



საქართველოს ეროვნული ბანკი
National Bank of Georgia

SUPERVISORY STRATEGY

2020-2022

2021 EDITION

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Statement of the Governor



The first document of the supervisory strategy was published by the National Bank in 2020 and it included the strategic priorities for 2020-2022 and the activities planned for their execution. The publication of this document is in full compliance with the steps taken by the National Bank in recent years, that were aimed at increasing the transparency of the central bank's activities.

We hope that the publication of the Strategy Document will significantly facilitate the effective planning of the

National Bank, establishing clear future vision for our staff, increasing predictability for the sector in future events, openness and greater access to information on supervisory priorities and plans for investors, international financial institutions and rating agencies, the society and other stakeholders.

The supervisory strategic priorities determined by the document serve to implement one of the principal mandates of the National Bank - promoting the stable functioning of the financial system. As we mentioned in a document published last year, the National Bank's supervisory priorities shall remain unchanged for 3 years (2020-2022). It should be noted that the annual strategy document puts particular emphasis on the key objectives and changes to the supervisory priorities planned for the next 12-18 months. On the one hand, it helps to provide information about current priorities to stakeholders proactively, and on the other hand, it helps us to plan the work needed to meet the priorities as effectively as possible.

In 2021, the National Bank will conduct its activities with the following supervisory priorities:

1. Strengthening the corporate culture that encourages leadership and initiatives;
2. Strengthening the cooperation with the stakeholders;
3. Facilitation of stable functioning of the financial sector;
4. Approximation to international standards;
5. Development of the ecosystems for sustainable financial technologies.

It should be noted that, despite the difficult processes in the world and in Georgia, last year the National Bank continued to work actively, implementing the strategic priorities and planned changes defined in the document. A brief report on the implementation of the events envisaged by the strategy is presented in this document and more detailed information on the activities and indicators of the National Bank will be reviewed in detail in the 2020 Annual Report.

Koba Gvenetadze

Governor of the National Bank

Mandate, Mission and Vision



Mandate

In terms of the supervision of the financial sector, the objective of the National Bank of Georgia, defined by law, is to facilitate the financial stability and transparency of the financial sector and protect the rights of consumers and investors.

Mission

Facilitation of a sustainable and healthy development of the financial sector, which is open to qualified investors, where a competitive environment is ensured and the interests of consumers are protected.

Vision

The National Bank of Georgia is an independent and competent supervisor of the financial sector, which has trust of the society, well-deserved respect among the stakeholders and a working environment that is oriented at employee development.

Risk Appetite Statement

In order to fulfill the mandate, considering the mission and vision, the National Bank supervises the activities of financial sector representatives, lending entities, credit information bureaus, facilitates the stable and efficient functioning of the financial system, the establishment of a competitive environment, the control of systemic risk and the reduction of risks. A prudential supervisory regime is oriented at sustainable functioning of the financial system. This does not imply inevitable avoidance of bankruptcy of all institutions in the financial system. Instead, it aims at timely identification of risks and threats to the bankruptcy and maximum mitigation of negative effects on stable functioning of the financial system as a whole, by taking appropriate measures.

Performance indicators

The work of the NBG can be measured through the following indicators:

1. The ratio of losses of depositors and creditors of the financial sector to the total values of liabilities to depositors and creditors;
2. The ratio of number and assets of bankrupt supervised institutions to the total number and assets of all supervised institutions, respectively.
3. Apart from the above-mentioned quantitative criteria, the implementation of the mandate of the NBG can also be measured by qualitative factors, such as assessments of the reforms related to the financial sector by the international organizations¹ and the international rating agencies².

¹ For example, the assessment program of the financial sector, which is conducted by joint mission of the International Monetary Fund (IMF) and the World Bank (WB)

² For example, the assessment reports of Fitch, Moody's, Standard and Poor's regarding the reforms performed by the National Bank of Georgia.

The supervisory regime and principles

To fulfill the supervisory mandate and strategy, the National Bank of Georgia supervises and regulates the financial sector upholding the following principles of the risk-based supervision:

- ◆ **Concentration on material risks** - Proportional focus, in particular, focusing on risks that pose the most substantial threat to the stability of the financial sector or the safeguarding of the financial resources of depositors, creditors and investors (Considering the relevant sequence determined by law);
- ◆ **Forward-looking approach** - Identification of threats and problems of the financial sector at an early stage and timely use of appropriate corrective measures to eliminate them;
- ◆ **Dialogue with the regulated financial institutions** - This enables the supervisor to become familiar with the internal culture of the financial institutions, its strategy and incentives; it also supports the strengthening of the internal control mechanisms and sophistication of the risk management by the supervisory board and the directorate;
- ◆ **Coordination of micro and macro-prudential supervision** - Taking into account ongoing systemic risks of the financial sector, the measures taken to mitigate these risks, the business and credit cycles and other factors of macroprudential policy, while conducting the micro-prudential analysis;
- ◆ **Consistency, compliance and compatibility** - Ensuring the compliance between the stated requirements for financial institutions, the use of consistent requirements and approaches in the decision-making process towards the financial institutions that share the same characteristics, and proportional response to the risks.
- ◆ **Effective use of internal resources** - risk-based supervisory processes and principles-based regulation imply the most effective allocation of supervisory resources and instead of engaging in the passive assessment process of regulatory compliance, focusing on the risks and the practical mitigation techniques.

VISION REGARDING INNOVATIONS

The rapid development of financial innovations and the efforts to reduce the risks may often contradict each other. The vision of the National Bank of Georgia regarding the financial stability implies a constant care for the improvement of optimal balance between the development of the financial market and risks. To fulfill this vision, the National Bank of Georgia is guided by the following principles:

- ◆ **Technological neutrality towards risks** - supervisory approach towards the risks is technologically impartial. To the National Bank of Georgia, it is important to assess the impact of a certain decision on the stability of financial system, regardless of the type of technological mean. The same supervisory requirement applies to the same risk, irrespective of the technological processes on which the business model of the financial institution is based.

- ◆ **Open regulation** - supervisory approach is open to the new ideas and initiatives, which serve for the purpose of financial market development and at the same time, do not increase the risk to financial stability and financial system. Anyone, whose innovative idea is hindered by the NBG's supervisory technique, can present evidence, based on international practice and local facts. To facilitate this, the National Bank of Georgia uses the following methods: a dialogue with the financial institutions, open public consultations regarding new regulations, the financial innovations office and regulatory sandbox.
- ◆ **Study of unknown risks** - the risk of new financial technologies and its potential impact are usually unknown, especially at the inception phase. The risk-oriented approach does not allow the usage of such technologies. To identify the risk, the National Bank of Georgia can use regulatory sandbox. This implies conduct of various tests by the financial institutions in the environment controlled by the NBG and the discussion of the results with the supervisor. The regulatory sandbox is primarily oriented at the identification of systemic risks.

The importance of the above-mentioned approach and principles particularly increases as a result of the events that followed the COVID-19 pandemic. Their implementation will ensure the development of the remote channels, which respond to the challenges of the COVID-19 and allow safe delivery of financial services. It is noteworthy that the National Bank intensively cooperates with the representatives of the sector and experts in the field of financial innovation and technology development processes.

Values

In the process of fulfilling the supervisory mandate and the strategy, each supervisor adheres to the following values:

Professionalism

Thorough understanding of the field and aspiration to grow

- Execution of duties and responsibilities on a high quality;
- Decision-making based on complete and thorough analysis;
- Respect towards made decision and its execution;
- Achievement of timely and proactive results; Also, ensuring that the benefits received as a result of a certain decision exceed the costs incurred.

Integrity

Compliance with the accepted social, ethical and professional standards

- A balanced and fair use of power;
- Impartiality in the process of decision-making and while on duty;
- Preservation of confidentiality.

Cooperation

The skills to establish trustworthy and reliable relationship with the stakeholders

- Respect and appreciation towards the opinion of others both within the National Bank of Georgia and outside;
- Helping the colleagues and cooperation with them in an effort to help them make healthy decisions and deliver successful results.

Teamwork

Work towards the common goals

- Coordinated definition of team objectives and recognition of team's achievement in accomplishing common goals;
- Mobilization of resources around the common objectives and orientation on the results of common work;
- Effective work in a team, trust among the team members and encouragement during the working.

Transparency

Openness towards the regulated entities, other stakeholders and the public while respecting the confidentiality principles defined by law.

- Receipt and processing of the evaluations and remarks and execution of respective corrective actions;
- Providing any stakeholder with the access to public information according to the legally defined rule.

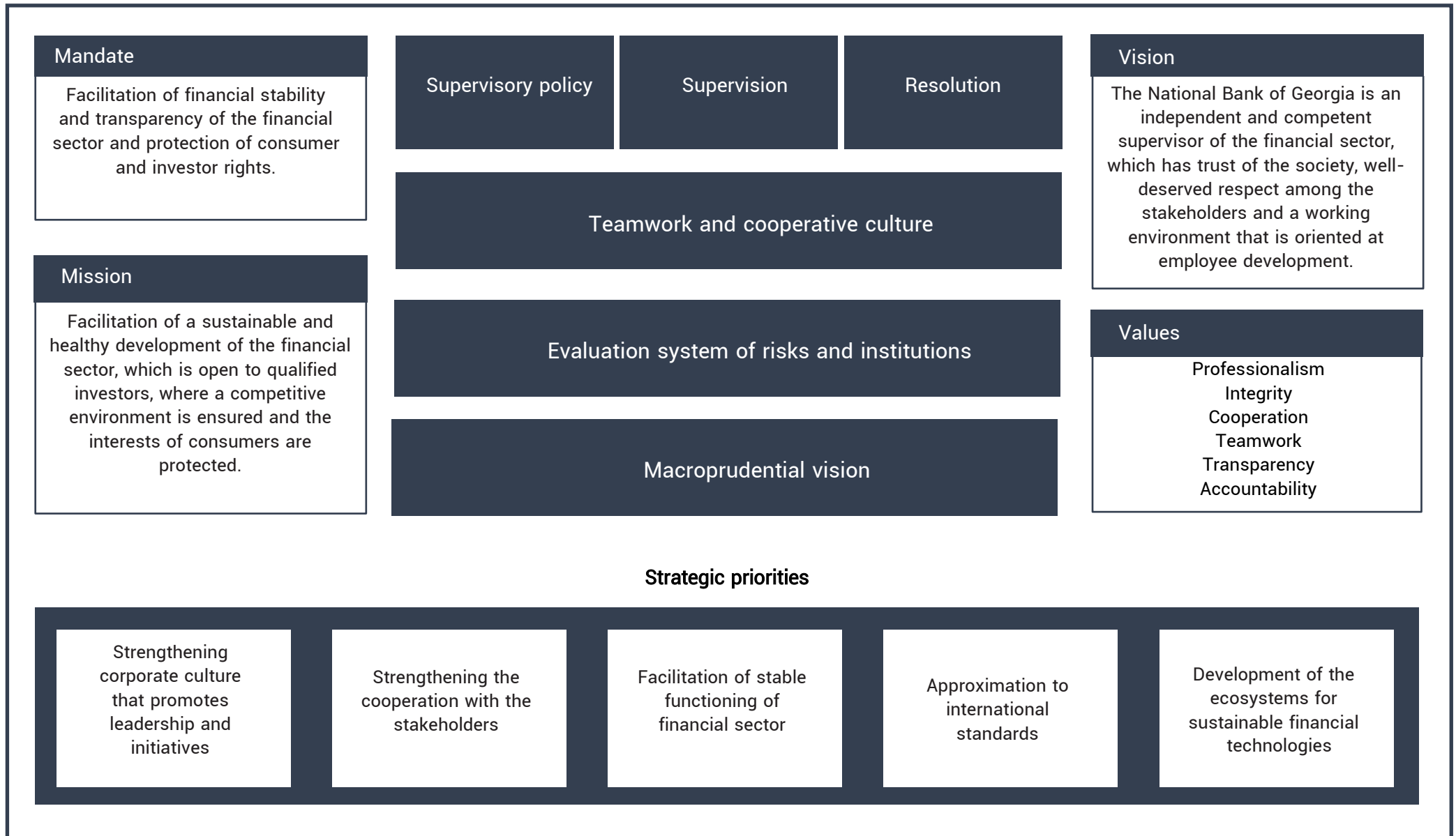
Accountability

Responsibility for one's own decisions and the results

- Making similar decisions when complex decisions and actions need to be taken;
- Upholding equal or a higher standard than required for regulated entities;
- Openness to criticism and rapid response to the flaws discovered in own activities.

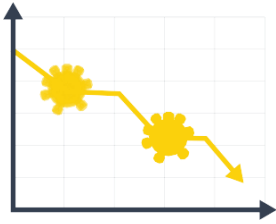
OPERATING MODEL

Operational model of supervisory function



New challenges of operational environment

The following new tendencies and challenges characterize the operational environment and influence the financial sector, as well as the supervisory strategy.



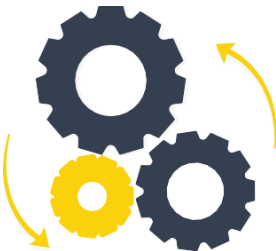
Coronavirus

- Negative impact of Coronavirus on the economy;
- Reduced risk appetite of financial institutions on lending;
- Potential increase of non-performing loans;
- Increased importance of the use of remote channels.



Non-financial risks

- Higher expectations towards the financial institutions on corporate social responsibility
- Increase of environmental, social and governance (ESG) risks, including the risks related to the gender equality and climate change;
- Increased dependency on information technologies and higher risks of cybersecurity.



Changes in the industry

- Decline in profitability margin and expected modifications in business models;
- Increased use of innovations by financial institutions, vis-a-vis increased competition;
- Increased use of financial, supervisory and regulatory technologies as well as of artificial intelligence, changes in the roles of financial intermediation, development of instant electronic payments and central bank digital currencies (CBDC).



Political environment

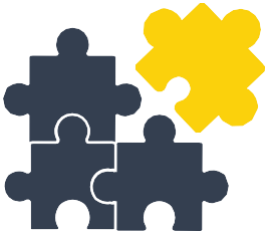
- Influence of political volatility on the activities of financial institutions and on the future strategy of the National Bank of Georgia;
- Necessity of closer cooperation with the government and the parliament, while maintaining the principle of independence.



Globalization

- Expansion strategies of the financial institutions and banking groups outside of the country;
- Approximation processes towards the directives defined by the Association Agreement and towards the standards of Basel Committee;
- Membership of Basel Consultative Group, the Group of Banking Supervisors from Central and Eastern Europe (BSCEE) and other organizations;
- Need for approximation towards the international financial reporting standards (IFRS).
- Perspectives for entering the market of advanced and reliable foreign financial institutions;
- Perspectives for the issuance of virtual currency by the National Bank.

Cooperational culture



- Higher expectations and necessity of synergy and information sharing culture;
- Need for deeper cooperation with various state institutions, including the Georgian National Competition Agency, the State Inspector's Service, the auditors, the ministries, the parliament, etc.
- Closer cooperation with organizations outside the country: Signing memorandum with the supervisory bodies of various countries, membership of international groups.

STRATEGIC SUPERVISORY PRIORITIES OF THE NATIONAL BANK OF GEORGIA 2020-2022



STRATEGIC PRIORITIES

Strengthening corporate culture that promotes leadership and initiatives

■ Strengthening the leadership culture and promotion of initiatives

- Promotion of new initiatives on every level of employees to explore the supervisory matters from various angles.
- Strengthening the leadership culture through the increase of duties and responsibilities of the employees. To this end, develop appropriate policies and procedures.
- Encouraging the culture of collaboration and information exchange, in-house training and coaching.

■ Strengthening the assessment of risk management

- Encouraging supervisors to identify risk and the practice of proposing solutions to problems from regulated entities.
- Strengthening the risk management assessment in parallel to the regulatory compliance examination of the regulated entities.

■ Increase rights and accountability of supervisors

- Maximizing the role of supervisor, responsibilities and accountability in the process of communication with regulated entities, including senior management of entities, supervisory board, independent board members and committees.
- Promotion of working groups and joint decision-making in response to the challenges identified in the process of supervision.

■ Ensuring a fair system of evaluation of the employee performance

- Implementation of employee evaluation system, which involves the evaluation of the employees by the managers as well as of the managers by the employees.
- Strengthening the culture of employee motivation, promotion and recognition on every level of work.

■ Acquiring and maintaining talent

- Implementation of the recruitment program of the employees, who are oriented at growth and development.
- Ensuring professional satisfaction of the existing employees and their maintenance.
- Increasing the opportunities for participating in the educational programs necessary for the improvement of relevant skills.

STRATEGIC PRIORITIES

Strengthening the cooperation with the stakeholders

■ Improvement of communication channels

- Increase of publicity regarding the supervision, including the improvement of publishing legal drafts of normative acts related to the supervision and the enhancement of consulting practices.
- Improvement of the official website of the National Bank of Georgia.
- Implementation of the practice of publishing supervisory strategy.
- Participation in public expert forums and discussions.
- Publishing the research and analytical reports.

■ Improvement of cooperation framework at the National Bank of Georgia to achieve synergies

- With the rise of complexity of the financial sector, the enhancement of information sharing practice between the structural units of the National Bank of Georgia (Banking and Non-Banking, Capital Market and Payment Systems Supervision, Specialized Risks Department, Supervisory Policy Department, Money Laundering Inspection and Supervision, Financial Stability, etc.).
- Adoption and sophistication of internal policy and procedures regarding the information sharing practices.
- Formalization of supervisory evaluations and decision-making processes, which includes approving supervisory plans, defining the roles of the Financial Sector Committee and other entities involved.
- Updating the General Risk Assessment Program (GRAPE) document which includes updating the guideline as well as formalizing the evaluation processes and developing an internal procedure which determines the progress of the process in detail, the structural units involved and terms, and the decision-making processes.
- Ensuring effective organizational structure in order to achieve maximum synergies.

■ Intensifying communication with stakeholders

- Enhancing direct communication with the supervised entities and stakeholders, external audit companies, public institutions, supervisors of other countries and international organizations.
- Deepening the cooperation with the state institutions (including the Georgian National Competition Agency, the State Inspector's Service, the auditors, the ministries, the parliament and others), involving the signing of memorandums with the relevant authorities.
- Ensuring an easy access to the information for the individuals seeking registration or license at the National Bank of Georgia.

STRATEGIC PRIORITIES

Facilitation of stable functioning of financial sector

■ Institutionalization of supervisory practice

- Similar to the commercial banks, proportional shift of the supervisory regime of other supervised entities to the risk-based principles.
- Proportional distribution of risk assessment practices and supervisory policy of commercial banks to the other supervised entities.
- Enhancement of internal policies and procedures of the National Bank of Georgia in compliance with the risk-based supervision and principles-based regulation.
- Strengthening the governance in supervisory decision-making process, increasing the role of employees involved in the process, enhancement of the accountability framework and process optimization.
- Improvement of supervisory information processing processes and tools.
- Preparation of the sectoral research.

■ Improving regulatory capital standards for commercial banks

- Increasing the quality of supervisory capital and improving capital-related standards:
 - Increasing the quality of regulatory capital of commercial banks, considering the economic cycles and the financial stress.
 - Improvement of the criteria for capital instruments to strengthen their loss absorbing function.
- Update risk-weighted asset approaches, including updating the standardized approach to credit risk weighting, introduction of additional methodologies for operational risk weighted assets, market risk weighted assets and counterparty credit risk.
- Introduction of a sectoral countercyclical capital buffer for unhedged borrowers.
- Updating the stress test manual according to the updated reserve rule and develop operational stress test requirements.

■ Developing elements of recovery and resolution framework

- Analyzing the first recovery plans developed by commercial banks and communication of relevant comments.
- Prepare first resolution plans at the National Bank and implementing work to improve the enforcement of resolution instruments.

- Based on the recommendations received under the Joint Mission of the International Monetary Fund and the World Bank (FSAP) and based on the needs identified in practice, continue to work on the improvement and development of the legal framework and other technical-procedural part
- Plan and implement relevant work within the Interagency Committee for Financial Stability.
- Strengthening the cooperation with the stakeholders in the recovery and resolution processes (banks, rating agencies, Interagency Committee for Financial Stability, the investors and others).

■ Facilitation of corporate governance and effective functioning of risk management

- Strengthening the roles of independent members of the supervisory boards and improvement of the assessment practices for their independence.
- Refinement of conflict-of-interest issues.
- Facilitation the improvement of the risk management in the supervised entities, strengthening the internal auditors and elaboration of cooperation framework with them.
- For the purpose of improving the credit risk management of commercial banks:
 - Defining the credit risk management regulations and basic principles.
 - In accordance with the updated Regulation on the Concentration of Exposures and Large Exposures, Credits and Major Risks, develop and implement policies to identify groups of interconnected borrowers.
 - Update of unhedged currency induced credit risk buffer (CICR) hedging guidelines and reporting
 - Improving and publicizing the guideline of the developers and existing real estate under the construction process.
- For the purpose of improving operational and cyber-risk management:
 - Establish an operational and cyber-risk information analysis and sharing center.
 - Determining the supervisory principles of the Cloud Computing model.
 - Defining information system auditor criteria and detailed business continuity management requirements.

■ Strengthening the standards of non-financial risk management

- Taking into account the Environmental, Social and Governance (ESG) standards, including the consideration of standards related to climate change risk management and other corporate social responsibility (CSR) in supervisory processes, including the Corporate Governance Code and assessment.
- Supporting the awareness-raising regarding the non-financial risks both within the National Bank of Georgia and in the supervised entities.
- Adoption of a Code of Ethics on debt/credit collection by financial institutions.

■ Improving and developing the supervisory framework of non-banking institutions

- Introduction of a new type of financial institution - micro-banks supervisory framework.
- Putting factoring entities and leasing companies under the regulation of the National Bank and developing an appropriate supervisory framework for this purpose. Collaborate with public agencies to establish a unified electronic database and trading platform for factoring operations.
- Introduce the framework of the temporary administration regime for microfinance organizations.
- Develop special legislation on insolvency and bankruptcy for microfinance organizations.
- Develop operational risk, cybersecurity and corporate governance requirements for microfinance organizations.
- Improving the regulatory framework for currency exchange points. Develop a regulatory framework for non-cash currency exchange points.

STRATEGIC PRIORITIES

Approximation to international standards³

■ Approximation to the directives defined by the Association Agreement⁴

- Directives and regulation on the activities of the credit institutions and capital adequacy,⁵ including:
 - *Improving the suitability criteria for administrators and shareholders;*
 - *Improving the framework for banking licensing and acquisition of a significant share in a commercial bank;*
 - *Adopting the consolidated supervision rule.*
- Directive regarding the supplementary supervision of the financial conglomerates.
- Directives regarding consumer credit and distance marketing.

■ Transition of local accounting standards to the international accounting and financial reporting standards

- Introducing reporting forms based on international financial accounting standards for commercial banks in cooperation with commercial banks.
- Collaborating with external auditors on the basis of an effective communication framework and facilitating/ ensuring their independence.
- Updating the asset classification and provisioning rules (improving compliance with IFRS) and executing relevant work (including quantitative evaluation (QIS)).
- Strengthening the monitoring of the implementation of the IFRS 9.
- Development of prudential filters for supervisory ratios.

■ Implementation of standards set by the Basel Committee on Banking Supervision

- High compliance with the main principles of effective banking supervision and implementation of the recommendations developed by the FSAP mission.
- Ensuring the compliance with the recommendations of the Basel Committee regarding the capital adequacy standards.
- Proportional⁶ adoption of other standards set by the Basel Committee.

³ Approximation to the standards listed in this priority implies taking into account the context, proportionality and relevance of the country in the process of their introduction.

⁴ The document does not include securities market representatives and payment services

Issues related to providers' supervision. Accordingly, the document does not provide directives and regulations related to the above issues.

⁵ See aspects of improving regulatory capital standards in the strategic priority of promoting the sustainable functioning of the financial sector.

⁶ The majority of Basel standards apply to the global systemically important banks; however, it defines the principle of proportionality, which implies the adjustment of these standards to smaller and less complex banks.

■ Refinement and development of competition implementation and promotion policies

- Develop and issue by-laws related to competition implementation standards issued on the basis of competition law issued to commercial banks, which include the following standards:
- standards issued on the basis of competition law issued to commercial banks, which include the following standards:
 - Rule and procedures on market analysis and submitting and reviewing concentration notifications.
 - Rule on investigation of a possible violation of competition, procedure for submitting and reviewing a complaint / application
- Strengthening the monitoring of issues related, but not limited to the cross sales of the banking groups, transactions between the group members and other issues related to the conflicts of interest.
- Refine and develop competition promotion policies, including by refining and developing elements of the sustainable financial technology ecosystem (see Objectives of strategic priority for the development of the ecosystem of sustainable financial technologies)

STRATEGIC PRIORITIES

Development of the ecosystems for sustainable financial technologies

■ Open supervisory approaches

- Development of the principles of open regulation and the readiness for their testing in a controlled environment.
- Extension of the risk-oriented principles to new technologies.
- Development of the Financial Innovation Office as the main channel of communication with the financial innovators community.
- Lightening the entry barriers to the financial market for the entities with innovative business models.
- Support for consolidation and development of financial innovators community.
- Cooperation and information sharing with the progressive supervisory community

■ Development of open banking

- Promote the opportunities to integrate the services of various financial institutions based on the needs of consumers of the financial sector. Increase the opportunities for the use and control of personal financial data by the consumers.
- Support the use of Open Application Programming Interface (Open API) within the banking as well as outside of it.
- Dynamic standardization of financial information and services in the electronic space.
- Development of machine-readable data.

■ Development of digital banking

- The use of technological capabilities to increase the access to financial services and support for the development of digital banking channels.
- Elaboration of the licensing framework for a digital bank.
- Facilitate the provision of banking services through electronic channels.
- Sustainable development of cloud architecture data storage and processing.
- Development of a modular banking model.
- Development of a cybersecurity framework for digital bank.

Regulatory sandbox

- Create a controlled environment for exploring unknown risks and use a regulation laboratory, including for unregulated entities.
- Development of a risk examination framework for various technologies.
- The analysis of the experiment results and upon necessity, reflection of them in the supervisory framework.
- Collaborate with supervisors of different countries as the part of an initiative to establish a global regulatory sandbox.
- Expand the area of application of the regulatory sandbox.

Support for the development of data analysis and SupTech at the National Bank

- Facilitation of the enhancement of data analysis, including through the SupTech instruments.
- Development of a credit register. Improve data quality and use for the optimization of the supervisory forms.
- Modeling of BigData and its use in the supervisory processes.
- Transfer supervisory information to the XBRL (Extensible Business Reporting Language) data exchange standard.
- Development of risk analytics tables (so-called dashboards).

Development of models

- Facilitate data processing to improve access to finance, development of machine learning and artificial intelligence models, especially for the retail sector.
- Creation of a supervisory framework for a sustainable development of statistical and artificial intelligence models.
- Develop principles for ethical use of models.
- Creation of a favorable ground for productive use of models, including through the increase of data quality and the development of open banking.
- Improving the quality, comparability and compatibility of models for IFRS 9 purposes. Determination of supervisory segmentation indicators for IFRS models through credit registry data.

MODERNIZATION OF PAYMENT SYSTEMS

- Central Bank Digital Currency:
 - In the context of the development of digital technologies, financial products and their channels of delivery to consumers require rethinking, which often necessitates radical changes. The development of private tokenized money in recent years underscores the need for further development of existing cash and non-cash technologies. The digital currency of the Central Bank is one of the modern candidates for the evolution of the ancient technology of money.
 - Given the peculiarities of the local market, explore the possibilities of introducing different technologies of digital currency of the Central Bank.
 - Establish central bank digital currency requirements and initiate public discussion. Start consulting with international donor organizations and technology firms.
 - To study the possible risks of the digital currency of the Central Bank, to develop mitigation measures. Exploring the possibility of using a regulation laboratory tool in the implementation process.
- Introduction of instant payment system
 - Establishing a new, instant and continuous (24/7) payment system to strengthen the innovative ecosystem in the financial sector;
 - Payment system infrastructure, which, on the one hand, will help strengthen assistance programs for small enterprises, and, on the other hand, will increase access to cash for these enterprises.
- Exploring the potential of payment systems integration with Europe and other partner countries

RISKS RELATED TO THE FULFILLMENT OF THE SUPERVISORY STRATEGY

Along with the preparation of a supervisory strategy, it is important to identify those risks, which may hinder the implementation of the strategy or require modification. The following risks are of particular importance:

- The changes in the priorities, which became necessary due to the force majeure situations or unexpected external factors, which were not covered in the supervisory strategy.
- The risks related to the acquisition and maintenance of necessary human resources to implement the strategy;
- The flaws in the infrastructure (building and technologies, including the security, access to confidential information) or the lack of it at the National Bank of Georgia, which interrupts the processes at the NBG.

The tendencies, the challenges⁷ and the above-mentioned risks characterizing the dynamic operational environment of the National Bank of Georgia, may influence the priorities defined by this document, the planned changes and the timeline of their implementation. To effectively respond to these challenges and effective fulfillment of a supervisory mandate, the National Bank of Georgia keeps the right to adapt these priorities and/or their implementation timeline.

THE FREQUENCY OF THE STRATEGY RENEWAL

The supervisory strategy document will be updated annually. This does not imply changing the supervisory priorities on a yearly basis but instead the possible modification of the timeline to effectively fulfill the supervisory mandate and the mission.





⁷ See page 10 new challenges of operational environment





ROADMAP FOR PLANNED CHANGES

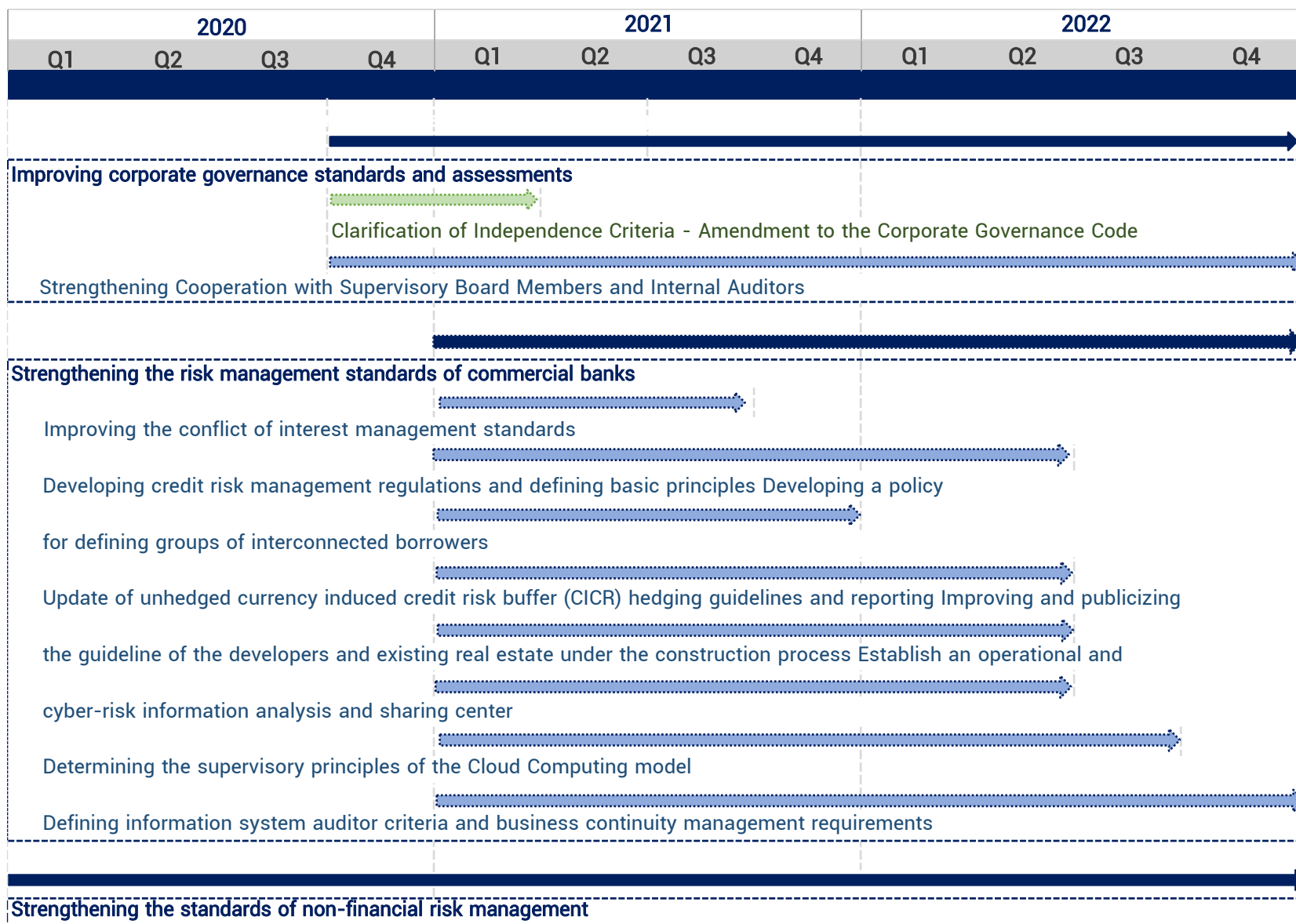
The standards and regulations set out in the Roadmap for planned changes are already largely covered by the National Bank's supervisory framework. However, in parallel with the constant refinement of international best practices and standards and changes in global and local trends, the National Bank is constantly updating and improving the regulatory framework related to supervision. The roadmap of these changes determines the directions of refinement and updates of the supervisory framework and the relevant deadlines.

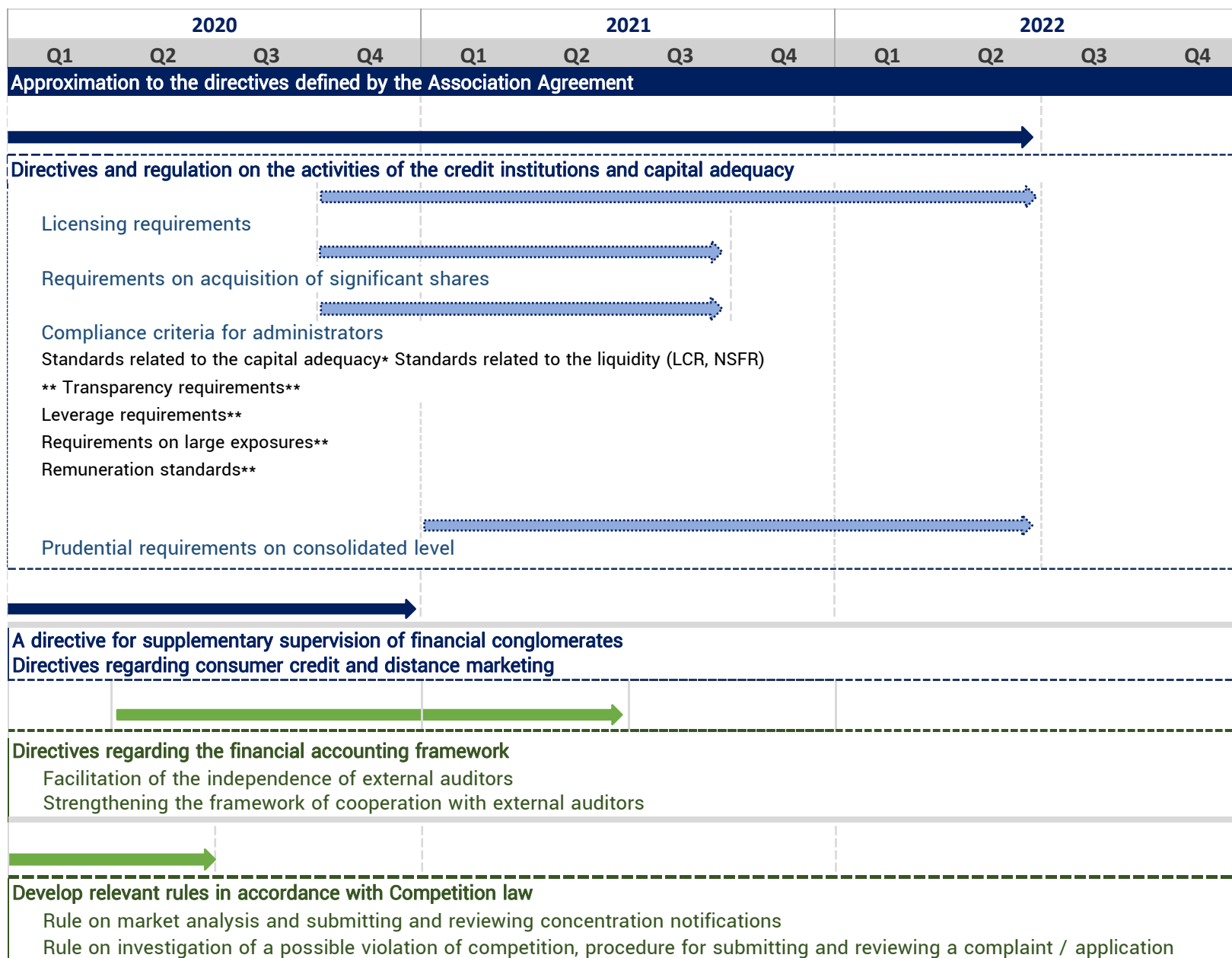
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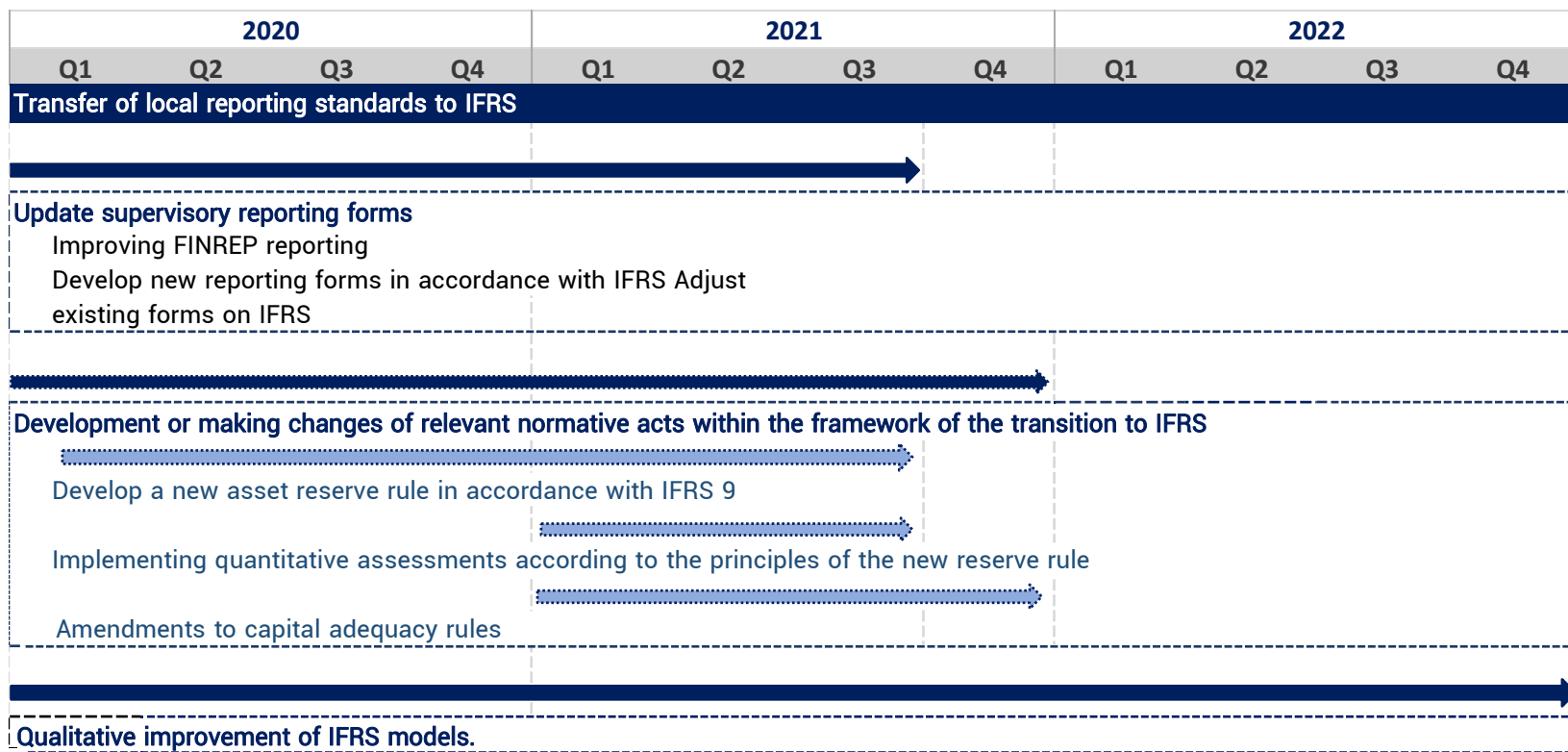
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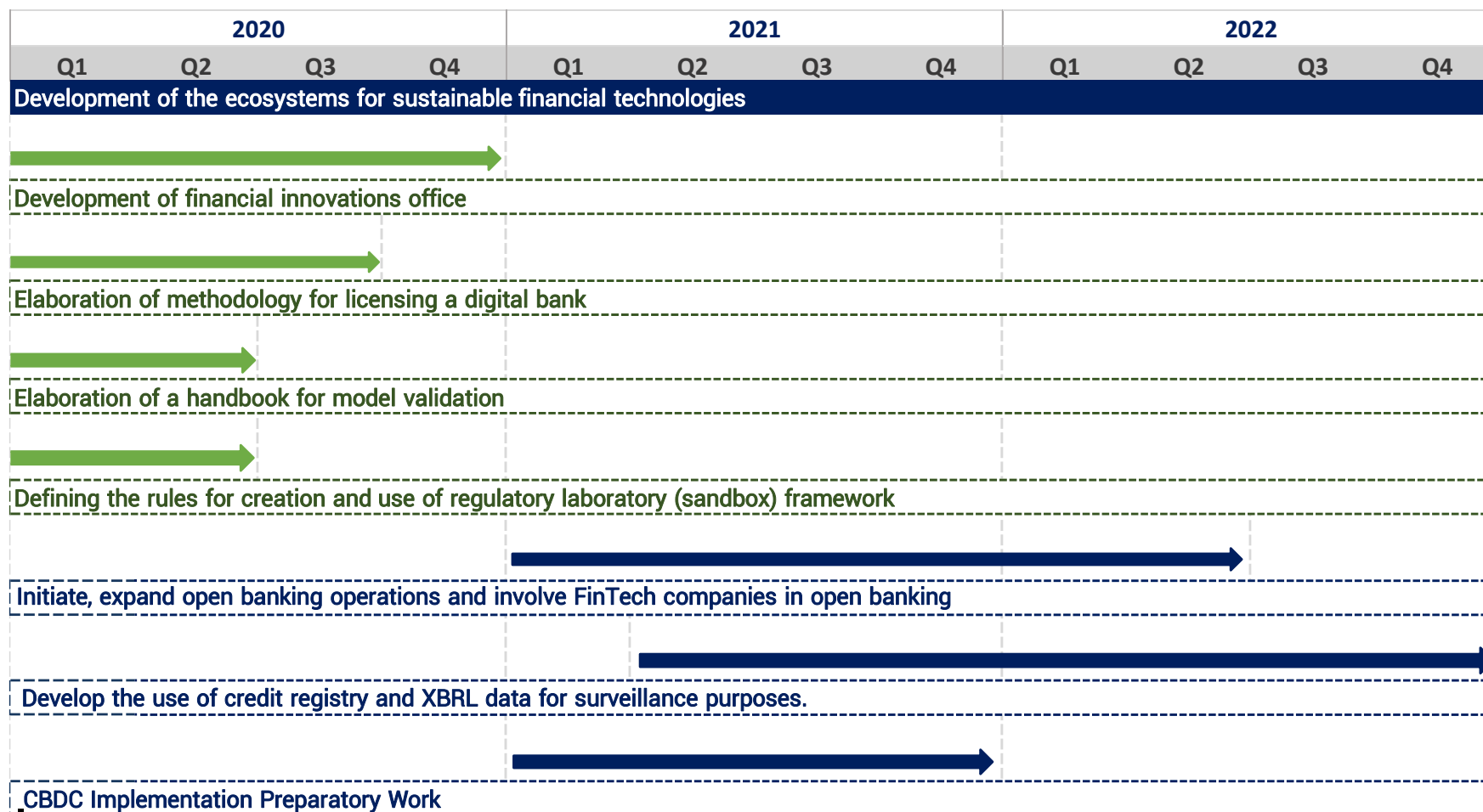
-  **Deadline for adoption of change**
-  The timeline of the adoption of subcomponents of the changes
-  Adopted change
-  The subcomponent obtained for the change

2020				2021				2022			
Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Implementation of the resolution framework											
											
Creation of a structural unit at NBG responsible for the resolution											
											
Creation of a resolution committee at NBG and adoption of respective rule											
											
The rule of identification and assessment of critical functions of commercial banks											
The rules regarding the preparation of a recovery plan											
Creation of an interagency committee of financial stability and adoption of respective decree and the rules of valuation bank assets and liabilities											
The rule of licensing a bridge bank											
The procedures for purchasing significant shares of a commercial bank under the resolution											
											
The rules regarding the resolution plan											
Additional requirements regarding the bridge bank and its activities											
Defining the rule, the type of collateral, the terms and conditions of loans of last resort											
Publication of joint legal acts with the Ministry of Finance											
The rule of creation of a resolution fund and its administration and rule of temporary state funding											
The rule of criteria and execution of contributions to the resolution fund											
The rule of appointment of a special manager											
The rules of recapitalization by write-down or conversion of the liabilities into shares (bail-in)											
The rules of recapitalization by issuance of new shares											
The rule of defining the powers and appointment procedures of a temporary administrator											









APPENDIX:

REPORT ON IMPLEMENTATION OF THE SUPERVISORY STRATEGY PUBLISHED IN 2020

In 2020, the National Bank implemented a number of important projects and reforms in accordance with the Roadmap of Changes defined by the strategy of the same year, which, in turn, responded to the set strategic priorities. More specifically, the above included the areas listed below.

Strengthening a culture of encouragement of leadership and initiative

- A number of working groups were assembled for wide-range review of supervisory issues at the National Bank in 2020-2021 years. Notable among them is the working group on competition compiled from staff with different specializations. They share the analyzed issues from competition lessons and discuss possible risks and opportunities for improving regulatory policy. Working groups have also been set up to review the capabilities of the crowdfunding⁸ platform and the transition of financial statements to International Financial Reporting Standards (IFRS).
- In 2020, the role of supervisors has advanced with regard to entities under the regulation. The growing role was evident in the communication process with management and supervisory boards.
- To encourage a culture of cooperation and information exchange, in parallel with the sharing of systemic risk assessment results, quarterly discussions with supervisors were introduced in 2020. Since 2020 information started to be shared in the form of newsletter, in order to get acquainted with the news, changes and trends of international supervisory practices, including the strategy papers of reputable central banks, the priorities of international standard-setting organizations (E.g. Basel Committee, European Central Bank, etc.), and monthly updates.
In order to successfully manage the IFRS transition project and improve the relevant skills for supervisors, by 2020, all supervisors were able to undergo relevant training in financial reporting and accounting.

⁸So-called crowdfunding

However, it should be noted, that the work and activities planned by the National Bank to promote employee engagement, leadership, and other initiatives have been delayed for some time due to the Covid-19 pandemic and associated constraints. The National Bank has had focus on more maintaining existing practices this year, however, significant improvements and initiatives are planned for the next 2 years.

Strengthening the cooperation with the stakeholders

- For the purpose of public consultations, a number of draft amendments or regulations related to supervision were published on the National Bank's website, which allowed interested third parties to share remarks and recommendations. It should be noted that the National Bank will continue to publish draft normative acts in the future and as the result of the updating the official website, this process will be further improved.
- Representatives of the National Bank Supervisory Board participated in several public professional forums and discussions throughout 2020 on the platforms of the Basel Consultative Group (BCG), the International Conference of Banking Supervisors (ICBS), the International Monetary Fund (IMF) and the World Bank (WB). In addition, cooperation with supervisors of the countries of the region was actively initiated by both the National Bank and other supervisors to share knowledge and experience. In order to get acquainted with the supervisory approaches of the National Bank of Georgia, the International Monetary Fund held a discussion forum. "Georgia - a small country, a big shock - the functioning of the financial system in conditions of unprecedented shock" - Representatives of the National Bank of Georgia were invited as speakers at the discussion forum on this topic. At the forum, the speakers of the National Bank spoke in detail about the important reforms implemented by the National Bank of Georgia before the COVID-19 pandemic, the challenges of the pandemic and the response measures of the National Bank.
- Noteworthy are the steps taken in 2020 to achieve synergy in terms of deepening internal cooperation and improving the sharing of information with the National Bank, including the establishment of working groups in various fields. For example, in 2020, the National Bank set up an internal working group on competition, which includes representatives of all relevant departments of the National Bank. The objective of the working group is to identify the challenges and difficulties in developing competition-related policies, considering the mandate of the National Bank, and to facilitate enforcement in practice, to discuss solutions and share experiences.
- In order to effectively implement its supervisory mandate and strategic priorities by 2020, the National Bank has cooperated with supervised entities, banking associations, external auditors, public institutions, media outlets, supervisors from other countries, and international organizations. In order to effectively cooperate with external auditors, in 2020 the National Bank developed a guideline to effective communication between audit firms and the National Bank, aiming to promote

the effectiveness of communication between the National Bank and audit firms related to supervisory entities.

- Increased cooperation with various public institutions within the country, including the Georgian National Competition Agency, the Communications Commission, with which the National Bank cooperates in a number of supervisory areas. An Interagency Committee for Financial Stability has been established, whose members together with the National Bank are the Ministry of Finance of Georgia, the Deposit Insurance Agency and the Insurance State Supervision Service of Georgia, whose function will be, among other things, to develop mechanisms for crisis situations and financial crisis management. It is also noteworthy that the National Bank, the Insurance State Supervision Service of Georgia, the Georgian National Energy and Water Supply Regulatory Commission, the Georgian National Communications Commission and the Service for Accounting, Reporting and Auditing Supervision are working on concluding a memorandum of understanding, with the aim to jointly discuss important problematic issues related to financial and governance reporting and to implement further initiatives based on the results of the discussions.
- Importantly, 2020 was also active in terms of the Financial Innovation Office. By 2020, more than 100 people addressed to the office, online meetings were held with them, discussing current topics in detail and future perspectives. The list of addressing persons and issues was varied. In particular, Georgian and foreign FinTech companies, brokerage companies, students, people with different innovative ideas addressed issues such as crowdfunding, digital banking and more.

Facilitation of stable functioning of financial sector

- During 2020, the National Bank approved all the legislative acts, the adoption of which was a necessary precondition for an effective framework for the resolution of commercial banks. As a result, the National Bank has a full-fledged framework for the recovery and resolution of commercial banks since January 1, 2021. In addition, the National Bank has established a structural unit (Resolution and Liquidation Division) authorized for resolution processes. Banks will present their first recovery plans by 2021, while the National Bank will develop resolution plans for banks.
- Active work has been underway since 2020 to facilitate the effective functioning of corporate governance and risk management. As a result, a draft of amendments to the Corporate Governance Code for Commercial Banks were developed. The amendments serve to strengthen the role of independent members of banks' supervisory boards. To this end, the criteria for the independence of the Supervisory Board were improved, their role in the Board Committees was increased, and the requirement for an independent Chairman of the Supervisory Board was introduced in systemically important commercial banks.
- To facilitate consistent, compatible, and comparable disclosures of Environmental, Social, and Governance (ESG) issues by commercial banks, the National Bank has developed appropriate reporting and disclosure principles and templates. Based on it, commercial banks published the information in May 2021. In addition, the National Bank continues to study international experience related to ESG standards. To this end, projects are planned this year with the International Finance Corporation (IFC) to share ESG risk management best practices.
- The National Bank has developed a draft Code of Ethics to define the principles of ethics on debt collection by financial institutions, which is based on international best practices, taking into account the specifics of the local market. The draft Code of Ethics was also made public for recommendations and remarks from stakeholders. Its approval is planned in the near future.
- In 2020, the National Bank published the Stress Test Methodology Manual, which aims to disclose to stakeholders the methodology for determining capital adequacy for commercial banks in times of stress, including the scenario used, the assumptions, and the approaches to each risk. At the same time, in 2021 and in the coming years, the National Bank will continue to work to refine the manual, including the new rule on provisioning.
- In 2020, the National Bank adopted the interest rate risk management regulation of the banking book, which aims to identify, assess, manage and impose interest rate risk on the banking book by promoting related requirements to facilitate the stability and sound functioning of the financial sector.
- As stated in last year's strategy, in order to mitigate the negative impact of the COVID 19 pandemic, the National Bank of Georgia launched a temporary supervisory roadmap in March 2020, using capital and liquidity buffers during times of financial stress to reduce existing capital and liquidity

requirements. During the period of capital conservation and the CICR buffer benefits, banks have limited capital allocation, including dividends, redemption of shares, equity investments, and variable payout obligations to provide management bonuses. The National Bank will announce a plan to restore the demand for the released capital buffers and their gradual increase dates in 2021, after which the banking sector will be given sufficient time to re-accumulate the buffers. The supervisory plan developed by the National Bank provided for mechanisms from the outset that would motivate commercial banks to recover capital buffers. In particular, in case of early restoration of the alleviated requirements, the restrictions on the distribution of capital for banks will be removed (dividends, redemption of shares, equity investments and the creation of variable payout obligations to pay management bonuses).

Approximation to international standards

- The National Bank continues to work intensively to transit local accounting standards into International Accounting Standards and Financial Reporting Standards (IFRS). To this end, during 2020, the reporting forms to be submitted to the National Bank were updated to comply with IFRS, a new asset provisioning rule was drafted, and capital approaches were introduced.
- In order to align with international best practice, the National Bank has been working to improve the Framework for the fit and proper criteria of administrators and shareholders by 2020, as well as the framework for licensing and acquisition of a significant share. A draft rule on shareholder suitability criteria has already been developed, as well as relevant changes to be made to the National Bank's Rule on Fit and proper criteria of administrators of commercial banks and Rule on Licensing of a commercial bank. However, as stated in the 2020 Strategy document, in response to the challenges of the coronavirus (COVID-19) pandemic, the National Bank has announced a temporary moratorium on the development and implementation of new supervisory plans, which also affected the above regulations and postponed their approval until 2021. This year, these projects will be published for consultation and consultations will be held with the representatives of the banking sector.
- The National Bank is actively working on approximation with the international practices of the systematic buffer determination methodology, including methodologies published by the Basel Committee on Banking Supervision (BCBS) and the European Banking Authority (EBA).

Development of the ecosystems for sustainable financial technologies

- At the end of 2019, a Financial Innovation Office was established at the National Bank to encourage FinTech companies and innovative ideas to further transform these ideas into a sustainable

financial model. The Innovation Office assists both those regulated by the National Bank and those outside the regulation in implementing innovative ideas through direct communication with the National Bank. During 2020, the Financial Innovation Office held a number of important meetings with individuals having innovative ideas.

- In 2020 the National Bank published the principles of digital banking licensing. By developing the digital banking model, the National Bank aims to facilitate: Development of innovative business models and diversity of financial products, entry of new technological players and increased competition in the financial sector. The principles define how the business model is considered by the National Bank as a digital bank and what additional requirements and simplified conditions are considered in the licensing process.
- In May 2020, the Regulation on the Establishment and Implementation of the Regulatory Sandbox Framework was enacted, which will enable the representatives of the financial sectors to test innovative services and products in a real-time supervisor-controlled environment. The regulation aims to facilitate testing and rapid introduction of innovative financial services and products created in the context of rapidly evolving financial technologies, to identify potential systemic risks in a timely manner, to ensure compliance with the National Bank's supervisory requirements, and to identify possible regulatory requirements.
- In order to establish the Credit Registry in June 2020, reporting forms were developed with the aim of improving supervision, easing the reporting burden over time for commercial banks, and subsequently sharing system aggregates with them.
- Intensive work has been underway since 2019 to introduce an open banking framework. Despite the pandemic, 2020 was active in this direction. In particular, with the involvement of the National Bank, the Banking Association of Georgia and commercial banks, an Open Banking Committee was established in 2020 with the aim of developing the standards required for the introduction of open banking in Georgia and promoting the further development of the project. The first version of the Open Banking Implementation Framework has already been developed by the Committee and the timelines for the introduction and gradual expansion of Open Banking have been defined. The deadline for commercial banks to meet the requirements of the first phase of open banking implementation was March 31, 2021. Following the successful implementation of the first phase, the main phases of the project are planned in stages in 2021.
- The XBRL portal has been operating since March 2021. Commercial banks regularly send part of their supervisory reports to the National Bank in XBRL format via portal. The XBRL Portal is a modern alternative to the existing portal, which will replace the existing system and allow banks to manage their accounts with the National Bank through it.
- During 2020, the National Bank approved a "Regulation on Risk Management Statistics for Statistical, Artificial Intelligence, and Machine Learning Models," preceded by consultations with representatives of financial institutions and other stakeholders. The regulation came into force in

January 2021.

- The National Bank is actively working towards the issuance of Central Bank Digital Currency (CBDC), which will significantly facilitate the use of new financial technologies, the efficiency of the payment system and financial engagement. In this process, the National Bank plans to actively cooperate with FinTech companies and interested financial institutions. This tool could become important for the financial ecosystem and have a major impact on private innovation and the creation of new financial technologies.
- Within the framework of the agreement signed with Georgia and the World Bank, the National Bank has started working on the establishment of a new, instant payment system, which will strengthen the innovative ecosystem in the financial sector, while playing an important role in digitalization of the economy and small and medium business development. The project will upgrade the payment system infrastructure, which will be implemented independently by the National Bank, which will facilitate, on the one hand, to strengthen assistance programs for small enterprises, and, on the other hand, create a new fast payment system that will increase access to cash for these enterprises. The project is scheduled to be completed by the end of 2022.

Coronavirus pandemic response measures

It should be noted that the publication of the first document of the supervisory strategy coincided with the active course of the New Coronavirus (COVID-19) pandemic, which turned out to be a significant complexity and challenge for the global economy, including, of course, for Georgia. At the outset of the pandemic, the National Bank began working to reduce the impact of the Coronavirus pandemic and take the necessary measures to address the challenges, as a result, entities under the supervision and the National Bank were given the opportunity to mobilize their resources to respond to current challenges. It should be noted that despite the COVID-19 pandemic, the long-term goals of the National Bank and the strategic priorities presented in the document remained unchanged.

The steps taken by the National Bank and the planned supervisory measures were detailed in the first strategy document. These measures included:

- Reducing the conservation and Pillar 2 buffer portion (two-thirds of the credit risk buffer caused by exchange rate fluctuations) for the banking sector, allowing the banking sector to continue funding the economy. The lowered regulatory capital requirements will gradually increase in parallel to the improvement of the economic indicators and the elimination of the negative effects caused by the pandemic. Consultations have already been held with the banking sector on the plan for the recovery of capital, and the date of its implementation will be decided by the Financial Stability Committee of the National Bank.

- In order to continue lending to the economy, supplying the required amount of liquidity to the financial sector, which meant to supply liquidity both within existing instruments and with new instruments.
- Proactive assessment of the quality of the loan portfolio by the National Bank and recognition of the expected credit losses. This approach was promoted by the comfortable volume of capital buffers accumulated in the banking sector as a result of past decisions of the National Bank. However, with the decision of the NBG, exposures, on which the financial institutions offered a grace period, were not provisioned solely for that reason and the supervisory burden was not increased.
- A temporary moratorium on financial institutions for financial institutions to develop and impose new supervisory requirements by September 2020 in order to alleviate the operational burden, with the aim of maximizing mobilization in response to existing challenges for financial institutions and the National Bank.
- Encourage initiatives to introduce remote channels. For this purpose, the National Bank is still actively reviewing the products and procedures presented by financial institutions related to remote lending and digital transformation.

In addition to the existing supervisory roadmap, it is important to have an exit strategy from this roadmap and a capital buffer recovery plan. To this end, the supervisory plan developed by the National Bank provided for such mechanisms from the very beginning, that would motivate commercial banks to restore capital buffers. In particular, in case of early restoration of the alleviated requirements, the restrictions on the distribution of capital for banks will be removed (dividends, redemption of shares, equity investments and the creation of variable payout obligations to issue management bonuses).

In addition to the measures already implemented, the National Bank continues to actively assess the impacts and challenges of the COVID-19 pandemic and to take them into account in its supervisory activities.

Evaluation of reforms

The reforms of the National Bank are evaluated by international organizations and partners. The International Monetary Fund and the World Bank are implementing the Financial Sector Assessment Program (FSAP) for 2020-2021. To this end, the FSAP mission has already completed meetings with the National Bank and other public agencies, as well as with representatives of the private sector. Documents showing the assessment results will be published by the end of the year. This includes assessing the stability and soundness of the financial sector, the reforms, development and growth prospects undertaken by the National Bank, and recommendations for further

development and advancement of the National Bank's supervisory framework. The recommendations will be considered in the current and future supervisory priorities and plans of the National Bank.

In 2020, the Executive Board of the International Monetary Fund (IMF) positively evaluated the National Bank's reforms and response measures to the Covid-19 Pandemic, including the reform of the 2020-2021 Recovery and Resolution Framework, which is said to contribute to the subsequent recovery of the pandemic.⁹

In April 2020, the rating agency Moody's published a report on the evaluation of the resolution framework¹⁰, which positively mentions the reform of the resolution. According to the assessment: "The implementation of the Recovery and Resolution Framework is an important step in terms of crisis management and strengthening the stability of the financial sector. Strengthening the resolution of the National Bank as a result of legislative changes and modernizing the framework is in line with the requirements of the relevant EU Directive (BRRD), international best practice and potentially helps to reduce creditor losses."

It should also be noted that in 2020 the European Bank for Reconstruction and Development (EBRD) positively assessed the activities of the National Bank as well, the EBRD Caucasus Region Transition Report for 2020-2021¹¹ states: "In order to give more discretionary powers to banks, last year the National Bank amended the regulation on lending to individuals and increased its transparency and communication. The adoption of a framework for the recovery of banks and the resolution, which was approved in December 2019, has strengthened Georgia's financial stability. "According to the EBRD, in addition to government measures to respond to Covid-19 and assist the economy, the National Bank reduced capital and liquidity requirements, easing normative / regulatory requirements to facilitate loan restructuring and to ease monetary policy in the face of low inflationary pressures.

⁹ <https://www.imf.org/en/News/Articles/2020/05/01/pr20202-georgia-imf-execbrd-complete-6threv-eff-approves-request-support-address-covid19>

¹⁰ https://www.moody's.com/researchandratings/region/europe/georgia/042075/005001000?stop_mobi=yes

¹¹ <https://www.ebrd.com/publications/transition-report-202021-georgia>

GLOSSARY

P2P platform	A platform that ensures that similar entities are connected to each other and that transactions between them are implemented without a third party.
XBRL (Extensible Business Reporting Language)	Extensible Business Reporting Language, which is an international standard for sharing supervisory reports.
Recovery plan	A plan developed by a commercial bank which together with other elements includes measures for the purpose of restoring a financial condition of a bank during significant financial difficulties.
Capital buffers	The amount of regulatory capital in excess of the required minimum amount of regulatory capital.
Capital instruments	Instruments, which satisfy the criteria of a regulatory capital.
Macroprudential policy	A combination of policy and procedures created to avoid accumulation of systemic risks, to reduce the probability of a crisis and to facilitate stable functioning of a financial system.
Machine readable data	Presentation of data in a form that enables its processing and perception through computer software.
Microprudential policy	A combination of policy and procedures created to facilitate sustainability of individual financial institutions.
Modular banking model	A banking model, in which a banking infrastructure is represented with independent modules based on their scope of activities and the replacement of each is relatively less difficult.
Prudential filter	Supervisory adjustments with the purpose of maintaining the quality of regulatory capital or other supervisory indicators by using approaches, different from the financial accounting framework, in their calculations.
Regulatory sandbox	A combination of terms and procedures for testing innovative financial products and/or services in a testing environment.
Resolution	Upon having enough grounds to terminate a license of a commercial bank, an alternative option to the liquidation, which implies the restructuring of a bank by the regulator in a manner that does not threaten the financial stability.

Risk based supervision/principles	Supervisory regime/principles, which imply allocation of more supervisory resources to more complex and/or riskier institutions and transactions.
Risk Analytics Dashboards	A graphic representation of the main activity indicators, which simplifies complex data and enables its consumers to easily access information regarding the business activities or specific processes.
Risk Appetite Statement	Statement which defines the risks assumed by this organization, serving for the purpose of achieving its objectives.
Risk Positions	Balance sheet or off-balance sheet items on which the financial institution has a claim.
Regulatory capital	A type of capital, which a financial institution has to have as required by the supervisor and which serves for the purpose of offsetting potential losses.
Grace Period	A period of time, during which a borrower is not charged with interest and commission and/or part of the principal amount and the payments are to be resumed after the end of grace period.
SupTech instruments	Supervisory technologies, which imply the use of innovation technologies in the supervision process by the supervisory authorities.
IFRS - International Financial Reporting Standards	International Financial Reporting Standards.
(IFRS 9)	International Financial Reporting Standard, which defines matters related to the recognition, termination of recognition, evaluation and impairment of financial assets and financial liabilities.
Financial Innovation Office	A means of communication between the National Bank of Georgia and the community of innovators of financial technologies with the purpose of providing an easy way to get direct feedback on supervisory questions, promoting responsible innovations in the financial sector and helping Fintech organizations/startups understand the supervisory approach and regulations of the National Bank of Georgia.
FSAP – Financial Sector Assessment Program	A joint program of International Monetary Fund (IMF) and World Bank, with the purpose of assessing sustainability of a financial sector, the quality of regulatory and supervisory framework and capacity to manage financial crisis in the country.

Cloud	An internet base for keeping and accessing data, documents and programs.
Open application programming interface (OpenAPI)	An interface which provides access to data based on open/public standards.
Open banking	Instant sharing of information and services within various financial organizations through electronic technologies.
Principles of open regulation	Discussion of amendments to the regulatory requirements, openness to the dialogue with the industry, which are in compliance with the statement of risk appetite and principles of supervision of the National Bank of Georgia (NBG).
Digital banking	A business model of a bank which provides banking services mostly via electronic channels and uses new and innovative financial technologies on the local market.