

O r d e r № 228/24
of the Governor of the National Bank of Georgia

21 November, 2019

Tbilisi

**On Approving the Regulation on the Concentration of Exposures and Large Exposures in
Commercial Banks**

In accordance with Article 15 (1) (g) of the Organic Law of Georgia on the National Bank of Georgia, Article 48 (3), Article 21 of the Law of Georgia on the Activities of Commercial Banks and under Article 25 (1) of the Organic law of Georgia on Normative Acts I hereby order:

Article 1

The approval of the attached regulation on the concentration of exposures and Large Exposures in commercial banks.

Article 2

That the decree of the President of the National Bank of Georgia № 49/04 of June 17, 2014 on "Credit Concentration and Large Exposures in Commercial Banks" shall be declared invalid from January 1, 2021.

Article 3

That this order shall come into force from January 1, 2021.

Governor of the National Bank of Georgia

Koba Gvenetadze

Regulation on the Concentration of Exposures and Large Exposures in Commercial Banks

Article 1: General Provisions

1. The purpose of the “Regulation on the Concentration of Exposures and Large Exposures in Commercial Banks” (*hereinafter - the Regulation*) is to promote stability and the healthy functioning of commercial banks and the financial sector, by setting requirements with respect to the Large Exposures that can arise from the concentration of exposures.

2. The requirements of this Regulation are mandatory for all commercial banks and the branches of foreign banks operating in Georgia (*hereinafter - the Bank*).

3. The requirements set out in this Regulation are based on the framework established by the Basel Committee on Banking Supervision and Regulation 575/2013, dated as of the 26th of June 2013, by the European Council and Parliament, on the prudential requirements of credit institutions and investment firms, as well as Directive 2013/36 dated as of the 26th of June 2013, by the European Council and Parliament on the prudential supervision of credit institutions and investment firms. If the provisions of this Regulation do not provide for a specific rule regulating a specific issue or definition of terms, the Bank, in agreement with the National Bank of Georgia (*hereinafter - the National Bank*), shall act in accordance to the said documents.

4. In the case of a disagreement between the Bank and the National Bank, on the issue of grouping clients into a Group of Connected Clients, the issue shall be resolved in accordance with the determination of the National Bank.

5. In the case of a violation/improper fulfilment of the requirements of this Regulation, the National Bank shall have the right to apply fines and penalties on the Bank and its administrators, as provided by law.

Article 2: Definition of Terms

1. The terms used in this Regulation have the following meanings:

A. **"Exposure Value"** - the value defined in Article 10 (1-2) of the Decree № 100/04 of the 28th of October, 2013, of the President of the National Bank of Georgia on the "Regulation on Capital Adequacy Requirements for Commercial Banks" (*hereinafter - the Basel III regulation*); in addition, credit conversion factor for all off-balance sheet items listed in the chapter XIV of the Basel III, regardless its risk weight, shall be 100%.

B. **"Large Exposure"** - the bank exposure with respect to one entity or a group of connected clients, the amount of which is equal to, or exceeds, 10% of the Bank's Tier 1 capital;

C. **"Tier 1 Capital"** - the Tier 1 Capital as defined by the Basel III regulation.

D. **“Group of Connected Clients”** - the group defined in paragraph 1, of Article 3, of this Regulation;

E. **Client** - a natural person, a legal entity or an organisational entity that does not have the status of a legal entity, in relation to which the bank has a direct exposure and/or which represents the receiver of risk exposure, including principal in case of off-balance sheet items;

F. **Investment Grade** - an assessment from an External Credit Assessment Institution (Fitch, Moody's, Standard & Poor's), recognised in accordance with the Basel III regulation, which equals or exceeds the rating of "BBB" or "Baa3";

G. **Credit Risk Mitigation Effect** – effect defined; under the Article 4 (3) (“e”) of this Regulation;

H. **Commercial Bank** – the Bank defined under Article 1 (2) of this Regulation, as well as any other commercial bank, including, the ones licensed in another country.

I. **Control** – as defined in the guideline about the identification of a group of connected clients and/or in the international financial reporting standards (IFRS).

J. **Cash assimilated instrument**- as defined in the k) subparagraph of the article 2 of the Basel III regulation

2. Other terms used in this Regulation have respective meanings as stipulated by the Georgian legislation.

Article 3: Definition of a Group of Connected Clients

1. For the purposes of this Regulation, a Group of Connected Clients may be two or more natural persons, or legal entities, or organisational entities without legal status, provided that at least one of the following conditions are met:

a) They constitute a single risk (unless otherwise is proved by the bank and prior agreed with the National Bank) because one client from the group, directly or indirectly, has control over other client or clients of the group;

b) They constitute a single risk because they are so interconnected that one client’s financial difficulties (for example, including, financial difficulties related to funding and/or payments difficulties, including loan payments, and etc.) can cause financial difficulties to the other client or clients of the group.

2. The National Bank will develop the guideline about the identification of a group of connected clients.

Article 4. Limits and Restrictions on Exposures

1. In order to regulate the concentration of exposures and regulate large exposures, the Bank shall adhere to the following limits:

A. Lending bank's exposure value after the credit risk mitigation, to a single client, or a Group of Connected Clients, except in cases where the client is Commercial Bank or the Group of Connected Clients includes one or more Commercial Banks, shall not exceed 25% of the lending bank's Tier 1 capital. Moreover, lending bank's exposure value prior to the Credit Risk Mitigation, except the cash on deposit with the lending bank, cash assimilated instruments held by the lending bank and securities as credit protection, shall not exceed 50% of the lending bank's Tier 1 Capital;

B. Lending bank's exposure value, after the credit risk mitigation, to a commercial bank or Group of Connected Clients which includes one or more commercial banks, shall not exceed the highest between the 25% of the lending bank's Tier 1 Capital and GEL 200 million. If the lending Bank's 25% of the Tier 1 Capital is less than GEL 200 million, the lending bank, with prior agreement with the National Bank, shall set an internal limit which shall not exceed 50% of the lending bank's Tier 1 Capital. In this case, lending bank's exposure value to a commercial bank or group of connected clients which includes one or more commercial banks shall not exceed the lowest between GEL 200 million and the lending bank's internal limit. Moreover, lending bank's Exposure Value to the Group of Connected Clients which includes one or more commercial banks, except Commercial Banks within that group, shall not exceed 25% of the lending bank's Tier 1 capital. Additionally, lending bank's exposure value to the commercial bank or group of connected clients which includes one or more commercial banks, prior to the credit risk mitigation, except the cash on deposit with the lending bank, cash assimilated instruments held by lending bank and securities as credit protection, shall not exceed 50% of the lending bank's Tier 1 Capital.

C. If the Bank has Exposure to the non-resident bank, or when the Group of Connected Clients includes non-resident Commercial Bank that according to the Basel III Regulation does not hold an investment rating by the eligible external credit assessment institution, then lending bank's exposure value after credit risk mitigation to this non-resident commercial bank or Group of Connected Clients, shall not exceed 25% of the lending Bank's Tier 1 Capital. In addition, lending bank's exposure value prior to credit risk mitigation, except the cash on deposit with lending bank, cash assimilated instruments held by the lending bank and securities as credit protection, shall not exceed 50% of the lending bank's Tier 1 capital.

D. Where the client of a resident systemically important bank is another resident systemically important bank, lending bank's exposure value after credit risk mitigation to this systematically important bank shall not exceed 15% of the lending bank's Tier 1 Capital. Moreover, lending bank's exposure value, prior to the credit risk mitigation, except the cash on deposit with the lending bank, cash assimilated instruments held by the lending bank and securities as credit protection, to other systematically important bank shall not exceed 50% of the lending bank Tier 1 Capital.

2. Issues related to the maximum amount of exposures to a single related party and all related parties transactions and large exposure issues associated with the related parties are regulated by the regulation of the management of conflicts of interest set by the National Bank.

3. When calculating the limits specified in paragraph 1 of this Article, the Bank shall apply the following rules:

A. The total Exposure Value of the Bank to a Group of Connected Clients is calculated by aggregating the Exposure Value of individual clients in the group;

B. Bank's Exposure with respect to the client shall be increased by the Exposure arising from the derivatives Backed by securities of that client;

C. In calculating the Exposure Value, the Exposure that are deducted from the Tier 1 capital in accordance with the Basel III Regulation shall not be taken into account;

D. When calculating the Exposure Value, Bank may use credit risk mitigation instruments with the approval of the National Bank for capital adequacy purposes in accordance with the Basel III Regulation (allowed Mitigation technique).

E. In the case when Bank uses allowed mitigation technique in calculating the Exposure Value credit risk mitigation shall be the following:

E.A. In case of funded credit protection, exposure value to a client may be reduced by the market value of the portion of exposure which is subject to the allowed mitigation technique;

E.B. In case of unfunded credit protection, Exposure Value to a client may be reduced by the amount of the unfunded credit protection. The amount of the unfunded credit protection is calculated according to the article 59 of Basel III regulation without taking into account risk weights.

F. Secured parts of exposures listed in the subparagraphs E.A and E.B of this paragraph, by which exposure to a client is reduced, shall be considered as the exposure to the provider of credit risk mitigation and shall be included in the calculation of the limits of the credit risk mitigation provider. In this case, exceptions are the cash on deposit with the lending bank and cash assimilated instruments issued by the lending bank.

4. Bank is prohibited from creating exposures to:

A. Purchase its own shares;

B. Purchase the shares of the Bank's major shareholder or controlling person;

C. Purchase the shares of a subsidiary of the bank.

5. The following exposures shall be exempted when calculating the limits set by this Regulation:

- A. exposures to the National Bank;
 - B. Exposures to central governments, central banks or public sector entities which, , would be assigned a 0% risk weight under the Basel III regulation;
 - C. exposures to international organizations or multilateral development banks which, , would be assigned a 0% risk weight under the Basel III regulation;
 - D. Exposures guaranteed by central governments, central banks, international organizations, multilateral development banks or public sector entities, which would be assigned a 0% risk weight under the Basel III regulation;
 - E. exposures to regional governments or local authorities where those claims would be assigned a 0% risk weight under the Basel III regulation;
 - F. exposures arising from undrawn credit facilities that are classified as low-risk off-balance sheet items which may be drawn only if it has been ascertained that it will not cause the limits under this regulation to be exceeded;
 - G. 50% of letter of credits and undrawn credit facilities which are classified as the medium/low risk off-balance sheet items under the Basel III regulation;
 - H. in the case of foreign exchange transactions, exposures incurred in the ordinary course of settlement during the two working days following payment;
 - I. in the case of transactions for the purchase or of securities, exposures incurred in the ordinary course of settlement during five working days following payment or delivery of the securities, whichever the earlier;
 - J. in the case of the provision of money transmission including the execution of payment services, clearing and settlement in any currency and correspondent banking or financial instruments clearing, settlement and custody services to clients, and other exposures arising from client activity which do not last longer than the following business day;
 - K. In the case that the lending Bank has an exposure to the Clients, specified in subparagraphs (A) - (E) of this paragraph, who are hedged by derivatives, the lending bank recognises the exposure derived from this derivative in relation to the provider of this derivative;
6. Bank shall not use a property as a credit protection for the loan to microfinance organization, loan issuing entity, non-bank deposit taking entity –credit union if this property is taken as a loan collateral by this microfinance organization, loan issuing entity and non-bank deposit taking entity – credit union.

Article 5. Use of Credit Ratings By External Credit Assessment Institutions (ECAIs)

1. The Bank shall use the most recent Credit Ratings.
2. If there are two different Credit Ratings for the past 12 months that differ from each other, provided by the eligible External Credit Assessment Institution, the lowest Rating shall be considered.
3. If there are more than two Credit Ratings for the past 12 months, provided by the eligible External Credit Assessment Institution, the two highest ratings shall be considered. If these two highest ratings are different from each other, the lowest shall be considered.

Article 6. Bank Policies, Procedures and Reporting

1. The Bank shall have sound administrative and accounting procedures and adequate internal controls in order to comply with the requirements of this regulation, including identifying Groups of Connected Clients and large exposures, as well as managing, monitoring, accounting and reporting large exposures, managing risks related to concentration, mitigation methods and its providers.

2. The Bank's risk management policies and procedures, and the risk appetite framework should include internal limits on concentration risk and large exposures. In addition, the Risk Committee of the Supervisory Board of the Bank shall receive quarterly reports on all material exposures and their quality. The concept of a material exposure shall be defined by the Bank. The report shall, at a minimum, include information on the exposures of the Bank's top 20 Clients. The National Bank may, including (but not limited), request the approval of material exposures by the Risk Committee of the Supervisory Board of the Bank.

3. On a monthly basis Banks shall report to the National Bank their exposures to Groups of Connected Clients, in accordance with the form developed by the National Bank. Such reporting at least shall include all Large Exposures referred to in subparagraph B of paragraph 1 of Article 2 of this Regulation.

4. A bank should take all appropriate steps to ensure that all requirements and limits under this regulation are compliant and its activities shall not cause the breach of this requirements and limits. In case any requirement or limit under this regulation is breached, the bank shall immediately inform the National Bank regarding this breach and within five working days shall submit the plan how to ensure the compliance.

Article 7. Transitional provisions

1. Bank shall develop internal guidelines about identification of group of connected clients, set by article 3 of this regulation, and within the one month after this regulation comes into force shall submit it to the National Bank.

2. Exposures created before January 1, 2021, which breach the requirements of this regulation, shall be compliant with the requirements of article 4 of this regulation at most June 1, 2021. In addition:

- a) Before January 31, 2021, banks shall submit to the National Bank the action plan for ensuring compliance with the requirements and limits set by article 4 of this regulation;
- b) Before June 1, 2021, banks shall act according to the action plan defined in subparagraph “a” of this paragraph.