Head Office

Strategy, Finance and Operations Division

YEAR END DISCLOSURE

DSK Bank Group

According to

Regulation 575/2013 on prudential requirements for

credit institutions and investment firms

2023

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**Please note, all tables containing quantitative information have been exported in a separate Excel file: *DSK Group\_Disclosures\_2023\_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 2023 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 21.2% compared to 20.3% at the end of 2022. 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 19.3% which improved compared to a year ago, when the share was 19.0%. DSK Bank has the largest branch network in the country with 292 branches as of December 31, 2023, which accounts for a share of 16.4% in the banking system.

For 2023 DSK Bank Group reports a profit after tax of the amount of BGN 1 025.6 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 2013 on 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 and emerging 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 as well as by ensuring a risk profile in line with the risk capacity expressed via capital;
* DSK Bank Group and OTP banking group strive to develop 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 risks are subject to ongoing control in order to ensure they are limited within acceptable boundaries.

Bank Group uses stress tests for estimation and analysis of the capacity to meet negative effects from significant adverse changes in risk components that can appear instressed situations or in rapid growth environments. Stress tests are performed for the material risks arising from the activities of the Bank. Stress test scenarios can range from adverse macroeconomic developments to measuring sensitivity to certain factors which increase the risk for specific risk types or for the entire Bank. Bank-wide stress scenarios are determined for every performed test considering the management view regarding relevant threats, potential changes in the environment and considering the bank-specifics. Three scenarios apply for the bank-wide stress tests: baseline, adverse and optimistic. Each of them impacts differently the profitability and capital position, providing a holistic view about the risk bearing capacity of the Bank. Results from the performed stress tests are presented to the management and are used as a basis for strategic managerial decisions and for operational steering of the institution.

* 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 Bank recognises that risk-taking is a fundamental aspect of its operations. The risk identification establishes the necessary mechanisms to detect, quantify, and monitor risks at an early stage, as well as to manage their potential influence on the Bank’s business objectives. In this regard, the risk identification is a crucial component of the overall risk appetite framework, allowing the Bank to identify the risks it is exposed to, evaluate their materiality, and ultimately set appropriate processes and limits, having a forward-looking perspective.

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

The risk identification process follows the so called “gross approach” meaning it does not consider 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 using the risk capacity (measured through capital) as a basis as well as considering:

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

(2) The probability 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:

1. Risks based on principles/rules:

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

2. 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
* Climate-related and 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 Governance Rules of DSK Bank.

DSK Bank employs the three lines of the defence model to manage risks and implement internal controls: The three lines of defence are:

1. The functions that are responsible for the risks (risk owners) and manage those risks (first line);
2. The functions exercising independent control over the risks;
3. The functions providing independent assurance (third line)

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, Operational Risk Management Committee, Retail Credit Risk Committee and Corporate Credit Risk Committee. Furthermore, the Head of the Risk Management Division is a member of the Data and Analytics Committee, the Product Development, Pricing and Sales Committee and the Assets and Liabilities Committee.

The independent Risk Management Division, as a second line of defence function, is responsible for defining and supporting the implementation of risk management frameworks and for identifying, monitoring, analyzing, measuring, and managing risks at the second level, in cooperation with or and independently of the first line of defence. In this role, it can initiate a review and provide recommendations for strengthening of controls set up at the first level, and support business areas in taking mitigation steps.

The compliance function is fulfilled by the Compliance Directorate of DSK Bank. It performs its activities in accordance with the legislative requirements, by focusing on controlling and managing the compliance risks associated with key areas of compliance, and namely: data protection, consumer protection, ethical issues, conflict-of-interest situations, adherence to international sanctions, anti-money laundering and counter-terrorism financing (AML/CFT), and capital market compliance. Compliance Directorate is also responsible for ensuring compliance with international tax agreements, participates in the process of coordination of internal banking documents and products and considers their compliance with the current legal framework and the supervisory requirements from the perspective of the key areas of compliance, and performs legislation monitoring.

Risk taking units, as the first line of defence, are primarily responsible for taking risks and managing them on an operational day-to-day basis in line with the institution’s policies, procedures, and control mechanisms. To ensure this, risk taking areas are responsible for incorporating and operating appropriate first-level controls into their processes, which ensure timely identification, monitoring and management of risks (including adherence to risk appetite and other risk limits) and their reporting to second-line of defence functions. Their responsibility also extends to compliance with legislative, supervisory and internal requirements for their own activities. Accordingly, the first line of defence plays a key role in establishing and operating a strong risk management of an institution and in complying with legal and supervisory requirements.

The audit function constitutes the third line of defense and strives to strengthen the Bank’s ability to create, protect and sustain value by providing independent, risk-based, and objective assurance, consulting, insight, and foresight. The internal audit function brings a systematic, disciplined approach to evaluate, and improve the effectiveness of governance, risk management, and control processes, as well as to enhance the reputation of DSK Bank.

The activities of the three lines of defense are supported by appropriate systems and controls, which are constantly evolving to address the ever-growing demad for timely and data driven decisions. Data from all key information systems is stored in a structured manner in data warehouse. It is used for steering management decisions and for regulatory reporting purposes. Numerous Indicators are subject to constant monitoring through dashboards reviewed by relevant monitoring managers, specialized committees and the management in its executive and its supervisory function.

On that basis the management of DSK Bank considers the mechanism employed to manage risks adequate to the business model, the size and complexity of DSK Group.

* 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 such as the Banking Group maintains its long-term sustainability. This goal is realised through considering of expected losses related to events which have occurred, 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 Banking 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.

The Risk Strategy of DSK Bank summarises the approach to risk, the risk management vision, mission, values, objectives, and the strategic initiatives that support management of risks within the set risk appetite. The Risk strategy incorporates the Risk Appetite Statement

**Risk Appetite Framework**

The Risk Appetite Framework (RAF) is the overall approach, including policies, processes, controls, and systems through which risk appetite is established, communicated, and monitored. It includes the process for developing a risk appetite statement, risk limits, and an outline of the roles and responsibilities of those overseeing the implementation and monitoring of the RAF. The RAF considers material risks to DSK Bank (as identified with the annual or ad-hoc risk identification process), as well as to the Bank’s reputation vis-à-vis policy holders, depositors, investors, and customers.

The Risk Appetite Framework sets the Bank’s and the Group’s Risk Appetite and forms part of the process of development and implementation of the Risk Strategy and determination of the risks undertaken in relation to the Risk Capacity. In this respect, both the Risk Appetite Framework and the Risk Appetite Statement (RAS) documents serve a central role within the Group’s Risk Strategy and complement it, since they define respectively the framework and the boundaries within which the Bank/the Group is to operate and maintain close interlinkages with other relevant Bank documents (i.e., policies/frameworks, processes, and plans).

Specifically, the Risk Appetite Framework describes the main Risk Appetite objectives and principles, illustrates the underlying Risk Appetite procedures including the escalation and monitoring processes, presents the interaction with other key strategic processes, as well as outlines the key risk appetite governance elements, controls, and the supporting systems and IT infrastructure.

The Risk Appetite Statement represents the written articulation of the aggregate level and types of risk that the Banking Group is willing to accept, tolerate or to avoid, to achieve its business objectives. The Statement includes quantitative measures and qualitative statements for risks assessed as material through the RIMA process.

* + 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.

For the retail segments the management of the risk is done on a portfolio basis. The process is supported through rules, regulations and procedures as well as by appropriate limits subject to a review and approval on an annual basis or more frequently, if needed (e.g. in case of material changes in the operating environment).

In the non-retail segment decisions are 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.

As of 31.12.2023 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 employees and responsible units in each subsidiary of the Group take decisions on credits according to the provided powers per the internal 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.
  + Collection 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, fulfilment 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 appetite**

The objective of DSK Group is to maintain the existing and new loan production with a quality which ensures sustainably profitable operation in the long term. The Group aims at a diversified and healthy credit portfolio, which is profitable over the lifetime cycle and is in line with the business strategy. It targets a portfolio without any major concentrations in a particular sector, geographical region or debtor group. The Group considers it of utmost importance to have proper sensitivity to identify changes in the economic climate (e.g. energy prices, inflation, interest rate/FX trends) in due time and adopt appropriate actions to manage the risks potentially spreading into DSK Group’s credit portfolio, thus limiting potential negative influence of internal or external factors over the existing portfolio and the new volume.

**Lending guidelines**

The objective of DSK Bank 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 “default”, “impaired” and “forborne” applied in the regulatory reporting, are fully compliant with the EBA definitions.

Climate-related and environmental risk management is on the top of the agenda for DSK Bank. DSK Banking Group aims at becoming the regional leader in financing a fair and gradual transition to a low-carbon economy and building a sustainable future. The Banking Group is committed to considering all relevant factors in loan origination and to further incorporate them into existing risk management frameworks taking a proportionate and risk-based approach.

* + 1. **Operational risk**

DSK Bank Group considers operational risk as a natural consequence of business operations pursuing the achievement of the business objectives. The Banking Group aims to minimize potential financial loss, inefficiencies and reputational damage arising from operational risk through continuous improvements on its operational risk management framework, and by designing and implementing effective controls to reduce operational risk while supporting business development.

The purpose of operational risk management is to generate added business value for the Banking Group by reducing the cost of operational risk. In order to achieve this goal, the fundamental part of the framework is the determination and monitoring of the level of risk appetite, taking risk-reducing measures in the event of threshold breach, introducing new controls, and testing existing controls.

* + 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.

It is performed by defining and maintaining an adequate limit system and by closing positions as necessary, while interest rate and exchange rate risks are maintained at a level that is consistent with the strategy and risk appetite.

The Banking Group aims to ensure low volatility regarding trading and banking book results and to minimize its sensitivity to yield curve shifts, exchange rate or financial instruments price changes. Market risks presented in the banking book or those undertaken for trading purposes are managed and monitored separately both in terms of organization and in terms of tools.

The Banking Group considers the liquidity risk with utmost importance and has established a sound liquidity management framework, which is compliant with the regulatory and the Group requirements and streamlined into strategic liquidity management and operational liquidity management. DSK Bank has a limited appetite for liquidity risk. The Bank aims to retain sufficient liquidity buffers to ensure a sound liquidity position and maintain liquidity ratios in excess of minimum requirements. Taking into account the limited tolerance towards liquidity risk the Bank accepts the potentially increased costs of maintaining excess liquidity buffers.

* + 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 unfavourable 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).

DSK Bank Group is reluctant towards reputational risk. Reputational risk management is integrated within the risk management philosophy of the Group. All activities of the Banking Group are subject to reputational risk assessment, whereas respective measures are taken to minimize this risk. DSK Bank Group considers reputation as crucially depending on its corporate identity and the way this identity is communicated to its stakeholders. The Banking Group aims at preserving a sustainable reputation as a reliable business partner and continuing building positive image through various programs, initiatives, corporate social responsibility, transparent communication and public relations management.

* 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.

DSK Bank Group 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 labour 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-fulfilment 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 Department at the Non-financial 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 unfavourable 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 Group 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 ensure a new risk or change the parameters of an insurance contract for already covered risk can be identified by the Operational Risk Management Department, 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 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 31.12.2023 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 1.94%. If applied to Tier 1 the Pillar 2 Requirements is 1.45% and if applied to the Common Equity Tier 1 the P2R is 1.09% .
* 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 – 1.84%;
* Other Systematically Important institution buffer – 1 % of total risk weighted exposure.
* Pillar 2 Capital Guidance of 1.75%.
  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 exceed the regulatory minimum level of 17.55% incl. combined capital buffer and P2G. The CET 1 capital adequacy reported by the Bank should be higher than 15.68%. The total capital adequacy, according to the regulatory framework, ratio should be higher than 20.03% 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 2023 is provided in the following attached Excel table: *EU CC1: Composition of regulatory own funds*.

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.***

Template EU LI1 shows that the accounting scope and the scope of prudential consolidation coincide. The EU LI1 template illustrates the main differences between the carrying amounts reported in the financial statements within the scope of prudential consolidation and the exposure amounts treated for prudential purposes as the basis for calculating risk-weighted exposures for each risk.

Items that reflect a deduction from regulatory capital are related to the intangible assets and the prudential treatment of software assets.

Template EU LI2 shows the main differences between the carrying amounts in the financial statements within the scope of prudential consolidation and the amounts of exposures to be treated for regulatory purposes as a basis for calculating risk-weighted exposures under each risk framework.

The main differences for the counterparty credit risk framework stem from the use of the Simplified Standardized Approach for the calculation of derivative exposure amounts.

EU LI2 also reports two differences in the credit risk framework, mainly due to a decrease in credit adjustments related to the easing of the effect of the introduction of IFRS9, according to Art. 473a of Regulation (EU) No 575/2013 (CRR) and an increase in the amount of provisions resulting from insufficient coverage for non-performing exposures (Art. 36, para.1, letter m)), which has a direct impact on the exposure - the basis for calculating the RWEA for regulatory purposes. The table also reflects the effect of credit conversion factors.

* 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 Banking 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, institutions and covered bonds.

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.

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

The Banking 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 counterparty limits set. Approved counterparty limits are obligatory before conclusion of deals with financial institutions. The Council of Credits and Limits (CCL) approves counterparty limits under the competences of Management Rules of the Bank.

The Bank Group acts through policy of CCR reduction 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 frozen on account.

DSK Bank Group calculates the derivatives’ exposure value applying the Simplified standardised approach, according to article 281 CRR as the sum of the replacement cost and the potential future exposure, adjusted by coefficient α. 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 10% of the group's total assets or EUR 300 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*.**

* + 1. **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 controlled 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 determined risk appetite 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 related 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 permitted 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. Assessment of market risk of portfolio is determined 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. The market risk in trade portfolio is controlled by “Market Risk Management” section of “General Policy and Risk Management” Department which is part of “Risk Management” Division. The management of the risk in Banking book is performed by “Assets and Liabilities Management” Department (ALM) as part of “Strategy, Finance and Data management” Division. Business units which perform all deals related to purchase and sale of financial instruments for corporate customers and individuals, purchase and sale of securities, for trade portfolio or for the Banking book, deals on money market as well as management of open currency position of the Bank are independent activities of the two departments – “General Policy and Risk Management” Department and “Assets and Liabilities Management” Department (ALM).

“General Policy and Risk Management” Department, Market Risk Management” section is responsible for second line of defence of banking book (ALM).

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 Banking 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 foreign exchange risk as at 31 December 2023***.

* *As of December 31, 2023 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 31.12.2023 is BGN 49 711 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*.**

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***

*From 2024 DSK Bank is officially no longer designated as “High NPL” Bank by the European Central Bank.*

In 2023 DSK Group continued to maintain a stable decreasing trend in the volume of non-performing loans as well as the corresponding ratio despite the accelerated growth in the new lending. The inflow rate and volume in the non-performing portfolio of newly deteriorated loans decreases compared to previous years. All segments report improved dynamic. The net volume of the non-performing loans and the corresponding ratio follow the same trend as the impairment coverage remains at a reasonably high level.

A number of initiatives contributed positively to the dynamic of the non-performing portfolio in 2023:

* The merger of the subsidiary OTP Factoring Bulgaria and the related portfolio cleaning
* Continuous application of the restructuring tools to boost early healing
* Accelerating the write-off and sale process through streamlining the exit and closing phase
* Improved segmentation, pooling and strategies applied
* Improving efficiency through digitalization and automation in the various phases of the collection process
* System developments to support operational management
* Rules and procedure improvements to ensure regularity and timeliness

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 Bank 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. **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) are above 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 31.12.2022 and 31.12.2023 are due to the increased balance sheet of the Bank and the increased market interest rates expectations after most central banks continued to increase their interest rates.
6. The average repricing maturity assigned to non-maturity deposits from retail and non-financial wholesale counterparties is 2.7 years.
7. The longest repricing maturity assigned to non-maturity deposits from retail and non-financial wholesale counterparties is 20 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, 2023 the leverage ratio was 11,19 %.

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 excess credit growth.

The CCyB is regulated with Ordinance No. 8 of the Bulgarian National Bank for capital Buffers of the banks. BNB discloses information for the fixed level of CCyB and ups to date it quarterly. The level of CCyB increased to 1.0% from January 2023 (previous level: 0.5%) and from October 2023 the Regulator increased the countercyclical capital buffer applicable to local credit risk exposures to 2.0%.

The specific for the Bank Group CCyB stands at 1.84% as of 2023 YE.

Relevant 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 2023 Supervisory Review and Evaluation Process (SREP) the Joint Supervisory Team (JST) determined for DSK Bank microprudential capital requirement of 1.94% for 2023 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 /1.04% as CET 1/;
* 75% of Tier 1 (T1) capital / 1.39% as T1/;

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

Effective from January 2024 the P2R becomes 1.85% on consolidated and individual level of DSK Bank to be held in the form of:

* 56.25% of Common Equity Tier 1 (CET1) capital /1.04% as CET 1/;
* 75% of Tier 1 (T1) capital / 1.39% as T1/;

The total SREP Capital Requirement of DSK Bank Group for 2024 is 9.85%.

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 sustainability 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 assesses its capital resource as of the end of 2023 in accordance with Directive 2013/36/EU and Regulation (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 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 ICAAP approach.

The core elements of the regulatory Own Funds (Regulatory capital in normative perspective) are the starting point for the quantification of AFR – in line with Principle 5 – Internal capital of high quality and clearly defined from ECB Guide to the internal capital adequacy assessment process (ICAAP). The share capital and the general reserves (which includes Reserve fund) are considered as most sustainable capital elements which have permanent character and sound quality as they can be reduced only with a prior permission of the Bulgarian National Bank according to art. 29 and art. 41 of the Law on Credit Institutions. The accumulated other comprehensive income is also included in the 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, accumulated other comprehensive income)
* 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.

With respect to the other elements of the regulatory own funds or accounting equity and their non-inclusion into the AFR formation, the considerations below should be taken into account:

* Goodwill: goodwill is an intangible asset, but also a capital asset. In accordance with the regulatory capital framework, intangible assets must be deducted at AFR equity level since they are not easily disposable in case of crisis event;
* Other intangible assets: deducted from the economic capital based on the same understanding as the previously described bullet;
* Other transitional adjustment of CET1 in relation to IFRS9 – these transitional adjustments have short-term effect till the end of 2024 which is not in line with the economic perspective aiming to show clearly, assuming the continuity of its operations, how its internal capital is available to cover risks in long-term horizon, thereby ensuring that continuity;
* Tier 2 instruments – Tier 2 capital instruments are not included in the AFR, in accordance with ECB Guide to ICAAP (Nov-2018), as these components would have loss-absorption capacity only in the case of non-continuation of the institution;
* FV adjustments on loan portfolio – the calculation is done by stepping on the residual maturity structure of the portfolio as of 31.12.2023. 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 perspectives. 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.

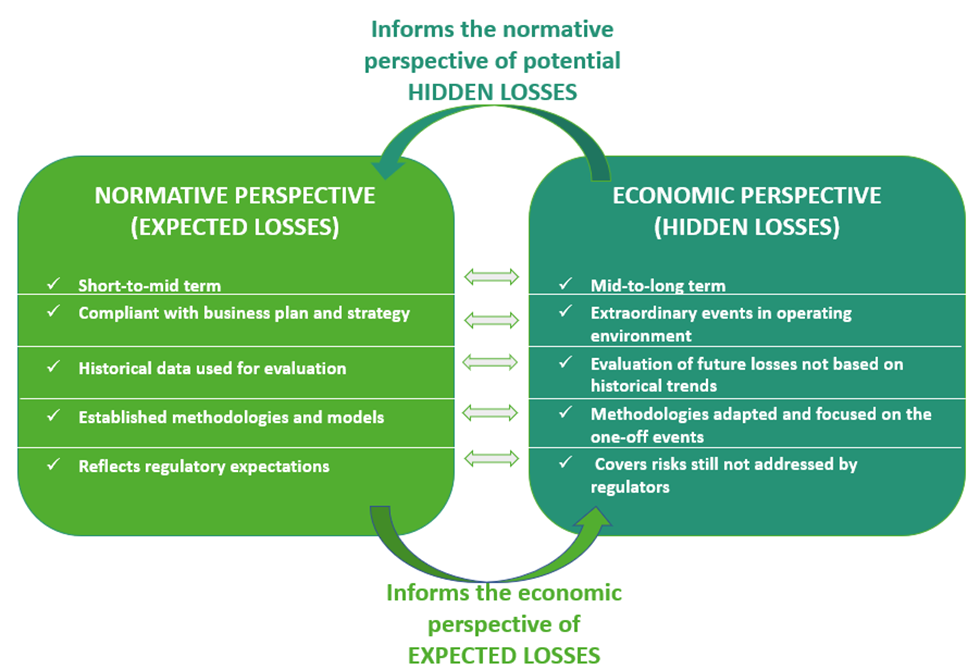
1. **Internal Risk Assessment**

According to 2024 risk identification process the following risks specific to the activity 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 credit risk using the following calculation:

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

As at 31.12.2023 the capital requirement for credit risk is above the capital requirement of the standardised approach and additional capital for credit risk is allocated in the normative and economic perspectives.

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

The credit risk from FX deviation and the residual risk from collateral price decrease were analysed, and the outcome from these assessments did not lead to additional internal capital allocation.

DSK Bank also assessed concentration risk in normative and economic perspective applying the relevant internal methodologies and thresholds. The result indicated that no additional internal capital has to be allocated. For financial institutions DSK Bank examined the potential negative effects from the probability of rating decrease throughout the change in the expected loss under 68.59% quantiles (Q) in the Baseline scenario, based on the one-factor model and 99.00% quantiles (Q) in the Stress scenario simulation. The Bank applies the assumption that once the financial institution counterparty migrates outside the investment rating grade, conservative treatment is applied. Simulation results are based on the difference between the expected loss under the current conditions and the simulated ones with migration, measured by the external reference data.

Additionally, DSK Bank conducted a stress test for climate-related and environmental transition risk impact in a 3-year-term perspective. The outcome of ~BGN 6m potential losses was included as add-on in the normative and the economic perspectives of ICAAP.

* **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 2023 is assessed at BGN 5 414 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/2022/14. 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 perspsective). 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 2023 is assessed at BGN 37 718 thousand under the normative perspective and BGN 20 050 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 2023 under the economic perspective is assessed at BGN 20 258 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 economic perspective DSK Bank assesses additionally aspects related to internal and external fraud, business disruption risk, cyber risk, compliance risk, as well as environmental risk.

The assessed required capital for operational risk at the end of 2023 amounts to BGN 81 073 thousand under the internal normative perspective. In the economic perspective the internally allocated capital for operational risk is BGN 101 714 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).

Euro adoption - the introduction of the euro in Bulgaria has been connected with high degree of uncertainty in terms of meeting the convergence criteria for joining the euro zone, notably the one on the price stability, the timing and the general political instability in the country. The 2024 Convergence report will examine the degree of price stability convergence of Bulgaria towards the euro area and whether the country meets the inflation rate criterion. However, the report was adopted in the end of June 2024. Hence, during the business plan preparation there was no explicit commitment from both national and EU authorities on a targeted date for the euro adoption . For this reason the bank could not make accurate assessment of the impact of the euro adoption on the P&L for the purpose of ICAAP. The assessment of the P&L impact from the Euro adoption indicates that the positive effects from it exceed considerably the negative effects and therefore no internal capital is allocated. Shortage on the labour market - The high intensity of regulatory initiatives and projects and the simultaneous launching of bank-wide projects requires allocation of additional expertise and human resources in order to ensure smooth “run the bank” activities” and successful implementation of the projects. The tight labour market in Bulgaria and the competition between employers lead to longer period needed for staffing of high-expertise positions. DSK Bank targets sustainable development of its human resources considering the dynamic regulatory and operating environment and the strategic advantage provided by the available high-level expertise at the Bank. In order to address the temporary shortage of specific high-expertise employees during the generally long staffing period which can take 1 year or above, DSK Bank uses consultancy services providing the currently lack of expertise and operating capacity.

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 - deviations from the strategy of the Bank to become a leader in digital banking. It depends on the successful implementation of the transformation program 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 ensure that all of that is performed in secured environment. The risk will 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 397 722thousand.

* **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 2023 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 7 300 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 176thousand 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 essence 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 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 rating migration risk in the amount of BGN 15 919 thousand. Furthermore, under the economic and stressed internal assessment an additional capital charge of BGN 6 140 is anticipated for environmental risk impacting counterparty credit risk;
* Business & strategic risks, incorporating the assumption that DSK Bank’s decreasing potential of its client base to generate the necessary economic value in a long-term perspective, as well as with regards to failing to improve the share of the E2E cash loan sales through digital channels in total new cash loans and remains considerably below its long-term target and in some cases below Bulgarian banking system average, it is expected that potential profit will be not realized. Additional loss of income is assumed with regards to the threat DSK Bank faces from competitors in the field of transactional services and daily banking products (i.e. Revolut). From this perspective in the economic stress test the bank allocates internal capital amounting to BGN 702 904 thousand for the client base and additional BGN 40 887 thousand for the digital transformation;
* Operational risk, incorporating potential losses in the economic perspective for ICT risk, external and internal fraud, compliance risk, as well as environmental risks. In addition, adverse result of the ECB's 2024 cyber resilience stress test has also been taken into account in the operational risk’s stress test calculation for the economic perspective, given the assumed long-term economic losses. The operational risk add-ons (including Cyber resilience, Compliance risk and environmental risk) amount to BGN 29 095 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.

The ICAAP reverse stress test is part of overall reverse stress testing process of the solvency position of DSK Bank which includes also recovery and resolution reverse scenarios which incorporate assumptions for higher severity of the capital adequacy deterioration.

*Reverse stress testing in the normative perspective*

Within the reverse stress test process the bank assumes also idiosyncratic losses to occur as these might lead to breach of the management buffer also in an environment which is less deteriorated.

This approach enables the management of bank to recognise potential threats in the operating environment within its early screening processes and timely react to evolving adverse developments.

The breach of the management buffer in the ICAAP reverse stress test is considered a natural hand-over point to recovery processes. Such situation shall be assessed as the first hard criterium indicating potential issues with the solvency position of the bank which need to be addressed by implementing short-to-mid term measures or recovery tools in order to restore compliance with the internal management buffer.

The reverse scenario assumes that the bank reports significant losses which fully offsets the banking revenues in the financial year and lead to a deduction of CET 1 in the amount needed to breach the management buffer.

Following the reverse stress test approach which is based on the combined effect from credit risk losses and severe idiosyncratic event, the bank applied an assumption for the most severe event with operational and compliance risk character, namely a massive GDPR. It is assumed that the competent authorities apply to DSK Bank the highest penalty which is equivalent to as 4% of OTP Group turnover for 2023 /considering the highest level of consolidation of the parent company/.

In addition to the above losses, sharp loan quality deterioration is expected to deteriorate the financial result of the bank to an extend in which loss is reported and deducted from CET 1.

*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 is a loss absorption capacity of 110% as this ratio includes the internal management buffer of 1% for the economic perspective.

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 2023 on a **standalone basis**:

* 16,33% MREL requirement with respect to the relation of total own funds and eligible liabilities to the total risk exposure amount (TREA); On top of the MREL target as a % of TREA, the bank has to meet the CBR;
* 5.90% MREL requirement with respect to the relation of total own funds and eligible liabilities to the total exposure measure (TEM).

To comply with the above-mentioned minimum requirements, the Bank meets the requirements with the necessary amount of own funds and eligible liabilities through:

* Common Equity Tier 1 Capital;
* Tier 2 instruments with a residual maturity of at least one year to the extent they do not qualify as Tier 2 items;
* Eligible liabilities instruments (in the form of loans), issued directly that are subordinated to excluded liabilities.

DSK Bank reported 29.19% MREL as % of TREA and 15.55% MREL as % of TEM as of 31 December 2023.

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

* ***EU TLAC1: Composition - MREL and, where applicable, G-SII Requirement for own funds and eligible liabilities***
* ***EU ILAC: Internal loss absorbing capacity: internal MREL and, where applicable, requirement for own funds and eligible liabilities for non-EU G-SIIs***
* ***EU TLAC2a: Creditor ranking - Entity that is not a resolution entity***

1. **Asset Encumbrance Policy**

The Bank has adopted Encumbered Assets Policy. According to the Policy, an asset is treated as encumbered if it has been pledged or is subject to any form of arrangement from which it cannot be freely withdrawn from. Based on this definition, the Bank identified the following cases where assets are considered as encumbered:

* Collateralization for budget funds.
* Collateralization in the case of OTC derivatives deals.
* Collateralization in the case of repo deals.
* Other specific cases – all other cases that may arise from the commercial activity of the Bank.

Relevant quantitative information as of the end of the year is provided in the following attached Excel tables:

* ***EU AE1: Encumbered and unencumbered assets***
* ***EU AE2: Collateral received and own debt securities issued***
* ***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 DSK Bank operates independent Remuneration Committee (the Committee or RemCo) that oversees 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 2023, the Committee held 4 (four) 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 to the classification of art. (10), 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.

DSK Bank 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 Banking 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 DSK Bank 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 DSK Bank 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 of the identified staff 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 instalments 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 instalments 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 virtual 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 250,000.
* 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.

**EU OVB: Disclosure on governance arrangements (per Art. 435.2 a), b), c))**

**Number of directorships held by members of the governing body.**

**According to the Declaration for the time spent, the members of the management body hold up to 3 director positions, and the chairman of the management body - up to 6 positions outside DSK Bank.**

**Information about the selection policy of the members of the governing body and about their actual knowledge, skills and expertise.**

The selection decision-making process is in accordance with Policy on Assessment of Suitability of members of Management Board / Board of Directors, Supervisory Board, executive officers, and key function holders of DSK Bank and Banking group in compliance with the standards of the OTP Banking Group.

The policy is to establish the basic rules of the selection, suitability, evaluation criteria and test methodology, applying the diversity policy and to clarify the tasks and responsibilities related to suitability assessments, which meet the requirements of the legislation and the recommendations of OTP Group.

The requirements of professional suitability and business reliability, as well as the provisions pertaining to Good Business Reputation shall apply to the members of the Management Bodies, Executive Officers, and Key Function Holders. It is crucial for the safety of the operations of DSK Bank and the other Financial Institutions under Paragraph (13) that they are managed by persons who are professionally fit and commercially reliable and are of sufficiently good repute.

**Information on the policy for equal representation in the composition of the governing body.**

In order to promote independent judgment and prudent decision-making, efforts should be made to ensure the diversity of management bodies to ensure the widest possible range of expertise and ability to be present. Aspects of diversity in the Management Body may include, but are not limited to, age, gender, expertise, education, and geographical location.

DSK Bank shall ensure equal treatment when establishing the composition of the Management Bodies.

In the selection process for Management Body members shall endeavour to ensure that both genders are represented among the candidates.

Diversity and Inclusion Policy determines targets for employment of under-presented gender in the Management Board and Supervisory Board of DSK Bank.

**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 2023, 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.

