

Decree N 26/04 of the Governor of the National Bank of Georgia

March 10, 2015

Tbilisi

On approving the

Regulation on the Management of the Conflict of Interests

In accordance with the requirements of Subparagraph “g” of Article 15 of the Organic Law of Georgia on the National Bank of Georgia and Article 25 of the Law of Georgia on Activities of Commercial Banks, I hereby rule:

Article 1.

The attached “Regulation on the Management of the Conflict of Interests” is approved.

Article 2.

Decree N 116 of May 4, 2001 of the Governor of NBG on the approval of the “Regulation on Conflict of Interests and Transactions between Bank Administrators and Related Parties” is void.

Article 3.

This decree will enter into force upon its publication.

Governor of the National Bank of Georgia

Giorgi Kadagidze

Regulation on the Management of the Conflict of Interests

Article 1: General Provisions

1. The purpose of this regulation is to ensure adequate supervision and control of the transactions with related parties by commercial banks (henceforth, banks) for the purpose of averting conflict of interests as much as possible.
2. For the purpose of averting violations that may occur when conducting transactions with the related parties, as well as conflict of interests, banks shall conduct transactions according to “arm’s length” principle, monitor transactions with the related parties, write off exposures to related parties according to standard policies and processes, and adopt relevant measures for risk control and mitigation.

3. The definitions mentioned in this decree are based on the International Accounting Standard - "IAS 24", and Core principles for Effective Banking Supervision by Basel Committee of Banking Supervision. In case certain questions relating to conflict of interests or certain definition are not settled by this regulation, a bank must use as guidance the aforementioned standards and existing best practice.

Article 2: Definition of Terms

The terms used in this regulation have the following meanings:

- a) Related Party – Following persons and entities that are related to the bank, entities over which the bank has control or joint control:
 - b.a. A person, his/her family member and persons related in other ways, if that person:
 - a.a.a Has a control or joint control of the bank;
 - a.a.b Has a significant influence on the bank;
 - a.a.c Is the member of the key management personnel of the bank or of a parent of the bank.
 - b.b. An entity, if any of the following conditions apply:
 - a.b.a The entity and the bank are members of the same group (a parent, a subsidiary, and fellow subsidiary are related to the others).
 - a.b.b One entity is an associate or joint venture of the other entity (or an associate or a joint venture of a member of a group, of which the other entity is a member).
 - a.b.c Both entities are joint ventures of the same third party.
 - a.b.d One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
 - a.b.e The entity is a post-employment benefit plan for the benefit of employees of the bank or an entity related to the bank.
 - a.b.f The entity is controlled or jointly controlled by a person identified in (a).
 - a.b.g A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).
 - a.b.h The entity, or any member of a group of which it is a part, provides key management personnel services to the bank or to the parent of the bank.

- b) A Related Party Transaction – transfer of resources, services or obligations between a bank and a related party, regardless of the price charged, including:
 - b.a. Purchases or sales of goods (finished or unfinished);
 - b.b. Purchases or sales of real estate or other assets;
 - b.c. Rendering or receiving of services;
 - b.d. Leases;
 - b.e. Construction agreement;
 - b.f. Transfers of research and development;
 - b.g. Transfers under financial agreements (including loans and equity contributions in cash or in kind);
 - b.h. Provision of guarantees or collateral;
 - b.i. Transactions with the third parties through the collateral provided by a related party;
 - b.j. Commitments to do something if a particular event occurs or does not occur in the future, including executory contracts (recognized and unrecognized);
 - b.k. Settlement of liabilities on behalf of the entity or by the entity on behalf of that related party.
 - b.l. Revision of any condition of current agreement, including restructuring, refinancing, granting of concessions;
 - b.m. Write-off or recovery of an exposure.
- c) Key Management personnel– persons, who have authority and responsibility for planning, directing and controlling the activities of the entity, directly, or indirectly, including any director and supervisory board member of that entity.
- d) Control – Situation in which investor is exposed, or has rights to exposure variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.
- e) Power – the situation, wherein an investor has existing rights that give it the ability to direct the relevant activities – i.e. the activities that significantly affect the investee's returns.
- f) Joint control – contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.
- g) Joint venture – a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Joint venture includes the subsidiaries of a joint venture as well (standard 11).
- h) Associate –an entity, over which an investor has significant influence. Associates include the subsidiaries of associates as well.

- i) Significant influence- the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control of those policies.
- j) Parent (Head organization) – entity which controls one or more entities (subsidiaries).
- k) Subsidiary – entity, which is controlled by another entity (parent/head entity).
- l) Close members of the family and business partners of a person – those close members of the family and close business partners who may be expected to influence, or be influenced by, that person in their dealings with the entity and include:
 - l.a) Those family members, who, in accordance with the Civil Code of Georgia, are included in lines I and II of legal successors.
 - l.b) Persons living in permanent union and their children, with whom a given person conducts joint activities.
 - l.c) Any other persons – relatives or close business partners who are able to influence, or be influenced by, that person in performing their business activities.
- m) Group – parent and subsidiaries.
- n) Risk exposure – asset or off-balance sheet element, which includes the bank's claims against the party (loans, deposits, debt instruments, investments in securities etc.), potential claims (the announcement of capital investment plan, a promise of creation of the exposure) and contingent liabilities (guarantees having or not having the character of credit substitutes and etc.)
- n) Risk exposure – asset or/and off-balance sheet element; (*enforces from June 1, 2020*)**
- o) Bank administrators - a member of the bank's supervisory board, directorate, as well as a person who alone or together with one or more others has the authority to enter into commitments on behalf of a bank. Such persons include the employees who are able to make material decisions on behalf of a bank under the delegation of powers and the scope of his/her functions.
- p) Supervisory arbitrage – conduct of an activity or a transaction by a bank in such form, which will result in the avoidance or easing of the requirements and restrictions established by the legislation.
- q) Total value of risk exposure - the value defined by the first and 2nd paragraphs of the article 10 of the Order N100/04 of the Governor of NBG on the approval of Capital Adequacy Requirements for Commercial Banks. In addition, credit conversion factor for off-balance sheet items listed in the XIV chapter of the abovementioned regulation is 100%, regardless its risk category. (*enforces from June 1, 2020*)**

Article 3: Core Principles of the Management of Conflict of Interests

1. Banks shall ensure that related party transactions are conducted on the basis of “arm’s length” principle, and such rules and conditions that are not more preferential than the analogous transactions carried out under the same conditions with the non-related parties.
2. General provisions with regards to the management of conflict of interests shall be fully reflected in the bank’s regulation on the management of the conflict of interests, which, at the very least, must cover the issues defined by Article 4 of this regulation and shall be approved by the supervisory board.
3. Banks must have adequate procedures and policies for the identification and management of potential conflict of interests. Through a bank’s processes and policies it must be possible to identify related parties and threats related to the conflict of interests in a timely manner.
4. For the purpose of identifying related parties, a bank must have a defined procedure on gathering information on related parties, which should include the disclosure requirement from the bank employees.
5. Bank must take all measures to identify the related parties defined by subparagraph “1.c”, article 2. For the purpose of this subparagraph, bank, at the very least, should collect and periodically update the information regarding close business partners of key management personnel determined by the aforementioned subparagraph. In addition, in case of identification such close members of the family or persons related in other way in process of daily activities, such persons should be counted as related parties and further transactions with them should be conducted in accordance with this Regulation. For the purpose of effective identification of such persons and avoiding conflict of interest, bank must determine additional approaches and policies in accordance with its risk environment.
6. The list of the key management personnel of the bank (positions or persons) must be approved by the supervisory board of a bank, and it must be subject to constant updates.
7. Banks must have established procedures for the approval of related party transactions, which must cover the adequately defined system of delegation of powers.

8. Within the system of delegation of powers for the approval of related party transactions, banks must have determined materiality thresholds according to the type of related parties and type and volume of transactions, based on which, a structural unit responsible for their approval shall be determined. The materiality threshold, established by a bank, must be in line with the scope and complexity of the bank's activities and related party transactions
9. Banks must have predetermined types and scope of collateral, required for risk exposures to related parties, which must be reflected in the bank's regulation on the management of conflict of interests. Regulation should include the information of minimum volume of collateral by the types of collateral and risk exposures.
10. A bank must have control and monitoring systems for the transactions carried out with the related parties, which are in line with the scope and complexity of the bank's activities and transactions with related parties. Such procedures must ensure the control and mitigation of risks caused by related party transactions, including, write-off of exposures to related parties according to standard policies and processes.
11. Related party transactions must be subject to periodic reporting with the bank's supervisory board and the National Bank of Georgia.
12. The risk management function of the bank must monitor related party transactions and control different sources of conflict of interests. The results of unhealthy practices, discovered by this unit, must be communicated with the supervisory board, and, upon request, to the National Bank of Georgia.
13. An Internal audit unit at a commercial bank is required, within the scope of its plan, to conduct the audit of the compliance of related party transactions with this regulation with reasonable frequency – at least once a year.
14. For the purpose of avoiding conflict of interests as much as possible, bank must ensure the adequate supervision and control of the transactions with the administrators, who are not the members of key management. Banks must implement all the necessary processes, which are required to conduct related party transactions by this Regulation. Bank policies and processes must ensure that no bank's administrators participate in the process of approval transaction with their related parties or transactions from which he/she may expect any direct/indirect gains.

Article 4: Regulation on the Management of the Conflict of Interests

1. A bank's regulation on the Management of the Conflict of Interests must address in detail following questions:
 - a. Goals and challenges of the regulation;

- b. Structural units responsible for the approval and introducing changes in the regulation;
 - c. Definition of terms;
 - d. Detailed procedures for identifying related parties.
 - e. Types of related party transactions, which are being controlled by the bank;
 - f. The process of related party transaction analysis, which includes detailed description of the responsibilities of different functions, and requisite mandatory documenting.
 - g. Types of permissible collateral and limits;
 - h. The process for approving related party transactions, including transactions to be approved by the supervisory board and limits of responsibilities delegated to other structural units;
 - i. Procedures for amending related party transaction agreements, and structural units responsible for approving them;
 - j. The procedure for writing off risk exposures to related parties;
 - k. Control and monitoring systems for the regulation on the management of conflict of interests according to individual transactions, including structural units responsible for the said processes;
 - l. Reporting system regarding related party transactions and the policy of disclosure/transparency;
 - m. Sanctions established by the bank for violating the provisions of the bank's regulation.
- 2. The supervisory board of the bank approves the regulation on the management of conflict of interests.
 - 3. Any amendments to the regulation must be approved by the supervisory board, and NBG should be immediately informed about it.
 - 4. Any exceptions to the regulation on the management of the conflict of interests must be approved by the supervisory board of the bank through reasoned consent and appropriate documentation. Information regarding such sanctioned deviation must be provided to NBG upon request.

Article 5: Approval of related party transactions

- 1. A bank is required to conduct related party transactions defined by paragraph 2 of this article only based on the consent from the supervisory board, excluding the cases allowed for by the limits defined by this regulation.

2. It is not permissible for the supervisory board to delegate the power for approving related party transactions to any other structural unit above the following limits:
 - a. Increasing risk exposures to related legal entities, as the result of which, carrying value of risk exposures to the party by the bank exceeds minimum of 200,000 GEL or 1% of regulatory capital; Exception of this subparagraph is creating short-term risk exposures to the members of the group of the bank for the liquidity purposes within the limits approved by the supervisory board. Such limits must be reflected in the minutes of the board and must be submitted to National Bank of Georgia within 10 business days.
 - b. Increasing risk exposures to related persons, as the result of which, carrying value of risk exposures to the party by the bank exceeds minimum of 150,000 GEL or 0.5% of the regulatory capital.
 - c. Carrying out of a related party transaction, as the result of which, annual total cash outflow from the bank in return for delivery of products or rendering of services exceeds maximum of 200,000 GEL and 0.1% of the total regulatory capital as the end of the reporting period;
 - d. Creating of risk exposure collateralized by deposits, to the related party, as the result of which, the total carrying value of risk exposure to the party by the bank exceeds 1,000, 000 (one million) GEL, if the said collateral meets the criteria of credit-financing collateral, established by the Order N100/04 of the Governor of NBG on the approval of Capital Adequacy Requirements for Commercial Banks.
3. Within the frame of limits given in Paragraph 2 of this article, the supervisory board of the commercial bank must itself determine appropriate limits for the bank and this must be reflected in the regulation on the management of conflict of interests. When determining such limits, the supervisory board must take into consideration the situation existing in the bank, potential threats of the conflict of interests, and the level of their management.
4. A member of the supervisory board must not participate in the approval of transactions, if a threat of conflict of interests exists, and a given member has a personal interest in the carrying out of the transaction. The presence of such member shall not be taken into consideration when determining the quorum of the meeting.
5. No key management personnel and/or any other related party shall participate in the discussions and decision-making regarding related party transactions, if he/she may be expecting any direct/indirect gains from this transaction. In addition, no such key management personnel or related party shall try to influence the decisions of a supervisory board regarding such operations.

6. For the purpose of approving the transaction, full information regarding related parties and planned transactions with them must be presented to the supervisory board;
7. Any amendments to the contracts with the related parties must be approved by the supervisory board, excluding specific cases established by this regulation, which do not change financial agreement, do not reduce and change type of the collateral, and do not infer granting concessions to the related party.
8. Paragraph 7 of this Article does not include cases where risk exposures to related parties do not exceed the limits defined by paragraph 2.
9. Information on related parties and transactions with them, presented at the supervisory board meetings, must be appropriately reflected in the board minutes, and must be submitted to the National Bank of Georgia within 10 business days. Upon NBG's request the information and materials presented to supervisory board in electronic and/or hard copy form regarding certain transaction must be submitted to the National Bank of Georgia.

The order of the President of the National Bank of Georgia №139/04 of 29 July 2019 – Website, 30.07.2019

Article 6: Prohibited Transactions with the related parties

1. It is not permitted to create such exposure with any related party the quality of which at the moment does not meet the criteria for “standard” category determined by the “Regulation on Assets Classification and the Creation and Use of Reserves for Losses by Commercial Banks.”
2. It is prohibited to create risk exposures to any related party with the collateral, the quality of which is significantly correlated with the bank's credit quality. Such collateral includes, and is not limited to, bank's (or its subsidiaries') securities and financial instruments.
3. A bank is at all times prohibited from creating risk exposures to related parties if the market value of the collateral received is less than 110% of the risk exposure except the cases defined by paragraphs 5, 6 and 7 of this Article
4. The fair value of collateral received to the total amount of risk exposure must not be less than the lower limits established by internal policies and processes. Without violation of paragraph 3 of this article, the power of making exception to this rule must be reflected in the regulation on the management of conflict of interest. Such decisions must be documented and the bank must be able to report data of such decisions.
5. It is permissible to create risk exposures to related parties if the collateral constitutes a deposit, the fair value of which is equal to or more than 100% of the total amount of risk exposure, and if the said collateral meets the criteria of credit-financing collateral,

established by the Order N100/04 of the Governor of NBG on the approval of Capital Adequacy Requirements for Commercial Banks.

6. It is permissible to create non-collateralized risk exposures to persons, if as a result of such transaction carrying value of the non-collateralized part of the total risk exposures of this person does not exceed 50,000 GEL and if the creating of such risk exposures is allowed by the internal policies and procedures of the bank. The collateralized part of the total risk exposure by this regulation, through the consideration of the requirements established for the collateral by this regulation.
7. It is permitted to grant non-collateralized risk exposures to financial subsidiaries of the commercial bank, in case of prior consent from the supervisory board of the bank and the National Bank of Georgia.
8. In case of prior consent from the supervisory board of the bank and the National Bank of Georgia it is permitted to determine additional cases where the bank has right to grant non-collateralized loans to related parties
9. A bank's shareholders must receive income from the bank's retained earnings in form of legally paid dividends, in accordance with their respective shares in the paid-in capital of the bank.
10. Any income received by a shareholder or a beneficiary owner from a bank, the payment of which is related to the service rendered by a shareholder for the bank, is subject to annual publication in form of a separate statement. The aforementioned statement must include, at the very least, information regarding the volume of the received income, according to individual shareholders and types of income (e.g. salary, rendered service, the beneficiary of which is a given shareholder). For the purpose of this paragraph, the list of shareholders does not include those members of the executive management; whose shares do not exceed 2% of the bank's paid-in capital.
11. The statement defined by paragraph 10 of this Article must be published annually no later than January 31.

Article 7: Limits on Transactions

1. The total value of risk exposures to one related party must not exceed 5% of the regulatory capital of the bank.
2. The total value of risk exposures to all related parties must not exceed 25% of the regulatory capital of the bank.
3. For the calculation of limits established by paragraphs 1 and 2 of this article, a bank must use the total amount of risk exposures before provisions for impairment losses are deducted.

4. Conducting a related party transaction, as the result of which, the annual costs expended by the bank exceeds 5% of the regulatory capital of the bank, requires the prior approval from the National Bank of Georgia.
5. For the calculation of limits established by this Article risk exposures do not include investments in related entities' capital which are deducted from the regulatory capital of the bank.

Article 7: Limits on Transactions

1. The total value of risk exposures to one related party must not exceed 5% of the Tier 1 capital of the bank.
2. The total value of risk exposures to all related parties must not exceed 25% of the Tier 1 capital of the bank.
3. Conducting a related party transaction, as the result of which, the annual costs expended by the bank exceeds 5% of the Tier 1 capital of the bank, requires the prior approval from the National Bank of Georgia.
4. For the calculation of limits established by this Article risk exposures do not include investments in related entities' capital which are deducted from the Tier 1 capital of the bank.

(enforces from June 1, 2020)

The Order of the President of the National Bank of Georgia № of November 25, 2019- Website 26.11.2019

Article 8: Reporting and Disclosure of Related Party Transactions

1. Banks must have adequate information systems for the monitoring of exposures to related parties. Any deviation from the policies, procedures or limits must be immediately communicated to the bank's supervisory board and, upon request, to NBG.
2. A bank's supervisory board must periodically receive reports regarding related party transactions, which must include the detailed description of these transactions. Such reporting must describe transactions and types of related parties in reasonable detail. Information regarding large transactions with related parties must be presented in the reports individually. The transactions with the members of the bank's supervisory board and directorate, as well as their family members and business partners and their companies must be presented individually. Such reports must in detail describe the quality of the exposure to related parties in detail, particularly, loans past due and provisions for impairment losses, as well as any write-offs. In addition, the report must present information regarding transactions carried out within the frames of sanctioned deviations from the established limits.

3. Each month, banks must present the report on the related party transactions to the National Bank of Georgia, in accordance with the form developed by the National Bank of Georgia.
4. Banks must ensure the correct disclosure of related party transactions in their annual financial statements, in accordance with IAS 24.
5. Each commercial bank is required to reason with arguments the differences between the information presented in the bank's annual audited financial statement and the analogous information presented to the National Bank of Georgia.

Article 9: The requirements for the Key Management

1. Members of the key management of a bank are required to ensure the avoidance of the conflict of interests and must not put their interests above those of the bank, or abuse their authority.
2. Members of the key management of a bank must ensure implementation, monitoring and, if necessary, periodic update of adequate policies and procedures related to the management of conflict of interest at the bank.
3. For the purpose of creating motivation for avoiding conflict of interest and implementing sound practice of managing conflict of interests in the bank, Members of the key management of a bank must in advance define adequate sanctions to be imposed when violations are identified.
4. Members of the key management of a bank must support the process of identifying related parties and, for that purpose, they are required to disclose information about their related parties. Such information must be disclosed as promptly as possible.
5. Members of the key management of a bank must not receive from (or grant to) the bank or the bank's related parties any such remuneration which exceeds the fair value of the actually rendered service.
6. Members of the key management of a bank are required to submit to NBG the information regarding their purchase or sale of the bank's shares, as well as transactions completed by them or through other financial instruments related to them. Before January 31st of every year, members of the key management of a bank are required to submit to NBG information regarding every such transaction completed by them during the year. If the volume of transactions (price of the transaction, or the price of those shares, through the instruments of which the given transaction was accomplished) carried out by a manager exceeds 200,000 GEL within the duration of the last 15 calendar days, the information must be submitted to NBG within 4 business days. Members of the key management of a bank must also submit to NBG information available to them regarding similar transactions completed by

persons related to them in the time periods established by this paragraph. Information submitted must include the description of a financial instrument, type of the transaction (e.g. purchase, sale), time and place of the completion of the transaction, and its price and volume.

7. If bank administrators participate in the trade of the bank's securities, the bank must not suffer damage from these activities.

Article 10: Rights of National Bank of Georgia

1. National Bank of Georgia has the right to:
 - a. Request from a bank to provide any information that will help the National Bank of Georgia determine whether a particular individual or a legal entity is a related party to the bank or not;
 - b. Request from a bank any information regarding transactions with related parties of the bank;
 - c. Request from a bank any information regarding transactions with related parties of the administrators;
 - d. Request bank to improve policies and procedures in order to enhance the management of conflict of interests;
 - e. If necessary, request bank to conduct external audit of risk specific transactions for the purpose of further investigation of the facts of conflict of interest and to ensure the compliance with this regulation. National Bank of Georgia has right to cooperate with the external auditor in the assessment process of compliance with this regulation. In case of any additional expenses related to the aforementioned service rendered by the auditor, the bank shall fully cover all expenses;
 - f. Request from a bank to deduct a specific exposure to a related party fully or partially from regulatory capital, if this exposure bears high risk in the NBG's opinion;
 - g. Prohibit a bank from conducting any transactions with the related parties, including direct or indirect transfer of cash or payment of any kind of bonuses, if excessive risks are identified;
 - h. Take actions permitted by the law in case regulatory arbitrage is identified;
 - i. Request from the relevant unit of the bank to dismiss the administrator or any other employee of a bank, who, according to the reasoned opinion of the National Bank of Georgia, has violated the requirements of this regulation, and if such action represents unsound practice.
2. If a bank and the National Bank of Georgia cannot agree on the recognition of the bank's specific customer or transaction as a related party or a related party

transaction, the bank must act in accordance with the instruction of the National Bank of Georgia

3. If the National Bank of Georgia considers that any requirement of this article was violated, or will have no consequences in the future due to timing or other circumstances, the National Bank of Georgia can take administrative and corrective actions, including revoking the bank's license or, if necessary, providing appropriate organization with all materials in order to commence criminal prosecution against the bank.
4. If the National Bank of Georgia considers that a member of the key management, a shareholder or a controlling person has received gain (via conducting transaction with the bank through his/her related party or himself/herself), which exceeds the amount that the person would have received if he/she acted on the basis of the "arm's length" principle, in accordance with this regulation, the National Bank of Georgia can request from the relevant unit of the bank to take measures to recognize such amount as a liability to the bank, and further, return the resources to the bank.

Article 11: Penalties and Sanctions

In case of violation of the requirements of this regulation, the National Bank of Georgia will impose penalties and sanctions defined by the law on a bank and its administrators.

Article 12: Transitional Provisions

1. Within five months' period after the effective date of this regulation, banks are required to update policies and procedures in compliance with this regulation, and they should develop a regulation on the management of conflict of interests in accordance with article 4 of this regulation.
2. Within the transitional period, defined by paragraph 1 of this article, banks should take all measures to ensure that their activities are conducted in compliance with this regulation.
3. Within the transitional period, defined by paragraph 1 of this article, the approval of transactions with identified related parties by bank is forbidden without the consent of the supervisory board, if the volume of the transactions exceeds the limits defined by paragraph 2 of article 5 of this regulation.
4. Within the transitional period, defined by paragraph 1 of this article, banks are prohibited from approving transactions with identified related parties if the approval violates the limitations established by paragraphs 3, 4 and 5 of article 6 and article 7 of this regulation.