital / 1.35% as T1/;

The total SREP Capital Requirement of DSK Bank Group is 9.8%.

Effective from January 2023 the P2R becomes 1.94% on consolidated and individual level of DSK Bank to be held in the form of:

* 56.25% of Common Equity Tier 1 (CET1) capital /1.09% as CET 1/;
* 75% of Tier 1 (T1) capital / 1.46% as T1/;

The total SREP Capital Requirement of DSK Bank Group for 2023 is 9.94%.

1. **Internal Capital Adequacy Assessment Process (ICAAP)**
2. **Capital Management and Internal Capital Structure**

The determination of the required ratios and levels of capital is a part of the annual business planning and risk management process of the Bank and revision of its long-term strategy. The internal management and analysis of the capital adequacy aim at maintaining an adequate amount of internal capital according to the level determined by the Bank’s management which corresponds to the risk profile of the bank and to its quality of management through respective systems for risk management. The following principles should be followed:

* A transparent corporate structure which ensures effective and reasonable risk management;
* Clearly defined levels of reporting and distribution of the tasks and responsibilities;
* The entire process of risk management in the Bank is managed by the Management Board;
* Comprehensible and effective systems for risk control and internal control which are independent from the controlled activities;
* The effective internal control system consists of three independent functions – risk control, adherence to rules, and internal audit;
* Public announcement and transparency of the bank’s activity and operations;
* The Bank regulates the management process of every significant type of risk within separate rules.

The plan for development of the capital base is consistent with the goals for development of the Bank’s activity and the acceptable levels of risk for achieving these goals. So far, the short- and long-term goals of the Bank have always been set within its current risk profile without predicting significant changes in the levels of influence of the separate risk components. This allows a relatively reliable assessment of the necessary development of the capital base and respective planning of an adequate capital position.

The Bank calculates the capital requirements during each process of planning, forecasting, or long-term strategic goal setting. On a regular basis the Bank conducts an updated rolling forecast in order to assesses the sustaibability of the approved business plan and strategy and to assesses the impact from deviations from plan on capital adequacy.

The necessity of capital calculated according to regulatory requirements, as well as according to the Internal Capital Adequacy Assessment Process (ICAAP), represented by two different approaches – according to DSK Bank’s policy and based on the supervisory assessment (SREP). The regulatory requirements shall be fulfilled with a reasonable reserve above the stipulated minimum. In case the ability to provide capital to cover the higher of the two (with a reasonable reserve above the minimum capital requirement according to the regulatory requirements or the result reached under ICAAP) is under question, the Bank reviews its objectives and risk profile.

**Structure of the total capital resource of the Bank**

The Bank asseses its capital resource as of the end of 2022 in accordance with Directive 2013/36/EU and Reglament (EU) №575/2013 as well as according to the Internal Capital Adequacy Assessment in normative and economic perspective.

**Capital Structure in the Normative perspective**

 The internal capital in the normative perspective is equal to the regulatory own funds (incl. post-budget developments) according to the approved capital plan of DSK Bank.

Relevant quantitative information is provided in the following attached Excel table: ***ICAAP - Capital structure - Normative perspective***.

**Capital Structure in the Economic perspective**

The economic capital or the so called Available Financial Resources (AFR) represent the economic view on the amount of the capital that is available to cover losses in a going concern perspective, in line with the chosen from us ICAAP approach.

The amount of regulatory Own Funds (Regulatory capital in normative perspective) is the starting point for the quantification of AFR. On top of this amount certain adjustments are made in order to ensure consistency with the economic value concept underlying the economic perspective.

Relevant quantitative information is provided in the following attached Excel table: ***ICAAP - Capital structure – Economic perspective***.

The concept of the economic capital is to include in it:

* Capital elements with long term character (i.e. share capital, general reserves)
* Items which represent deductions of regulatory CET 1 but are related to the profit generation on a long-term basis (i.e. Goodwill, intangible assets)
* FV adjustments on balance-sheet items - eventual difference between fair value and book value is included in the AFR to assure consistency with economic capital calculation and coherence with overall risk assessment.

Excluded from economic capital are:

* CET 1 elements with short term character are excluded (i.e. transitional arrangement related to IFRS 9 which shall be applied until the end of 2024)
* Tier 2 instruments – Tier 2 capital instruments are not included in the AFR, in accordance with ECB guide on ICAAP (Nov-18), as these components would have loss-absorption capacity only in the case of non-continuation of the institution.

Details on FV adjustments on balance-sheet items:

* FV adjustments on loan portfolio – the calculation is done by stepping on the residual maturity structure of the portfolio as of 31.12.2022. The methodology is based on NPV of cash flows.

Relevant quantitative information is provided in the following attached Excel table:***ICAAP - Capital adequacy parameters.***

The Bank Group has a stable and adequate capital position which allows coverage of the risks specific to its operations. DSK estimates a capital buffer compared to both the regulatory requirements for capital adequacy and the necessary capital base obtained as a result of internal capital adequacy assessment under both normative and economic perpsective. This capital buffer is a result mainly from the followed policy for capitalisation of profit from previous years, as well as a reasonable risk management and defining risk appetite in the activity. As a result of these the Bank Group has a sufficiently stable position of Tier I capital.

1. **Internal Risk Assessment**

According to 2022 risk identification process the following risks specific to the actiiviry of the Bank were covered in ICAAP

* Credit risk
* Market risk
* Operational risk
* Liquidity risk
* Interest rate risk of non-trading book activities (IRRBB)
* Credit spread risk of non-trading book activities (CSRBB)
* Business and Strategic risks
* Reputational risk (incl. step-in risk)
* Environmental risk

The identified risks are divided in their assessment based on their nature into:

* Risks evaluated in normative perspective;
* Risks evaluated in economic perspective.

These are two different concepts, which inform each other but are not directly comparable.

This separation into economic and normative perspective enables a more holistic approach in the ICAAP calculations as both expected (predictable) risks and hidden extraordinary risks inform each other building a comprehensive estimation for the losses the Bank is exposed to. Generally, the economic losses are perceived as hidden losses that might occur in addition to the losses in the normative perspective. For this reason, the assessed capital to be allocated in the economic perspective is considered as an add-on to the estimated capital need in the normative perspective in order to fully assess the capital needed for coverage of both normative and economic risks.

1. **Additional capital under ICAAP**
* **Additional capital for credit risk**

For the purpose of ICAAP DSK Bank assesses the required capital for counterparty credit risk using the following calculation:

**Internal Capital Requirement (CR) = Total loss (TL) – Expected Loss (EL) = Unexpected Loss (UL)**

As at 31.12.2022 the capital requirement for credit risk is above the capital requirement of the standardised approach and additional capital for counterparty credit risk is allocated in the normative and economic perspectives.

As final outcome, for credit risk DSK Bank stands at BGN 1 224 049 thousand under the normative perspective and BGN 1 423 828 thousand under the economic perspective.

Assessed were also counterparty credit risk arised from FX deviation, from supply chain disruption and the residual risk from concentration collateral price decrease but the results from these calculation did not lead to additional internal capital allocation.

DSK Bank also assessed concentration risk and in country risk in normative and economic perspective but the calculations indicated that no additional internal capital has to be allocated.

* **Additional capital for market risk**

Additional capital for currency risk*:*

In accordance with the adopted interbank rules, the currency positions on trading portfolio are monitored on a daily basis. Additionally, an independent of the business unit calculates and reports the condition of the positions and the risk of the positions as a whole for the Bank. The level of currency risk is measured through VaR models, prepared based on the applied stressed values of currency rates. The model is back-tested regularly and the results are reported to the management of the Bank periodically.

The additional capital that the Bank allocates according to the calculations regarding the level of currency risk is lower than 0.1% from the capital base.

Additional capital for interest rate risk in the trading portfolio

In the assessment of the interest rate risk in the trading portfolio of the Bank are applied models which generally assess the exposure and VaR. The applied VaR has a confidence level 99% and 1 day time horizon. As most of the assets in the portfolio are not actively traded on the market, the management considers that VaR is not an adequate tool for the allocation of the capital requirements. Therefore for the assessment of the capital requirements of the trading portfolio is applied the result from the standardised method, while the additional capital requirements are based on the applied stress-test scenario.

Overall, the total required capital for market risk for 2022 is assessed at BGN 7 573 thousand under both the normative and economic perspectives, the main driver being interest rate risk in the trading portfolio.

* **Additional capital for interest rate risk of non-trading book activities (IRRBB)**

The capital requirements for this type of risk are based on the applied stress-test scenarios. They are done according to Guidelines on the management of interest rate risk arising from non-trading book activities – EBA/GL/2018/02. The Bank calculates two main indicators – change in the net interest income (NII: an earning-based indicator) and change in the economic value of equity (EVE: a value-based indicator). There are limits set for those two indicators in the interest rate risk in the banking book management policy of the Bank. For the calculation of capital needed under ICAAP the impact of all shocks scenarios is calculated as a sum of positive and negative changes in net interest income (in the normative perspective) and economic value of equity (in the economic perpsective). This is done for every significant currency. Then the results for each of the indicators are taken into consideration accordingly for the normative and economic perspectives..

Based on the asset and liability structure, the management considers that the proposed standard shock determines adequately the level of interest rate risk of the Bank and the result should be used for determining the required capital. The required capital for 2022 is assessed at BGN 74 231 thousand under the normative perspective and BGN 70 418 thousand under the economic perspective.

* **Additional capital for credit spread risk non-trading book activities (CSRBB)**

Credit spread risk is part of the IRRBB process. It is the risk driven by changes of the market price for credit risk or other potential characteristic that is not captured through the other existing IRRBB metrics. The Bank holds available for sale (AFS) securities that are subject to credit spread risk. CSRBB is calculated in the economic perspective based on the IRRBB management policy, taking into consideration bond market value, bond modified duration and an applied spread shock. The required capital for CSRBB for 2022 under the economic perspective is assessed at BGN 27 739 thousand.

* **Additional capital for liquidity risk**

The liquidity risk management principles of the Bank are following all regulatory and OTP Group requirements and sound bank practices. The Bank has set in place a Liquidity Risk Management policy (LRMP). The policy sets out a robust liquidity management framework which is well integrated into the Bank risk management process. It clearly defines the internal liquidity governance and the liquidity risk measurement and control practices. The Bank has established monitoring system for all regulatory, OTP Group and internally defined indicators. On a regular basis are executed liquidity stress tests to assess the sufficiency of the liquidity position. In addition, DSK Bank incorporated Contingency Funding Plan which defines the management actions during periods of liquidity stress.

The Bank considers that the capital is not an adequate tool for covering liquidity risk.

* **Additional capital for operational risk**

For the purpose of the normative perspective under ICAAP the bank assesses the capital needed for operational risk coverage applying the Advanced Measurement Approach (AMA) which is also applied for the assessment of the regulatory requirement for operational risk according to Pillar I requirements.

In the еconomic perspective DSK Bank assesses additionally aspects related to internal and expernal fraud, business disruption risk, cyber risk and compliance risk

The assessed required capital for operational risk in the fourth quarter of 2022 amounts to BGN 50 212 thousand. under the normative perspective through the Advanced Measurement Approach. In the economic perspective the internally allocated capital for operational risk is BGN 83 227 thousand.

* **Additional capital for business and strategic risks**

The business and strategic risk assessment is performed based on two main components, each one having two sub-categories, i.e.:

1. Business model risks, further categorised into:
* Client base structure - this is a risk related to the decreasing potential of our client base to generate the necessary economic value in a long-term perspective. There are two main directions of the decreasing potential: overall demographic trend in Bulgaria and client base composition effect (the age buckets split).
1. Strategic risk, further divided into:
2. Operating environment - this is a risk related to not proper assessment of the operating environment or extraordinary events which could change the general framework and respectively could impact negatively the results of the Bank. The risk is incorporated in the following three building blocks: (1) Recovery Indicators Monitoring; (2) Risk Appetite Framework and (3) Business rolling forecasts (sensitivity analyses on the officially approved business plan). The assessment of this risk is based on the expected effects from the sensitivity analyses performed.
3. Digital transformation & labour market overheating - the risk is related to the strategy of the Bank to become a leader in digital banking. It depends on the successful implementation of the transformation programme which includes change of the operating model (develop in-house capabilities and more flexible approach of working based on agile and service design principles), renew of core technology and ensuring that all of that is performed in secured environment. In this relation, DSK’s strategy accomplishment in due course also depends to a great extent on the timely recruitment of highly qualified IT specialists with proven knowledge in order to guarantee a smooth digital transition. The current challenging situation on the Bulgarian labour market associated with resource supply scarcity, however, fuels the digitalisation-related risk. Respectively, taking that into account, DSK Bank identifies a principle risk related to the bank not reaching its cash loan sales target. At this stage, however, setting additional capital aside is not considered, as this process is more so managed as part of the recruitment activities.

The described risk will overall result in inability to meet clients’ expectations which respectively will lead to lower number of clients and lower market share of digital sales.

Although under the normative perspective there is no need for allocation of additional capital for business and strategic risks, according to the economic perspective the capital requirement stands at BGN 295 755 thousand.

* **Additional capital for reputational risk**

For the purpose of reputation risk assessment in the normative perspective the Bank has developed a monitoring system which reflects different aspects related to the image of the Bank. In case the indicators breach a predefined threshold additional capital for reputation risk shall be allocated. Additionally, DSK assesses step-in risk in relation to possible adverse reputational impact from connected unconsolidated entities (Company for Cash Services and DSK Asset Management) based on historical data for provided financial support to these companies in order to avoid negative customer perceptions and publicity.

In 2022 the above-mentioned indicators remained below the given thresholds but because of the inherent risk of events which are not under the direct control of the Bank and which could not be foreseen, allocated is additional capital buffer of the amount of BGN 7 908 thousand for reputational risk coverage under the normative perspective (based on internal assessment and reflecting the allocated capital for step-in risk).

DSK Bank has assessed reputation risk in the economic perspective due to possible negative impact on the bank’s image from OTP’s subsidiaries in Russia and Ukraine. In general, in situations where the attention of the mass public is drawn by specific events, media representatives contact proactively the credit institutions due to the relevance of the topic. This media approach gives the opportunity to banks to share deliberate information and influence the mass public without additional cost. However, due to the retail business model of DSK Bank in case of events which impact negatively the image and perception of the Bank, it is highly probable that an image campaign will be launched. Respectively, the expected cost for an image campaign is allocated as capital for reputation risk in the economic perspective (as an add-on to the normative perspective) which means total internal assessment for economic perspective of BGN 8 830 thousand under the economic perspective (also considering the allocated capital for step-in risk).

1. **ICAAP stress tests**

For the purpose of ICAAP the Bank conducts stress tests in the normative and the economic perspectives covering all identified risks in order to enable assessment and analysis of its ability to meet a negative impact of significant adverse changes in the risk components, which are beyond expectations during the normal planning process. The results from the ICAAP stress test shall be used for assessment of the capital depletion in case of adverse development of the environment which in its essesence is comparable with the determined by the competent authority P2G.

In order to enhance the stress-testing process and to ensure that all the material risks are properly integrated, the Bank applies three different approached for stressing risks in the above-mentioned perspectives:

* Bank-wide stress-testing (risks impacted by the macroeconomic and operating environment) – credit risk and business & strategic risks;
* Risks stressed by idiosyncratic events – operational and reputational risks;
* Risks stressed by separate models – market risk, interest rate risk of non-trading book activities (IRRBB) and credit spread risk of non-trading book activities (CSRBB).

The risks with highest impact within the context of ICAAP stress testing are:

* Credit risk, where, in the regular stress test under the economic perspective the Bank also assessed additional  internal capital for counterparty credit risk arising from higher inflation and increasing interest rates amounting to BGN 100 000 thousand. Under the economic and stressed internal assessment an additional capital charge is anticipated coming to BGN 2 819 thousand, for environmental risk impacting counterparty credit risk;
* Business & strategic risks, incorporating the assumption that DSK Bank fails to improve the share of the consumer loan sales through digital channels in total new consumer loans and therefore remains considerably below its long-term target, it is thus expected that potential profit will be not realised. From this perspective in the economic stress test the bank allocates internal capital amounting to BGN 18 400 thousand;
* Operational risk, including add-ons representing potential losses in the economic perspective for ICT risk, external and internal fraud, compliance risk, as well as environmental risks. These add-ons amount to 16 502 thousand.

The ICAAP stress tests in economic perspective are performed in order to place focus on economic value considerations, unexpected losses or long-term threats that can materially diminish DSK Bank Group’s risk bearing capacity. The stress test in the economic perspective therefore aims to reveal possible threats which could lead to higher allocated capital for risk coverage and lower available financial resources. The combination of both indicates the extent to which DSK Bank Group is resilient to the joint realisation of risks under economic considerations. It is also indicative of the realisation potential of the separate risk categories when an assumption for stress is applied as these could deviate significantly from their baseline values.

The results of the economic stress tests supplement the normative stress test outcome which is rather short-term oriented due to its alignment with the business planning time horizon of three years.

As a result of the conducted calculations and stress tests, a conclusion could be made that the Bank has sufficient capital to meet the regulatory requirements as well as a sufficient capital buffer to meet a more risk-sensitive environment.

*Reverse stress test conduction*

DSK Bank performs a reverse stress under both the normative and economic perspectives in order to estimate potential factors that could lead to insufficient capital coverage and to explore which conditions in the macroeconomic environment could lead to such an event.When conducting the stress test, which is performed using projected data for the end of 2023, the capital buffer levels as of the end of 2023 have been respectively applied.

*Reverse stress testing in the normative perspective*

These conditions should be major effects leading to breach of the following elements of the targeted capital level by the Bank:

* Management buffer
* Pillar 2 Guidance (P2G)
* Countercyclical capital buffer
* Capital conservation buffer

Considering the strategy of DSK Bank and its shareholders for preserving its activity as a credit institution and the size and systemic importance of the Bank the sum of the following capital targets should be considered a trigger for breaching capital adequacy within the reverse stress test:

* Minimum capital requirement of 8%;
* Pillar 2 Requirement of 1.94% determined for DSK Bank;
* Systemic risk buffer;
* Other-systemically important institution buffer (O-SII buffer).

In order to report a capital adequacy level below 13.94% (i.e. the above-mentioned trigger for breaching capital adequacy) in December 2025, DSK Bank has estimated the amount of total losses that have to be generated during a 3-year period.

There were 2 scenarios defined where the generated risk cost and expenses offset the revenues in the 3-year period and lead to a loss as annual financial result:

1. Credit risk loss – the sole driver in this scenario being the deteriorated loan quality in all bank products. Compared to the published forecast by the International Monetary Fund and the Bank of England for the expected GDP growth in Russia in 2022, this scenario assumes even a more severe shrinkage of the economy than in a country with imposed severe international sanctions on multiple levels and the resulting international isolation of the economy.

Combined effect from several risks – credit risk combined with operational event with impact on reputational and liquidity risk, the aim being to explore how accelerating loan portfolio deterioration can be supplemented by losses from these other risks so that the joint effect can lead severe capital depletion although each of the risks observed separately has not such a major negative effect. The macroeconomic indicators underlying the targeted loan exposure deterioration in this scenario are compared to the forecasted macroeconomic values for Russia. The comparison with the expected 2022 economic standpoint of Russia indicates that such scenarios can be realised in extreme situation differing from a pure economic crisis.

*Reverse stress testing in the economic perspective*

The main purpose of the ICAAP reverse stress test in the economic perspective is to identify possible threats for available financial resources which contribute to the strong loss absorption capacity of the bank.

The trigger for the reverse stress test a loss absorption capacity of 100%.

The severity of the reverse stress test is reached through the following assumptions impacting the loss absorption capacity of the bank:

* + The risks to which DSK is exposed in the economic perspective are considered with their stressed value from the regular stress test;
	+ The available financial resources as risk bearing capacity are challenged through possible negative impact from the environment (i.e. interest rates curves).
1. **Minimum Requirement for Own Funds and Eligible Liabilities (MREL)**

The MREL requirement has been introduced by Directive 2014/59/EU. Effective from 1 January 2022 the defined for DSK Bank MREL requirements became binding. A 3-year transitional period has been set by the resolution authorities allowing for gradual increase of the MREL targets until 1 January 2024.

According to the Joint Decision of the Resolution Authorities DSK Bank has to comply with the MREL requirements in 2022 on a **standalone basis**.

Please refer to Chapter ***III. Minimum Requirement for Own Funds and Eligible Liabilities (MREL)*** of DSK Bank’s Standalone ***Year End Disclosure according to Regulation 575/2013 on prudential requirements for credit institutions and investment firms*** for 2022 for more details.

1. **Asset Encumbrance Policy**

In 2014 the Bank accepted policy aiming to regulate asset encumbrance. The policy corresponds with Recommendation B - Risk management of asset encumbrance by institutions of European Systemic Risk Board (ESRB).

With the policy the Bank defines groups of assets that could be encumbered: securities from the Bank’s portfolios; cash on accounts of the Bank and other cash receivables from third parties.

Relevant quantitative information on consolidated asset encumbrance data as of 31 December 2022 is provided in the following attached Excel tables:

* ***EU AE1: Encumbered and unencumbered assets***
* ***EU AE2: Collateral received and own debt securities issued***

Sources of encumberance

DSK Bank Group encumbers assets mainly for collateralisation of liabilities to State Budget according to The Public Finance Act. Assets pledged are more than liabilities to State Budget because of the specific of prices used and the discount applied from regulator on each emission.

Received as collateral government debt securities are connected with repo deals with OTP Bank. The coverage of exposures is controlled on daily basis on current market prices.

Relevant quantitative information is provided in the following attached Excel table: ***EU AE3: Sources of encumbrance.***

1. **Remuneration Policy and Practices**
2. **Remuneration Policy of the Bank**

The decision-making process is in accordance with the Remuneration Policy keeping the OTP Banking group standards.

* 1. **Information relating to the bodies that oversee remuneration.**

In Bank DSK operates independent Remuneration Committee (the Committee) that oversee the remuneration. The Committee consists of three members, elected by the Supervisory Board from among its members for a period of 3 (three) years, currently with a mandate until 20.08.2025. The majority of the committee members are independent within the meaning of art. 10a, point 2 of the Credit Institutions Act.

The Committee is delegated to review, and make recommendations to the Supervisory Board on the Group’s remuneration policy and practices. The RemCo ensures that all employees and identified staff are appropriately remunerated in accordance with the Group’s strategy as well as its long-term and short-term performance. In 2022, the Committee has held 3 (three) meetings.

Scope of remuneration policy: a. Institutional scope – all subsidiaries of DSK Bank included in prudent consolidation; b. personal scope - Members of the Management Board, Supervisory Board, Executive Directors and Heads of Divisions of DSK Bank AD and Banking Group Subsidiaries are classed as identified staff members. According with the classification of art. 0, members of the management bodies of DSK Bank belong under the consolidated-level personal scope.

The personal scope of the Remuneration Policy has been determined on three levels:

* **consolidated-level** personal scope includes those (staff members identified at consolidated level) whose professional activity has a material impact on the risk profile of the entire OTP Group;
* **sub-consolidated-level** personal scope includes those staff members whose professional activity has a material impact on the risk profile of the DSK Bank and their subsidiaries;
* **local-level** personal scope includes those staff members whose professional activity has a material impact only on the risk profile of DSK Bank only.

Bank DSK applies the same rules as for the identified staff for all the other managers out of the scope of the Remuneration policy but directly reporting to executive directors.

Remuneration Committee directly oversees the remuneration of the senior officers in the independent control functions, including the risk management, internal audit and compliance functions, and make recommendations to the Supervisory Board on the design of the remuneration package and amounts of remuneration to be paid.

* 1. **Information relating to Design and structure of the remuneration system for identified staff:**

The most important principle of the Bank Group Remuneration Policy is that the rate of performance-based remuneration (variable element) – subject to the preliminary and subsequent evaluation of risks – is relevant to realisation level of the targets at bank group/bank and individual level.

The basic principle of the performance measurement and assessment system is to link the rate of performance-based remuneration – with ex-ante and ex-post assessment of risks – to the degree of the accomplishment of Bank strategic-level and objectives in the framework of a **two-level performance measurement system:** to the level of fulfilment of strategic goals, and individual objectives (numerical indicators, individual targets and competences)

By placing emphasis on institutional targets, the two-level system contributes to the clear definition and monitoring of priorities, and ensures the better tracking of individual performances, thereby improving the flexibility of the performance assessment system.

The criteria of institutional-level performance assessment are as follows:

* For **Bank DSK**, group-level RORAC+ (risk-adjusted ROE/COE), C/I (Total non-interest expense in % of total income), Market Share indicators,
* For **leasing company**, the return on assets (ROA).

Individual targets are assigned among the number of specific indicators (qualitative KPI’s) carefully précised every year and focused on the specific business targets and risks measurement.

The Remuneration Policy stipulates differentiated income levels conforming to the value of the jobs and based on classifications. The remuneration comprises fixed and performance-based remuneration. The fact that the amount of the fixed remuneration for the persons belonging to the scope of the Policy is high enough to provide compensation for the professional work and is in line with the level of education, ranking, the required level of experience and skills, and the relevant business sector ensures the enforcement of a flexible remuneration policy.

Performance measurement system applied in Bank DSK is very sensitive to the key risks and business strategy performance. Institutional goals are combined with individual targets depending on the business line and position of the manager in the hierarchy of the Bank in particular proportions, which form final evaluation of contribution of each manager.

In Bank DSK no award of guaranteed variable remuneration is applied. Mandatory severance payments are paid to identified staff, according to the provisions of Labor Code of Bulgaria.

* 1. **Description of the ways in which current and future risks are taken into account in the remuneration processes.**

The link between risk and remuneration is guaranteed by directly linking the variable remuneration ratio with the relevant risk profile.

The main criterion for performance measurement related to performance-based remuneration is return on risk adjusted capital (RORAC+ (ROE/COE)), which is included in the strategic goals for each assessed person. Set of indicators measuring different type of risks (credit risk, liquidity risk, ESG risk) are included in the KPI library.

KPI library is reviewed on an annual basis. Depending on the position and level of hierarchy mandatory indicators are stipulated. *Prudent operation* *and pursuit of controls* is a mandatory KPI for all the positions.

* 1. **The ratios between fixed and variable remuneration set in accordance with point (g) of Article 94(1) CRD:**

In DSK Bank the variable elements of the remuneration do not exceed 100% of the fixed elements from the total remuneration for each person, in compliance with the applicable regulatory provisions.

The performance remuneration based on performance appraisal of the managers identified on consolidation level in the scope of the Remuneration Policy takes place uniformly in the form of cash bonus and shares in the proportion of 50-50%. As a general rule 60% of the performance-based remuneration specified for individual level shall be deferred for period of five years following the performance evaluation, during which period the deferred installments shall be paid at an equal rate (12%-12%-12%-12%-12%) in accordance with the procedure and deadline set forth in the applicable internal regulation.

The performance remuneration based on performance appraisal of the managers identified on sub-consolidation and local level in the scope of the Remuneration Policy takes place uniformly in the form of cash bonus and synthetic shares, in the proportion of 50-50%. 40% of the performance-based remuneration specified for individual level shall be deferred for period of four years following the performance evaluation, during which period the deferred installments shall be paid at an equal rate (12%-12%-12%-12%-12%) in accordance with the procedure and deadline set forth in the applicable internal regulation.

It is possible to omit the application of the deferral and share based payment rules in case of those consolidated, sub-consolidated or local level identified positions, where the established performance-based remuneration on a yearly basis 1) does not exceed EUR 50 000 provided that the ratio of performance-based remuneration to total remuneration; 2) does not exceed 33.33%.

The ratio of the fixed and performance-based remuneration connected to the various positions of additional persons belonging to the scope of the Remuneration Policy is established, based on the subject to the consideration of the aspects below:

* performance appraisal system and method of defining the risk levels;
* length of the deferred appraisal and payment period, and of the retention period;
* the structure of the organisational unit / Bank Group member affiliate, nature and complexity of its activity;
* position of the employees within the organisational hierarchy, and risk assumption/decision-making levels allocated to the various positions.
	1. **Ways in which the institution seeks to link performance during a performance measurement period with levels of remuneration.**

Individual bonus amounts are defined within the annual performance appraisal process, based on the principles of transparency and clarity to ensure a direct link between variable remuneration and performance. The final evaluation reflects the individual performance and is directly applied in the calculation of the variable remuneration.

Performance-based remuneration based on performance evaluation is provided uniformly in the form of a cash bonus and share awards, in equal (50/50) proportions. The form of share awards differs among the identified people at consolidated or sub-consolidated and local level.

The share-based portion of variable remuneration for staff identified at consolidated level is settled, as a general rule, either in the form of remuneration converted into shares or as preferentially priced share award:

* **Remuneration converted into shares** means the conversion of the share-based portion of performance-based remuneration into OTP Bank’s ordinary shares, at the share price determined by the Supervisory Board of OTP Bank Plc. The number of units of remuneration converted into shares, per individual, is determined by the ratio of the amount of performance-based remuneration given in shares and the price of the share.
* A **preferentially priced share award** is the right to purchase OTP Bank ordinary shares at a discounted price, under the parameters determined by the Supervisory Board of OTP Bank Plc. In the case of a preferentially priced share award, the number of shares per individual is determined by the ratio of the amount of the share-based variable remuneration and the value of the share award.
	1. **Description of the ways in which the institution seeks to adjust remuneration to take account of long-term performance.**

**Deferral and retention rules relating to performance-based remuneration**

* The performance-based remuneration payable to identified persons under a deferred payment schedule is divided up into short-term (non-deferred) and deferred instalments.
* 50% of the share-based part (shares or virtual shares) of the short-term (non-deferred) instalment of the performance-based remuneration is retained for one year in the case of staff identified at consolidated level. Accordingly, for staff identified at consolidated level, half of the short-term (non-deferred) instalment of the share-based performance-based remuneration is the non-retained part, while the other half is the retained part. Bank DSK may specify a retention period which is longer or of higher proportion.
* With respect to the deferred instalments, the ex post risk adjustment is applied. With respect to the retained part, an ex post risk adjustment only needs to be applied insofar as the clawback rules are applicable in respect of the retained part.
* For staff identified at consolidated level, 60% of the performance-based remuneration awarded at the individual level is deferred.
* For staff identified at sub-consolidated and local level, 40% of the performance-based remuneration awarded at the individual level is deferred.
* For staff identified at sub-consolidated and local level, 60% of the performance-based remuneration is deferred if the total remuneration awarded to the identified person in the year preceding the assessed year exceeded EUR 240,000.
* The deferred part of the performance-based remuneration is paid out in equal instalments. It may be required that the deferred performance-based remuneration is only paid out in the last year of the deferral period.
* At the earliest, the short-term (non-deferred) instalment may be paid out in the year following the assessed year, the first deferred instalment and the retained part in the second year following the assessed year, and the remaining deferred instalments annually thereafter.
* In respect of those shares which make up the share-based part of the share-based performance-based remuneration, and which will be paid to the identified employee in the future (deferred and retained part, ESOP member’s share), the employee does not have a right of disposal (so as an example for this part he/she is not entitled to conclude a preliminary or binding contract, and cannot offer it as a collateral), and moreover, concerning these shares he/she is not entitled for dividends until the time of acquiring such shares.

Relevant quantitative information is provided in the following attached Excel tables:

* ***EU REM1: Remuneration awarded for the financial year***
* ***EU REM2: Special payments to staff whose professional activities have a material impact on institutions’ risk profile (identified staff)***
* ***EU REM3: Deferred remuneration***
* ***EU REM4: Remuneration of 1 million EUR or more per year***
* ***EU REM5: Information on remuneration of staff whose professional activities have a material impact on institutions’ risk profile (identified staff)***

**The description of the main parameters and rationale for any variable components scheme and any other non-cash benefit is in accordance with point (f) of Article 450(1) CRR.**

The incentive system provides a balanced structure of “upfront” and “deferred” payments, in cash and/or in shares, to be paid over a multi-year period for all Identified Staff.

**Information on whether the institution benefits from a derogation laid down in Article 94(3) CRD in accordance with point (k) of Article 450(1) CRR.**

With reference to the remuneration paid in 2022, no derogation was applied pertaining to art. 94 paragraph 3 of the CRD.

1. **Pillar 3 disclosure of environmental, social and governance risks (ESG) risks**

Under Article 449a of Regulation (EU) No 575/2013, large institutions which have issued securities that are admitted to trading on a regulated market of any Member State shall disclose information on environmental, social and governance (ESG) risks. Pursuant to Article 18a(3) of Commission Implementing Regulation (EU) 2021/637 of 15 March 2021 in conjunction with Article 1(1) of Commission Implementing Regulation (EU) 2022/2453 of 30 November 2022, institutions shall disclose the information referred to in Article 449a of Regulation (EU) No 575/2013 as from 31 December 2022. The qualitative and quantitative information that institutions in scope must disclose and the associated instructions for the disclosures of ESG risks are defined in Annex XXXIX and Annex XL respectively to Commission Implementing Regulation (EU) 2021/637 of 15 March 2021.

DSK Bank AD has been designated as an Other Systemically Important Institution (D-SII) and is accordingly a large institution under Article 4 (146) (b) of Regulation (EU) No 575/2013, but has not issued securities that are admitted to trading on a regulated market of any Member State. Considering the above mentioned, DSK Bank AD is outside the scope of Article 449a of Regulation (EU) No 575/2013 and does not disclose information on environmental, social and governance risks.

