MACEDONIAN BANK FOR DEVELOPMENT PROMOTION

ANNUAL REPORT
2017

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I. BUSINESS ENVIRONMENT

1. Macroeconomic environment

The business environment in 2017 was under certain influence of the political instability since the last year. However, conditions have stabilized in the last quarter of this year, which led to increased optimism of the economic entities.

In the fourth quarter of 2017 the gross domestic product registered an annual growth rate of 1.2%, which represents certain recovery in relation to previous three quarters when it equaled 0.0%; -1.3% and 0.2% respectively. The latest projections showed that the growth of domestic economy will continue until the end of the year, but significant downward revision of the expected growth rate was made (2.5% and 0.5%), as reflection of the realizations in the first half of the year. Intensification of the GDP growth was expected in 2018 (3.2%) and in 2019 (3.5%).

In the fourth quarter of 2017, accelerated growth of inflation was registered to 2.2% per year, compared to 1.6% in the third quarter. This resulted in cumulative increase of 1.4% of consumer prices for the whole year. Inflation in 2017 almost entirely arose from the growth of the fundamental component, in conditions of neutral contribution of food component and minimal positive contribution of energy component. In view of the developments, which mainly were in compliance with the projections, the risks of the expected inflation for 2018 and 2019 (moderate acceleration and amounting to 2%) continue to be connected to the uncertainty of the expected movement of prices of primary products.

At the beginning of 2017, NBRM did downward correction of the interest rate of treasury bills for 0.25p.p. thereby reducing it to 3.25%. In the last quarter of 2017, NBRM did not modified the monetary policy, whereas the basic interest rate of treasury bills remained at the same level. Thus, the interest range between the basic interest rates of NBRM and ECB was relatively stable. Signals in the beginning of 2018 suggest additional relaxation of the NBRM monetary policy.

External environment data expressed through the balance of payments show moderately improved achievements compared to the current account projections, whereby the financial account was less favourable compared to the expectations. In the third quarter, the current account noted surplus of EUR 183.1 million (1.8% of GDP), reflecting the higher surplus than the expectations in the balance of goods and services. On the other hand, net-outflows of EUR 278 million (2.7 of GDP) were realized within the financial account in circumstances of significantly negative deviations with the foreign direct investments and trade loans. The latest data on gross foreign currency reserves for the fourth quarter showed quarterly growth, as well as the foreign trade data which as of November, suggested improved achievements compared to expectations.

In regard with the movement on the financial markets, on the primary government securities market, the Ministry of Finance continued to redirect the due amounts of short-term securities in securities with longer maturities. The new issues of government securities were mostly with FX clause and were almost equally purchased from banks and other investors. The secondary securities market registered growth in turnover, partly due to the executed repo transactions, while yields on the executed transactions registered no significant changes. Macedonian Eurobond yields on international markets continued to decline, causing a further narrowing of spreads relative to yields on German government bonds, which remained relatively stable. Public finance in 2017, was within the projections. At the end of the year, the Republic of Macedonia Budget deficit was Denar 16,896 million, which represents

2.7% of the nominal GDP. The budget deficit was financed from domestic sources through net emission of new government securities and withdrawal of deposits from the government account with the NBRM.
In regard with the risks in the macroeconomic environment, they were not significantly changed, although risks referred to global environment were slightly more favourable. Economy gradually recovered, in one part supported by the loan activity of domestic banks and it was without price pressures and in conditions of further maintenance of adequate level of foreign reserves. At the end of 2017, the global economic data were better compared to the expectations, especially in the euro zone, which caused upward revision of the growth rate of this region, as our key trade partner. At the same time, the movements of the financial markets at the end of the year registered strengthened optimism of the investors, especially at the stock exchange in US and Europe. However, despite of the favourable global macroeconomic environment and improved observations for the following period, there were still risks connected to the global protectionist trends, effects of Brexit, tightening the global financial conditions and geopolitical tensions.

2. Banking sector

Last year there was regrouping in the banking sector. One bank joined the group of large banks and now in the Macedonian banking sector five out of fifteen banks are large banks. The total funds in the banking sector at the end of the year were Denar 562.1 billion, and the total profit was Denar 6.6 billion. MBDP is ranked on the ninth place in the banking system in Macedonia according to two criteria.
Liquidity indicators were mainly stable, with a trend of slight decline which continued in the third quarter of 2017, but at a slower pace in comparison to the second quarter of the year. Value of these indicators was on satisfactory level and did not deviate from their usual value. The share of liquid assets to total assets of the banks retained close to one third. The credit to deposit ratio in the banking system was still under the recommended 100%.
Solvency indicators and banking system capitalization increased in the third quarter of 2017, mainly as a result of the growth of capital positions in circumstances of quite modest growth or even decline of certain activity categories. The growth of own funds resulted from issuing of new subordinate instruments. Risk-weighted assets decreased as result of the decline of assets weighted according to credit risk. The largest part of the own funds growth was used for meeting the capital buffer with the systematically important banks. Seven banks determined by NBRM as systematically important banks have obligation to fulfill half of the capital buffer for systematical importance. Results of the conducted stress-test simulations as of 30.09.2017 were improved compared to the end of the second quarter.
Banking sector in 2017 remained profitable, as well. Profit increased for 3.6% compared to the previous year, and almost the entire profit was concentrated in the large banks group.
Credit activity of the banking sector in 2017 accelerated, which is usual for the movements on the credit market for the end of the year, especially in December. Analyses according to sectors show that the faster credit growth resulted from the increased credit support of the corporate sector, which explains the largest part of the new lending in the last quarter, which is usual for this period of the year. On annual basis, the credit growth exceeded the expectations, whereby total credits increased for 5.8%. Analyzing the factors affecting the credit market, survey researches show positive movements on the side of demand, as well as on the side of credit offer. In

circumstances of retained growth of economic activity and favourable credit conditions in the banking sector, the private sector continued to increase the credit demand. Sound solvent and liquid position of the banks and increased competition in the banking sector were factors which continued to have stimulating influence over the credit offer.

In regard with the financial sources, in the last quarter there was strong growth of total deposits resulting in an annual growth rate of total deposits of 5.2%. The growth of total deposits in the last quarter derived from simultaneous increase of households and company deposits. It was expected that the deposit base will continue to increase in the following period, thus providing stable sources for financing of the credit growth, which according to the October projections, in the following two years will amount between 6 and 7%.

In general, the newest macroeconomic picture shows sound economic fundamentals and stable external position, which enables maintenance of adequate level of foreign currency reserves in the following period. In terms of the foreign interest rate, as an important factor for domestic monetary policy, the new projection does not foresee important changes, and risks for achievement of the newest macroeconomic scenario have decreased, especially on domestic plan.

Source: National Bank of the Republic of Macedonia, State Statistical Office, Ministry of Finance

II. BANK'S PROFILE

Macedonian Bank for Development Promotion AD Skopje (MBDP) is the only development Bank in the Republic of Macedonia established with a special Law on Establishing the Macedonian Bank for Development Promotion (Official Gazette of RM no. 24/98, 6/2000, 109/2005 and 130/2008). A new Law on the Macedonian Bank for Development Promotion was adopted in 2009 (Official Gazette of RM no. 105/2009), anticipating that the provisions of the Banking Law apply to MBDP, unless otherwise regulated by the Law on the MBDP, and the National Bank within its competences performs the supervision on the MBDP operations. The Ministry of Finance supervises operations of the MBDP performed on behalf of and for the account of the Republic of Macedonia. MBDP is responsible with all its assets for its liabilities.

MBDP's strategic orientation is to provide support and incite development of the Macedonian economy through supporting the small- and medium-sized enterprises by offering wide range of financial products (credit lines, guarantees and export credit insurance) tailored to the needs of final beneficiaries. The Bank operates in accordance with the strategic policies, objectives and priorities of the Republic of Macedonia.

III. BUSINESS POLICY AND OBJECTIVES

MBDP's Business Policy is based on the Law on the MBDP, the Banking Law, and other applicable regulations. Business Policy lays down the Bank's objectives, Bank's operation elements, risk management, management of the sources of funding, control of expenses, credit policy, insurance policy, personnel policy, etc.

During 2017, by taking appropriate measures and carrying out diversified activities, the MBDP was focused on implementation of set goals defined with the Business Policy, such as:

- Efficient use of the Bank total credit potential,
- Enlarging the credit insurance volume of export and domestic short-term receivables against commercial and political risks,
- Development of factoring,
- Growing the client base,
- Finding new and favourable sources of funding,
- Introducing new financial products,
- Establishing efficient internal risk management systems, i.e. risk identification, assessment, monitoring and control,
- Maintaining the capital value and increasing it, through the policy for appropriating the net profit for reserves and additional increase of the initial capital,
- Continuously maintaining an adequate level of own funds in order to maintain the internally defined capital adequacy ratio,
- Continuous improvement of work organization and promoting the business processes,
- Human resources management and continuous building of their knowledge and capabilities,

- Harmonization of the Bank's operations with the legal and subordinate legislation,
- Continuously taking activities to prevent money laundering and financing of terrorism,
- Development and improvement of information technology and implementation of new software solutions in order to achieve complete and integrated system for registration, analysis and reporting which will encompass all phases and organizational units in the Bank,
- Conducting cost effective management policy,
- Deepening the cooperation with similar institutions from the country and abroad, etc.

Bank's Business Policy is based on the ground of harmonization with the legal regulations, adherence to the liquidity principle, stability, solvency, profitability and costs effectiveness, professionalism and operational efficiency, flexibility towards borrower's needs, etc.

IV. REPORT ON CORPORATE GOVERNANCE

1. Management Bodies

The corporate governance of the MBDP in 2017 was carried out in conformity with the Banking Law (Official Gazette of RM no. 67/07, 90/09, 67/10, 26/13, 15/15, 153/15 and190/16), the Law on the MBDP (Official Gazette of RM no. 105/09), the rules of good Corporate Governance prescribed by the National Bank of the Republic of Macedonia Council and the Code of Corporate Governance adopted by the Assembly of the Macedonian Bank for Development Promotion. The particularity of MBDP as development Bank, being in complete ownership by the Republic of Macedonia, should be taken into consideration in making assessment of the Bank governance. During 2017, the Bank carried out its operations through the following bodies:

1. Assembly
2. Supervisory Board
3. Auditing Committee
4. Management Board
5. Risk Management Committee
6. Credit Committee
7. Insurance Committee

During 2017, the persons with special rights and responsibilities in the Bank (natural person who is member of Supervisory Board, Management Board, Auditing Committee, Risk Management Committee and other managing persons in the Bank according to the Statute of the Bank) have neither declared conflict of interests nor relation to third party in accordance with the Banking Law.

1.1. Assembly

The Republic of Macedonia is a sole shareholder of the Bank.

The sole shareholder manages the Bank through the Assembly represented by representatives of the state capital. Members of the Supervisory Board are also representatives of the state capital in the Bank's Assembly. Bank's Assembly in the reporting year 2017 held 1 (one) regular meeting.

At the meeting held on May 16, 2017, the Assembly discussed/adopted the following acts:

- Annual Report on the Bank's operations in 2016,
- Annual Report on Supervisory Board operations in 2016 with assessment of each board member performance and of the Board collective performance,
- Report of the independent auditors related to the financial statements of the Bank for the year ending 31.12. 2016 and the written opinion thereon prepared by the Supervisory Board,
- Annual account and financial statements of the Bank in 2016,
- Decision on use and allocation of the profit in 2016,
- The Rules of Procedure of the MBDP Assembly no.02-201of 20.03.1999,
- Decision on amendment and modification of the Statute of the Macedonian Bank for Development Promotion dated 24.12.2009.

1.2. Supervisory Board

In accordance with the decision of the Government of the Republic of Macedonia for appointing members of the Supervisory Board of the Macedonian Bank for Development promotion AD Skopje no. 24-1206/1 dated 02.02.2015, registered at MBDP on 05.02.2015 under no.03-625/1 and decision no.24-8584/1 of 14.10.2016, registered at the MBDP under no. 03-3836/1 of 18.11.2016 the Supervisory Board of the Bank carried out its function with the following members in the first half of 2017:

- **Mrs. Romela Popovikj Trajkova**, President of the MBDP Supervisory Board, BA in economics, MBA – MBA Management, Head of Department for Economic Policies and Regulatory Reforms at the Government of the Republic of Macedonia,

- **Ms. Marina Blazhekovikj**, member of the MBDP Supervisory Board, BA in economics, MBA – MBA Management, employed at the Faculty of Administration and Management of Information Systems – Bitola,

- **Mr. Armir Sadiki**, member of the MBDP Supervisory Board, BA in law, Adviser in the Cabinet of the Minister at the Ministry of Education and Science of the Republic of Macedonia,

- **Mr. Metodija Tanevski**, member of the MBDP Supervisory Board, BA in Law with passed bar exam, Head of Legal Department at the State Market Inspectorate of the Republic of Macedonia.

On May 08, 2017, Metodija Tanevski resigned from his position as a member of the Supervisory Board of the Bank, bringing copy of the resignation in the Bank on May 05, 2017.

In accordance with the decision of the Government of the Republic of Macedonia for appointment of members of the MBDP Supervisory Board no. 24-4133/1 of 25.07.2017, registered at MBDP on 01.08.2017 under no. 03-2072/1, and the decisions of the Governor of the National Bank of the Republic of Macedonia for issued consent for appointment of members of the Supervisory Board of MBDP, no. 35225 dated 15.11.2017, 35226 dated 15.11.2017, 35227 dated 15.11.2017, the Supervisory Board of the Bank was constituted on the meeting held on 24.11.2017 the following new members:

- Mrs. Sofche Jovanovska – Chief of the Cabinet of the Deputy Prime Minister of the Republic of Macedonia, responsible for economic affairs and coordination with the economic sectors,
- Mr. Nikola Popovski – Prof. PhD in economics, at the FON University Skopje,
- Mr. Veland Ramadani – Associate Professor, PhD in economics, Business and Economics Faculty at the South East European University, Tetovo, Macedonia,

During 2017, these members of the Supervisory Board held 3 (three) meetings.
Government of the Republic of Macedonia appoints the members of the Supervisory Board and at the same time they are representatives of the state capital in the Bank's Assembly in accordance with the Law on the Macedonian Bank for Development Promotion.

The Supervisory Board supervises the operations of the Management Board, approves the policies for conducting financial activities and supervises their implementation. The Supervisory Board is responsible for ensuring good practice, management and stability of the Bank, as well as timely and accurate financial reporting to the National Bank of the Republic of Macedonia.

The Supervisory Board of the Bank also performs the following activities:

1) Adopts the Bank's business policy and development plan,
2) Appoints and dismisses members of the Bank's Management Board,
3) Appoints and dismisses members of the Risk Management Committee,
4) Appoints and dismisses members of the Auditing Committee
5) Approves the Bank's financial plan,
6) establishes internal audit department,
7) Approves the annual plan of the Internal Audit Department,
8) Adopts the information security policy,
9) Adopts the Bank's risk management policies,
10) Adopts a policy of avoiding conflict of interest to identify any conflict of interest and prevention measures and actions; 11) adopts a remuneration policy in accordance with the business policy, development plan, financial plan and policy to avoid conflicts of interests of the bank;

12) adopts and implement policies for the method of selection, monitoring of operations and dismissal of members of the supervisory board, risk management board, audit committee and board of directors;

13) Discusses the reports on the activities of the Bank's Management Board,

14) Discusses the reports of the Risk Management Committee,

15) Discusses the reports of the Auditing Committee,

16) Discusses the reports of the Internal Audit,

17) Discusses the reports of the Compliance Officer/Department,

18) Approves the annual account and the financial statements of the Bank,

19) approves the exposure to a person of more than 20% of the Bank's own funds, with the exception of exposure based on purchase of securities issued by the National Bank and the Republic of Macedonia;

20) approves the transactions with persons related to the Bank exceeding Denar 6,000,000,

21) approves the acquiring equity holdings and purchase of securities higher than 5% of the Bank's own funds, other than purchase of securities issued by the National Bank and the Republic of Macedonia,

22) approves the proposal of the Auditing Committee for appointing audit company or the proposal for terminating the agreement with the audit company and is responsible for ensuring appropriate audit,

23) adopts the internal audit policy,

24) discusses the supervisory reports, other reports submitted by the National Bank, the Public Revenue Office and other competent bodies and proposes, i.e. undertakes measures and activities for addressing the identified shortcomings and weaknesses in the bank's operations,

25) approves the annual report on the Bank's operations and submits written opinion thereon to the Bank's Assembly,

26) discusses the report of the auditing company and submits written opinion thereon to the Bank's Assembly,

27) adopt the Corporate Governance Code which regulates the rules for Bank's management and supervision

28) adopts the bank's Code of Conduct,

29) Provides consent for concluding reinsurance agreements within the overall obligations of the Bank on the basis of the insurance operations,

30) Sets the general conditions for trade credit insurance against commercial and political risk,

31) Provides consent of agreements with the R. Macedonia,

32) Provides consent for business trips abroad, in case more than three employees travel,

33) Adopts the report for inventory of assets and the sources of assets,

34) Makes decision on writing off claims,

35) Discusses the reports on rescheduled debts and debts with extended maturity period,

36) Monitors the implementation of the decisions, conclusions, guidelines adopted by the Assembly of the Bank,

37) Makes decision in second instance upon complaint of unsatisfied employees against decision of the Management Board of the Bank or upon objection for reconsideration of the decision,

37) Approves the limits of exposure of certain types of risk,

39) Approves introduction of new products which significantly affect the risk profile of the Bank,

40) Approves the policy for publishing reports and data by the Bank,

41) The Supervisory Board makes self-assessment of its operations from the aspect of the individual members and jointly at least once a year, and notifies the Assembly thereon,

42) Performs other activities in compliance with this Statute, general acts of the Bank and legal and subordinate regulations.

Supervisory Board Members are entitled to a monthly compensation for the engagement in the Board on the grounds of the Decision adopted by the Bank's Assembly.

Within its competences set by law, the Supervisory Board undertook many activities and, among the more important, adopted the following acts:

1) Decision for approval of the Plan of activities of the Internal Audit Department in 2017,
2) Decision on adopting the annual account and the financial statements of the Bank for 2016,
3) Draft Decision on use and allocation of the Bank's profit for 2016,
4) Draft Decision on convening a meeting of the MBDP Assembly,
5) Draft Decision on modifying the Statute of the Bank,
6) Decision for approval of the Financial Plan on operations of the Macedonian Bank for Development Promotion in 2017,
7) Decision on modification and amendment of the Decision on interest rates of MBDP,
8) Decision on approval of the Annual Report of MBDP operations for 2016,
9) Draft Decision on amending and modifying the Statute of the Bank dated 24.12.2009,
10) Decision on dismissing and appointing of members of the Auditing Committee,
11) Decision on approval of the Auditing Committee proposal for appointing an audit company to conduct audit of the Bank financial statement for the years 2017 – 2018,
12) Decision on modification of the Financial Plan on operation of the MBDP in 2017,
13) Decision on signing a reinsurance agreement for 2018.

The Supervisory Board approved, i.e. adopted the reports, information and other proposed documents related to the Bank's operations in 2017.

1.3. Auditing Committee

In the first half of 2017, the Auditing Committee performed its activities comprised of the following members:

1) **Miov Nikolaki –** President, BA in economics, certified auditor, partner and employee in the auditing company Efekt plus
2) **Klimentina Poposka –** BA in economics, associated professor of finance at the Institute of Economics-Skopje, Ss Cyril and Methodius University-Skopje
3) **Romela Popovikj Trajkova**
4) **Marina Blazhekovikj**
5) **Armir Sadiki**

On April 04, 2017, Nikolaki Miov resigned as member of the Auditing Committee of the Bank.

In the second half of 2017, in accordance with the change in members of the Bank's Supervisory Board, adequately a change was made in the members of the Auditing Committee, thereby working with the following members:

Nikola Popovski – President,
Klimentina Poposka - BA in economics, associated professor of finance at the Institute of Economics-Skopje, Ss Cyril and Methodius University-Skopje,
Sofche Jovanovska
Veland Ramadani

The Auditing Committee performs the following activities:

1) discuss the financial statements of the Bank and make sure that the disclosed financial information on the Bank's operations are accurate and transparent as specified by the accounting regulations and international accounting standards,
2) review and make assessment of the internal control systems,
3) monitor the operations and assess the efficiency of the Internal Audit Department,
4) monitor the Bank's audit process and assess the work of the audit company,
5) adopt the Bank's accounting policies,
6) monitor the compliance of the Bank's operations with the regulations related to the accounting standards and the financial statements,
7) hold meetings with the Management Board, the Internal Audit Department and the audit company as to the identified non-compliances with the regulations and weaknesses in the Bank's operations,
8) discuss the reports of the Risk Management Committee,
9) proposes the appointment of audit company and termination of agreement with an audit company, and
10) report to the Bank's Supervisory Board on its operations at least once quarterly.

Auditing Committee at its sessions discussed the financial statements of the Bank, assessed the objectivity of the disclosed financial information on the Bank's

operations, as well as their compliance to the regulations related to the accounting regulations and the international accounting standards.
Auditing Committee monitored the work of the Internal Audit Department and assessed the work of the independent auditing company, which conducted the audit of the financial statement of the Bank for the business year 2017.

Auditing Committee discussed the risk profile of the Bank at its meetings, analyzing each risk to which the Bank is exposed during operations respectively.

1.4. Management Board

The Bank's Management Board consists of two members, appointed by the Supervisory Board upon a prior consent by the Governor of the National Bank of the Republic of Macedonia.
Members of the Management Board are appointed as Chief Executive Officer and Chief Operating Officer. The Chief Executive Officer is appointed for a mandate of 6 (six) years, and the Chief Operating Officer for a mandate of 4 (four) years.

Members of the Management Board are as follows:

- **Dragan Martinovski** – Chief Executive Officer, BA in economics (appointed with the Decision of the Supervisory Board no. 02-1764 dated 01.04.2013),
- **Besim Bilali** – Chief Operating Officer, MA in economics (appointed with the Decision of the Supervisory Board no. 02-489/9 dated 29.01.2015)

The Management Board of the Bank performs the following activities:

1) manage the Bank,
2) represent the Bank,
3) enforce the decisions of the Assembly and the Supervisory Board of the Bank, i.e. ensures their implementation,
4) take initiatives and give proposals for promoting the Bank's operations,
5) appoint and dismiss the individuals with special rights and responsibilities pursuant to the provisions under this Law and the Bank's Statute,
6) develop the Bank's business policy and development plan,
7) develop financial plan of the Bank,
8) develop a Bank's information security policy,
9) prepare an annual report on the Bank's operations and submit it to the Supervisory Board,
10) develop Code of Conduct
11) decide upon investment of the credit insurance funds against commercial and political risks,
12) decide upon lending and borrowing liquidity loans irrespective of the amount and term within the limits laid down by the Banking Law and the acts of the Bank,
13) establish the internal organization and systematization of work and work tasks in the Bank, decides upon employment, promotion, redeployment, professional upgrade, determining salary and salary allowances, acknowledgement of exceptional commitment to work, pronunciation of

disciplinary measures, material liability of employees and termination of employment,

14) perform duties other than those the Supervisory Board is competent for.

The Management Board within its competences acquired by the Law and the Statute adopted all necessary internal acts that regulate the working conditions of the Bank in compliance with the legal regulations and subordinate acts. The Management Board reported to the Supervisory Board on its operations.

On December 22, 2016 the Supervisory Board adopted a decision on separation of the responsibilities between the members of the Management Board of the Bank according to specific segments of the Bank's operations as follows:

1. Chief Executive Officer shall be responsible for the business policy and planning, financial reports of the Bank and human recourses, lending and credit insurance, general and legal matters, the cabinet of the Management Board, financial operations and accounting,
2. Chief Operating Officer shall be responsible for risk management, IT, compliance to regulations, anti-money laundering and financing of terrorism, information security system, treasury, liquidity, payment operation in the country and abroad.

1.5. Risk Management Committee

During 2017, the Risk Management Committee performed its activities comprised of the following members:

- **Besim Bilali** – Chief Operating Officer, MA in economics
- **Aleksandar Stanojkovski –** Credit and Guarantee Division Manager, BA in economics
- **Qenan Idrizi** – Manager of Treasury and Liquidity Division, PhD in economics

The Risk Management Committee performs the following activities:

1) permanently monitors and assesses the risk level of the Bank, and identify the acceptable level of exposure to risk in order to minimize the losses as a result of the Bank's risk exposure,
2) establishes risk management policies and monitors their implementation,
3) follows the regulations of the National Bank pertaining to the risk management and the Bank's compliance with such regulations,
4) assess the Bank's risk management systems,
5) determines short- and long-term strategies for managing certain types of risk the Bank is exposed to,
6) analyzes the reports on the Bank's risk exposure developed by the Bank's risk assessment units and proposes risk hedging strategies, measures and instruments,
7) monitors the efficiency of the internal control systems in the risk management,

8) analyzes the risk management effects on the Bank's performances,
9) analyzes the effects of the proposed risk management strategies, as well as the proposed risk hedging strategies, measures and instruments,
10) assessment of compliance of the prices of products and services offered by the Bank with the levels of risk taken, in accordance with the Bank's business policy and development plan,
11) informs the Supervisory Board quarterly on the changes in the Bank's risk positions, the changes in the risk management strategies, the risk management effects on the Bank's performances as well as the undertaken measures and instruments for hedging risks and the effects thereof,
12) approves exposure to a person/entity from 10% to 20% of the Bank's own funds.

The Risk Management Committee shall make self-assessment of its operations from the aspect of individual members and jointly at least once a year and submits it to the Bank Supervisory Board.

In the course of 2017, the Risk Management Committee made decisions on meetings held at least once a week. The Risk Management Committee reported to the Bank's Supervisory Board on its operations pursuant to the Banking Law.

1.6 Credit Committee

The Credit Committee consists of three members. The members of the Management Board are members of the Bank's Credit Committee pursuant to the Bank's Statute. The third member of the Credit Committee is appointed by the Supervisory Board of the Bank. In 2017, the Credit Committee performed its activities and was composed of three members as follows:

- **Dragan Martinovski - President**
- **Besim Bilali – Member**
- **Toni Petroski – Member**

The Credit Committee has the following rights and responsibilities:

1) decide on the investments and credit debts, guarantees and other exposures to a borrower up to 10% of the Bank's own funds,
2) discuss and approve loans within the credit policy, the Bank Statute, and in accordance with the principles of banking operations laid down by the Law on MBDP,
3) manage existing loans by providing current assessment on the borrower's creditability at least once a year,
4) terminate agreement of an existing loan due to threat of non-payment of the loan liabilities and, if possible, requires additional collateral in case of loss threat,
5) adopt Book of procedure,
6) perform other duties stated in the credit policy established in compliance with the Law on Macedonian Bank for Development Promotion, the Banking Law and the Statute.

In the course of 2017, the Credit Committee held meetings at which they discussed and approved credit applications submitted by the intermediary banks participants in the MBDP loan programmes.

Pursuant to Decision of the MBDP Supervisory Board on making agreement with the Republic of Macedonia for transferring the competence on managing and disposing of the funds from the Compensation Fund from foreign aid and the Compensation Fund from other foreign aid, the Supervisory Board of the Bank has authorised the Credit Committee to make decisions upon the credit applications for using funds from the Compensation Fund from foreign aid and the Compensation Fund from other foreign aid which value is above EUR 150,000 in Denar countervalue calculated according to the middle exchange rate of the NBRM valid on the day of its approval.

Credit Committee pursuant to the Credit Committee Book of procedure, without holding a session, processed the credit applications and made decisions thereon.

The above mentioned persons, i.e. persons with special rights and responsibilities have neither reported conflict of interest nor connection to third party pursuant to the Banking Law.

1.7 Insurance Committee

The Insurance Committee has three members. The members of the Management Board are members of the Bank's Insurance Committee pursuant to the Bank's Statute. The third member of the Insurance Committee is appointed by the Supervisory Board of the Bank. In 2017, the Insurance Committee performed its activities with the following members:

- **Dragan Martinovski – President**
- **Besim Bilali – member**
- **Toni Petroski – member**

The Insurance Committee has the following rights and responsibilities:

1) lay down the special conditions for trade credit insurance against commercial and political risk as well as insurance limits,
2) discuss and approve conclusion of insurance agreements,
3) assess risks of insurance operations,
4) manage insurance policies by making current assessments of the insurance risk, at least once a year.

The Insurance Committee during 2017, discussed and adopted insurance limits on its sessions.

The Insurance Committee, pursuant to the Rules of Procedure of the Insurance Committee, without holding a meeting, discussed the proposal credit applications and made decision upon them.

The above mentioned persons, i.e. persons with special rights and responsibilities have neither reported conflict of interest nor connection to third party pursuant to the Banking Law.

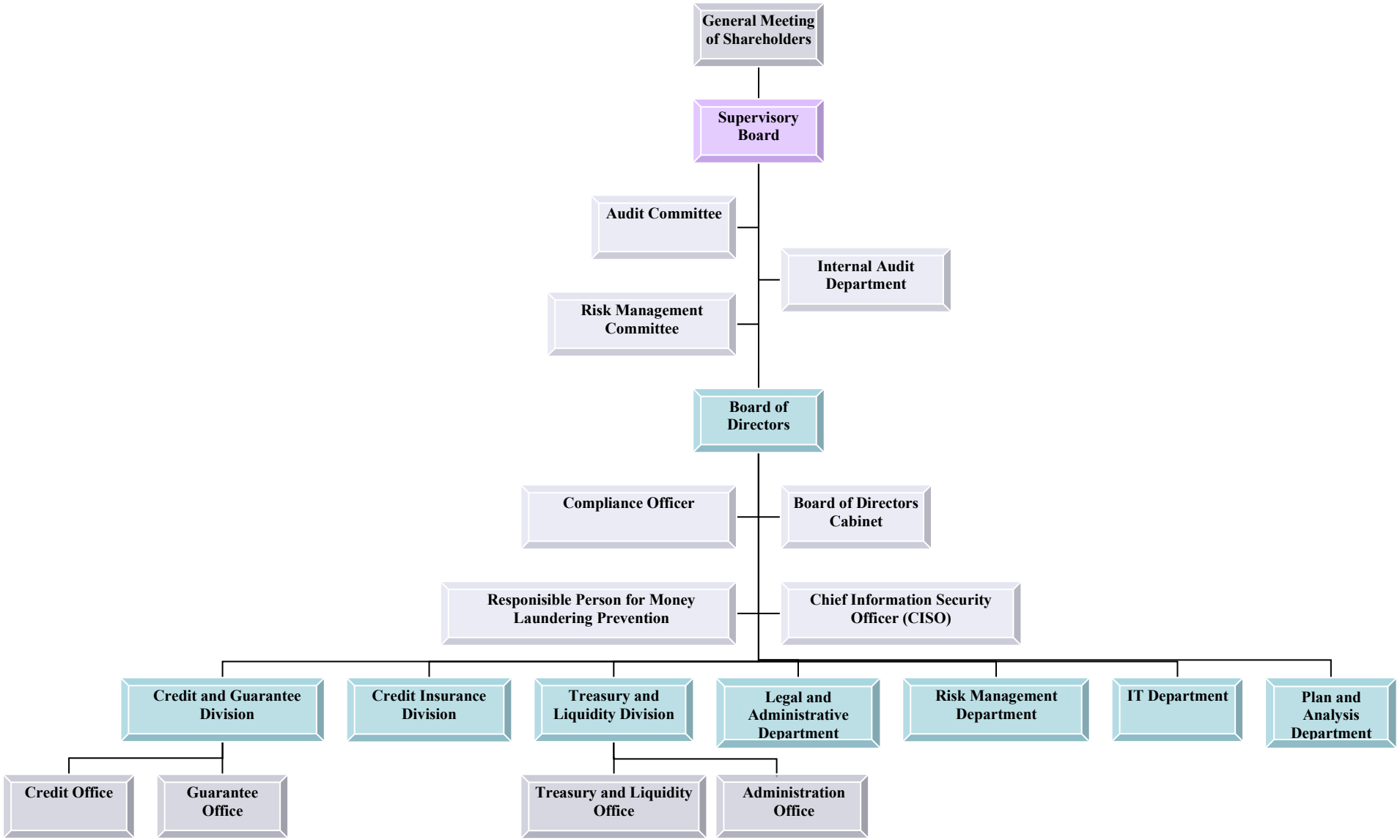
In the reporting period, the Management Board and the persons with special rights and responsibilities in the Bank were paid off 18.771 thousand Denars on the grounds of gross salary, compensation on salary, bonus, insurance and other rights. The Supervisory Board members were paid off 420 thousand Denars on the grounds of compensation for taking part at meetings, and to the Auditing Board 214 thousand Denars were paid off on the grounds of compensation for their work on the meetings.

V. ORGANIZATIONAL STRUCTURE

The Bank is organized in three divisions: Credit and Guarantee Division, Credit Insurance Division, Division for Treasury and Liquidity and five departments: Internal Audit Department, Risk Management Department, IT Department, Legal and Administrative Department, and Planning and Analysis Department. The Bank has also appointed Compliance Officer, Information Systems Security Officer, and Anti-Money Laundering Officer.

MBDP does not have branch offices.

As of 31 December 2017 MBDP has 37 employees.


General Meeting of Shareholders
Supervisory Board
Audit Committee
Internal Audit Department
Risk Management Committee
Board of Directors
Compliance Officer
Board of Directors Cabinet
Responisible Person for Money Laundering Prevention
Chief Information Security Officer (CISO)
Credit and Guarantee Division
Credit Insurance Division
Treasury and Liquidity Division
Legal and Administrative Department
Risk Management Department
IT Department
Plan and Analysis Department
Credit Office
Guarantee Office
Treasury and Liquidity Office
Administration Office

VI. SHAREHOLDER'S STRUCTURE

Pursuant to the Law on Macedonian Bank for Development Promotion (Official Gazette no.105/2009), MBDP is a joint stock company and the Republic of Macedonia is the sole shareholder in the Bank. The Government of the Republic of Macedonia is subscribed in the Bank's Book of Shareholders with a total number of 384,103 ordinary voting shares at par value of 3,108.00 Denars per share.

VII. CORPORATE GOVERNANCE CODE

The MBDP Supervisory Board at its session held on 06.12.2017 adopted the Corporate Governance Code of MBDP. The Code is prepared in compliance with the Decision of the National Bank Council on basic principles of corporate governance in a Bank.

Macedonian Bank for Development Promotion, i.e. the Bank's management bodies and employees during 2017 adhered to the principles of corporate governance in a whole adopted in the Corporate Governance Code, such as:

- principle of protecting the rights and interests of the sole shareholder,
- principle of efficient governance,
- principle of efficient control of financial and economic activities,
- principle of transparent and objective disclosure of information on MBDP,
- principle of legality and ethics,
- principle of social responsibility,
- principle of segregation of responsibilities,
- policy of solving corporate conflicts,
- principle of joint action with the employees and fair compensation,
- principle of industry and responsibility,
- personal data protection, and
- corporate adviser.

VIII. CONFLICT OF INTEREST PROTECTION POLICY

Basic postulates for the Bank's conflict of interest protection policy are laid down in the Bank's Code of Conduct adopted by the Management Board and approved by the Bank's Supervisory Board at the session held on 27.01.2011 and the Policy on identification of potential conflict of interest and determination of measures and activities undertaken in case of conflict of interest dated 09.06.2010. Code of Conduct is reviewed by the Bank's Supervisory Board at least once a year.
Persons with special rights and responsibilities in the Bank provide written statement, bi-annually, on existence, i.e. non-existence of a conflict of their personal interest with the Bank's interests in compliance with the legal provisions and the provisions of the Bank's conflict of interest protection policy.

Members of the Bank's Supervisory Board and Management Board and the persons with special authorisations are not present when adopting decisions that question their

objectivity due to existence of conflict of interest between their personal and the Bank's interest on the grounds of the contents of the decision which is subject of adoption by a competent body. Members of the Bank's Supervisory Board and Management Board and the persons with special authorisations before making decision on matters regarding their conflict of interest, leave the meeting and provide written statement including the grounds of the conflict of interest.

IX. FINANCIAL PERFORMANCE OF THE BANK DURING 2017

In its financial operations in the period between 01.01.2017 till 31.12.2017, the Bank reached net profit of 89,615 thousand Denars. At the same time, the total balance of 12,483,539 thousand Denars has decreased by 16% in comparison to the previous year.

1. Balance Sheet

1.1. Assets

1.1.1. Cash and Cash Equivalents

As of 31 December 2017 the cash and cash equivalents amount to 1,118,038 thousand Denars, representing 8.96% of the Bank's total assets.

1.1.2. Loans to and Receivables from Banks

As at 31 December 2017, total loans to and receivables from banks amount to 11,188,538 thousand Denars, representing 89.63% of the total assets. Total loans to and receivables from banks have decreased by 11.88% in comparison to the previous year.

Analysis of the Bank credit portfolio related to currency structure show dominant participation of Denar credits with foreign currency exchange clause.

1.2. Sources of Funding

1.2.1. Total Liabilities

As at 31 December 2017, the Bank's total liabilities amounted to 9,928,958 thousand Denars, and have fallen for 19.91% in comparison to the end of 2016. As at 31.12.2017, the credit liabilities decreased for 19.93% comparing to 31.12.2016.

Credit liabilities in foreign currency dominate in the currency structure of the total loan funding sources, whereas according the maturity structure pursuant to maturity date they are regarded as long-term liabilities.

1.2.2. Capital and Reserves

The capital and reserves represent 20.46% of the total sources of funding. The total Bank capital as of 31 December 2017 was on a level of 2,554,581 thousand Denars, composed of the initial capital, reserves established from the gained profit in the previous years and the profit in the current period.

2. Income Statement

In the period between 1 January 2017 and 31 December 2017 MBDP reached total income amounting to 325,624 thousand Denars, expenses amounting to 236,009 thousand Denars and positive financial result of 89,615 thousand Denars.

In the reporting period the total interest income amounted to 272,526 thousand Denars and the total interest expense amounted to 139,027 thousand Denars. The net interest income amounted to 133,499 thousand Denars and are lower than the previous year for 16.11%.

Net fee and commission income was 15.055 thousand Denars for 2017 and represent an increase of 76.81% in comparison to the previous year.

Income and expenses and sources of funding in foreign currency or denominated in currency clause are presented in the income statement translated to Denars at the exchange rate of the National Bank in the Republic of Macedonia on net base.

The Bank in compliance with the regulations and adopted acts sets the percentage that determines the impairment and maintaining of provisions to cover possible credit risks. In 2017, the impairment amount on financial assets showed net income of 669 thousand Denars, and 1,948 thousand Denars on the basis of expense due to paid indemnification of non-financial assets on net base.

Other business expenses contain depreciation and amortization, overall and administrative costs and other operating expenses totaling 64,313 thousand Denars, i.e. 2.61% less than the same period previous year.

The calculated tax for 2017 amounted to 10,149 thousand Denars.

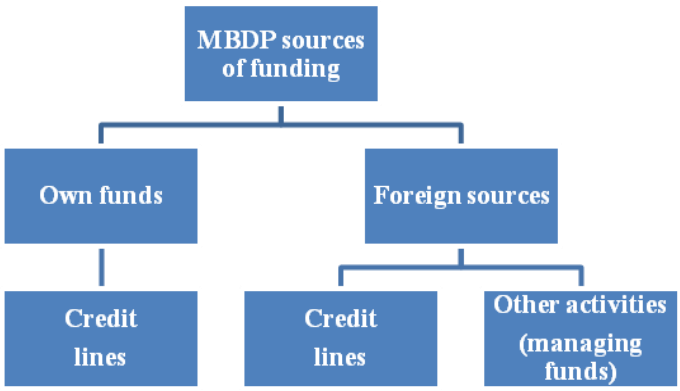
X. CREDIT ACTIVITIES

As in the previous years, in 2017 also, MBDP carried out its credit activities mainly through the commercial banks that it entered into agreement with as follows:

- Halk Banka AD Skopje
- Sparkasse Banka Macedonia AD Skopje
- Eurostandard Banka AD Skopje
- Komercijalna Banka AD Skopje
- NLB Tutunska Banka AD Skopje
- Ohridska Banka AD Skopje
- ProKredit Banka AD Skopje
- Stopanska Banka AD Bitola
- Stopanska Banka AD Skopje
- TTK Banka AD Skopje
- UNI Banka AD Skopje
- Centralna Cooperativna Banka AD Skopje

The Bank carried out part of its lending activities (agricultural loans, financing projects for processing of agricultural products, as well as financing of export and municipalities for projects from the IPA Component) directly to the end beneficiaries without mediation of the intermediary banks.

MBDP used two sources of funding for financing its lending activities, its own funds and foreign sources (funds provided by foreign financial institutions, bilateral creditors and other creditors and donors).



Credit Lines from MBDP Own Funds

MBDP created several credit lines of own sources which terms and conditions are shown below:

Credit line	Amount in EUR	Repayment period	End user interest rate
Credit line for development of small and medium sized enterprises	from 15,000 to 500,000	up to 11 years, grace period of up to 1 year included	fixed up to 6.5% p.a. and/or variable up to 3M EURIBOR +3.75
Financing of export oriented production	from 15,000 to 2,000,000 through banks and up to 1,000,000 direct lending	up to 2 years	fixed up to 6% p.a. and/or variable up to 3M EURIBOR +3.75
Permanent working capital financing	from 30,000 to 300,000	up to 3 years	fixed up to 6.5% p.a. and/or variable up to 3M EURIBOR +3.75

Financing of municipalities for implementation of projects financed under EU IPA Component	from 10,000 to 300,000	up to 2 years	fixed 5.75% p.a.

In the course of 2017, the above credit lines provided support to projects of small and medium-sized enterprises in the field of manufacturing, construction, transport as well as export oriented companies and municipalities in total amount of EUR 34.7 million, thereby supporting 203 projects.

Credit Lines by Foreign Financial Institutions, Bilateral Creditors and Other Sources

In the course of 2017, MBDP continued to utilize and carry out the credit lines from foreign creditors and donors.

At the same time, during 2017, MBDP continued to extend loans from the revolving fund of EIB I, EIB II, EIB III and EIB IV credit lines. Conditions of the credit products from EIB as well as from the rest of the international institutions are detailed in the Table below:

Credit Line	Amount	Repayment period	End user interest rate
EIB credit line for investment credits	from 10,000 up to 3,500,000 EUR	up to 8 years with up to 24 months grace period included	up to 5.5% p.a.
EIB credit line for permanent working capital (TOS)	from 5,000 up to 666,700 EUR	up to 3 years with up to 6 months grace period included	up to 5.5% p.a.
EIB credit line for priority projects and Mid Cap companies	up to 6,000,000 EUR	up to 8 years with up to 24 months grace period included	up to 5.5% p.a.
Commodity Credit Line from the Republic of Italy Revolving Fund	from 50,000 up to 400,000 EUR	up to 6 years with 12 months grace period included	6% p.a.
Credit Line for financing micro, small and medium sized enterprises from KfW (KMB1, KMB2, KMB3)	up to 50,000 EUR from KMB1 up to 300,000 EUR is allowed	up to 4 years for KMB1up to 11 years is allowed	determined by the intermediary bank

Project "Financial support for self employment"	for 1 unemployed person up to 7,000 EUR, depending on person's status and age	up to 7 years with 18 months grace period included	1 % p.a., interest not paid during grace period
Agricultural Credit Discount Fund OKF (ZKDF)	up to 100,000 EUR for primary agricultural production up to 300,000 EUR for processing agricultural products and up to 300,000 EUR for export trade of primary agricultural products and their manufactured products	agreed with the financial institution	from 4% up to 6.5% p.a.
Credit line for production, processing, and export of agricultural products (Compensation funds)	up to 300,000 EUR (500,000 EUR for purchase of grape, wheat, fruits and vegetables)	up to 5 years with grace period of 1 year included for fixed assets, and 1.5 years with grace period of 3 months included for working capital	2% p.a.

EIB Credit Line

EIB credit line funds were targeted for financing fixed assets, permanent working capital and priority projects and Mid Cap companies. The following credit programs were supported from the funds of this credit line:

Investment Loans from EIB

Single credit amount intended to final beneficiaries:	From EUR 10,000 up to EUR 3,500,000
Repayment period:	Up to 8 years
Grace period included:	Up to 2 years
Purpose:	Support to identified projects: • Purchasing fixed assets: o Real estate (except land) o Equipment

	○ Working capital (not exceeding 30% of the loan value) • Investment in intangible assets

Loans for Permanent Working Capital from EIB

Single credit amount intended to final beneficiaries:	From EUR 5,000 up to EUR 666,700
Repayment period:	Up to 3 years
Grace period included:	Up to 6 months
Purpose:	To fulfill the requests for permanent increase of working capital within expansion of company business operations

Loans for Priority Projects and Mid Cap from EIB

Single credit amount intended to final beneficiaries:	Up to EUR 6,000,000
Repayment period:	Up to 8 years
Grace period included:	Up to 2 years
Purpose:	Providing support to priority projects in the area of industry, education, culture, ecology, etc.

In 2017, 189 loans were disbursed out of the revolving funds from this credit line in the total amount of EUR 25.5 million.

Commodity Credit Line from the Republic of Italy - Revolving Fund

Within the bilateral cooperation between the Republic of Macedonia and the Republic of Italy, the governments of these two countries signed Financial Convention for granting a Commodity Credit Line in an amount of EUR 12.7 million to be used for purchasing machinery, equipment, and technology from Italian origin to satisfy the needs of Macedonian companies. Funds were granted for projects that will provide new production, modernization, completion of the production process and overcoming of bottle necks. The credit line was implemented through the intermediary banks and funds were fully employed. Investments from this credit line are made only from the revolving fund. As of 31.12.2017 the exposure of this credit line is EUR 307.6 thousand.

SME Credit Line from KfW (KMB 1, 2, and 3)

Credit line funds are composed of three phases, and Macedonian Bank for Development Promotion AD Skopje was appointed as an Agent of the Fund established with the funds from KfW 1 credit line, whereas in the second and third phase MBDP was in the role of a borrower. The credit line funds were disbursed through Halk Banka AD Skopje, Ohridska Banka AD Skopje, ProCredit Banka AD Skopje, and savings house Mozhnosti doo Skopje. Loan beneficiaries were micro and

small enterprises, individual entrepreneurs, craftsman, sole traders, vendors, other micro and small entities. In regard to this credit line, in 2017, MBDP invested EUR 8.5 million.

Other Credit Lines and Projects

Project “Financial support for self employment"

The project "Financial support for self-employment" started in 2008 (holder of the project is the Employment Bureau of RM). The aim of the Project is to create an efficient system of economic and social support and productive involvement of the unemployed category of people in the Republic of Macedonia. The credit programme is targeted at supporting the long time unemployed people, unemployment compensation beneficiaries and first time employed young people. Loan beneficiaries are obliged to stay outside of the unemployment list at least until the repayment of the loan.

MBDP acting as an Agent, signed agreements with six intermediary banks for implementation of this Project including: Ohridska Banka AD Skopje, NLB Banka AD Skopje, Sparkasse Banka Macedonia AD Skopje, Komercijalna Banka AD Skopje, Stopanska Banka AD Bitola, and Halk Banka AD Skopje.

As of 31 December 2017, the credit line balance was EUR 10.4 million.

Renewable Loan Fund (RLF)/Agricultural Credit Discount Fund (ACDF)

Since 1 July 2010, the administration of the ACDF credit line was transferred to the Macedonian Bank for Development Promotion under the name, administration of the credit line Renewable Loan Fund (pursuant to the Administration Agreement made between the Ministry of Finance and MBDP).

Implementation of the RLF/ACDF credit activities commenced in 2003 and as of 31 December 2017, 6,170 loans were approved in the total amount of EUR 79.6 million, of which EUR 62.0 million were ACDF funds (total of all sources of financing IFAD-1, IFAD-2, PSDL-1, PSDL 2, and EIB) whereas the financial intermediary institutions took part with EUR 17.6 million. In the reporting period the average loan amount was EUR 12,905.

In total, 13 financial institutions are taking part in the implementation of ACDF, out of which 11 are commercial banks and 2 are saving houses.

In circumstances of limited funds, during 2017, 61 credits were disbursed in total amount of EUR 774.8 thousand of which 619.9 thousand were RLF/ACDF funds, whereas the rest EUR 154.9 thousand were participation of financial institutions. In the monitored period the average credit amount was EUR 12,702.

In the course of 2017, the purpose of all disbursed loans was primary agricultural production.

Special Credit Guarantee Scheme

The credit line from the European Agency for Reconstruction (EAR) was used for financing SMEs. During 2011, the credit line was redesigned and a new agreement was concluded between the Government of the Republic of Macedonia and the MBDP for managing the Special credit guarantee scheme for SMEs. The credit line provides finance for purchasing fixed assets, with a possibility for financing working capital up to 30%. The minimum amount per loan was set at EUR 10,000, and the maximum was EUR 300,000. Loans were extended through commercial banks (that MBDP has concluded framework agreement with), and they participate with minimum 30% own funds in the loan structure.

As at 31 December 2017, exposure regarding the Special credit guarantee scheme was EUR 559.5 thousand.

Credit line for production, processing and export of agricultural products

The purpose of the credit line funding was to provide finance to produce, process and export agricultural products. Its realization began in 2012. The credit line was established with the purpose to directly support the companies which main activity was production, processing and export of agricultural products. As of 31 December 2017, loan applications totaling EUR 20.1 million were approved.

XI. TRADE CREDIT INSURANCE

Trade Credit Insurance Instruments
(export credit and domestic insurance)

MBDP is development institution in the Republic of Macedonia that provides short term insurance of foreign and domestic receivables against commercial and political risk.

MBDP offered the following insurance products during 2017:

Short Term Insurance against Commercial Risks

- Pre-shipment
  - Bankruptcy

- Post-shipment
  - Bankruptcy
  - Protracted default

Insurance against Political Risk

- War risk or similar events
- License canceling risk

- Breach of contract

Reinsurance Agreement

In 2017, MBDP reinsured the total insured export credit and domestic portfolio. The reinsurance was conducted in compliance with the concluded Quota Share Reinsurance Agreement (compulsory) with the reinsures Atradius RE, and Nationale Borg.

More favourable conditions were reached with the Quota Share Reinsurance Agreement, in regard with the risk undertaken, premium rates, insured risks, etc., in comparison to the previous years. MBDP undertakes 35% of the insured risk of export credit insurance according to the Quota Share Reinsurance Agreement and the reinsurers undertake 65% of the MBDP insured risk for approved credit limits up to EUR 1,500,000. In case of approved credit limits for buyers exceeding EUR 1,500,000, MBDP undertakes 20% of the insured risk, whereas the reinsurers undertake 80% of the insured risk.

The risk share of individual reinsurer is as follows:
Atradius RE, Ireland – 66.67%
Nationale Borg, Netherlands – 33.33%

Scope of Work

Short Term Export Credit Insurance Policy against Commercial Risk

In the course of 2017, MBDP signed short term export credit and domestic insurance policies against commercial risk with 54 insureds, and according to them credit limits were approved for domestic and foreign buyers.

Insured Exports

In the course of 2017, the Macedonian Bank for Development Promotion made insurance in an amount of EUR 65 million, of which EUR 53.5 million was export credit insurance, representing increase of 7.9% in respect of 2016 and collected premium of EUR 293,277 representing increase of 10%, also. The rest EUR 1.5 million are from insured domestic receivables against short term commercial risk, and the Bank collected premium in an amount of EUR 70,51.

Chart: Insured exports and domestic receivables against commercial risk per year (in EUR)

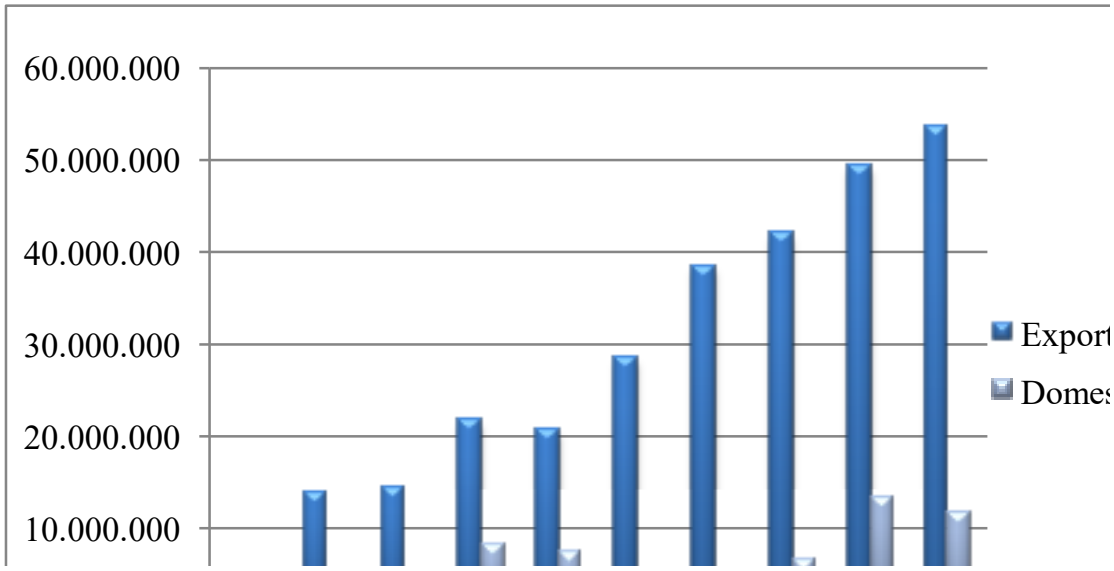
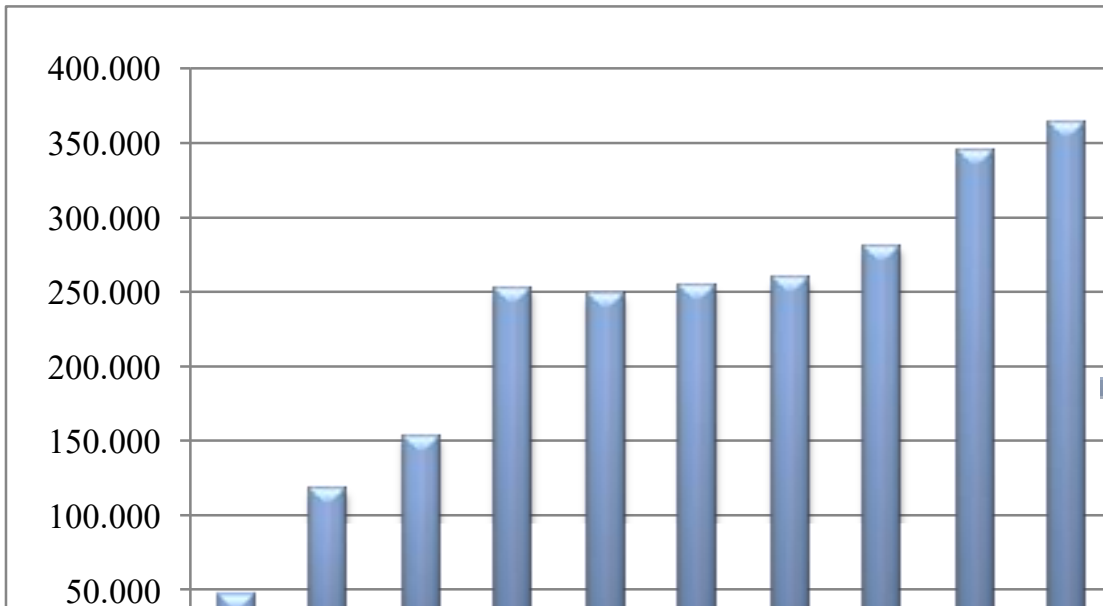


Chart: Premium gained (export – domestic) per year (in EUR)



MBDP pays 65% of the total collected premium to the reinsurers. Consequently, reinsurers participate with 65% in undertaking risk, i.e. in the amount of indemnity, and MBDP with 35%.

Indemnity

In the course of 2017, Macedonian Bank for Development Promotion paid indemnity to the insureds in the amount of EUR 73,051, due to occurrence of insured event (bankruptcy, protracted default).

International Cooperation

MBDP is a full member of the International Union of Export Credit Agencies – Prague Club since 1999 (Part of Berne Union). MBDP as a full member in 2017 took active participation in Berne Union operations, thus making contribution to achieving of and respecting the Club's goals: mutual cooperation, exchange of information, international standards acceptance, promotion of credit insurance, providing international support and exchange of information. MBDP attended both regular semiannual meetings of members of the Prague Club and Berne Union.

Factoring

Factoring service is a specific type of short-term financing, where MBDP in the role of "Factor", on the grounds of a contract concluded in a written form, assigns-purchases the foreign receivables of another domestic entity with a right of recourse.

Contractual parties in factoring are as follows:

- Seller/exporter of goods and services, the one who issues invoice,
- Debtor/buyer of the goods and services,
- Factor (legal person/MBDP, party that provides factoring, i.e. purchases the account receivables).

MBDP provides with-recourse factoring of export receivables.

Factoring is flexible financial instrument which provides improvement of the company cash flow and liquidity.

Implementing the factoring service, MBDP shall contribute to providing easier short-term finance to the companies in order to satisfy their current needs, thus becoming a type of accelerator of the business cycles implemented in the companies especially the export oriented ones.

The clearly defined Factoring procedures and their consistent application shall provide:

- establishment of clearly defined principles and procedures of operation,
- application of standard forms and models in implementation of factoring.

MBDP pays special attention to the creditworthiness of the buyer/debtor in the process of with-recourse factoring of export receivables.

Following are advantages of factoring to the companies:

- improvement of cash flow,
- acceleration of business cycles,
- increase of working capital,
- growth and development of business.

Factoring fully confirms its role as alternative and specific method of finance, which gradually shall become more popular and used, having in mind the international experience and the Macedonian companies' needs of working capital.

In the course of 2017, MBDP through factoring supported the exports of the Macedonian exporters. MBDP supported the export of Macedonian products and services to buyers located in 4 countries of the region and EU.

Factoring provided in 2017

Period	01.01.2017-31.12.2017 in EUR
Purchased receivables	588,924
Finance	471,139
Interest	10,429
Fee	1,945

XII. RISK MANAGEMENT

Macedonian Bank for Development Promotion AD Skopje has established risk management system and continually manages the risks pursuant to the nature, the type and the scope of the financial activities it performs. Risk management system encompasses strategy, policy, procedures and other internal acts of risk management, appropriate organizational layout (clear organizational structure, efficient risk management process and efficient internal control and audit system) and Bank capital adequacy assessment process for covering risks.

MBDP has established system on management of all material risks the Bank is exposed to. Material risks are determined pursuant to internal methodology including qualitative assessment, i.e. assessment of the influence of an individual risk on operations, as well as history data on the loss amount which can be related to an individual risk.

Risk represents the probability of certain activity or event to have direct adverse influence on the profit and/or on the own funds, or to impede the fulfillment of the Bank's objectives. Risk is properly managed when it is identified, understood, assessed, monitored and controlled. Appropriate risk management is primarily based on internal acts for identification, assessment, control and monitoring of individual risks, stress testing rules, rules on introducing new products, rules on using external services, as well as internal information system. In addition, risks are not identified and assessed in isolation, since one transaction may cause several risks and one type of risk may influence the increase of other risks.

Bank's risk management system includes at least:

- Credit risk
- Country risk
- Credit risk, arising from currency risk
- Risk of concentration of Bank's exposure
- Liquidity risk
- Currency risk
- Interest rate risk in the portfolio of Banking activities
- Operational risk
- Legal risk
- Reputation risk
- Strategic risk

1. Credit Risk

Credit risk is a Bank's risk of loss stemming from client's or other contractual party failure to settle its liabilities in the agreed amount and/or terms. Having in mind that all changes of the macroeconomic indicators in a country lead to qualitative changes of the clients besides credit risk the Bank also includes the country risk. Loans are the biggest and the most obvious sources of credit risk. There are, also, other sources of credit risk arising from Bank's operations which are included in the balance sheet and off-balance evidence.

The Bank controls the credit risk by adopting credit policy and procedures which determine the internal control system in order to prevent risk occurrence. The Bank operates on the basis of defined criteria for new credit risk exposures, as well as dispersion of the current credit risk exposures. Prior to approval of any activity which may influence the credit risk exposure, the Bank assesses the risk profile on individual basis (client/transaction) which includes: assessment (quantitative and qualitative) of the creditworthiness of the client/contractual party, the regularity of the debtor's liabilities settlement based on history data, and collateral quality. At least once a month, the Bank makes assessment whether there is objective evidence that financial assets are impaired and calculates the impairment loss on individual basis. In case of impairment indicators, the Bank assesses the compensable amount of the asset. The impairment loss is determined as a difference between the accounting value of a claim and its present value, i.e. the financial asset is determined as damaged if its accounting value is higher than its estimated compensable amount. Thus, the Bank on the basis of indicators showing that the accounting value is higher

than the compensable amount estimates the compensable amount of the asset and recognizes impairment loss.
As of 31.12.2017, the credit risk exposure by risk category is as follows:

- A category – 99.73%
- B category – 0.23%
- C category – 0.00%
- D category – 0.00%
- E category – 0.04%

The Bank has not determined impairment for around 98.67% of the total credit risk exposure. As of 31 December 2017, the total amount of the impairment / special reserve was 0.09% of the total credit risk exposure which represents a low risk level.

2. Country Risk

Country risk is the risk that the economic, social, and political environment and events in certain foreign country may impact the Bank's operations. In order to manage country risk, the Bank establishes adequate system for identification, assessment, monitoring and control, having in mind that the country risk is not limited to exposure to entities which domicile country is other than the Republic of Macedonia, but it considers the factors that may influence the exposure to domestic entities if the creditworthiness of the entity is significantly influenced by the events in another country. Country risk management is integrated with the credit risk management process.

The objective of the Bank's policy of country risk management is to provide necessary preconditions for identification of Bank's exposure to country risk and to limit the exposure according to risk level.

Exposure to country risk is calculated individually for each credit risk exposure. For each country group classification loss % is envisaged in accordance with the credit risk management policy. Country risk is calculated as percentage of the net credit exposure.

3. Credit risk arising from foreign exchange risk

Credit risk arising from foreign exchange risk the resident-loan beneficiary is exposed to is an integral part of the credit risk and is integrated in the risk management system. Credit risk arising from foreign exchange risk the resident-loan beneficiary is exposed to is current or prospective risk to the capital and profit arising from resident-loan beneficiary ability to regularly settle its liabilities pursuant to the loan agreement because changes in the exchange rate adversely affect, i.e. increase the liabilities of the loan beneficiary. The risk is connected to the currency the loan or other placements are approved in. Credit risk arising from foreign exchange risk arises when there is mismatched currency position (mismatched structure of foreign currency claims and liabilities) of the loan beneficiary according to currency and maturity. The currency induced credit risk is characteristic for the Bank, because

portion of the assets and liabilities are stated in foreign convertible currency or in domestic currency, but indexed to a foreign currency.

4. Concentration Risk

The concentration risk is determined as every individual exposure or group of exposures which potentially may result in considerable losses that may impact the Bank's financial condition or the regularity of performing Bank's operations.

The Bank performs the concentration risk management by laying down exposure limits, as well as defining and monitoring the large exposures to certain persons in accordance with the criteria defined in the Law on the Macedonian Bank for Development Promotion AD Skopje and other subordinate regulations obliging the Bank to perform its operations.

5. Liquidity Risk

Liquidity risk is determined as current or future risk of the Bank failing to provide sufficient funds for settlement of its short-term liabilities at the moment those liabilities fall due, or to provide the funds needed at much higher costs.

The basic principles for liquidity risk management are set forth in the policy and procedures for liquidity risk management. In order to manage the liquidity risk, MBDP maintains an appropriate level of liquid assets, continually monitors the present liquidity, provides sufficient amount of Denars and foreign currency assets for timely settlement of liabilities and for disbursement of loans. Present surplus of liquid assets are placed in highly liquid securities, in deposits up to 7 days with the National Bank of RM, in short-term loans to commercial banks in Macedonia and in deposits with foreign banks.

Treasury and liquidity division monitors the Bank's liquidity, matches all inflows and outflows in every currency, takes activities for maintaining highly liquid portfolio, and monitors the residual and expected maturity structure in order to meet Bank's objectives defined in the Bank's strategy.

6. Interest Rate Risk in the Banking Book

Interest rate risk in the banking book denotes the risk of loss arising from the adverse movements in the interest rates, and which have influence on the items in the Bank's banking book. Interest rate risk is determined as the most significant market risk, which has influence not only in the trading book, but also in the banking book.

Managing of interest rate risk which has direct influence on the income and the economic value of the banking book, is determined as part of the Bank's risk management integrated system. MBDP established a system for managing the interest rate risk that corresponds to the nature and the volume of financial activities it performs, as well as with the level of exposure to the interest rate risk.

7. Currency Risk

The currency risk denotes a risk of loss due to a change in cross-currency exchange rates and/or change in the value of the Denars relative to the value of other foreign currencies. The Bank establishes a system for identification, measuring, monitoring and controlling the currency risk it is exposed to in its operations, thus encompassing all the activities and transactions which in the balance and off-balance records are registered in foreign currencies and in Denars indexed with FX clause.

MBDP usually grants the foreign credit funds in the same currency or in Denars with FX clause in the currency of funds' origin. Bank's policy is to manage the foreign currency positions or Denars positions with FX clause in a manner that enable monitoring, controlling and mitigating the adverse impact from the foreign exchange on the stability of Bank's financial position.

8. Operational Risk

Operational risk management represents the probability of Bank loss and adverse influence on the Bank capital as a result of inadequate or weak internal systems, inadequate personnel, inadequate or failed systems of the Bank, as well as external events that may cause loss. Operational risk, compared to the credit and market risk, can not generate higher income. Operational risk also includes:

- Legal risk – current or prospective risk to the Bank's profit and own funds, caused by violation or non-adherence to the legal framework, agreements, prescribed practices, ethics standards, or as a result of misinterpretation of the regulations, rules, agreements and other legal documents,
- Money laundering and terrorist financing risk – deliberate or unintentional involvement of the Bank in activities which by the present regulation or international standards represent money laundering or financing terrorism,
- Risk of inappropriate information system – denotes a risk of Bank's loss arising from loss, unauthorized use or unavailability of information, information tools and/or services offered by the Bank.

Strategic and reputational risks are excluded from the operational risk definition.

Operational risk management is part of the integrated approach for management of all risks the Bank is exposed to. Operational risk management is implemented at each level within the organizational structure and at the same time is integrated in the day-to-day activities of the Bank. In this way probabilities for occurrence of loss events are minimized, improvement of Bank's operating process and services quality is achieved, as well as increase in efficiency of performance. Decrease of operational risk exposure is facilitated through continuous training of personnel, monitoring the frequency and prevention of mistakes.

9. Legal Risk

The objective of the legal risk management is to determine the grounds of the legal risk management system in order to minimize and eliminate the factors causing this type of risk, i.e. to eliminate and decrease the consequences of legal risk occurrence

at a level acceptable to the Bank from financial viewpoint and from aspect of the Bank's reputation.

10. Reputational Risk

Reputation risk is current or prospective risk to the Bank's profit and own funds, arising from the adverse assessments of the Bank's operations by the customers, creditors, shareholders, investors and supervisors. Protecting the Bank's reputation is responsibility of each employee. The Bank has established a system of regular monitoring of Bank's activities for reputation risk management, as well as activities for decreasing the probabilities for occurrence of any of the reputation risk sources.

The Bank has established proactive approach to the reputation risk management process, having in mind the current shareholders structure, i.e. the Bank's sole shareholder (the Republic of Macedonia), as well as the fact that the reputation risk is a risk of losing trust in the Bank, affecting the earnings and capital due to adverse opinion for the business operations irrespective whether real basis exists for such opinion, i.e. impossibility to predict this risk on the basis of real indicators, non-existence of database, and non-existence of possibility for appropriate quantification of the risk.

11. Strategic Risk

Strategic risk is a current or perspective risk to the Bank's profit, or own funds, arising from the changes in the business environment, adverse business decisions, improper implementation of the decisions or lack of Bank responsiveness to the changes in the business environment. Bank's policy is to make the strategic decision making process rational and objective, which will contribute to the strategic risk management, resulting with the same result irrespective who is implementing it. The Bank establishes system for regular monitoring of Bank's activities for strategic risk management, as well as activities for decreasing the probabilities for occurrence of any of the strategic risk sources.

12. Capital Adequacy

The Bank has established policy for maintaining of own funds in order to provide and continually ensure adequate level of own funds, depending of the type and scope of financial activities and the level of risks arising from the conduct of such activities. The Bank policy is the maintaining of own funds to contribute to the maintaining of capital adequacy rate in order to ensure that the Bank will remain solvent in a long run.

As of 31 December 2017, the MBDP capital adequacy rate was 27.36%.

XIII. PLANNING AND ANALYSIS

In the course of 2017, Planning and analysis department within the strategic business objectives of the Bank, performed activities related to designing of reports and providing data and information referring to:

- Macroeconomic analysis and research as base for introduction of new and development of the existing products of the Bank,
- Country and business analysis in the countries where MBDP is exposed through its clients,
- Analysis of the financial activities of the Bank,
- Developing the financial plan for 2017,
- Developing the Strategy (Business plan and development) of MBDP 2017-2019.

XIV. COMPLIANCE OF THE BANK'S OPERATIONS WITH THE REGULATIONS

The compliance officer solely and independently identifies and monitors the risks arising from non-compliance of the Bank's operations with the regulations.

During 2017, the compliance officer continually followed the adopting of draft-regulations, publishing of new legal and subordinate acts, modifications and amendments to the positive legal regulation and assessed their influence on the Bank's operations. The members of the Supervisory Board, Management Board and the Bank employees were informed for the modifications of the legal and subordinate regulation and the necessary activities were undertaken in order to harmonize the Bank's operations to the new regulation.
The compliance officer monitored the Bank adherence to the regulations that apply to its operations and to the Bank's internal acts, as well.

In the course of 2017, the compliance officer by giving recommendations took active part in the creation and modification of the Bank's internal acts in order to harmonize them with the new legal and subordinate acts.

During 2017, trainings were continually carried out and employees were informed in regard with the manner of implementation of the new legal regulations and the Bank's internal acts in the everyday work.

Also, during 2017, the compliance officer controlled the fulfillment of the Bank's obligations related to timely delivery of reports to institutions and internal reports, gave opinion and recommendations related to present activities of the divisions/departments in order to ensure consistent application and adherence to the regulations.

The Management Board and the Supervisory Board were regularly informed though monthly and quarterly reports for the performed activities related to fulfillment of the compliance function.

XV. ACTIVITIES PURSUANT TO THE LAW ON PREVENTION OF MONEY LAUNDERING

Pursuant to the Law on Prevention of Money Laundering and Other Proceeds of Crime and Financing of Terrorism (Official Gazette of RM No.130/2014 and 192/2015), the Programme on prevention of money laundering and financing of terrorism and procedures of MBDP, as entity which has obligation to undertake measures and activities for prevention of money laundering and financing of terrorism has undertaken the following activities:

- Procedures on client's acceptance,
- Procedures on client due diligence,
- Procedures on risk analysis and risk analysis indicators,
- Procedures on assessing the risk of holders of public function,
- Procedures on identification of unusual transactions and suspicion for money laundering and terrorist financing,
- Procedures for keeping data and documents of unusual transactions and suspicion for money laundering and terrorist financing,
- Procedures for keeping data and documents and submission of reports to the Financial Intelligence Office,
- Permanent training plan for the Bank's employees in the area of prevention of money laundering and terrorist financing,
- Manner of cooperation with the Financial Intelligence Office,
- Procedure and plan for performing internal control and audit on the implementation of the measures and activities,
- Appointment of responsible person.

In the course of 2017, the responsible person of the Bank for prevention of money laundering and terrorist financing cooperated with the Financial Intelligence Office and other institutions. The responsible person of the Bank for prevention of money laundering and terrorist financing attended the trainings organized by the Office and other institutions.

During 2017, trainings for the employees were held where the latest recommendations of the Office were presented as well as the manner of their use in practice.

XVI. INFORMATION SYSTEM SECURITY

Information System Security Policy regulates the implementation of international security standards and protective mechanisms for diminishing the risk of causing damages and minimizing the loss as well as managing the operational risk. The Policy should provide confidentiality, integrity, and availability of the information system assets, ensure continuity in providing information, data, and services and protect employees from human mistake. Information System Security Policy was amended accordingly to include the threats in the digital space. The Bank follows the world trends and is capable to respond appropriately.

The Bank established Manual on risk assessment. This Manual on risk assessment represents the foundation for implementation of successful and detailed risk assessment of the information system risks. The Bank also considers the threats

coming from the digital space. The qualitative method is applied in the assessment procedure.

Risk analysis and risk assessment of the Information System Security is submitted to the management bodies on a yearly basis, and at least two reports related to information system security. At least once a year the Bank conducts self assessment of the risks arising from the threats in the digital space.

The business continuity plan of the Bank ensures that the plan for continuity of work will be implemented in cases of operations and business process disruption in moments when the Bank is incapable of meeting the undertaken business obligations. The continuity plan includes strategies, activities and procedures for continuity of business operations and functions related to restoration of communication and information assets. Catastrophe renewal plan is an integral part of the business continuity plan.

The Bank has secondary location.

The Bank takes activities to strengthen the information security system controls on regular basis. It follows the world trends in the area of cybercriminal and takes administrative, organizational and technical measures for their diminishing.

Additionally, the Bank accelerated its operation on implementing measures for management, fulfilling requirements and controls of the SWIFT service in order to strengthen the security of the local computer network being a point where hacker's attacks are concentrated.

XVII. INFORMATION TECHNOLOGY

In the course of 2017, the information technology department successfully followed the development of the Bank, continually providing IT support to the business processes.

- Up-grading activities to the existing integrated banking information system and to the other business software solutions were continually. They included implementation of new functions for more efficient execution of the business activities in the Bank at all levels and achieving higher degree of confidentiality, integrity and availability of data they provide,

- activities which provide greater availability of the ICT resources to the Bank employees were continually undertaken, and considerable emphasis was placed for providing greater security when using the ICT resources pursuant to the good practice recommended for bank operations,

- in accordance with the needs for improvement of the risk resistance degree in the digital space, activities were taken in the Bank for implementation of

modern technologies and ICT assets for protection of the information infrastructure (equipment, data, etc.).

XVIII. INTERNAL AUDIT

Internal audit department is an independent organizational unit, functionally and organizationally separated from the rest of the Bank's organizational units, in the hierarchy positioned above the operating organizational units, and closely below the Supervisory Board and the Auditing Committee.

Main objective of the internal audit operations is to provide impartial and independent assessment of the internal control system adequacy and efficiency, accuracy of the accounting records and financial statements, harmonization of the Bank's internal policies and procedures with the legal regulations, as well as the general efficiency of the Bank's operations.

Internal audit department during 2017 performed its activities in accordance with the Annual plan of operations, created on a basis of preliminary analysis of the core business processes of the Bank and potential risks those business processes were exposed to. The Annual plan of operations was approved by the Bank Supervisory Board.

In the course of 2017, Internal audit department conducted 13 regular audits, monitored the implementation of the presented recommendations, reported to the Bank's Supervisory Board on regular basis and cooperated with the Management Board, Auditing Committee, the National Bank and the external auditor of the Bank.

Management Board

SIGNED

Dragan Martinovski
Chief Executive Officer

SIGNED

Besim Bilali
Chief Operating Officer