JSC PASHA Bank Georgia

Financial statements

Year ended 31 December 2020
together with independent auditor's report

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Selected explanatory notes to the financial statements

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Independent auditor's report

To the Shareholders and Board of Directors of JSC PASHA Bank Georgia

Report on the audit of the financial statements

Opinion

We have audited the financial statements of JSC PASHA Bank Georgia (the "Bank"), which comprise the statement of financial position as at 31 December 2020, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2020 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board of Accountants' (IESBA) International Code of Ethics for Professional Accountants (including International Independence Standards) (IESBA Code) and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of matter paragraph

We draw attention to Note 24 to the financial statements, which describes a significant concentration of the Bank's transactions with related parties. Our opinion is not modified in respect of this matter.

Other information included in in the Bank's 2020 Annual Report

Other information consists of the information included in The Banks 2020 Annual Report, other than the financial statements and our auditor's report thereon. Management is responsible for the other information. The Bank's 2020 Annual Report is expected to be made available to us after the date of this auditor's report.

Our opinion on the financial statements does not cover the other information and we will not express any form of assurance conclusion thereon in our report on the audit of the financial statements.

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In connection with our audit of the financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of management and those charged with governance for the financial statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

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- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Marchello Gelashvili

On behalf of EY LLC

Tbilisi, Georgia

4 March 2021

Statement of financial position

As at 31 December 2020

(Amounts in tables are in thousands of Georgian lari)

	Notes	*2020*	*2019*
Assets			
Cash and cash equivalents	5	39,118	88,951
Amounts due from credit institutions	6	46,518	58,670
Loans to customers	7	320,118	297,785
Investment securities	8	46,223	26,480
Property and equipment	9	6,738	8,876
Right of use assets	10	8,921	5,240
Intangible assets	11	4,241	4,607
Income tax asset		–	183
Other assets	12	1,527	1,496
Total assets		**473,404**	**492,288**
Liabilities			
Amounts due to credit institutions	13	131,091	110,130
Amounts due to customers	14	210,222	241,708
Provisions	18	395	416
Deferred income tax liability	16	226	64
Lease liabilities	10	10,528	5,575
Other liabilities	12	6,116	4,469
Subordinated debt	15	31,742	27,589
Total liabilities		**390,320**	**389,951**
Equity			
Share capital	17	103,000	103,000
Additional paid-in capital	17	1,155	1,155
Accumulated deficit		(21,071)	(1,818)
Total equity		**83,084**	**102,337**
Total equity and liabilities		**473,404**	**492,288**

Signed on behalf of the Board of Directors of the Bank on 4 March 2021:

Arda Yusuf Arkun — Chairman of the Board of Directors

Selim Berent — Chief Financial Officer, Member of the Board of Directors

JSC PASHA BANK GEORGIA 404433671

The accompanying selected explanatory notes on pages 5 to 46 are an integral part of these financial statements.

Statement of comprehensive income

For the year ended 31 December 2020

(Amounts in tables are in thousands of Georgian lari)

	Notes	2020	2019
Interest revenue calculated using effective interest rate			
Loans to customers		28,444	23,089
Investment securities		4,575	2,675
Amounts due from credit institutions		992	2,839
		34,011	**28,603**
Interest expense			
Amounts due to customers		(7,714)	(4,696)
Amounts due to credit institutions		(5,764)	(5,596)
Subordinated debt		(1,581)	(48)
Lease liabilities		(600)	(303)
		(15,659)	**(10,643)**
Net interest income		**18,352**	**17,960**
Credit loss expense on interest bearing assets	5, 6, 7, 8, 18	(12,305)	(3,665)
Net interest income after impairment losses		**6,047**	**14,295**
Net (losses)/gains from foreign currencies			
- dealing		(9,196)	4,240
- translation differences		14,225	(134)
Net fee and commission income	19	835	601
Other operating income		500	299
Non-interest income		**6,364**	**5,006**
Personnel expenses	20	(16,597)	(15,339)
General and administrative expenses	20	(7,976)	(8,367)
Depreciation and amortisation	9, 10, 11	(6,504)	(3,424)
Net losses on modification of financial assets measured at amortised cost	7	(261)	
Provisions		(3)	(10)
Other operating expenses		(161)	(643)
Non-interest expenses		**(31,502)**	**(27,783)**
Loss before income tax		**(19,091)**	**(8,482)**
Income tax expense	16	(162)	(578)
Net loss for the year		**(19,253)**	**(9,060)**
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods		–	–
Total comprehensive loss for the year		**(19,253)**	**(9,060)**

The accompanying selected explanatory notes on pages 5 to 46 are an integral part of these financial statements.

Statement of changes in equity

For the year ended 31 December 2020

(Amounts in tables are in thousands of Georgian lari)

	Notes	*Share capital*	*Additional paid-in capital*	*(Accumulated deficit) retained earnings*	*Total equity*
1 January 2019		**103,000**	**–**	**7,242**	**110,242**
Below market rate loan from Parent and entities under common control	15	–	1,155	–	**1,155**
Total comprehensive loss or the year		–	–	(9,060)	**(9,060)**
31 December 2019		**103,000**	**1,155**	**(1,818)**	**102,337**
Total comprehensive loss for the year		–	–	(19,253)	**(19,253)**
31 December 2020		**103,000**	**1,155**	**(21,071)**	**83,084**

The accompanying selected explanatory notes on pages 5 to 46 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December 2020

(Amounts in tables are in thousands of Georgian lari)

	Notes	2020	2019
Cash flows from operating activities			
Interest received		30,676	28,689
Interest paid		(12,113)	(9,782)
Fees and commissions received		1,715	1,456
Fees and commissions paid		(947)	(874)
Realised (losses)/gains from dealing in foreign currencies		(9,196)	4,240
Personnel expenses paid		(16,523)	(14,489)
General and administrative expenses paid		(8,329)	(5,391)
Other income received		7	4
Cash flows (used in) / from operating activities before changes in operating assets and liabilities		**(14,710)**	**3,853**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		18,731	10,226
Loans to customers		5,111	(103,013)
Other assets		(86)	–
Net increase/(decrease) in operating liabilities			
Amounts due to credit institutions		6,468	(12,130)
Amounts due to customers		(56,598)	130,755
Other liabilities		1,561	–
Net cash (used in) / from operating activities before income tax		**(39,523)**	**29,691**
Income tax paid		–	(549)
Net cash (used in) / from operating activities after income tax		**(39,523)**	**29,142**
Cash flows from investing activities			
Purchase of investment securities	8	(30,484)	(9,173)
Proceeds from redemption of investment securities	8	12,250	3,090
Purchase of property and equipment		(371)	(7,415)
Proceeds from sale of property and equipment		38	–
Purchase of intangible assets		(960)	(2,764)
Net cash (used in) investing activities		**(19,527)**	**(16,262)**
Cash flows from financing activities			
Principal repayments of lease liability		(3,232)	(1,212)
Proceeds from subordinated debt		–	29,055
Net cash (used in) / from financing activities		**(3,232)**	**27,843**
Effect of exchange rates changes on cash and cash equivalents		12,468	1,733
Effect of expected credit losses on cash and cash equivalents		(19)	(8)
Net (decrease)/increase in cash and cash equivalents		**(49,833)**	**42,448**
Cash and cash equivalents, beginning	5	88,951	46,503
Cash and cash equivalents, ending	5	**39,118**	**88,951**

The accompanying selected explanatory notes on pages 5 to 46 are an integral part of these financial statements.

(Amounts in tables are in thousands of Georgian lari)

1. Principal activities

JSC PASHA Bank Georgia (the "Bank") was formed on 17 December 2012 as a joint stock company under the laws of Georgia. The Bank operates under a general banking license issued by the National Bank of Georgia (the "NBG") on 17 January 2013 (Identification code: 404433671).

The Bank accepts deposits and extends credit, transfers payments in Georgia and abroad, exchanges currencies and provides other banking services to its commercial customers. The Bank continues its expansion into retail market under the Re|Bank brand name, based on strategic initiatives approved by the Bank's shareholders.

Starting from 2017 the Bank is a member of the deposit insurance system. The system operates under the Law of Georgia on Deposit Insurance System and insures all types of deposits of resident and non-resident individuals up to GEL 5,000, with certain exceptions.

The Bank has eight service offices in Georgia as of 31 December 2020. The Bank's registered legal address is 37M, Ilia Chavchavadze Avenue, 0179, Tbilisi, Georgia.

As at 31 December 2020 and 2019, the Bank's 100% owner was OJSC PASHA Bank (the "Parent"), the Republic of Azerbaijan. As at 31 December 2020 and 2019 the Bank is ultimately owned by Mrs. Leyla Aliyeva, Mrs. Arzu Aliyeva and Mr. Arif Pashayev, who exercise joint control over the Bank.

These financial statements have not yet been approved by the Parent on the general meeting of shareholders of the Bank. The shareholders have the power and authority to amend the financial statements after the issuance.

2. Basis of preparation

General

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below.

These financial statements are presented in Georgian lari ("GEL"), unless otherwise indicated.

3. Summary of accounting policies

Effect of COVID-19 pandemic

Due to the rapid spread of COVID-19 pandemic in 2020 many governments, including the Georgian Government, have introduced various measures to combat the outbreak, including travel restrictions, quarantines, closure of business and other venues and lockdown of certain areas. These measures have affected the global supply chain, demand for goods and services, as well as scale of business activity. It is expected that pandemic itself as well as the related public health and social measures may influence the business of the entities in a wide range of industries.

Support measures were introduced by the Government and the National Bank of Georgia to counter the economic downturn caused by the COVID-19 pandemic. These measures include, among others, subsidized lending to affected industries and individuals, payment holidays and easing of certain regulatory restrictions to help the financial sector maintain its capabilities to provide resources and to help customers avoid liquidity shortages as a result of the COVID-19 containment measures.

The Bank continues to assess the effect of the pandemic and changing economic conditions on its activities, financial position and financial results.

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

Changes in accounting policies

The Bank has early adopted *Amendment to IFRS 16: COVID-19-Related Rent Concessions*, which provides lessees with an exemption from assessing whether a COVID-19-related rent concession is a lease modification. No other standard, interpretation or amendment that has been issued but is not yet effective was early adopted by the Bank.

Several other amendments effective since 1 January 2020 were applied but do not have an impact on the financial statements of the Bank.

Fair value measurement

Fair values of financial instruments measured at amortised cost are disclosed in Note 22. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability; or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Bank. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. Fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 − quoted (unadjusted) market prices in active markets for identical assets or liabilities;
- Level 2 − valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable;
- Level 3 − valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

Financial assets and liabilities

Initial recognition

Date of recognition

All regular way purchases and sales of financial assets and liabilities are recognised on the trade date i.e. the date that the Bank commits to purchase the asset or liability. Regular way purchases or sales are purchases or sales of financial assets and liabilities that require delivery of assets and liabilities within the period generally established by regulation or convention in the marketplace.

Initial measurement

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments. Financial instruments are initially measured at their fair value and, except in the case of financial assets and financial liabilities recorded at FVPL, transaction costs are added to, or subtracted from, this amount.

Measurement categories of financial assets and liabilities

The Bank classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms, measured at either:

- Amortised cost;
- FVOCI;
- FVPL.

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

The Bank classifies and measures its derivative portfolio at FVPL. The Bank may designate financial instruments at FVPL, if so doing eliminates or significantly reduces measurement or recognition inconsistencies.

Financial liabilities, other than loan commitments and financial guarantees, are measured at amortised cost or at FVPL when they are held for trading, are derivative instruments or the fair value designation is applied.

Amounts due from credit institutions, loans to customers, investment securities at amortised cost

The Bank only measures amounts due from credit institutions, loans to customers and other financial investments at amortised cost if both of the following conditions are met:

- The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows;
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (SPPI).

The details of these conditions are outlined below:

Business model assessment

The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.

The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- How the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel;
- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed;
- How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected);
- The expected frequency, value and timing of sales are also important aspects of the Bank's assessment.

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Bank's original expectations, the Bank does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

The SPPI test

As a second step of its classification process the Bank assesses the contractual terms of financial asset to identify whether they meet the SPPI test.

'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium/discount).

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Bank applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

In contrast, contractual terms that introduce a more than de minimis exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

Letters of credit and undrawn loan commitments

The Bank issues letters of credit and loan commitments. Undrawn loan commitments and letters of credits are commitments under which, over the duration of the commitment, the Bank is required to provide a loan with pre-specified terms to the customer.

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

Performance guarantees

Performance guarantees are contracts that provide compensation if another party fails to perform a contractual obligation. Performance guarantees do not transfer credit risk. The risk under performance guarantee contracts is the possibility that the failure to perform the contractual obligation by another party occurs. Therefore, performance guarantees are not considered financial instruments and thus do not fall in scope of IFRS 9.

Reclassification of financial assets and liabilities

The Bank does not reclassify its financial assets subsequent to their initial recognition, apart from the exceptional circumstances in which the Bank changes the business model for managing financial assets. Financial liabilities are never reclassified. The Bank did not reclassify any of its financial assets and liabilities in 2020.

Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions.

The Bank derecognises a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognised as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognised loans are classified as Stage 1 for ECL measurement purposes, unless the new loan is deemed to be POCI. When assessing whether or not to derecognise a loan to a customer, amongst others, the Bank considers the following factors:

- Change in currency of the loan;
- Change in counterparty;
- If the modification is such that the instrument would no longer meet the SPPI criterion.

If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Bank records a modification gain or loss, presented within interest revenue calculated using EIR in the statement of profit or loss, to the extent that an impairment loss has not already been recorded.

For modifications not resulting in derecognition, the Bank also reassesses whether here has been a significant increase in credit risk or whether the assets should be classified as credit-impaired. Asset that has been classified as credit-impaired as the result of modification, can be recorded as Stage 2 or Stage 3 if certain criteria are met according to the Banks approved methodology.

Derecognition of financial assets and liabilities

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- The rights to receive cash flows from the asset have expired;
- The Bank has transferred its rights to receive cash flows from the asset, or retained the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material Delay to a third party under a “pass-through” arrangement; and
- the Bank either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Bank has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank’s continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

Derecognition of financial assets and liabilities (continued)

Write-off

Financial assets are written off either partially or in their entirety only when the Bank has stopped pursuing the recovery. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to credit loss expense. A write-off constitutes a derecognition event.

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in profit or loss.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the National Bank of Georgia, excluding mandatory reserves, and amounts due from credit institutions that mature within ninety days of the date of origination and are free from contractual encumbrances.

Mandatory reserve deposit with the NBG

Mandatory reserve deposits with the NBG are carried at amortised cost and represent interest bearing mandatory reserve deposits which are not available to finance the Bank's day to day operations and hence are not considered as part of cash and cash equivalents for the purposes of the statement of cash flows. Mandatory reserve is included in amounts due from credit institutions.

Leases

Bank as a lessee

The Bank applies a single recognition and measurement approach for all leases, except for short-term leases and leases of low-value assets. The Bank recognises lease liabilities to make lease payments and right-of-use assets representing the right to use the underlying assets.

Right-of-use assets

The Bank recognises right-of-use assets at the commencement date of the lease (i.e., the date the underlying asset is available for use). Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any remeasurement of lease liabilities. The cost of right-of-use assets includes the amount of lease liabilities recognised, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received. Unless the Bank is reasonably certain to obtain ownership of the leased asset at the end of the lease term, the recognised right-of-use assets are depreciated on a straight-line basis over the shorter of its estimated useful life and the lease term. Right-of-use assets are subject to impairment.

Lease liabilities

At the commencement date of the lease, the Bank recognises lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments (including in-substance fixed payments) less any lease incentives receivable, variable lease payments that depend on an index or a rate, and amounts expected to be paid under residual value guarantees. The variable lease payments that do not depend on an index or a rate are recognised as expense in the period on which the event or condition that triggers the payment occurs.

In calculating the present value of lease payments, the Bank uses the incremental borrowing rate at the lease commencement date if the interest rate implicit in the lease is not readily determinable. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made. In addition, the carrying amount of lease liabilities is remeasured if there is a modification, a change in the lease term, a change in the in-substance fixed lease payments or a change in the assessment to purchase the underlying asset.

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

Leases (continued)

Short-term leases and leases of low-value assets

The Bank applies the short-term lease recognition exemption to its short-term leases (i.e., those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). It also applies the lease of low-value assets recognition exemption to leases of office equipment that are considered of low value. Lease payments on short-term leases and leases of low-value assets are recognised as expense on a straight-line basis over the lease term.

Significant judgement in determining the lease term of contracts with renewal options

The Bank determines the lease term as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease, if it is reasonably certain not to be exercised.

Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. The right of set-off must not be contingent on a future event and must be legally enforceable in all of the following circumstances:

- The normal course of business;
- The event of default; and
- The event of insolvency or bankruptcy of the entity and all of the counterparties.

These conditions are not generally met in master netting agreements, and the related assets and liabilities are presented gross in the statement of financial position.

Taxation

The current income tax expense is calculated in accordance with the regulations of Georgia.

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (applicable to undistributed profits) and tax laws, that have been enacted or substantively enacted by the end of the reporting period.

Georgia also has various operating taxes that are assessed on the Bank’s activities. These taxes are included as a component of other operating expenses.

Property and equipment

Property and equipment are carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met.

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	Years
Furniture and fixtures	4
Computers and equipment	3-4
Motor vehicles	4
Other equipment	4-5
Leasehold improvements	3-5

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

Property and equipment (continued)

The asset's residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year-end.

Costs related to repairs and renewals are charged when incurred and included in other operating expenses, unless they qualify for capitalization.

Intangible assets

Intangible assets include computer software and licenses. Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic lives and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end.

Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of obligation can be made.

Contingencies

Contingent liabilities are not recognised in the statement of financial position but are disclosed unless the possibility of any outflow in settlement is remote. A contingent asset is not recognised in the statement of financial position but disclosed when an inflow of economic benefits is probable.

Share capital

Ordinary shares are classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from the proceeds in equity. Any excess of the fair value of consideration received over the par value of shares issued is recognised as additional paid-in capital.

Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

Interest and similar income and expense

The Bank calculates interest revenue on debt financial assets measured at amortized cost or at FVOCI by applying the EIR to the gross carrying amount of financial assets other than credit-impaired assets. EIR is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest revenue or expense.

When a financial asset becomes credit-impaired, the Bank calculates interest revenue by applying the effective interest rate to the net amortised cost of the financial asset. If the financial assets cures and is no longer credit-impaired, the Bank reverts to calculating interest revenue on a gross basis.

Interest revenue on all financial assets at FVPL is recognised using the contractual interest rate.

Fee and commission income

The Bank earns fee and commission income from several types of services it provides to its customers. Fee income can be divided into the following categories:

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

Recognition of income and expenses (continued)

Fee income earned from services that are provided over a certain period of time

Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income on guarantees and letters of credit. Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

Fee income earned at a point in time

Fees arising from settlement and cash operations are recognized upon completion of the underlying transactions. Each cash operation and settlement operation is treated as a separate performance obligation.

Fee income from providing transaction services

Fees arising from negotiating or participating in the negotiation of a transaction for a third party − such as where the Bank's performance obligation is the arrangement of the acquisition of shares or other securities − are recognised on completion of the underlying transaction. Fees or components of fees that are linked to certain performance obligations are recognised after fulfilling the corresponding criteria. When the contract provides for a variable consideration, fee and commission income is only recognized to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur until the uncertainty associated with the variable consideration is subsequently resolved.

Foreign currency translation

The financial statements are presented in Georgian lari ("GEL"), which is the Bank's functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognised in the statement of profit or loss as gains less losses from foreign currencies − translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Differences between the contractual exchange rate of a transaction in a foreign currency and the NBG exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies. The official GEL exchange rates at 31 December 2020 and 2019 were 3.2766 GEL and 2.8677 GEL to 1 USD, respectively, 4.0233 GEL and 3.2095 GEL to 1 EUR, respectively and 1.9288 GEL and 1.6861 GEL to 1 AZN, respectively.

Standards issued but not yet effective

The new and amended standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements are disclosed below. The Bank intends to adopt these new and amended standards and interpretations, if applicable, when they become effective.

IFRS 9 Financial Instruments – Fees in the '10 per cent' test for derecognition of financial liabilities

As part of its 2018-2020 Annual Improvements to IFRS standards process, the IASB issued an amendment to IFRS 9. The amendment clarifies the fees that an entity includes when assessing whether the terms of a new or modified financial liability are substantially different from the terms of the original financial liability. These fees include only those paid or received between the borrower and the lender, including fees paid or received by either the borrower or lender on the other's behalf. An entity applies the amendment to financial liabilities that are modified or exchanged on or after the beginning of the annual reporting period in which the entity first applies the amendment.

The amendment is effective for annual reporting periods beginning on or after 1 January 2022 with earlier adoption permitted. The Bank will apply the amendments to financial liabilities that are modified or exchanged on or after the beginning of the annual period in which it will first apply the amendment and does not expect this will result in a material impact on its financial statements.

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

Interest Rate Benchmark Reform – Phase 2 Amendments to IFRS 9, IAS 39 IFRS 7, IFRS 4 and IFRS 16

In August 2020 the IASB issued Interest Rate Benchmark Reform – Phase 2 Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16, (IBOR reform Phase 2) to address the accounting issues which arise upon the replacement of an IBOR with a RFR.

IBOR reform Phase 2 includes a number of reliefs and additional disclosures. The reliefs apply upon the transition of a financial instrument from an IBOR to a risk-free-rate (RFR).

Changes to the basis for determining contractual cash flows as a result of interest rate benchmark reform are required as a practical expedient to be treated as changes to a floating interest rate, provided that, for the financial instrument, the transition from the IBOR benchmark rate to RFR takes place on an economically equivalent basis.

The Bank will apply IBOR reform Phase 2 from 1 January 2021.

4. Significant accounting judgments and estimates

Estimation uncertainty

In the process of applying the Bank's accounting policies, management has used its judgments and made estimates in determining the amounts recognized in the financial statements. The most significant use of judgments and estimates are as follows:

Impairment losses on financial assets

The measurement of impairment losses both under IFRS 9 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances. The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- The Bank's internal credit grading model, which assigns PDs to the individual grades;
- The Bank's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a LTECL basis;
- The segmentation of financial assets when their ECL is assessed on a collective basis;
- Development of ECL models, including the various formulae and the choice of inputs;
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs;
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

As at 31 December 2020, the Bank introduced certain changes in its process of estimation of expected credit losses in the context of the ongoing COVID-19 pandemic. In particular, it has revised indicators of significant increase in credit risk and does not automatically consider the credit risk to have significantly increased in the case of a loan modification being part of the Government support measures. The Bank also updated forward looking information, including forecasts of macroeconomic indicators and scenarios' weights. The Bank applied post-model adjustments and additional sectoral overlays based on ratings shift or stressed parameters to reflect appropriately the uncertainty associated with the spread of COVID-19 pandemic.

As at 31 December 2020, in order to reflect the significant remaining uncertainty relating to the potential effect of the further economic disruption being caused by COVID 19 and prospects of future recovery, the Bank revised credit ratings of all borrowers based on new macroeconomic projections and borrower monitoring results. The Bank automatically assigned Ca-C (worst) rating to clients with unavailable updated monitoring results.

(Amounts in tables are in thousands of Georgian lari)

4. Significant accounting judgments and estimates (continued)

Estimation uncertainty (continued)

Post-model adjustments and management overlays made in estimating the reported ECL as at 31 December 2020 are set out in the following table:

	Modelled ECL	*Post-model adjustments and management overlays*	*Total ECL*	*Adjustments as a % of total ECL*
Corporate	(3,802)	(1,118)	**(4,920)**	22.7%
Commercial	(8,005)	(3,954)	**(11,959)**	33.1%
Consumer	(610)	−	**(610)**	0.0%
Total	**(12,417)**	**(5,072)**	**(17,489)**	**33.1%**

Post-model adjustments

Post-model adjustments represent adjustments in relation to data and model limitations as a result of the COVID-19 economic disruption. The adjustments are based on a combination of portfolio level credit risk analysis and an evaluation of ECL coverage at an exposure level. They include the effect of Government and other support programmes.

Management overlays

Management overlays reflect the significant uncertainty as a consequence of the COVID-19 pandemic. Considerations included the potential severity and duration of the economic disruption and the heightened credit risk of specific sectors and loan classes / segments, such as apparel, business and consumer service, consumer durables, homebuilding and property development, oil and gas, passenger airlines, real estate and other commercial property firms.

The amount of allowance for loans to customers, investment securities and credit related commitments recognized in the statement of financial position at 31 December 2020 was GEL 17,489 thousand (2019: GEL thousand 5,791), GEL 415 thousand (2019: GEL 397) and GEL 395 (2019: GEL 414) respectively. Refer to Note 7, Note 8 and Note 18.

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. Additional details are provided in Note 22.

Leases − estimating the incremental borrowing rate

The Bank cannot readily determine the interest rate implicit in the lease, therefore, it uses its incremental borrowing rate (IBR) to measure lease liabilities. The IBR is the rate of interest that the Bank would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. The IBR therefore reflects what the Bank 'would have to pay', which requires estimation when no observable rates are available (such as for subsidiaries that do not enter into financing transactions) or when they need to be adjusted to reflect the terms and conditions of the lease.

The Bank estimates the IBR using observable inputs (such as market interest rates) when available and is required to make certain entity-specific estimates. More details are provided in Note 10.

(Amounts in tables are in thousands of Georgian lari)

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2020	*2019*
Cash on hand	5,452	4,608
Current accounts with the NBG	2,776	2,742
Current accounts with other credit institutions	15,608	17,203
Time deposits with credit institutions up to 90 days	15,310	64,406
Less: allowance for impairment	(28)	(8)
Cash and cash equivalents	**39,118**	**88,951**

As at 31 December 2020, current accounts and time deposit accounts with credit institutions denominated in EUR, GEL and USD represent 58.09%,19.52% and 18.41% of total current and time deposit accounts respectively (31 December 2019: EUR 9.08%, GEL 28.19%, USD 61.38%).

All balances of cash equivalents are held at amortized cost and are allocated to Stage 1.

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2020	*2019*
Mandatory reserve with the NBG	46,518	58,670
Time deposits for more than 90 days	–	–
Less: allowance for impairment	–	–
Amounts due from credit institutions	**46,518**	**58,670**

In 2020 the credit institutions are required to maintain a mandatory interest earning cash deposit with the NBG at the level of 5% and 25% (2019: 5% and 25%) of the average of funds attracted from customers and non-resident financial institutions for the appropriate two-week period in GEL and foreign currencies, respectively.

An analysis of changes in the gross carrying value and corresponding ECL in relation to time deposits for more than 90 days during the year ended 31 December 2020 is as follows:

	Gross carrying value	*ECL*
As at 1 January 2020	**–**	**–**
New assets originated	13,160	(81)
Assets repaid	(14,329)	79
Foreign exchange and other movements	1,169	2
At 31 December 2020	**–**	**–**

An analysis of changes in the gross carrying value and corresponding ECL in relation to time deposits for more than 90 days during the year ended 31 December 2019 is as follows:

	Gross carrying value	*ECL*
As at 1 January 2019	**20,395**	**(291)**
New assets originated	575	(2)
Assets repaid	(21,057)	292
Foreign exchange and other movements	87	1
At 31 December 2019	**–**	**–**

All balances of amounts due from credit institutions are held at amortized cost and are allocated to Stage 1.

(Amounts in tables are in thousands of Georgian lari)

7. Loans to customers

Loans to customers comprise:

	2020	*2019*
Corporate	159,634	158,850
Commercial	168,018	143,112
Consumer	9,955	1,615
Loans to customers	**337,607**	**303,577**
Less − allowance for impairment	(17,489)	(5,792)
Loans to customers	**320,118**	**297,785**

Commercial loans include loans to medium sized companies.

An analysis of changes in the gross carrying value in relation to loans to customers during the year ended 31 December 2020 is as follows:

Corporate loans at amortized cost, gross	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2020	**158,010**	**–**	**840**	**158,850**
New assets originated	130,286	48	-	**130,334**
Assets repaid	(143,551)	(930)	(249)	**(144,730)**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	(34,943)	34,943	–	**–**
Transfers to Stage 3	–	–	–	**–**
Amounts written off	–	–	(591)	**(591)**
Foreign exchange and other movements	12,442	3,329	–	**15,771**
At 31 December 2020	**122,244**	**37,390**	**–**	**159,634**

Corporate loans at amortized cost, allowance for ECL	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2020	**(1,790)**	**–**	**(705)**	**(2,495)**
New assets originated	(1,206)	(1)	–	**(1,207)**
Assets repaid	504	22	59	**585**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	4,652	(4,652)	–	**–**
Transfers to Stage 3	–	–	–	**–**
Amounts written off	–	–	591	**591**
Foreign exchange and other movements	(3,458)	1,009	55	**(2,394)**
At 31 December 2020	**(1,298)**	**(3,622)**	**–**	**(4,920)**

Commercial loans at amortized cost, gross	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2020	**141,304**	**1,808**	**–**	**143,112**
New assets originated	97,745	1,479	–	**99,224**
Assets repaid	(92,545)	(3,233)	(3,238)	**(99,016)**
Transfers to Stage 1	3,138	(3,138)	–	**–**
Transfers to Stage 2	(43,752)	43,752	–	**–**
Transfers to Stage 3	(3,843)	(3,205)	7,048	**–**
Amounts written off	–	–	–	**–**
Foreign exchange and other movements	18,440	5,864	394	**24,698**
At 31 December 2020	**120,487**	**43,327**	**4,204**	**168,018**

(Amounts in tables are in thousands of Georgian lari)

7. Loans to customers (continued)

Commercial loans at amortized cost, allowance for ECL	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2020	**(2,954)**	**(218)**	**–**	**(3,172)**
New assets originated	(3,300)	(32)	–	**(3,332)**
Assets repaid	1,344	43	114	**1,501**
Transfers to Stage 1	(90)	90	–	**–**
Transfers to Stage 2	5,065	(5,065)	–	**–**
Transfers to Stage 3	1,660	1,292	(2,952)	**–**
Amounts written off	–	–	–	**–**
Foreign exchange and other movements	(4,914)	(3,320)	1,278	**(6,956)**
At 31 December 2020	**(3,189)**	**(7,210)**	**(1,560)**	**(11,959)**

Consumer loans at amortized cost, gross	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2020	**1,523**	**83**	**9**	**1,615**
New assets originated	19,888	70	–	**19,958**
Assets repaid	(11,805)	(12)	–	**(11,817)**
Transfers to Stage 1	3	(3)	–	**–**
Transfers to Stage 2	(529)	529	–	**–**
Transfers to Stage 3	–	–	–	**–**
Amounts written off	–	–	–	**–**
Foreign exchange and other movements	83	116	–	199
At 31 December 2020	**9,163**	**783**	**9**	**9,955**

Consumer loans at amortized cost, allowance for ECL	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2020	**(98)**	**(18)**	**(9)**	**(125)**
New assets originated	(79)	–	–	**(79)**
Assets repaid	18	–	–	**18**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	93	(93)	–	**–**
Transfers to Stage 3	–	–	–	**–**
Amounts written off	–	–	–	**–**
Foreign exchange and other movements	(418)	(6)	–	**(424)**
At 31 December 2020	**(484)**	**(117)**	**(9)**	**(610)**

An analysis of changes gross carrying value in relation to loans to customers during the year ended 31 December 2019 is as follows:

Corporate loans at amortized cost, gross	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**163,285**	**–**	**–**	**163,285**
New assets originated	194,666	–	–	**194,666**
Assets repaid	(204,455)	–	–	**(204,455)**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	(840)	–	840	**–**
Amounts written off	–	–	–	**–**
Foreign exchange and other movements	5,354	–	–	**5,354**
At 31 December 2019	**158,010**	**–**	**840**	**158,850**

(Amounts in tables are in thousands of Georgian lari)

7. Loans to customers (continued)

Corporate loans at amortized cost, allowance for ECL	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2019	**(1,891)**	**–**	**–**	**(1,891)**
New assets originated	(2,273)	–	–	**(2,273)**
Assets repaid	1,300	–	–	**1,300**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	705	–	(705)	**–**
Amounts written off	–	–	–	**–**
Foreign exchange and other movements	369	–	–	**369**
At 31 December 2019	**(1,790)**	**–**	**(705)**	**(2,495)**

Commercial loans at amortized cost, gross	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2019	**27,121**	**–**	**–**	**27,121**
New assets originated	172,393	–	–	**172,393**
Assets repaid	(60,972)	–	–	**(60,972)**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	(1,733)	1,733	–	**–**
Transfers to Stage 3	–	–	–	**–**
Amounts written off	–	–	–	**–**
Foreign exchange and other movements	4,495	75	–	**4,570**
At 31 December 2019	**141,304**	**1,808**	**–**	**143,112**

Commercial loans at amortized cost, allowance for ECL	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2019	**(437)**	**–**	**–**	**(437)**
New assets originated	(3,717)	–	–	**(3,717)**
Assets repaid	607	–	–	**607**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	218	(218)	–	**–**
Transfers to Stage 3	–	–	–	**–**
Amounts written off	–	–	–	**–**
Foreign exchange and other movements	375	–	–	**375**
At 31 December 2019	**(2,954)**	**(218)**	**–**	**(3,172)**

Consumer loans at amortized cost, gross	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2019	**841**	**–**	**–**	**841**
New assets originated	2,031	–	–	**2,031**
Assets repaid	(1,194)	–	–	**(1,194)**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	(83)	83	–	**–**
Transfers to Stage 3	(9)	–	9	**–**
Amounts written off	(70)	–	–	**(70)**
Foreign exchange and other movements	7	–	–	**7**
At 31 December 2019	**1,523**	**83**	**9**	**1,615**

(Amounts in tables are in thousands of Georgian lari)

7. Loans to customers (continued)

Consumer loans at amortized cost, allowance for ECL	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2019	**(85)**	**–**	**–**	**(85)**
New assets originated	(54)	–	–	**(54)**
Assets repaid	18	–	–	**18**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	18	(18)	–	**–**
Transfers to Stage 3	9	–	(9)	**–**
Amounts written off	70	–	–	**70**
Foreign exchange and other movements	(74)	–	–	**(74)**
At 31 December 2019	**(98)**	**(18)**	**(9)**	**(125)**

Modified and restructured loans

The Bank derecognises a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognised as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognised loans are classified as Stage 1 for ECL measurement purposes, unless the new loan is deemed to be POCI.

If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Bank records a modification gain or loss, to the extent that an impairment loss has not already been recorded.

During 2020, the Bank has modified the terms and conditions of certain corporate and commercial loans, including introduction of payment holidays, as part of the measures introduced by the Government related to consequences of COVID-19 pandemic. The Bank considered these modifications to be non-substantial.

The table below includes Stage 2 and 3 assets that were modified during the period, with the related modification loss suffered by the Bank.

Loans modified during the period	***2020***	***2019***
Amortised cost before modification	151,074	–
Net modification loss	(261)	–

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters. The types of collateral normally obtained are charges over real estate properties, also cash covers and guarantees, provided by borrowers or third parties, including the Parent.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for loan impairment.

Concentration of loans to customers

As at 31 December 2020, the Bank had a concentration of loans due from three major groups of borrowers in the total exposure of GEL 62,181 thousand that represented 18.42%of the total gross loan portfolio (31 December 2019: GEL 72,878 thousands with 24.01% of the gross loan portfolio). An allowance of GEL 1,310 thousand (31 December 2019: an allowance of GEL 551 thousand) was recognised against these loans.

(Amounts in tables are in thousands of Georgian lari)

7. Loans to customers (continued)

Concentration of loans to customers (continued)

Loans are made within Georgia in the following industry sectors:

	2020	*2019*
Trade and services	164,561	147,837
Real estate management	79,530	57,375
Non-banking credit organizations	35,296	61,146
Construction	34,113	26,925
Individuals	9,955	1,615
Energy	8,547	6,635
Agro	4,869	1,442
Mining	136	208
Other	600	394
	337,607	**303,577**

As at 31 December 2020, the Bank applied management overlays to reflect the significant uncertainty related to the potential severity and duration of the economic disruption and the heightened credit risk of specific sectors, such as apparel, business and consumer service, consumer durables, homebuilding and property development, oil and gas, passenger airlines, real estate and other commercial property firms, due to the impact of COVID-19 pandemic.

8. Investment securities

As at 31 December 2020, investment securities comprised of bonds of financial institutions and other companies registered in Georgia and Treasury bonds of the Ministry of Finance of Georgia:

Investment securities comprise:

	2020	*2019*
Debt securities at amortised cost		
Bonds of financial institutions	20,720	6,656
Corporate bonds	20,449	20,221
Treasury bonds of the Ministry of Finance of Georgia	5,469	–
	46,638	**26,877**
Less: allowance for impairment	(415)	(397)
Total debt securities	**46,223**	**26,480**

An analysis of changes in the gross carrying value in relation to investment securities during the year ended 31 December 2020 is as follows:

	Bonds of financial institutions	*Corporate bonds*	*Treasury bonds of the Ministry of Finance of Georgia*	*Total*
Gross carrying value as at 1 January 2020	**6,656**	**20,221**	**–**	**26,877**
New assets originated	14,004	11,232	5,248	**30,484**
Assets repaid	–	(12,250)	–	**(12,250)**
Foreign exchange and other movements	60	1,246	221	**1,527**
At 31 December 2020	**20,720**	**20,449**	**5,469**	**46,638**

(Amounts in tables are in thousands of Georgian lari)

8. Investment securities (continued)

An analysis of changes in the ECL allowances during the year ended 31 December 2020 is as follows:

	Bonds of financial institutions	*Corporate bonds*	*Treasury bonds of the Ministry of Finance of Georgia*	*Total*
ECL as at 1 January 2020	**(214)**	**(183)**	**–**	**(397)**
New assets originated	(95)	(161)	–	**(256)**
Assets repaid	–	98	–	**98**
Foreign exchange and other movements	149	(9)	–	**140**
At 31 December 2020	**(160)**	**(255)**	**–**	**(415)**

An analysis of changes in the gross carrying value in relation to investment securities during the year ended 31 December 2019 is as follows:

	Corporate bonds	*Bonds of financial institutions*	*Total*
Gross carrying value as at 1 January 2019	**18,566**	**1,902**	**20,468**
New assets originated	2,700	6,482	**9,182**
Assets repaid	(1,190)	(1,900)	**(3,090)**
Foreign exchange and other movements	145	172	**317**
At 31 December 2019	**20,221**	**6,656**	**26,877**

An analysis of changes in the ECL allowances during the year ended 31 December 2019 is as follows:

	Corporate bonds	*Bonds of financial institutions*	*Total*
ECL as at 1 January 2019	**(203)**	**(39)**	**(242)**
New assets originated	(25)	(195)	**(220)**
Assets repaid	19	9	**28**
Foreign exchange and other movements	26	11	**37**
At 31 December 2019	**(183)**	**(214)**	**(397)**

All balances of investment securities are held at amortized cost and are allocated to Stage 1.

(Amounts in tables are in thousands of Georgian lari)

9. Property and equipment

The movements in property and equipment were as follows:

	Furniture and fixtures	*Computers and equipment*	*Motor vehicles*	*Other equipment*	*Leasehold improvements*	*Total*
Cost						
1 January 2019	**2,130**	**3,918**	**525**	**579**	**2,070**	**9,222**
Additions	1,812	1,108	17	400	4,621	**7,958**
Disposals and write-offs	(993)	(292)	–	(266)	(1,938)	**(3,489)**
31 December 2019	**2,949**	**4,734**	**542**	**713**	**4,753**	**13,691**
Internal transfer	–	187	–	–	(187)	**–**
Additions	70	235	19	30	50	**404**
Disposals and write-offs	(25)	(19)	–	(55)	(211)	**(310)**
31 December 2020	**2,994**	**5,137**	**561**	**688**	**4,405**	**13,785**
Accumulated depreciation						
1 January 2019	**(1,846)**	**(2,609)**	**(247)**	**(467)**	**(1,917)**	**(7,086)**
Depreciation charge	(208)	(494)	(103)	(43)	(357)	**(1,205)**
Disposals and write-offs	987	291	–	263	1,935	**3,476**
31 December 2019	**(1,067)**	**(2,812)**	**(350)**	**(247)**	**(339)**	**(4,815)**
Internal transfer	–	(24)	–	–	24	**–**
Depreciation charge	(461)	(719)	(92)	(100)	(977)	**(2,349)**
Disposals and write-offs	13	10	–	9	85	**117**
31 December 2020	**(1,515)**	**(3,545)**	**(442)**	**(338)**	**(1,207)**	**(7,047)**
Net book value						
1 January 2019	**284**	**1,309**	**278**	**112**	**153**	**2,136**
31 December 2019	**1,882**	**1,922**	**192**	**466**	**4,414**	**8,876**
31 December 2020	**1,479**	**1,592**	**119**	**350**	**3,198**	**6,738**

As of 31 December 2020 fully depreciated items amounted 3,326 GEL (2019: 3,225 GEL).

10. Right of use assets

The movements in right of use assets were as follows:

	Right-of-use assets
1 January 2019	**5,715**
Additions	845
Disposals and write-offs	–
31 December 2019	**6,560**
Additions	7,796
Disposals and write-offs	(1,985)
31 December 2020	**12,371**
Accumulated depreciation	
1 January 2019	**–**
Depreciation charge	(1,320)
Disposals and write-offs	–
31 December 2019	**(1,320)**
Depreciation charge	(2,828)
Disposals and write-offs	698
31 December 2020	**(3,450)**
Net book value	
1 January 2019	**5,715**
31 December 2019	**5,240**
31 December 2020	**8,921**

(Amounts in tables are in thousands of Georgian lari)

10. Right of use assets (continued)

The movement in right-of-use assets and lease liabilities during the year ended 31 December 2020 were as follows:

	Right-of-use assets			
	Buildings	***Motor vehicles***	***Total***	***Lease liabilities***
As at 1 January 2020	**4,937**	**303**	**5,240**	**5,575**
Additions	7,796	–	**7,796**	7,793
Disposals and write offs	(1,608)	(377)	**(1,985)**	(1,604)
Depreciation expense	(2,790)	(38)	**(2,828)**	–
Disposals and write-offs	586	112	**698**	–
Interest expense	–	–	**–**	600
Payments	–	–	**–**	(3,232)
Rent concessions	–	–	**–**	(148)
Foreign currency translation difference	–	–	**–**	1,544
As at 31 December 2020	**8,921**	**–**	**8,921**	**10,528**

The Bank recognised rent expense from short-term leases of GEL 854 thousand for the period ended 31 December 2020.

The movement in right-of-use assets and lease liabilities during the year ended 31 December 2019 were as follows:

	Right-of-use assets			
	Buildings	***Motor vehicles***	***Total***	***Lease liabilities***
As at 1 January 2019	**–**	**–**	**–**	–
Transition effect	5,715	–	**5,715**	5,516
Additions	468	377	**845**	968
Depreciation expense	(1,246)	(74)	**(1,320)**	–
Interest expense	–	–	**–**	303
Payments	–	–	**–**	(1,212)
As at 31 December 2019	**4,937**	**303**	**5,240**	**5,575**

The Bank recognised rent expense from short-term leases of GEL 1,474 thousand for the period ended 31 December 2019.

(Amounts in tables are in thousands of Georgian lari)

11. Intangible assets

The movements in intangible assets were as follows:

	Licenses	*Computer software*	*Total*
Cost			
1 January 2019	**151**	**3,615**	**3,766**
Additions	–	3,625	**3,625**
Disposals and write offs	–	(1,295)	**(1,295)**
31 December 2019	**151**	**5,945**	**6,096**
Additions	–	961	**961**
Disposals and write offs	(2)	(557)	**(559)**
31 December 2020	**149**	**6,349**	**6,498**
Accumulated amortization			
1 January 2019	**(77)**	**(1,176)**	**(1,253)**
Amortisation charge	(15)	(884)	**(899)**
Disposals and write offs	–	663	**663**
31 December 2019	**(92)**	**(1,397)**	**(1,489)**
Amortisation charge	(15)	(1,312)	**(1,327)**
Disposals and write offs	2	557	**559**
31 December 2020	**(105)**	**(2,152)**	**(2,257)**
Net book value			
1 January 2019	**74**	**2,439**	**2,513**
31 December 2019	**59**	**4,548**	**4,607**
31 December 2020	**44**	**4,197**	**4,241**

12. Other assets and liabilities

Other assets comprise:

	2020	*2019*
Other non-financial assets		
Prepaid expenses	624	451
Inventory	192	194
Repossessed collateral	140	–
Prepayments for operating lease	29	121
Prepaid taxes other than income tax	10	20
Prepayments for acquisition of property plant and equipment and intangible assets	2	35
	997	**821**
Other financial assets		
Derivative financial assets	302	422
Funds in settlement	147	28
Accrued commission receivable on guarantees and letters of credit	41	39
Other	40	186
	530	**675**
Total other assets	**1,527**	**1,496**

(Amounts in tables are in thousands of Georgian lari)

12. Other assets and liabilities (continued)

The table below shows the fair values of derivative financial instruments, recorded as assets, together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying asset or liability and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are not indicative of the credit risk.

	2020			*2019*		
	Notional amount	*Fair values*		*Notional amount*	*Fair value*	
		Asset	*Liability*		*Asset*	*Liability*
Interest rate contracts						
Forwards − foreign	106,617	45	−	76,175	15	3
Forwards − domestic	40,764	257	640	24,519	407	227
Total derivative assets/liabilities		**302**	**640**		**422**	**230**

Foreign and domestic in the table above stand for counterparties where foreign means non-Georgian entities and domestic means Georgian entities.

Other liabilities comprise:

	2020	2019
Other financial liabilities		
Funds in settlement	1,997	101
Payables and accrued expenses	984	1,666
Derivative financial liabilities	640	230
	3,621	**1,997**
Other non-financial liabilities		
Payable to employees	2,448	2,374
Deferred income	24	31
Taxes other than income tax	23	67
	2,495	**2,472**
Total other liabilities	**6,116**	**4,469**

13. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	Note	*2020*	*2019*
Time deposits and loans from non-resident commercial banks		87,600	77,905
Loan from the National Bank of Georgia		15,000	−
Deposits from the Ministry of Finance		10,996	7,013
Overdraft from the Parent	24	8,201	20
Time deposits and loans from the Parent	24	4,915	8,341
Time deposits from resident commercial banks		4,262	10,196
Current accounts of the Parent	24	117	6,655
Amounts due to credit institutions		**131,091**	**110,130**

As at 31 December 2020 the time deposits and loans of non-resident commercial banks are comprised of USD denominated deposits and loans of entity under common control and other non-resident bank (2019: USD, EUR and TRY denominated deposits and loans of entities under common control and other non-resident banks).

As at 31 December 2020 time deposits of resident commercial banks comprise of deposit placed by one resident commercial bank, is denominated in USD and matures in January 2021 (2019: time deposits of resident commercial banks comprise of deposits placed by two resident commercial banks, are denominated in GEL and EUR and mature in January and February 2020).

Loans from the National Bank of Georgia represent short-term GEL refinancing facilities used by the Bank to uphold its liquidity needs in GEL. Deposits from the Ministry of Finance represent GEL 5,514 of short-term funds attracted from the Ministry of Finance as a refinancing facility similar to that of the National Bank of Georgia and GEL 5,482 of the long-term deposit placed by the Ministry as the liquidity support measure in return for the similar term treasury bonds purchased by the Bank.

(Amounts in tables are in thousands of Georgian lari)

14. Amounts due to customers

The amounts due to customers include the following:

	2020	*2019*
Current and demand accounts	71,000	100,324
Time deposits (including certificates of deposit)	139,222	141,384
Amounts due to customers	**210,222**	**241,708**
Held as security against guarantees issued (Note 18)	14,001	14,351

As at 31 December 2020, amounts due to customers included balances with three major customers of GEL 91,567 thousand that constituted 43.56%of the total of customer accounts (31 December 2019: 122,338 thousand that constituted 50.61%of the total of customer accounts).

An analysis of customer accounts by economic sector follows:

	2020	*2019*
Insurance	69,450	63,831
Trade and service	60,716	104,123
Individuals	42,077	36,671
Non-banking credit organizations	18,343	14,570
Construction	13,907	18,182
Real estate management	2,215	760
Mining	1,593	700
Energy	1,086	1,489
Agro	297	773
Other	538	609
Amounts due to customers	**210,222**	**241,708**

15. Subordinated debt

Subordinated loans consisted of the following:

	2020	*2019*
Subordinated loans	31,742	27,589
Subordinated loans	**31,742**	**27,589**

On 19 December 2019 the Bank received a USD denominated subordinated loans with an interest rate of 5% p.a. maturing in December 2025 from the Parent and entities under common control. Management considered that interest rate on the loan is better than market rate for the similar instruments, therefore loan was recognized at fair value using market interest rate. The difference of GEL 1,155 between fair value and nominal amount of the loan is recognized as additional paid-in capital. Annual effective interest rate equals 5.88%. The loan is not redeemable before the maturity.

The amortised value of the subordinated loan qualified for the inclusion in the Tier 2 capital under the NBG Basel III requirements, was GEL 32,551 (31 December 2019: GEL 28,677).

(Amounts in tables are in thousands of Georgian lari)

16. Taxation

In June 2016, amendments to the Georgian tax law in respect of corporate income tax became enacted. The amendments became effective from 1 January 2017 for all Georgian companies except the banks, insurance companies and microfinance organization, for which the effective date was initially set at January 2019. On 5 May 2018 amendment was made in tax code and the date was revised to January 2023.Therefore the bank had recognized those deferred tax asset and deferred tax liability which are estimated to be realised before 2023. Under the new regulation, corporate income tax will be levied on profit distributed as dividends, rather than on profit earned as under the current regulation. The amount of tax payable on a dividend distribution will be calculated as 15/85 of the amount of net distribution. The companies will be able to offset corporate income tax liability arising from dividend distributions out of profits earned in 2008-2016 by the amount of corporate income tax paid for the respective period under the current regulation. Dividends distributions between Georgian resident companies will not be subject to corporate income tax.

The corporate income tax expense/benefit for the year ended 31 December 2020 and 2019 comprised:

	2020	*2019*
Reassessment of prior year tax declaration	–	(366)
Deferred tax expense	(162)	(212)
Income tax expense	**(162)**	**(578)**

In 2020 and 2019 the income tax rate applicable to the Bank's income is 15%. The effective income tax rate differs from the statutory income tax rate. A reconciliation of the income tax benefit/ expense on statutory rates with actual is as follows:

	2020	*2019*
Loss before income tax	**(19,091)**	**(8,482)**
Statutory tax rate	15%	15%
Theoretical income tax benefit at the statutory rate	**2,864**	**1,272**
Tax exempt income	79	93
Non-deductible expenses	(52)	(138)
Reassessment of prior year tax declaration	–	(366)
Unrecognised tax losses carried forward	(3,053)	(1,439)
Income tax expense	**(162)**	**(578)**

The Bank's accumulated tax losses at 31 December 2020 equals GEL (20,356), on which the bank has tax loss carried forward GEL 3,053, which was not recognized.

Deferred tax liabilities as at 31 December 2020 and 31 December 2019 and their movements for the respective period:

	2019	*Through statement of profit and loss*	*2020*
Tax effect of deductible temporary differences			
Right of use assets	198	424	622
Property and equipment	–	52	52
Amounts due from credit institutions	–	4	4
Other assets	–	24	24
Subordinated debt	–	9	9
Other liabilities	248	(23)	225
Deferred tax asset	**446**	**490**	**936**
Tax effect of taxable temporary differences			
Investment securities	(53)	(39)	(92)
Property and equipment	(59)	59	–
Intangible assets	(126)	13	(113)
Loans to customers	(126)	(477)	(603)
Lease liabilities	(146)	(208)	(354)
Deferred tax liability	**(510)**	**(652)**	**(1,162)**
Deferred tax (liability)/asset	**(64)**	**(162)**	**(226)**

(Amounts in tables are in thousands of Georgian lari)

16. Taxation (continued)

	2018	*Through statement of profit and loss*	*2019*
Tax effect of deductible temporary differences			
Recognised tax losses carried forward	193	(193)	–
Right of use assets	–	198	198
Property and equipment			
Amounts due from credit institutions	44	(44)	–
Other liabilities	110	138	248
Deferred tax asset	**347**	**99**	**446**
Tax effect of taxable temporary differences			
Investment securities	(58)	5	(53)
Property and equipment	176	(235)	(59)
Intangible assets	(69)	(57)	(126)
Loans to customers	(248)	122	(126)
Lease liabilities	–	(146)	(146)
Deferred tax liability	**(199)**	**(311)**	**(510)**
Deferred tax (liability)/asset	**148**	**(212)**	**(64)**

17. Equity

As at 31 December 2020 and 2019, the Bank's authorized, issued and fully paid capital amounted to GEL 103,000 thousand comprising of 103,000,000 common shares with nominal value of GEL 1 each. Each share entitles one vote to the shareholder.

In accordance with Georgian legislation, dividends may only be declared by the Bank's Parent from the net income as shown in the Bank's financial statements prepared in compliance with the NBG requirements. The Bank is obliged to officially inform the NBG of any dividends declared and the NBG reserves the right to suspend or restrict the disbursement of dividends should the Bank be in breach of the NBG regulations.

No dividends were declared or paid during the year ended 31 December 2020 and 2019.

Additional paid-in capital represents the difference between a fair value and a nominal amount at initial recognition of the subordinated loans received from the Parent and entities under common control.

18. Commitments and contingencies

Operating environment

The economic policies of Georgia in the last decade have been mostly consistent and effective in terms of investment and increasing short-term economic growth rates. Nevertheless, these policies failed for the most part in laying the foundations for increasing the competitiveness of the Georgian economy and ensuring long-term economic growth. Moreover, the rates of economic growth have not been sufficient to reach significant part of Georgian population and failed to have an impact on reducing unemployment and poverty levels. According to Georgia's socio-economic development strategy, the economic policy of Georgia is based on the principles of fast and efficient economic growth driven by development of the real sector of economy, implementation of economic policies that would facilitate inclusive economic growth and rational use of natural resources, ensuring environmental safety and sustainability. Georgia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Georgian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

The negative effect of COVID 19 pandemic on the Georgian economy has been severe. Tourism, the most affected sphere all around the world, had been the major driver in the economic growth of Georgia in the past several years, involving many interrelated sectors such as hotels, restaurants, travel agencies, real estate and development and other. Based on the preliminary assessments Georgian GDP shrank by 6.1% in 2020, the level of unemployment reached 12%, GEL devaluated against USD by 14% for the period from 1 January 2020 to 31 December 2020 and current account deficit reached 12%. The level of inflation during 2020 remained around 4%, which was expected in the result of weakening internal demand and government subsidies on utilities for population on the backdrop of the pandemic. As of the year end the NBG expects to stay at the present levels of the rate of refinancing of 8% in the observable future, continuing to target the 3% inflation level. The government has been implementing the anti-crisis economic recovery plan, which includes financial support to vulnerable groups of population and entrepreneurs, deferral of property and income tax payments for companies operating in the tourism sector, providing opportunity to borrowers to restructure their loans with commercial banks and other. Georgia's international partners have allocated 3 billion USD to aid the recovery of the country's economy.

(Amounts in tables are in thousands of Georgian lari)

18. Commitments and contingencies (continued)

Operating environment (continued)

In line with the overall developments in the Georgian banking sector, the Bank has also suffered from the effects of the economic downturn caused by COVID 19 with significant deterioration of the performance and credit risk of the borrowers operating in the vulnerable sectors. This has resulted in increase in the Bank's impairment charges as described in notes 7 and 18 to these financial statements. Despite the growth of impairment losses and resulting decline and the Bank's capital buffers, the management maintains strong liquidity positions supported by the NBG's measures to strengthen banking sector resilience amidst the crisis, healthy NPL levels due to timely restructuring actions and continued support from the Parent. The Parent's operating environment has also been negatively affected by the consequences of COVID-19 pandemic with its economy being particularly sensitive to oil and gas prices, which had tumbled to their historical lows during the period. Being one of the systemic banks in the country, the Parent has been subject to certain regulatory easing measures, including the revised capital adequacy requirements.

As the COVID-19 outbreak continues and the uncertainty remains about further developments of pandemic duration and the extent of the possible economic recovery in the nearest future, the management of the Bank continues to closely monitor the situation to timely assess and respond to related challenges and risks. The decline in the coronavirus cases recorded as of the date of issue of this financial statements and government's actions to pursue the mass vaccination process and remove the earlier imposed restrictions somewhat strengthen recovery prospects towards year 2021.

Taxation

Georgian tax legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant tax authorities. It is possible that transactions and activities that have not been challenged in the past may be challenged in the future. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

Management believes that its interpretation of the relevant legislation as at 31 December 2020 is appropriate and that the Bank's tax, currency and customs positions will be sustained.

Legal

In the ordinary course of business, the Bank is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations of the Bank.

During the year 2020 the Bank has had two ongoing litigations. In the first claim the Bank is jointly and severally liable defendant together with its employees. The amount of the claim equals GEL 883. The Bank is also involved as defendant in another litigation around one of its expired lease agreements, where the amount of claim against the Bank is GEL 1,835. The Bank's management believes that the probability of any losses resulting from either of the cases is low, therefore no provision has been recognized in relation to them.

Commitments and contingencies

As at 31 December 2020 and 2019, the Bank's commitments and contingencies comprised the following:

	2020	*2019*
Credit related commitments		
Unused credit lines	35,706	41,543
Letters of credit	181	980
	35,887	**42,523**
Operating lease commitments		
Not later than 1 year	139	112
More than 1 year but less than 5 years	38	–
	177	**112**
Performance guarantees issued		
Performance guarantees issued	34,872	37,255
	34,872	**37,255**
Less: ECL for credit related commitments	(395)	(414)
Commitments and contingencies (before deducting collateral)	**70,541**	**79,476**
Less: deposits held as security against guarantees issued (Note 14)	(14,001)	(14,351)
Commitments and contingencies	**56,540**	**65,125**

(Amounts in tables are in thousands of Georgian lari)

18. Commitments and contingencies (continued)

Legal (continued)

An analysis of changes in the ECL allowances during the year ended 31 December 2020 is, as follows:

	Letters of credit	*Unused credit lines*	*Total*
ECL as at 1 January 2020	**(1)**	**(413)**	**(414)**
New exposures	–	(235)	**(235)**
Matured exposures	1	654	**655**
Foreign exchange and other movements	–	(401)	**(401)**
At 31 December 2020	**–**	**(395)**	**(395)**

All balances of guarantees issued and letters of credit are allocated to stage 1.

An analysis of changes in the ECL allowances during the year ended 31 December 2019 is, as follows:

	Letters of credit	*Unused credit lines*	*Total*
ECL as at 1 January 2019	**(2)**	**(68)**	**(70)**
New exposures	–	(214)	**(214)**
Matured exposures	1	464	**465**
Foreign exchange and other movements	–	(595)	**(595)**
At 31 December 2019	**(1)**	**(413)**	**(414)**

19. Net fee and commission income

Net fee and commission income comprise:

	2020	*2019*
Guarantees and letters of credits issued	1,041	843
Settlement operations	370	299
Plastic card operations	219	223
Cash operations	85	99
Brokerage operations	–	8
Fee and commission income	**1,715**	**1,472**
Settlement operations	(492)	(376)
Plastic card operations	(380)	(438)
Cash operations	(5)	(3)
Guarantees and letters of credits issued	(3)	(53)
Brokerage operations	–	(1)
Fee and commission expense	**(880)**	**(871)**
Net fee and commission income	**835**	**601**

Revenue from contracts with customers

The Bank's revenue from contracts with customers is mostly represented by fee and commission income. Revenue from contracts with customers recognized in the statement of profit or loss for the year ended 31 December 2020 amounted to GEL 1,715 thousand (2019: GEL 1,472 thousand).

The Bank recognised the following contract assets and liabilities in statement of financial position related to its contracts with customers:

	2020	*2019*
Deferred income (presented within other liabilities)	24	31

(Amounts in tables are in thousands of Georgian lari)

19. Net fee and commission income (continued)

Revenue from contracts with customers (continued)

The Bank usually collects fees and commissions in advance of completion of the underlying transaction or shortly thereafter (for contracts where performance obligation is satisfied point in time, such as settlement transactions). For services provided over time (such as those related to fees for guarantees and letters of credit issued), the Bank usually charges upfront monthly, quarterly or annual fees covering respective portion of the overall contract period.

The Bank recognised GEL 31 revenue from contracts with customers in the current reporting period that relates to carried-forward contract liabilities included in deferred income as at 31 December 2019.

20. Personnel, general and administrative expenses

Personnel, general and administrative expenses comprise:

	2020	***2019***
Salaries	13,635	12,178
Bonuses and other employee benefits	2,962	3,161
Personnel expenses	**16,597**	**15,339**
Professional services	3,268	3,242
Advertising costs	1,843	1,386
Operating leases	854	1,474
Communication	304	229
Utilities	272	220
Personnel training	228	244
Recruitment costs	203	35
Office supplies	159	514
Insurance	131	89
Transportation and business trip expenses	95	261
Membership fees	84	57
Taxes other than income tax	78	81
Security expenses	65	30
Corporate hospitality and entertainment	62	126
Maintenance and exploitation	57	75
Charity costs	21	50
Deposit insurance fee	13	5
Other	239	249
General and administrative expenses	**7,976**	**8,367**

In other general and administrative expenses are included one-time costs related to the opening of new branches.

Remuneration of the Bank's auditor for the years ended 31 December 2020 and 2019 comprises (net of VAT):

	2020	***2019***
Fees for the audit of the Bank's annual financial statements for the year ended 31 December	138	124
Expenditures for other assurance services	55	52
Expenditures for other professional service	10	6
Total fees and expenditures	**203**	**182**

Fees and expenditures payable to other auditors and audit firms in respect of other professional services comprised GEL 34 thousand (2019: GEL 37 thousand).

The average number of the Bank's employees during 2020 was 337, including average 3 top management employees, average 49 middle management employees, average 282 other full-time employees and average 3 employees under temporary service contracts (2019: average number of employees was 258, including average 3 top management employees, average 46 middle management employees, average 207 other full-time employees and average 2 employees under temporary service contracts).

(Amounts in tables are in thousands of Georgian lari)

21. Risk management

Introduction

Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk and market risk, the latter being subdivided into trading and non-trading risks. It is also subject to operating risks.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's strategic planning process.

Risk management structure

Board of Directors

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies and principles. The Board of Directors is ultimately responsible for identifying and controlling risks and different departments and committees which are responsible for managing and monitoring risks.

Risk management

The Risk Management Department is responsible for determining, implementing and maintaining risk management framework.

Asset and Liability Committee

Asset and Liability Committee (ALCO) is responsible for managing the Bank's assets and liabilities and the overall financial structure. It is also primarily responsible for the funding, liquidity, interest rate, and capital adequacy risks of the Bank.

Internal Audit

Risk management processes throughout the Bank are audited by the internal audit function on a constant basis, which examines the adequacy of the procedures, their design and operational effectiveness, and the Bank's compliance both with the regulatory requirements and internal procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Audit Committee.

Audit Committee

The Audit Committee is responsible for the fundamental risk issues and manages and monitors relevant risk decisions and performance of control functions by other departments in the Bank pertaining to general control environment, manual, IT dependent or application controls, intentional or unintentional misstatement risks, risk of fraud or misappropriation of assets, information security, anti-money laundering, etc. Audit committee is comprised of three members, out of which two are independent.

Risk measurement and reporting systems

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept. In addition the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risk types and activities. The main body to which the risks are reported is ALCO. The respective meetings are held once a month.

Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and by monitoring exposures in relation to such limits.

(Amounts in tables are in thousands of Georgian lari)

21. Risk management (continued)

Credit risk (continued)

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. The credit quality review process allows the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

Actual exposure per borrower against limits is monitored on loans granted. The Credit Committee may initiate a change in the limits. Where appropriate, the Bank obtains collateral and corporate guarantees. The credit risks are monitored on a continuous basis and are subject to annual or more frequent reviews.

Credit-related commitments risks

The Bank makes available to its customers guarantees which may require that the Bank make payments on their behalf. Such payments are collected from customers based on the terms of guarantee. They expose the Bank to similar risks to loans and these are mitigated by the same control processes and policies.

Impairment assessment

The Bank calculates ECL based on several probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the EIR. A cash shortfall is the difference between the cash flows that are due to the Bank in accordance with the contract and the cash flows that the entity expects to receive. The mechanics of the ECL calculations are outlined below and the key elements are as follows:

PD The *Probability of Default* is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio.

EAD The *Exposure at Default* is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments.

LGD The *Loss Given Default* is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD.

The ECL allowance is based on the 12 months' expected credit loss (12mECL), unless there has been significant increase in credit risk since origination or other impairment indicators were identified, in which case the ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss or LTECL). The 12mECL is the portion of LTECL that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Both LTECL and 12mECL are calculated on either an individual basis or a collective basis, depending on the nature of the underlying portfolio of financial instruments.

The Bank has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument. Based on the above process, the Bank groups its loans into Stage 1, Stage 2, Stage 3 and POCI, as described below:

Stage 1: When loans are first recognised, the Bank recognises an allowance based on 12mECL. Stage 1 loans also include facilities where the credit risk has improved and the loan has been reclassified from Stage 2.

Stage 2: When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECL. Stage 2 loans also include facilities, where the credit risk has improved and the loan has been reclassified from Stage 3.

Stage 3: Loans considered credit-impaired. The Bank records an allowance for the LTECL.

POCI: Purchased or originated credit impaired (POCI) assets are financial assets that are credit impaired on initial recognition. POCI assets are recorded at fair value at original recognition and interest revenue is subsequently recognised based on a credit-adjusted EIR. ECL are only recognised or released to the extent that there is a subsequent change in the lifetime expected credit losses.

(Amounts in tables are in thousands of Georgian lari)

21. Risk management (continued)

Credit risk (continued)

Definition of default and cure

The Bank considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments. The Bank considers amounts due from banks defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements.

As a part of a qualitative assessment of whether a customer is in default, the Bank also considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Bank carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate.

The Bank has defined certain criteria which should be met in order to consider asset as cured. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the updated credit grade, at the time of the cure, and whether this indicates there has been a significant increase in credit risk compared to initial recognition.

Internal rating and PD estimation process

The Bank's Credit Risk Department operates its internal rating models. The Bank runs separate models for its key portfolios in which its customers are rated from Aaa to Ca-C using internal grades. The models incorporate both qualitative and quantitative information and, in addition to information specific to the borrower, utilize supplemental external information that could affect the borrower's behavior. Where practical, they also build on information from the national and international external rating agencies. PDs, incorporating forward looking information and the IFRS 9 stage classification of the exposure, are assigned for each grade. This is repeated for each economic scenario as appropriate.

Treasury and interbank relationships

The Bank's treasury and interbank relationships and counterparties comprise financial services institutions, banks. For these relationships, the Bank's credit risk department analyses publicly available information such as financial information and other external data, e.g., the external ratings, and assigns the internal rating, as shown in the table below.

Corporate and commercial lending

For corporate and commercial loans, the borrowers are assessed by specialised credit risk employees of the Bank. The credit risk assessment is based on a credit scoring model that takes into account various historical, current and forward-looking information such as:

- Historical financial information together with forecasts and budgets prepared by the client. This financial information includes realised and expected results, solvency ratios, liquidity ratios and any other relevant ratios to measure the client's financial performance. Some of these indicators are captured in covenants with the clients and are, therefore, measured with greater attention;
- Any publicly available information on the clients from external parties. This includes external rating grades issued by rating agencies, independent analyst reports, publicly traded bond prices or press releases and articles;
- Any macro-economic or geopolitical information, e.g., GDP growth relevant for the specific industry and geographical segments where the client operates;
- Any other objectively supportable information on the quality and abilities of the client's management relevant for the company's performance.

(Amounts in tables are in thousands of Georgian lari)

21. Risk management (continued)

Credit risk (continued)

Consumer lending

Consumer lending comprises of loans, credit cards and overdrafts offered to clients. Credit risk and relevant loan loss allowance on this portfolio is assessed on a collective basis for performing loans and individual basis in relation to non-performing loans.

The Bank's internal credit rating grades are as follows:

Internal rating Grade	*Internal rating*	*PD*	*Internal rating description*
Class 1	Aaa	0.0010%	High grade
Class 1	Aa1	0.0018%	High grade
Class 1	Aa2	0.0032%	High grade
Class 1	Aa3	0.0055%	High grade
Class 1	A1	0.0097%	High grade
Class 1	A2	0.0169%	High grade
Class 1	A3	0.0296%	High grade
Class 1	Baa1	0.0517%	Standard grade
Class 1	Baa2	0.0904%	Standard grade
Class 1	Baa3	0.1581%	Standard grade
Class 1	Ba1	0.2761%	Standard grade
Class 1	Ba2	0.4820%	Standard grade
Class 1	Ba3	0.8400%	Standard grade
Class 2	B1	1.4600%	Standard grade
Class 2	B2	2.5259%	Standard grade
Class 3	B3	4.3360%	Standard grade
Class 3	Caa1	7.3454%	Sub-standard grade
Class 3	Caa2	12.1777%	Sub-standard grade
Class 3	Caa3	19.5191%	Sub-standard grade
Class 3	Ca-C	29.7853%	Sub-standard grade
	Default	100.0000%	Impaired

Exposure at default

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments too. To calculate the EAD for a Stage 1 loan, the Bank assesses the possible default events within 12 months for the calculation of the 12mECL. For Stage 2, Stage 3 and POCI financial assets, the exposure at default is considered for events over the lifetime of the instruments.

Loss given default

The credit risk assessment is based on a standardised LGD assessment framework that results in a certain LGD rate. These LGD rates take into account the expected EAD in comparison to the amount expected to be recovered or realised from any collateral held.

Significant increase in credit risk

The Bank continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12mECL or LTECL, the Bank assesses whether there has been a significant increase in credit risk since initial recognition.

The Bank also applies a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as moving a customer/facility to the watch list, or the account becoming restructured due to credit event. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

When estimating ECLs on a collective basis for a group of similar assets, the Bank applies the same principles for assessing whether there has been a significant increase in credit risk since initial recognition.

(Amounts in tables are in thousands of Georgian lari)

21. Risk management (continued)

Credit risk (continued)

Grouping financial assets measured on a collective basis

Dependent on the factors below, the Bank calculates ECLs either on a collective or on an individual basis.

Asset classes where the Bank calculates ECL on an individual basis include:

- All Stage 3 assets, regardless of the class of financial assets;
- Stage 2 and Stage 3 corporate and commercial portfolio;
- Exposures that have been classified as POCI when the original loan was derecognised and a new loan was recognised as a result of a credit driven debt restructuring.

Asset classes where the Bank calculates ECL on a collective basis include:

- The smaller and more generic balances of the Bank's commercial portfolio;
- Stage 1 and 2 consumer lending.

The Bank groups these exposures into smaller homogeneous portfolios, based on a combination of internal and external characteristics of the loans, for example internal grade, overdue bucket, product type, or borrower's industry.

Forward-looking information and multiple economic scenarios

In its ECL models, the Bank relies on a range of forward looking information as economic inputs, such as:

- GDP growth;
- Inflation.

The inputs and models used for calculating ECLs may not always capture all characteristics of the market at the date of the financial statements. To reflect this, qualitative adjustments or overlays are occasionally made as temporary adjustments when such differences are significantly material.

The Bank obtains the forward-looking information from the sources published by the NBG, GeoStat, IMF, World and Regional Economic Outlooks, S&P Global Ratings and other. Experts of the Bank's Credit Risk Department determine the weights attributable to the multiple scenarios. The tables show the values of the key forward looking economic variables/assumptions used in each of the economic scenarios for the ECL calculations. The figures for "Subsequent years" represent a long-term average and so are the same for each scenario as at 31 December 2020:

Key drivers	*ECL scenario*	*Assigned probabi-lities, %*	*2021*	*2022*	*2023*	*2020*	*2021*	*2022*
GDP growth, %								
	Upside	25%	5.5%	5.5%	5.0%	5.5%	6.0%	5.0%
	Base case	50%	4.5%	4.0%	4.5%	4.5%	5.0%	5.0%
	Downside	25%	2.5%	4.0%	4.5%	2.5%	3.5%	4.5%
Inflation level								
	Upside	25%	3.5%	3.0%	3.0%	4.5%	3.5%	3.0%
	Base case	50%	3.7%	3.0%	3.0%	4.5%	2.5%	3.0%
	Downside	25%	5.5%	4.0%	3.0%	7.0%	5.0%	3.0%

(Amounts in tables are in thousands of Georgian lari)

21. Risk management (continued)

Credit risk (continued)

Credit quality per class of financial asset

The credit quality of financial assets is managed by the Bank internal credit ratings, as described above. The table below shows the credit quality by class of financial assets as at 31 December 2020, based on the Bank's credit rating system updated:

	Note	*High grade*	*Standard grade*	*Sub-standard grade*	*Impaired*	*Total*
Cash and cash equivalents, except for cash on hand	5	9,866	23,828	–	–	**33,694**
Amounts due from credit institutions	6	–	46,518	–	–	**46,518**
Corporate		–	128,623	31,011	–	**159,634**
Commercial		–	45,882	117,932	4,204	**168,018**
Consumer		5,054	3,985	907	9	**9,955**
Debt investment securities at amortized cost	8	–	46,638	–	–	**46,638**
Unused credit lines	18	7,014	18,817	9,875	–	**35,706**
Letters of credit	18	–	–	181	–	**181**
Total		**21,934**	**314,291**	**159,906**	**4,213**	**500,344**

The table below shows the credit quality by class of financial assets at 31 December 2019:

	Note	*High grade*	*Standard grade*	*Sub-standard grade*	*Impaired*	*Total*
Cash and cash equivalents, except for cash on hand	5	49,272	35,079	–	–	**84,351**
Amounts due from credit institutions	6	–	58,670	–	–	**58,670**
Corporate		–	148,894	9,116	840	**158,850**
Commercial		–	85,887	57,225	–	**143,112**
Consumer		731	521	354	9	**1,615**
Debt investment securities at amortized cost	8	–	26,877	–	–	**26,877**
Unused credit lines	18	2,333	24,560	14,650	–	**41,543**
Letters of credit	18		345	635	–	**980**
Total		**52,336**	**380,833**	**81,980**	**849**	**515,998**

The geographical concentration of Bank's financial assets and liabilities is set out below:

	2020				***2019***			
	Georgia	*OECD*	*Other Non-OECD*	*Total*	*Georgia*	*OECD*	*Other Non-OECD*	*Total*
Assets								
Cash and cash equivalents	27,131	10,103	1,884	**39,118**	36,061	12,283	40,607	**88,951**
Amounts due from credit institutions	46,518	–	–	**46,518**	58,670	–	–	**58,670**
Loans to customers	320,084	–	34	**320,118**	297,785	–	–	**297,785**
Investment securities	46,223	–	–	**46,223**	26,480	–	–	**26,480**
Other assets	458	12	60	**530**	485	168	22	**675**
	440,414	**10,115**	**1,978**	**452,507**	**419,481**	**12,451**	**40,629**	**472,561**
Liabilities								
Amounts due to credit institutions	30,257	-	100,834	**131,091**	17,209	302	92,619	**110,130**
Amounts due to customers	111,160	166	98,896	**210,222**	148,977	7,758	84,973	**241,708**
Lease liabilities	10,528	–	–	**10,528**	5,575	–	–	**5,575**
Other liabilities	3,192	90	339	**3,621**	1,655	72	270	**1,997**
Subordinated debt	–	–	31,742	**31,742**	–	–	27,589	**27,589**
	155,137	**256**	**231,811**	**387,204**	**173,416**	**8,132**	**205,451**	**386,999**
Net assets/(liabilities)	**285,277**	**9,859**	**(229,833)**	**65,303**	**246,065**	**4,319**	**(164,822)**	**85,562**

(Amounts in tables are in thousands of Georgian lari)

21. Risk management (continued)

Liquidity risk and funding management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. Funds attracted from the Parent provide sufficient sources for the Bank's operations in the foreseeable future. The Bank manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Bank maintains a portfolio of corporate bonds that can be pledged to the NBG in the event of an unforeseen interruption of cash flow. In addition, the Bank maintains a cash deposit (obligatory reserve) with the NBG, the amount of which depends on the level of customer funds attracted.

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on the certain liquidity ratios established by the NBG.

The liquidity coverage ratio (LCR) is calculated as the ratio of high-quality liquid assets (HQLA) to net cash outflow. The Bank is required to maintain at all times the stock of liquid assets to enable it to cover its net cash outflows in the 30 calendar days stress scenario. The minimum LCR requirement set by the NBG is 100% for foreign currency and combined LCR and 75% for national currency LCR respectively. At 31 December the Bank reported the following LCR levels:

	2020, %	***2019, %***
GEL	97.5	108.9
Foreign currency	160.0	155.5
Combined	139.7	139.9

Based on the NBG's liquidity support measures on the backdrop of the COVID 19 pandemic, the LCR ratio's foreign currency component had been removed for all commercial banks operating in Georgia on 1 May 2020 for the duration of one calendar year or other such term as may be deemed appropriate by the regulator based on the assessment of the liquidity needs of the sector.

The net stable funding ratio (NSFR) requires the Bank to maintain a stable funding profile in relation to the composition of its assets and off balance sheet activities in order to reduce the likelihood, that disruptions to the Bank's regular sources of funding will significantly erode its liquidity position. The NSFR is calculated as the ratio of available amount of stable funding over the required amount of stable funding. At 31 December the Bank reported the following NSFR levels:

	2020, %	***2019, %***
NSFR	127.0	124.5

The minimum required average liquidity ratio (LK), calculated as the ratio of the average volume of liquid assets over the average volume of liquid liabilities, has been removed from the NBG's liquidity requirements beginning 1 January 2020 but remains for monitoring purposes. At 31 December the Bank reported the following LK:

	2020, %	***2019, %***
Average liquidity ratio (LK)	39.3	52.1

(Amounts in tables are in thousands of Georgian lari)

21. Risk management (continued)

Liquidity risk and funding management (continued)

Analysis of financial liabilities by remaining contractual maturities

The tables below summarize the maturity profile of the Bank's financial liabilities at 31 December based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

As at 31 December 2020	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Financial liabilities					
Amounts due to credit institutions	38,387	260	96,085	6,324	**141,056**
Amounts due to customers	82,320	18,832	120,451	–	**221,603**
Lease liabilities	827	2,484	8,155	–	**11,466**
Other financial liabilities	3,621	–	–	–	**3,621**
Subordinated debt	–	1,661	39,415	–	**41,076**
Total undiscounted financial liabilities	**125,155**	**23,237**	**264,106**	**6,324**	**418,822**

As at 31 December 2019	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Financial liabilities					
Amounts due to credit institutions	32,539	333	86,694	–	**119,566**
Amounts due to customers	112,747	73,341	64,134	–	**250,222**
Lease liabilities	407	1,221	4,489	–	**6,117**
Other financial liabilities	1,997	–	–	–	**1,997**
Subordinated debt	–	1,386	5,819	30,203	**37,408**
Total undiscounted financial liabilities	**147,690**	**76,281**	**161,136**	**30,203**	**415,310**

The table below shows the contractual expiry by maturity of the Bank's financial commitments and contingencies. Each undrawn loan commitment is included in the time band containing the earliest date it can be drawn down.

	Note	*Less than 3 months*	*1 to 5 years*	*Over 5 years*	*Total*
2020	18	35,887	–	–	**35,887**
2019	18	42,523	–	–	**42,523**

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments. The maturity analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the table above. These balances are included in amounts due in less than three months in the tables above.

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchanges, and equity prices. Except for the concentrations within foreign currency, the Bank has no significant concentration of market risk.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank has set limits on positions by currency based on the NBG regulations. Positions are monitored on a daily basis.

(Amounts in tables are in thousands of Georgian lari)

21. Risk management (continued)

Market risk (continued)

The tables below indicate the currencies to which the Bank had significant exposure at 31 December on its monetary assets and liabilities. The analysis calculates the effect of a reasonably possible movement of the currency rate against the GEL, with all other variables held constant on the statement of profit or loss. The effect on equity does not differ from the effect on the statement of profit or loss. A negative amount in the table reflects a potential net reduction in the statement of profit or loss or equity, while a positive amount reflects a net potential increase.

Currency	*Change in currency rate 2020*	*Effect on profit before tax 2020*	*Change in currency rate 2019*	*Effect on profit before tax 2019*
USD	15%/(15%)	548/(548)	15%/(15%)	(268)/268
EUR	15%/(15%)	200/(200)	15%/(15%)	105/(105)

Prepayment risk

Prepayment risk is the risk that the Bank will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected.

The effect on profit before tax for one year assuming 10% of repayable financial instruments were to prepay at the beginning of the year, with all other variables held constant, is as follows:

	Decrease of net interest income
2020	3,103
2019	2,826

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Bank's statement of profit or loss.

The sensitivity of the statement of profit or loss is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December.

Currency	*Increase/ (decrease) in basis points 2020*	*Sensitivity of net interest income 2020*
GEL	100/(100)	1,042 /(1,042)

Currency	*Increase/ (decrease) in basis points 2019*	*Sensitivity of net interest income 2019*
GEL	100/(100)	805/(805)

Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but a control framework and monitoring and responding to potential risks could be effective tools to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

(Amounts in tables are in thousands of Georgian lari)

22. Fair value measurements

Fair value hierarchy

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

	Fair value measurement using			
At 31 December 2020	***Level 1***	***Level 2***	***Level 3***	***Total***
Assets for which fair values are disclosed				
Cash and cash equivalents	39,118	–	–	**39,118**
Amounts due from credit institutions	–	–	46,518	**46,518**
Loans to customers	–	–	320,118	**320,118**
Investment securities	–	5,469	40,754	**46,223**
Assets measured at fair value				
Other assets − derivative financial assets	–	302	–	**302**

	Fair value measurement using			
At 31 December 2020	***Level 1***	***Level 2***	***Level 3***	***Total***
Liabilities for which fair values are disclosed				
Amounts due to credit institutions	–	–	131,091	**131,091**
Amounts due to customers	–	–	210,222	**210,222**
Lease liabilities	–	–	10,528	**10,528**
Liabilities measured at fair value				
Other liabilities − derivative financial liabilities	–	640	–	**640**

	Fair value measurement using			
At 31 December 2019	***Level 1***	***Level 2***	***Level 3***	***Total***
Assets for which fair values are disclosed				
Cash and cash equivalents	88,951	–	–	**88,951**
Amounts due from credit institutions	–	–	58,670	**58,670**
Loans to customers	–	–	297,785	**297,785**
Investment securities	–	–	26,480	**26,480**
Assets measured at fair value				
Other assets − derivative financial assets	–	422	–	**422**

	Fair value measurement using			
At 31 December 2019	***Level 1***	***Level 2***	***Level 3***	***Total***
Liabilities for which fair values are disclosed				
Amounts due to credit institutions	–	–	110,130	**110,130**
Amounts due to customers	–	–	241,708	**241,708**
Lease liabilities	–	–	5,575	**5,575**
Liabilities measured at fair value				
Other liabilities − derivative financial liabilities	–	230	–	**230**

(Amounts in tables are in thousands of Georgian lari)

22. Fair value measurements (continued)

Fair value of financial assets and liabilities not carried at fair value

Set out below is a comparison by class of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

	Carrying value 2020	*Fair value 2020*	*Unrecognised gain(loss) 2020*	*Carrying value 2019*	*Fair value 2019*	*Unrecognised gain(loss) 2019*
Financial assets						
Cash and cash equivalents	39,118	39,118	–	88,951	88,951	–
Amounts due from credit institutions	46,518	46,518	–	58,670	58,670	–
Loans to customers	320,118	320,118	–	297,785	297,785	–
Investment securities	46,223	46,984	761	26,480	26,668	188
Other financial assets	530	530	–	422	422	–
Financial liabilities						
Amounts due to credit institutions	131,091	131,091	–	110,130	110,130	–
Amounts due to customers	210,222	210,222	–	241,708	241,708	–
Other financial liabilities	3,621	3,621	–	1,997	1,997	–
Lease liabilities	10,528	10,528	–	5,575	5,575	–
Subordinated debt	31,742	31,742	–	27,589	27,589	–
Total unrecognised change in fair value			**761**			**188**

Valuation techniques and assumptions

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the financial statements.

Assets and liabilities for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. All of the Bank's financial assets excluding loans to customers and investment securities (i.e. cash and cash equivalents and amounts due from credit institutions) and financial liabilities (amounts due to customers) are either liquid or are maturing within 3 months from the reporting date.

The fair value of loans to customers, amounts due to customers, amounts due to credit institutions and subordinated debt is estimated by comparing market interest rates when they were first recognized with current market rates offered for similar financial assets and liabilities. The loans to customers issued and amounts due to customers, amounts due to credit institutions and subordinated debt obtained within 12 months period ended 31 December 2020 remain at market interest rates, while the contractual interest rates of those loans issued and amount due to customer, amount due to credit institutions and subordinated debt obtained in 2019 approximate market interest rates as at 31 December 2020. Hence their carrying value approximates their fair value.

Forward foreign exchange contracts are derivatives valued using a valuation technique with market observable inputs. The applied valuation technique for such derivatives includes forward pricing models using present value calculations.

Investment securities

As at 31 December 2020 investment securities represent fixed rated financial assets carried at amortized cost. The fair value for investment securities is derived by discounting the future cash flows using current market rates for similar financial assets.

(Amounts in tables are in thousands of Georgian lari)

23. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled. See Note 21 "Risk management" for the Bank's contractual undiscounted repayment obligations.

	2020			***2019***		
	Within one year	***More than one year***	***Total***	***Within one year***	***More than one year***	***Total***
Cash and cash equivalents	39,118	–	**39,118**	88,951	–	**88,951**
Amounts due from credit institutions	46,518	–	**46,518**	58,670	–	**58,670**
Loans to customers	127,244	192,874	**320,118**	110,805	186,980	**297,785**
Investment securities	6,602	39,621	**46,223**	–	26,480	**26,480**
Property and equipment	–	6,738	**6,738**	–	8,876	**8,876**
Right of use assets	–	8,921	**8,921**	–	5,240	**5,240**
Intangible assets	–	4,241	**4,241**	–	4,607	**4,607**
Income tax asset	–	–	**–**	183	–	**183**
Other assets	1,350	177	**1,527**	1,434	62	**1,496**
Total	**220,832**	**252,572**	**473,404**	**260,043**	**232,245**	**492,288**
Amounts due to credit institutions	42,926	88,165	**131,091**	32,362	77,768	**110,130**
Amounts due to customers	96,205	114,017	**210,222**	181,468	60,240	**241,708**
Provisions	395	–	**395**	416	–	**416**
Deferred income tax liability	226	–	**226**	64	–	**64**
Lease liabilities	–	10,528	**10,528**	–	5,575	**5,575**
Other liabilities	6,116	–	**6,116**	4,469	–	**4,469**
Subordinated debt	–	31,742	**31,742**	–	27,589	**27,589**
Total	**145,868**	**244,452**	**390,320**	**218,779**	**171,172**	**389,951**
Net	**74,964**	**8,120**	**83,084**	**41,264**	**61,073**	**102,337**

24. Related party disclosures

In accordance with IAS 24 *Related Party Disclosures*, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The outstanding balances of related party transactions are as follows:

	2020				***2019***			
	The Parent	***Key management personnel***	***Entities under common control***	***Other***	***The Parent***	***Key management personnel***	***Entities under common control***	***Other***
Cash and cash equivalents	270	–	961	–	265	–	3,343	–
Loans to customers	–	36	–	–	–	7	4,266	–
Other assets	–	2	0	9	–	–	–	–
Amounts due to credit institutions	(13,233)	–	(22,192)	–	(15,015)	–	(14,838)	–
Amounts due to customers	–	(9,766)	(92,526)	–	–	(7,923)	(80,352)	(30)
Other liabilities	–	–	(334)	–	–	–	(265)	–
Subordinated debt	(15,871)	–	(15,871)	–	(13,794)	–	(13,794)	–

(Amounts in tables are in thousands of Georgian lari)

24. Related party disclosures (continued)

The income and expense arising from related party transactions are as follows:

	2020				*2019*			
	The Parent	***Key management personnel***	***Entities under common control***	***Other***	***The Parent***	***Key management personnel***	***Entities under common control***	***Other***
Fee and commission income	1	−	5	−	1	−	1	−
Fee and commission expense	(3)	−	(4)	−	(80)	−	(2)	−
Interest income on loans to customers	−	56	71	−	−	4	389	−
Interest income on amounts due from credit institutions	(2)	−	32	−	(2)	−	25	−
Interest expense on amounts due to credit institutions	(252)	−	(651)	−	(779)	−	(1,545)	−
Interest expense on amounts due to customers	−	(311)	(2,989)	−	−	(215)	(1,661)	−
Interest expense on subordinated debt	(790)	−	(790)	−	(24)	−	(24)	−
Professional fees	−	−	−	−	−	−	(66)	(67)

Compensation of key management personnel was comprised of the following:

	2020	*2019*
Salaries and other short-term benefits	2,264	1,920

Key management personnel as at 31 December 2020 comprised of 5 members of the Supervisory Board and 3 members of the Board of Directors of the Bank (2019: 5 members of the Supervisory Board and 4 members of the Board of Directors).

25. Capital adequacy

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the ratios established by the NBG in supervising the Bank.

The primary objectives of the Bank's capital management are (i) to ensure that the Bank complies with externally imposed capital requirements set by the NBG and (ii) to safeguard the Bank's ability to continue as a going concern. Compliance with capital adequacy ratios set by the NBG is monitored monthly with reports outlining their calculation reviewed and signed by the Bank's Chief Accountant or Chief Financial Officer and subsequently submitted to the NBG.

During year ended 31 December 2020 the Bank followed externally imposed capital requirements as adjusted based on the NBG's special supervisory plan effected in response to COVID19 (described in the NBG special supervisory plan paragraph below). As at 31 December 2020 the Bank was in slight breach of the single outsider ratio, which limits the bank's single exposure to largest borrower to 15% of its regulatory capital. This breach does not lead to any regulatory punishment, because of the moratorium on penalties announced by NBG for the effective period of the special supervisory plan.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities.

NBG capital adequacy ratio

Capital framework, capital requirements are divided into Pillar 1 Requirements for Common Equity Tier 1, Tier 1 and Regulatory Capital and additional buffers under Pillar 1 and Pillar 2.

(Amounts in tables are in thousands of Georgian lari)

25. Capital adequacy (continued)

NBG capital adequacy ratio (continued)

Pillar 1

- The capital conservation buffer (which was incorporated in minimum capital requirements) is separated and set at 2.5%;
- A countercyclical capital buffer is currently set at 0%;
- A systemic risk buffer will be introduced for systematically important banks over the 4 years period.

Pillar 2

- A currency induced credit risk (CICR) buffer replaced conservative weighting for un-hedged FX loans denominated in foreign currencies;
- Concentration buffer for sectoral and single borrower exposure will be introduced;
- A net stress buffer will be introduced based on stress testing results provided by the Bank;
- A General Risk-assessment Programme (GRAPE) buffer defined by the regulator, based on the Bank's specific risks.

NBG special supervisory plan

On 31 March 2020, NBG announced its supervisory plan to combat the negative effects of COVID-19. The plan alleviates the regulatory burden on commercial banks in the period of distress in order to enable them to carry on their businesses and continue lending to real economy. In particular, NBG has allowed commercial banks to use their capital buffers by eliminating the 2.5% conservation buffer and decreasing the foreign currency induced credit risk buffer by 2/3. NBG has also put in place a moratorium on any regulatory breaches of commercial banks caused by external factors such as additional credit losses, foreign exchange rate fluctuations and so on. These alleviations have been put in effect for an indefinite period of time and their reversal will be carried out only within reasonable time frames that will be further suggested by NBG.

The NBG requires the Bank to maintain a minimum total capital adequacy ratio of 14.26%, Tier 1 Capital ratio of 7.75% and Core Tier 1 Capital ratio of 5.81% of risk-weighted assets, computed based on Basel III requirements. As at 31 December 2020 the Bank's capital adequacy ratio on this basis was as follows:

	Notes	*31 December 2020*	*Adjustments*	*31 December 2020 Per the NBG*
Share capital	17	103,000	–	103,000
Retained earnings		(1,818)	(1,971)	(3,789)
Less: intangible assets, net	11	(4,241)	–	(4,241)
Current period loss		(19,253)	(3,941)	(23,194)
Core tier 1 capital		**77,688**	**(5,912)**	**71,776**
Tier 1 capital		**77,688**	**(5,912)**	**71,776**
Tier 2 capital		32,551	–	32,551
Supplementary capital		(18,299)	24,156	5,857
Total regulatory capital		**91,940**	**18,244**	**110,184**
Risk weighted assets				**511,914**
Capital adequacy ratio				21.52%
Core Tier 1 capital / Tier 1 capital adequacy ratio				14.02%

(Amounts in tables are in thousands of Georgian lari)

25. Capital adequacy (continued)

NBG special supervisory plan (continued)

	Notes	*31 December 2019*	*Adjustments*	*31 December 2019 Per the NBG*
Share capital	17	103,000	–	103,000
Retained earnings		7,242	(2,821)	4,421
Less: intangible assets, net	11	(4,607)	–	(4,607)
Current period loss		(9,060)	852	(8,208)
Core tier 1 capital		**96,575**	**(1,969)**	**94,606**
Tier 1 capital		**96,575**	**(1,969)**	**94,606**
Tier 2 capital		28,677	–	28,677
Supplementary capital		6,604	(929)	5,675
Total regulatory capital		**131,856**	**(2,898)**	**128,958**
Risk weighted assets				**495,111**
Capital adequacy ratio				26.05%
Core Tier 1 capital / Tier 1 capital adequacy ratio				19.11%