JSC Terabank

Consolidated financial statements

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

Contents

Independent auditor's report

Consolidated financial statement

Notes to the consolidated financial statements

EY LLC
Kote Abkhazi Street, 44
Tbilisi, 0105, Georgia
Tel: +995 (32) 215 8811
Fax: +995 (32) 215 8822
www.ey.com/ge

შპს იუაი
საქართველო, 0105 თბილისი
კოტე აფხაზის ქუჩა 44
ტელ: +995 (32) 215 8811
ფაქსი: +995 (32) 215 8822

Independent auditor's report

To the Shareholders and Board of Directors of JSC Terabank

Opinion

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

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2020 and its financial performance and its consolidated 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 consolidated financial statements* section of our report. We are independent of the Group 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.

Other matter paragraph

The consolidated financial statements of the Group as at and for the year ended 31 December 2019 were audited by another auditor who expressed an unmodified opinion on those financial statements on 31 May 2020.

Other information included in the Group's 2020 Annual Report

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

Our opinion on the consolidated 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 consolidated financial statements.

Building a better working world

In connection with our audit of the consolidated 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.

Responsibilities of management and the Audit Committee for the consolidated financial statements

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

In preparing the consolidated financial statements, management is responsible for assessing the Group'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 Group or to cease operations, or has no realistic alternative but to do so.

The Audit Committee is responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated 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 consolidated 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 consolidated 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 Group's internal control.
- 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 Group'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 consolidated 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 Group to cease to continue as a going concern.

Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Audit Committee 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.

Ruslan Khoroshvili

On behalf of EY LLC

Tbilisi, Georgia

11 May 2021

Consolidated statement of financial position

As at 31 December 2020

(in thousands of Georgian lari, unless otherwise stated)

	Notes	2020	2019
Assets			
Cash and cash equivalents	5	81,958	56,988
Mandatory reserve deposit with the National Bank of Georgia		150,957	115,597
Loans to customers	7	898,812	743,719
Investment securities	6	87,311	59,009
Repossessed property	7	20,204	13,208
Premises and equipment	8	25,483	25,159
Other intangible assets		2,579	2,820
Goodwill	9	20,374	20,374
Income tax asset		1,873	423
Other assets	10	7,214	6,747
Total assets		**1,296,765**	**1,044,044**
Liabilities			
Loans from financial institutions and lease liabilities	12	187,294	112,632
Deposits and balances from credit institutions	15	10,938	5,522
Current accounts and deposits from customers	16	861,486	703,148
Deferred tax liability	11	772	843
Other liabilities	17	11,590	9,636
Subordinated loans	13	61,489	52,986
Total liabilities		**1,133,569**	**884,767**
Equity			
Share capital	18	121,372	121,372
Retained earnings		41,824	37,905
Total equity		**163,196**	**159,277**
Total liabilities and equity		**1,296,765**	**1,044,044**

These consolidated financial statements were approved by the Management Board on 11 May 2021 and were signed on its behalf by:

Thea Lortkipanidze
General Director

Sophie Jugeli
Chief Financial Officer

The consolidated statement of financial position is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 8 to 47.

Consolidated statement of profit or loss and other comprehensive income

For 2020

(in thousands of Georgian lari, unless otherwise stated)

	Notes	*2020*	*2019* Reclassified*
Interest income calculated using the effective interest method	19	88,794	81,899
Interest expense	19	(47,460)	(38,018)
Net interest income		**41,334**	**43,881**
Impairment loss on debt financial assets and loan commitments, net	4	(20,393)	(2,417)
Fee and commission income	20	6,274	7,860
Fee and commission expense	20	(3,387)	(3,656)
Net gain from foreign exchange transactions	21	7,998	5,403
Other income		243	1,559
Operating income		**32,069**	**52,630**
Personnel expenses		(13,823)	(15,979)
Depreciation and amortization		(5,305)	(4,808)
Other provisions charge		(35)	(611)
Loss from sale and revaluation of repossessed assets		(1,600)	(1,366)
Other operating expenses	22	(7,458)	(7,906)
Profit before income tax		**3,848**	**21,960**
Income tax benefit/(expense)	11	71	(1,930)
Profit and total comprehensive income for the year		**3,919**	**20,030**

The consolidated statement of profit or loss and other comprehensive income is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 8 to 47.

Consolidated statement of changes in equity

For 2020

(in thousands of Georgian lari, unless otherwise stated)

	Share capital	*Retained earnings*	*Total equity*
Balance at 1 January 2019	**121,372**	**26,383**	**147,755**
Profit and total comprehensive income for the year	–	20,030	**20,030**
Dividends declared and paid (Note 18)	–	(8,508)	**(8,508)**
Balance at 31 December 2019	**121,372**	**37,905**	**159,277**
Profit and total comprehensive income for the year	–	3,919	**3,919**
Balance at 31 December 2020	**121,372**	**41,824**	**163,196**

The consolidated statement of changes in equity is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 8 to 47.

Consolidated statement of cash flows

For 2020

(in thousands of Georgian lari, unless otherwise stated)

	Notes	*2020*	*2019*
Cash flows from operating activities			
Interest received		85,549	82,740
Interest paid		(45,892)	(36,945)
Fees and commissions received		6,274	7,860
Fees and commissions paid		(3,335)	(3,638)
Net (loss)/gain received from trading in foreign currencies	21	(2,161)	1,421
Other operating income received		243	1,559
Personnel expenses paid		(15,365)	(15,412)
Other operating expenses paid		(6,861)	(8,182)
Income tax paid		(1,450)	(4,014)
Cash flows from operating activities before changes in operating assets and liabilities		**17,002**	**25,389**
Changes in:			
Mandatory reserve deposits with the National Bank of Georgia		(15,203)	8,430
Loans to customers		(96,672)	(48,872)
Other assets and repossessed property		178	(1,235)
Tax assets		–	742
Deposits and balances from banks		5,311	5,031
Current accounts and deposits from customers		77,649	(20,589)
Other liabilities		3,028	(8,777)
Net cash used in operating activities		**(8,707)**	**(39,881)**
Cash flows from investing activities			
Acquisition of investment securities		(87,228)	(31,956)
Proceeds from redemption of investment securities		61,650	28,238
Acquisition of premises and equipment		(3,886)	(2,143)
Proceeds from disposal of premises and equipment		13	743
Acquisition of intangible assets		(1,501)	(1,521)
Net cash used in investing activities		**(30,952)**	**(6,639)**
Cash flows from financing activities			
Dividends paid		–	(8,508)
Repayment of lease liabilities		(1,974)	(2,023)
Receipts of the loans from the financial institutions		81,533	50,552
Repayment of the loans from the financial institutions		(23,366)	(19,097)
Repayment of the subordinated loans		(9,918)	(1,461)
Proceeds from subordinated loans		9,210	4,917
Net cash from financing activities	14	**55,485**	**24,380**
Effect of exchange rates changes on cash and cash equivalents		9,144	10,211
Net decrease in cash and cash equivalents		**24,970**	**(11,929)**
Cash and cash equivalents, beginning	5	56,988	68,917
Cash and cash equivalents, ending	5	**81,958**	**56,988**

The consolidated statement of cash flows is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 8 to 47.

(in thousands of Georgian lari, unless otherwise stated)

1. Reporting entity

Organisation and operations

These consolidated financial statements comprise the financial statements of JSC Terabank (the Bank) and its subsidiary (the Group). The Bank's registration number is 204546045.

The Bank's principal activities are accepting deposits, maintenance of customer accounts, credit operations, issuing guarantees, cash and settlement operations, and securities and foreign exchange transactions. The Bank's activities are regulated by the National Bank of Georgia (the NBG). The Bank has a general banking license issued by the NBG on 25 January 2008.

The Bank's registered legal address is 3 K. Tsamebuli Avenue, Tbilisi, 0103, Georgia. The Bank operates through 26 branches, service centers and service desks, which are located in all major cities of Georgia.

The Bank has one subsidiary, Standard Insurance LLC (Legal address: Chavchavadze Av # 43), which did not have operations in 2020 and 2019.

As at 31 December 2020 and 2019, the Bank's shareholding structure is as follows:

Owners	***2020 Ownership interest, %***	***2019 Ownership interest, %***
Sheikh Nahayan Mubarak Al Nahyan	65%	45%
Sheikh Hamdan Bin Zayed bin Sultan Al Nahyan	–	20%
Sheikh Mohamed Bin Butti Al Hamed	15%	15%
Sheikh Mansour bin Zayed Bin Sultan Al Nahyan	15%	15%
Investment Trading Group LLC	5%	5%
	100%	**100%**

Related party transactions are described in detail in Note 26.

2. Basis of preparation

(a) Statement of compliance

The accompanying consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS).

(b) Basis of measurement

The consolidated financial statements are prepared on the historical cost basis, except hedging instruments, measured at fair value through profit or loss.

(c) Functional and presentation currency

The functional currency of the Bank and its subsidiary is the Georgian lari (GEL) as, being the national currency of Georgia, it reflects the economic substance of the majority of underlying events and circumstances relevant to them.

The GEL is also the presentation currency for the purposes of these consolidated financial statements.

Financial information presented in GEL is rounded to the nearest thousand.

(d) Use of estimates and judgments

In preparing these consolidated financial statements, management has made judgment, estimates and assumptions that affect the application of the Group's accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

(in thousands of Georgian lari, unless otherwise stated)

2. Basis of preparation (continued)

(d) Use of estimates and judgments (continued)

Judgements

Information about judgments made in applying accounting policies that have the most significant effects on the amounts recognised in the consolidated financial statements is included in the following notes:

- Establishing the criteria for determining whether credit risk on the financial asset has increased significantly since initial recognition, determining methodology for incorporating forward-looking information into measurement of ECL and selection and approval of models used to measure ECL – Note 4.

Assumptions and estimations uncertainty

(e) Effect of COVID-19 pandemic

Due to the rapid spread of COVID-19 pandemic in 2020 many governments, including the government of Georgia imposed various restrictions over activities within the country to contain the spread of the virus and manage its consequences. The restrictions imposed at various times include ban on all cross-border travel, restriction over all travel within the country during specific hours, closing of all public transport, stopping all commercial activity except those which can be done distantly from home as well as except specific business (groceries, pharmacies, commercial banks, gas stations, post offices etc.). The restrictions imposed by the Government of Georgia do not apply to any of the Bank's operations. The Bank continues working under the business continuity plan with personnel mostly working remotely from home, as much as possible.

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year is included in the following notes:

- Note 4 and Note 7 – impairment of financial instruments: determining inputs into the ECL measurement model, including incorporation of forward-looking information and assessment of impact of COVID-19 on expected credit losses;
- Note 7 (d) – Valuation of repossessed assets;
- Note 9 – impairment of goodwill.

(f) Changes in accounting policies and presentation

The Group 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 and its effect was not material. No other standard, interpretation or amendment that has been issued but is not yet effective was early adopted by the Group.

Reclassifications

The following reclassifications have been made to 2019 consolidated statement of profit or loss and other comprehensive income to conform to the 2020 presentation:

	As previously reported	*Reclassification*	*As adjusted*
Net fee and commission income	4,204	–	(4,204)
Fee and commission income	–	7,860	7,860
Fee and commission expense	–	(3,656)	(3,656)

(in thousands of Georgian lari, unless otherwise stated)

3. Significant accounting policies

The Group has consistently applied the following accounting policies to all periods presented in these consolidated financial statements.

(a) Basis of consolidation

(i) Subsidiaries

Subsidiaries are investees controlled by the Group. The Group controls an investee when it is exposed to, or has rights to, variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. In particular, the Group consolidates investees that it controls on the basis of de facto circumstances, including cases when protective rights arising from collateral agreements on lending transactions become significant. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

(ii) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

(b) Foreign currency translation

Transactions in foreign currencies are translated to GEL at exchange rates at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to GEL at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the reporting period.

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value is determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

Foreign currency differences arising on retranslation are recognised in profit or loss.

(c) Interest

Effective interest rate

Interest income and expense are recognised in profit or loss using the effective interest method. The 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- The gross carrying amount of the financial asset; or
- The amortised cost of the financial liability.

When calculating the effective interest rate for financial instruments other than purchased or originated credit-impaired assets, the Group estimates future cash flows considering all contractual terms of the financial instrument, but not expected credit losses. For purchased or originated credit-impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including expected credit losses.

The calculation of the effective interest rate includes transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Amortised cost and gross carrying amount

The 'amortised cost' of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any expected credit loss allowance.

The 'gross carrying amount of a financial asset' measured at amortised cost is the amortised cost of a financial asset before adjusting for any expected credit loss allowance.

(in thousands of Georgian lari, unless otherwise stated)

3. Significant accounting policies (continued)

(c) Interest (continued)

Calculation of interest income and expense

The effective interest rate of a financial asset or financial liability is calculated on initial recognition of a financial asset or a financial liability. In calculating interest income and expense, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit-impaired) or to the amortised cost of the liability. The effective interest rate is revised as a result of periodic re-estimation of cash flows of floating rate instruments to reflect movements in market rates of interest. The effective interest rate is also revised for fair value hedge adjustments at the date amortisation of the hedge adjustment begins.

However, for financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortised cost of the financial asset. If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis.

For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying the credit-adjusted effective interest rate to the amortised cost of the asset. The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset improves.

For information on when financial assets are credit-impaired, see Note 3 (e) (iv).

Presentation

Interest income calculated using the effective interest method presented in the consolidated statement of profit or loss and other comprehensive income includes interest on financial assets measured at amortised cost.

Interest expense presented in the consolidated statement of profit or loss and other comprehensive income includes financial liabilities measured at amortised cost.

(d) Fees and commissions

Fee and commission income and expense that are integral to the effective interest rate on a financial asset or financial liability are included in the effective interest rate (see Note 3 (c)).

If a loan commitment is not expected to result in the draw-down of a loan, then the related loan commitment fee is recognised on a straight-line basis over the commitment period.

A contract with a customer that results in a recognised financial instrument in the Group’s financial statements may be partially in the scope of IFRS 9 and partially in the scope of IFRS 15. If this is the case, then the Group first applies IFRS 9 to separate and measure the part of the contract that is in the scope of IFRS 9 and then applies IFRS 15 to the residual.

Other fee and commission expenses relate mainly to transaction and service fees, which are expensed as the services are received.

(e) Financial assets and financial liabilities

i. Classification

On initial recognition, a financial asset is classified as measured at: amortised cost, FVOCI or FVTPL.

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- The asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- 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.

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- The asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- 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.

(in thousands of Georgian lari, unless otherwise stated)

3. Significant accounting policies (continued)

(e) Financial assets and financial liabilities (continued)

For debt financial assets measured at FVOCI, gains and losses are recognised in other comprehensive income, except for the following, which are recognised in profit or loss in the same manner as for financial assets measured at amortised cost:

- Interest income using the effective interest method;
- ECL and reversals; and
- Foreign exchange gains and losses.

When a debt financial asset measured at FVOCI is derecognised, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss.

All other financial assets are classified as measured at FVTPL.

In addition, on initial recognition, the Group may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Business model assessment

The Group makes an assessment of the objective of the business model in which a financial asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information that is considered includes:

- The stated policies and objectives for the portfolio and the operation of those policies in practice, including whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of assets;
- How the performance of the portfolio is evaluated and reported to the group's management;
- The risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- How managers of the business are compensated – e.g. Whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- The frequency, volume and timing of sales in prior periods, the reasons for such sales and expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Group's stated objective for managing the financial assets is achieved and how cash flows are realised.

Financial assets that are held for trading and those that are managed and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

Assessment whether contractual cash flows are solely payments of principal and interest

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as a profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Group considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Group considers:

- Contingent events that would change the amount and timing of cash flows;
- Leverage features;
- Prepayment and extension terms;
- Terms that limit the Group's claim to cash flows from specified assets – e.g. non-recourse asset arrangements;
- Features that modify consideration for the time value of money – e.g. periodic reset of interest rates.

(in thousands of Georgian lari, unless otherwise stated)

3. Significant accounting policies (continued)

(e) Financial assets and financial liabilities (continued)

A prepayment feature is consistent with the SPPI criterion if the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable compensation for early termination of the contract.

Reclassification

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Group changes its business model for managing financial assets.

Financial liabilities

The Group classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost.

Reclassification

Financial liabilities are not reclassified subsequent to their initial recognition.

ii. Derecognition

Financial assets

The Group derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Group neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

Financial liabilities

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

iii. Modification of financial assets and financial liabilities

Financial assets

If the terms of a financial asset are modified, the Group evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different (referred to as 'substantial modification'), then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and a new financial asset is recognised at fair value plus any eligible transaction costs. Any fees received as part of the modification are accounted for as follows:

- Fees that are considered in determining the fair value of the new asset and fees that represent reimbursement of eligible transaction costs are included in the initial measurement of the asset; and
- Other fees are included in profit or loss as part of the gain or loss on derecognition.

Changes in cash flows on existing financial assets or financial liabilities are not considered as modification, if they result from existing contractual terms, e.g. changes in interest rates initiated by the Group due to changes in the NBG key rate, if the loan agreement entitles the Group to do so. The Group performs a quantitative and qualitative evaluation of whether the modification is substantial, i.e. whether the cash flows of the original financial asset and the modified or replaced financial asset are substantially different. The Group assesses whether the modification is substantial based on quantitative and qualitative factors in the following order: qualitative factors, quantitative factors, combined effect of qualitative and quantitative factors. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset deemed to have expired.

The Group concludes that the modification is substantial as a result of the following qualitative factors:

- Change the currency of the financial asset;
- Change in collateral or other credit enhancement.

(in thousands of Georgian lari, unless otherwise stated)

3. Significant accounting policies (continued)

(e) Financial assets and financial liabilities (continued)

If cash flows are modified when the borrower is in financial difficulties, then the objective of the modification is usually to maximise recovery of the original contractual terms rather than to originate a new asset with substantially different terms. If the Group plans to modify a financial asset in a way that would result in forgiveness of cash flows, then it first considers whether a portion of the asset should be written off before the modification takes place (see below for write-off policy). This approach impacts the result of the quantitative evaluation and means that the derecognition criteria are not usually met in such cases. The Group further performs qualitative evaluation of whether the modification is substantial.

If the modification of a financial asset measured at amortised cost does not result in derecognition of the financial asset, then the Group first recalculates the gross carrying amount of the financial asset using the original effective interest rate of the asset and recognises the resulting adjustment as a modification gain or loss in profit or loss. For floating-rate financial assets, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs or fees incurred and fees received as part of the modification adjust the gross carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.

If such a modification is carried out because of financial difficulties of the borrower (see Note 3(e)(iv)), then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income calculated using the effective interest method (see Note 3(c)).

For fixed-rate loans, where the borrower has an option to prepay the loan at par without significant penalty, the Group treats the modification of an interest rate to a current market rate using the guidance on floating-rate financial instruments. This means that the effective interest rate is adjusted prospectively.

Financial liabilities

The Group derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognised at fair value. The difference between the carrying amount of the financial liability extinguished and the new financial liability with modified terms is recognised in profit or loss. Consideration paid includes non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability.

Group performs a quantitative and qualitative evaluation of whether the modification is substantial considering qualitative factors, quantitative factors and combined effect of qualitative and quantitative factors. The Group concludes that the modification is substantial as a result of the following qualitative factors:

- Change the currency of the financial liability;
- Change in collateral or other credit enhancement.

For the quantitative assessment the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability.

If the modification of a financial liability is not accounted for as derecognition, then the amortised cost of the liability is recalculated by discounting the modified cash flows at the original effective interest rate and the resulting gain or loss is recognised in profit or loss. For floating-rate financial liabilities, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs and fees incurred are recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

iv. Impairment

The Group recognises loss allowances for expected credit losses (ECL) on the following financial instruments that are not measured at FVTPL:

- Financial assets that are debt instruments;
- Loan commitments and financial guarantee contracts issued.

(in thousands of Georgian lari, unless otherwise stated)

3. Significant accounting policies (continued)

(e) Financial assets and financial liabilities (continued)

The Group measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured as 12-month ECL:

- Debt investment securities that are determined to have low credit risk at the reporting date; and
- Other financial instruments on which credit risk has not increased significantly since their initial recognition (see Note 4).

12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Financial instruments for which a 12-month ECL is recognised are referred to as 'Stage 1' financial instruments.

Lifetime ECLs are the ECLs that result from all possible default events over the expected life of the financial instrument. Financial instruments for which a lifetime ECL is recognised are referred to as 'Stage 2' financial instruments (if the credit risk has increased significantly since initial recognition, but the financial instruments are not credit-impaired) and 'Stage 3' financial instruments (if the financial instruments are credit-impaired).

Measurement of ECLs

ECLs are a probability-weighted estimate of credit losses and are measured as follows:

- Financial assets that are not credit-impaired at the reporting date: the present value of all cash shortfalls – i.e. The difference between the cash flows due to the entity in accordance with the contract and the cash flows that the group expects to receive;
- Financial assets that are credit-impaired at the reporting date: the difference between the gross carrying amount and the present value of estimated future cash flows;
- Undrawn loan commitments: the present value of the difference between the contractual cash flows that are due to the group if the commitment is drawn down and the cash flows that the group expects to receive; and
- Financial guarantee contracts: the present value of the expected payments to reimburse the holder less any amounts that the Group expects to recover.

See also Note 4.

Restructured financial assets

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised (see Note 3(e)(iii)) and ECL are measured as follows.

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset (see Note 4);
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Credit-impaired financial assets

At each reporting date, the Group assesses whether financial assets carried at amortised cost are credit-impaired (referred to as 'Stage 3 financial assets'. A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following observable data:

- Loans past due more than 90 days;
- Bankruptcy proceedings and/or legal proceedings that may affect the company's ability to service its obligations;
- Death of borrower, liquidation of the borrower's company (if legal entity);
- Fraud event or other force-majeure that may affect the company's solvency.

(in thousands of Georgian lari, unless otherwise stated)

3. Significant accounting policies (continued)

(e) Financial assets and financial liabilities (continued)

A loan that has been renegotiated due to a deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment.

In making an assessment of whether an investment in sovereign debt is credit-impaired, the Bank considers the following factors.

Presentation of allowance for ECL in the consolidated statement of financial position

Loss allowances for ECL are presented in the consolidated statement of financial position for financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;

Write-offs

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Group determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

Recoveries of amounts previously written off are included in 'impairment losses on financial instruments' in the statement of profit or loss and other comprehensive income.

Financial assets that are written off could still be subject to enforcement activities in order to comply with the Group's procedures for recovery of amounts due.

(f) Cash and cash equivalents and mandatory reserve with the NBG

Cash and cash equivalents consist of cash on hand, amounts due from the NBG, excluding mandatory reserves, amounts due from credit institutions and other highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by the Group in the management of short-term commitments. Cash and cash equivalents are carried at amortised cost in the consolidated statement of financial position.

The mandatory reserve deposit is an interest-bearing deposit calculated in accordance with regulations issued by the NBG and whose withdrawability is restricted. The mandatory reserve deposit with the NBG is not considered to be a cash equivalent, due to restrictions on its withdrawability.

(g) Loans to customers

'Loans to customers' caption in the consolidated statement of financial position include debt financial assets measured at amortised cost; they are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method.

(h) Investment securities

The 'investment securities' caption in the statement of financial position includes: debt investment securities measured at amortised cost (see Note 3(e)(i)); these are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method.

(i) Repossessed property

Repossessed property represents non-financial assets acquired by the Group in settlement of overdue loans. The assets are initially recognised at net book value of respective loan when acquired and included in premises and equipment, other financial assets or inventories depending on their nature and the Group's intention in respect of recovery of these assets and are subsequently remeasured and accounted for in accordance with the accounting policies for these categories of assets.

(j) Provisions

A provision is recognised in the consolidated statement of financial position when the Group has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(in thousands of Georgian lari, unless otherwise stated)

3. Significant accounting policies (continued)

(k) Inventories

Inventories are measured at the lower of cost and net realisable value. The cost of inventories is based on the specific identification method, and includes expenditure incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition.

Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

(l) Financial guarantees and loan commitments

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when it is due in accordance with the terms of a debt instrument. Loan commitments are firm commitments to provide credit under pre-specified terms and conditions.

Financial guarantees issued are initially measured at fair value. Subsequently, they are measured as follows:

► At the higher of the loss allowance determined in accordance with IFRS 9 (see Note 3(e)(iv)) and the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of IFRS 15.

The Group has issued no loan commitments that are measured at FVTPL.

(l) Financial guarantees and loan commitments

For other loan commitments:

► The Group recognises a loss allowance (see Note 3(e)(iv)).

Liabilities arising from financial guarantees and loan commitments are included within provisions.

(m) Premises and equipment

Premises and equipment are carried at cost less accumulated depreciation and any accumulated impairment. Costs of minor repairs and maintenance are expensed when incurred. Costs of replacing major parts or components of premises and equipment items are capitalised and the replaced part is retired.

At the end of each reporting period management assesses whether there is any indication of impairment of premises and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in profit or loss for the year. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's value in use or fair value less costs to sell.

Gains and losses on disposals determined by comparing proceeds with carrying amount are recognised in profit or loss.

Land is not depreciated. Depreciation on other items of premises and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives:

Premises	50 years
Office and computer equipment	5-15 years
Vehicles	5 years
Furniture, fixtures and other fixed assets	5 years
Leasehold improvements	5-10 years

The residual value of an asset is the estimated amount that the Group would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

(in thousands of Georgian lari, unless otherwise stated)

3. Significant accounting policies (continued)

(n) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the acquirer's share of the identifiable assets, liabilities and contingent liabilities of the acquired subsidiary or associate at the date of exchange. Goodwill on acquisitions of subsidiaries is presented separately in the consolidated statement of financial position. Goodwill is carried at cost less accumulated impairment losses, if any.

The Group tests goodwill for impairment at least annually and whenever there are indications that goodwill may be impaired. Goodwill is allocated to the cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the business combination. Such units or group of units represent the lowest level at which the Group monitors goodwill and are not larger than an operating segment. Gains or losses on disposal of an operation within a cash generating unit to which goodwill has been allocated include the carrying amount of goodwill associated with the operation disposed of, generally measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit which is retained.

Impairment is determined by assessing the recoverable amount of the cash-generating unit to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised. Impairment losses relating to goodwill cannot be reversed in future periods.

(o) Intangible assets other than goodwill

Acquired intangible assets are stated at cost less accumulated amortisation and impairment losses. Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Amortisation is charged to profit or loss on a straight-line basis over the estimated useful lives of intangible assets. The estimated useful lives range from 1 to 10 years.

(p) Share capital

Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognised as a deduction from equity, net of any tax effects.

Dividends

The ability of the Group to declare and pay dividends is subject to the rules and regulations of Georgia. Dividends in relation to ordinary shares are reflected as an appropriation of retained earnings in the period when they are declared.

(q) Income tax

Income tax expense comprises current and deferred tax. Income tax is recognised in profit or loss except to the extent that it relates to items recognised directly in equity or in other comprehensive income.

Current tax

Current tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Current tax payable also includes any tax liability arising from dividends.

On 13 May 2016 the Parliament of Georgia passed the bill on corporate income tax reform (also known as the Estonian model of corporate taxation), which mainly moves the moment of taxation from when taxable profits are earned to when they are distributed. The law has entered into force in 2016 and is effective for tax periods starting after 1 January 2017 for all entities except for financial institutions (such as banks, insurance companies, microfinance organizations, pawnshops), for which the law will become effective from 1 January 2023.

The new system of corporate income taxation does not imply exemption from corporate income tax (CIT), rather CIT taxation is shifted from the moment of earning the profits to the moment of their distribution; i.e. the main tax object is distributed earnings. The Tax Code of Georgia defines distributed earnings (DE) to mean profit distributed to shareholders as a dividend. However some other transactions are also considered as DE, for example non-arm's length cross-border transactions with related parties and/or with persons exempted from tax are also considered as DE for CIT purposes. In addition, the tax object includes expenses or other payments not related to the entity's economic activities, free of charge supply and over-limit representative expenses.

The corporate income tax arising from the payment of dividends is accounted for as an expense in the period when dividends are declared, regardless of the actual payment date or the period for which the dividends are paid.

(in thousands of Georgian lari, unless otherwise stated)

3. Significant accounting policies (continued)

(q) Income tax (continued)

Deferred tax

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences:

- The initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss;
- Temporary differences related to investments in subsidiaries, associates and joint arrangements to the extent that where the Group is able to control the timing of the reversal of the temporary differences and it is probable that they will not reverse in the foreseeable future.

Deferred tax assets are recognised for unused tax losses, unused tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be used. Future taxable profits are determined based on the reversal of relevant taxable temporary differences. If the amount of taxable temporary differences is insufficient to recognise a deferred tax asset in full, then future taxable profits, adjusted for reversals of existing temporary differences, are considered, based on the business plans for individual subsidiaries in the Group. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised; such reductions are reversed when the probability of future taxable profits improves.

The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities until 1 January 2023, using tax rates enacted or substantially enacted at the reporting date. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available until 1 January 2023 against which the temporary differences, unused tax losses and credits can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Unrecognised deferred tax assets are reassessed at each reporting date and recognised to the extent that it has become probable that future taxable profits will be available against which they can be used.

In determining the amount of current and deferred tax the Group takes into account the impact of uncertain tax positions and whether additional taxes, penalties and late-payment interest may be due. The Group believes that its accruals for tax liabilities are adequate for all open tax years based on its assessment of many factors, including interpretations of tax law and prior experience. This assessment relies on estimates and assumptions and may involve a series of judgments about future events. New information may become available that causes the Group to change its judgment regarding the adequacy of existing tax liabilities; such changes to tax liabilities will impact the tax expense in the period that such a determination is made.

Due to the nature of the new taxation system described above, the financial institutions registered in Georgia will not have any differences between the tax bases of assets and their carrying amounts from 1 January 2023 and hence, no deferred income tax assets and liabilities will arise thereon.

(r) Leases

The Group recognises a right-of-use asset and a lease liability at a lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove any improvements made.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Group's incremental borrowing rate. Generally, incremental borrowing rate is used as the discount rate.

The lease liability is measured at amortised cost using the effective interest method. It is remeasured when there is a change in future lease payments or in assessment of whether the Group will exercise extension or termination option. A corresponding adjustment is made to the carrying amount of the right-of-use asset, or the amount is recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero.

(in thousands of Georgian lari, unless otherwise stated)

3. Significant accounting policies (continued)

(r) Leases (continued)

The Bank has elected not to recognise right-of-use assets and lease liabilities for leases of low-value assets and short-term leases. The Bank recognises the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

(s) New standards and interpretations issued but not yet effective

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 Group will apply IBOR reform Phase 2 from 1 January 2021 and its effect is being assessed.

IFRS 17 – In May 2017, the IASB issued IFRS 17 *Insurance Contracts* (IFRS 17), a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, IFRS 17 will replace IFRS 4 *Insurance Contracts* (IFRS 4) that was issued in 2005.

The Group is currently in the process of assessing the impact of adopting IFRS 17 on its consolidated financial statements.

4. Financial risk review

This note presents information about the Group's exposure to financial risks. For information on the Group's financial risk management framework, see Note 23.

Credit risk – amounts arising from ECL

Inputs, assumptions and techniques used for estimating impairment

See accounting policy in Note 3(e)(iv).

Impact of COVID-19 on credit risk

The Bank has announced several initiatives for its borrowers to assist with business disruptions caused by COVID-19. These included payment holidays in different forms, extending repayment periods, shifting interest and principal payments to later dates. These initiatives were announced in different "waves" (first waves started in March 2020 and largely ended by summer; next wave started in late September while the last wave started in November and was linked to the most recent lockdown announced by the Government). Grace periods, in various forms, were short-term, usually not exceeding 3 months. Exceptions were made to borrowers with seasonal payments (for example, seaside hotels) or to the borrowers where financial situation has deteriorated significantly (these borrowers were classified as "restructured").

Payment holidays were offered in different forms:

- Complete payment holiday for three months with extension of loan repayment schedule for similar period;
- Modifying repayment schedule by shifting payments to the later dates (only three months' payment were altered) while not changing overall loan repayment period;
- Shifting only principal payments to a later date;
- Capitalization of accrued payments and their distribution over remaining repayment period.

(in thousands of Georgian lari, unless otherwise stated)

4. Financial risk review (continued)

Credit risk – amounts arising from ECL (continued)

The Bank has identified number of loans as loans with increased credit risk. Identification was based on several criteria:

- Client's business activities are in one of the four riskier sectors (hotels and tourism, real estate development, restaurants and cafes, real estate management) and client demonstrates weakness as a result of realization of pandemic risks;
- Number of payment holidays used (for retail and micro clients);
- Client's demonstrated financial weakness (after Bank's assessment) as a result of decline revenues linked to pandemic.

Gross carrying value of the loans transferred to Stage 2 due to COVID-19 pandemic amounts to GEL156,278 thousand as at 31 December 2020.

The table below represents these Stage 2 loans and its changes in ECL.

	Gross carrying value	*Modelled ECL*	*Post-model adjustments and management overlays*	*Total ECL*
Business loans	140,105	667	16,220	**16,887**
Consumer loans	5,923	23	804	**827**
Mortgage loans	10,250	19	940	**959**
Total	**156,278**	**709**	**17,964**	**18,673**

Customer assessments were made on an ongoing basis since the second quarter of 2020, and ECL was revisited in light of the changed outlook. Despite the associated uncertainty, the best estimate of the respective credit losses, whether or not crystallized as at the reporting date, has already been reflected in the Bank's ECL estimate as at 31 December 2020.

Significant increase in credit risk

When determining whether the credit risk (i.e. risk of default) on a financial instrument has increased significantly since initial recognition, the Group considers reasonable and supportable information that is relevant and available without undue cost or effort, including both quantitative and qualitative information and analysis based on the Group's historical experience, expert credit assessment and forward-looking information.

The Group uses the following criteria for determining whether there has been a significant increase in credit risk:

- The exposure is overdue for more than 30 days;
- Its financial standing deteriorated and the exposure has been restructured;
- Other weaknesses that the bank deems to have negative effect on borrower's performance (e.g. watch list clients).

Generating the term structure of PD

Overdue days are primary input into the determination of the term structure of PD for all exposures in Markov's model of migration matrices. Migration matrices are constructed using historical data over the past 60 months and are calculated based on loan numbers.

Determining whether credit risk has increased significantly

The Group assesses whether credit risk has increased significantly since initial recognition at each reporting period. What is considered significant will differ for different types of lending, in particular between financial assets assessed individually and collectively. The Bank uses overdue status of the financial assets as a backstop indicator and other qualitative indicators to assess whether significant increase in credit risk has occurred.

As a backstop, the Group considers that a significant increase in credit risk occurs no later than when an asset is more than 30 days past due. Days past due are determined by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received.

(in thousands of Georgian lari, unless otherwise stated)

4. Financial risk review (continued)

Credit risk – amounts arising from ECL (continued)

Definition of default

The bank considers loan to be in default if any of the following criteria are met:

- Loans past due more than 90 days;
- Bankruptcy proceedings and/or legal proceedings that may affect the company's ability to service its obligations;
- Death of borrower, liquidation of the borrower's company (if legal entity);
- Fraud event or other force-majeure that may affect the borrower's ability to repay the loan.

Default status is assessed regularly (monthly). In General loan remains as default if during its lifetime it was under default at least once, but there might be rear cases, which Group assess separately.

Incorporation of forward-looking information

The Group incorporates forward-looking information into both the assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and the measurement of ECL.

The Group uses expert judgment in assessment of forward-looking information. This assessment is based also on external information. External information may include economic data and forecasts published by governmental bodies and monetary authorities in the countries where the Bank operates, such as the National Bank of Georgia.

The Group has identified and documented key driver of credit risk for each portfolio of financial instruments and, using an analysis of historical data, has estimated relationships between macro-economic variable and credit risk.

Among the tested macroeconomic parameters such as inflation, currency depreciation, only real GDP proved to have statistically significant influence on portfolio probabilities of default. Historical correlations over the past 3 years showed the high relationship between real GDP and PD. When real GDP was growing PD was decreasing respectively. Based the historical correlation PD is adjusted by using Vasicek model.

Vasicek model uses the correlation between macro parameter and PD estimated through least square regression and adjusts PD based on historical dependency according to the forecasted real GDP growth.

Real GDP growth estimates are derived from various reliable sources (usually, NBG Macroeconomic Forecast Scenarios; occasionally, IMF forecast as well). NBG forecast provide three scenarios – baseline, upside and adverse. These scenarios are assigned weights of 50%, 25% and 25%, respectively. Weighted average is then applied in ECL calculations.

For 2020 ECL calculations, the Group continued to use adverse scenario. This was done to reflect ongoing uncertainty around pace and strength of recovery, as well as any future risks associated with another wave of pandemic-related lockdown and its impact on Georgian economy. Therefore, macroeconomic scenario currently includes GDP decrease of -5.1% in 2021. Due to the specifics of the Group's ECL model, the management does not take into account any recoveries in subsequent years. The Group believes this projection takes into account risks related to further deterioration of economy due to the pandemic (especially, taking into account NBG's most recent guidance of 4% growth in baseline scenario and 1% growth in adverse scenario, as well as IMF's 3.5% growth rate estimate).

Modified financial assets

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer. An existing loan whose terms has been modified may be derecognized and the renegotiated loan recognized as a new loan at fair value.

The Bank renegotiates loans to customers in financial difficulties to maximize collection opportunities and minimize the risk of default. Under the Group's restructuring policy, the loan is restructured if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

The revised terms usually include extending the maturity, changing the timing of interest payments and amending the terms of loan covenants. Restructuring is a qualitative indicator of significant increase in credit risk, as well as default and credit impairment. So the Bank considers such client as non-standard and moves to Stage 2. However, as explained in this note above, not all restructuring occurring in 2021 due to COVID-19 were considered as indicators of increase in credit risk.

(in thousands of Georgian lari, unless otherwise stated)

4. Financial risk review (continued)

Credit risk – amounts arising from ECL (continued)

Measurement of ECL

The key inputs into the measurement of ECL are the term structure of the following variables:

- Probability of default (PD);
- Loss given default (LGD);
- Exposure at default (EAD).

ECL for exposures in Stage 1 is calculated by multiplying the 12-month PD by LGD and EAD. Lifetime ECL is calculated by multiplying the lifetime PD by LGD and EAD.

The Group estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. Vintage approach is used to determine the percentage of recovered portfolio of defaulted loans through its lifetime. Such loans are grouped by the default months and repaid exposure is linked to each group. Statistical results are used to forecast the future recoveries for the newly defaulted portfolios. Finally, cash flows are discounted by the effective interest rates and divided by the default portfolio to calculate LGD.

For loans collateralized by deposits (cash covers) and where the deposit currency is different from the loan currency LGD is calculated if the currency is depreciated by 20%. In case of gold pawn loans, loss is equal to the difference between the exposure and gold collateral revaluated by the ounce average price of the last twelve months.

EAD represents the expected exposure in the event of a default. Exposure at default calculated for the scheduled loans, overdrafts, credit cards and credit lines separately for each lifetime period. Historical behavior is observed to calculate the average default periods from the disbursement of the loan. Based on historical data analysis, it is showed that loss identification period is 6 months. So that point is used to calculate the EAD by subtracting the scheduled principal repayments till the forecasted overdue date and add three months interest accrued from overdue date till the date when the loan becomes default.

EAD for overdrafts, credit cards and credit lines is calculated directly from the historical data, for this purposes utilization rates – weight of disbursed exposure from the approved limit – of all defaulted overdrafts and credit cards are calculated.

Expected credit loss allowance

The following tables show reconciliations from the opening to the closing balances of the expected credit loss allowance by class of financial instruments.

Loans to customers at amortised cost – Business loans	***2020***				***2019***			
	Stage 1	***Stage 2***	***Stage 3***	***Total***	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Balance at 1 January	**2,876**	**3,763**	**7,075**	**13,714**	**2,397**	**2,516**	**7,980**	**12,893**
Transfer to Stage 1	136	–	(136)	**–**	78	(10)	(68)	**–**
Transfer to Stage 2	(487)	505	(18)	**–**	(77)	383	(306)	**–**
Transfer to Stage 3	(40)	(1,051)	1,091	**–**	(54)	(1,257)	1,311	**–**
Unwinding	–	–	435	**435**	–	–	–	**–**
Net remeasurement of loss allowance	(832)	10,060	1,539	**10,767**	(1,292)	931	30	**(331)**
New financial assets originated or purchased	8,247	–	–	**8,247**	3,126	–	–	**3,126**
Transfer to Stage 2	(6,262)	6,262	–	**–**	(1,200)	1,200	–	**–**
Transfer to Stage 3	(274)	–	274	**–**	(102)	–	102	**–**
Write-offs	–	–	(1,788)	**(1,788)**	–	–	(1,974)	**(1,974)**
Balance at 31 December	**3,364**	**19,539**	**8,472**	**31,375**	**2,876**	**3,763**	**7,075**	**13,714**

(in thousands of Georgian lari, unless otherwise stated)

4. Financial risk review (continued)

Expected credit loss allowance (continued)

Loans to customers at amortised cost – Consumer loans	*2020*				*2019*			
	Stage 1	*Stage 2*	*Stage 3*	*Total*	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Balance at 1 January	**691**	**441**	**2,359**	**3,491**	**837**	**846**	**3,183**	**4,866**
Transfer to Stage 1	34	(18)	(16)	**–**	131	(42)	(89)	**–**
Transfer to Stage 2	(34)	34	–	**–**	(10)	11	(1)	**–**
Transfer to Stage 3	(11)	(99)	110	**–**	(15)	(198)	213	**–**
Unwinding	–	–	136	**136**	–	–	–	**–**
Net remeasurement of loss allowance	(245)	588	1,300	**1,643**	(560)	(292)	411	**(441)**
New financial assets originated or purchased	594	–	–	**594**	580	–	–	**580**
Transfer to Stage 2	(309)	309	–	**–**	(116)	116	–	**–**
Transfer to Stage 3	(70)	–	70	**–**	(156)	–	156	**–**
Write-offs	–	–	(1,733)	**(1,733)**	–	–	(1,514)	**(1,514)**
Balance at 31 December	**650**	**1,255**	**2,226**	**4,131**	**691**	**441**	**2,359**	**3,491**

Loans to customers at amortised cost – Mortgage loans	*2020*				*2019*			
	Stage 1	*Stage 2*	*Stage 3*	*Total*	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Balance at 1 January	**249**	**172**	**677**	**1,098**	**308**	**258**	**467**	**1,033**
Transfer to Stage 1	–	–	–	**–**	–	–	–	**–**
Transfer to Stage 2	(23)	23	–	**–**	(5)	5	–	**–**
Transfer to Stage 3	–	(71)	71	**–**	(3)	(42)	45	**–**
Unwinding	–	–	64	**64**	–	–	–	**–**
Net remeasurement of loss allowance	(49)	763	–	**714**	(125)	(91)	158	**(58)**
New financial assets originated or purchased	300	–	–	**300**	148	–	–	**148**
Transfer to Stage 2	(135)	135	–	–	(42)	42	–	**–**
Transfer to Stage 3	(78)	–	78	–	(32)	–	32	**–**
Write-offs	–	–	–	**–**	–	–	(25)	**(25)**
Balance at 31 December	**264**	**1,022**	**890**	**2,176**	**249**	**172**	**677**	**1,098**

Loans to customers at amortised cost – Pawn loans	*2020*				*2019*			
	Stage 1	*Stage 2*	*Stage 3*	*Total*	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Balance at 1 January	**–**	**–**	**12,805**	**12,805**	**24**	**–**	**12,498**	**12,522**
Transfer to Stage 1	17	–	(17)	**–**	–	–	–	**–**
Transfer to Stage 2	–	–	–	**–**	–	–	–	**–**
Transfer to Stage 3	–	–	–	**–**	–	–	–	**–**
Net remeasurement of loss allowance	(17)	–	–	**(17)**	(24)	–	559	**535**
Repayments through repossessing	–	–	(9,483)	**(9,483)**	–	–	–	–
Write-offs	–	–	(3,305)	**(3,305)**	–	–	(252)	**(252)**
Balance at 31 December	**–**	**–**	**–**	**–**	**–**	**–**	**12,805**	**12,805**

The following table provides a reconciliation between amounts shown in the above tables reconciling opening and closing balances of expected credit loss allowance per class of financial instrument.

	2020				
	Loans to customers at amortised cost – Business loans	***Loans to customers at amortised cost – Consumer loans***	***Loans to customers at amortised cost – Mortgage loans***	***Loans to customers at amortised cost – Pawn loans***	***Total***
Net remeasurement of loss allowance	10,767	1,643	714	(17)	**13,107**
New financial assets originated or purchased	8,247	594	300	–	**9,141**
Subtotal	**19,014**	**2,237**	**1,014**	**(17)**	**22,248**
Recoveries of amounts previously written off	(57)	(1,798)	–	–	**(1,855)**
Total	**18,957**	**439**	**1,014**	**(17)**	**20,393**

(in thousands of Georgian lari, unless otherwise stated)

4. Financial risk review (continued)

Expected credit loss allowance (continued)

	2019				
	Loans to customers at amortised cost – Business loans	***Loans to customers at amortised cost – Consumer loans***	***Loans to customers at amortised cost – Mortgage loans***	***Loans to customers at amortised cost – Pawn loans***	***Total***
Net remeasurement of loss allowance	(331)	(441)	(58)	535	**(295)**
New financial assets originated or purchased	3,126	580	148	–	**3,854**
Subtotal	**2,795**	**139**	**90**	**535**	**3,559**
Recoveries of amounts previously written off	(1)	(1,116)	(25)	–	**(1,142)**
Total	**2,794**	**(977)**	**65**	**535**	**2,417**

The significant changes in the gross carrying amount of the Loans to customers' portfolio are further explained below.

Loans to customers at amortised cost – Business loans	*2020*				*2019*			
	Stage 1	***Stage 2***	***Stage 3***	***Total***	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Balance at 1 January	**497,333**	**17,281**	**22,228**	**536,842**	**420,135**	**13,629**	**17,520**	**451,284**
Transfer to Stage 1	205	–	(205)	**–**	265	(27)	(238)	**–**
Transfer to Stage 2	(89,049)	89,081	(32)	**–**	(9,010)	9,963	(953)	**–**
Transfer to Stage 3	(6,213)	(5,005)	11,218	**–**	(6,279)	(6,776)	13,055	**–**
New financial assets originated or purchased	296,910	–	–	**296,910**	320,430	–	–	**320,430**
Transfer to Stage 2	(46,436)	46,436	–	**–**	(4,781)	4,781	–	**–**
Transfer to Stage 3	(816)	–	816	**–**	(311)	–	311	**–**
Repayments and other movements (including foreign currency revaluations)	(141,597)	6,073	(5,986)	**(141,510)**	(223,116)	(4,289)	(5,493)	**(232,898)**
Unwinding	–	–	435	**435**	–	–	–	**–**
Write-offs	–	–	(1,788)	**(1,788)**	–	–	(1,974)	**(1,974)**
Balance at 31 December	**510,337**	**153,866**	**26,686**	**690,889**	**497,333**	**17,281**	**22,228**	**536,842**

Loans to customers at amortised cost – Consumer loans	*2020*				*2019*			
	Stage 1	***Stage 2***	***Stage 3***	***Total***	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Balance at 1 January	**88,290**	**3,145**	**5,128**	**96,563**	**91,115**	**3,377**	**5,424**	**99,916**
Transfer to Stage 1	117	(95)	(22)	**–**	319	(142)	(177)	**–**
Transfer to Stage 2	(4,709)	4,709	–	**–**	(1,085)	1,091	(6)	**–**
Transfer to Stage 3	(1,253)	(485)	1,738	**–**	(1,496)	(628)	2,124	**–**
New financial assets originated or purchased	31,214	–	–	**31,214**	46,195	–	–	**46,195**
Transfer to Stage 2	(2,572)	2,572	–	**–**	(753)	753	–	**–**
Transfer to Stage 3	(91)	–	91	**–**	(202)	–	202	**–**
Repayments and other movements (including foreign currency revaluations)	(23,458)	(464)	(204)	**(24,126)**	(45,803)	(1,306)	(925)	**(48,034)**
Unwinding	–	–	136	**136**	–	–	–	**–**
Write-offs	–	–	(1,733)	**(1,733)**	–	–	(1,514)	**(1,514)**
Balance at 31 December	**87,538**	**9,382**	**5,134**	**102,054**	**88,290**	**3,145**	**5,128**	**96,563**

(in thousands of Georgian lari, unless otherwise stated)

4. Financial risk review (continued)

Expected credit loss allowance (continued)

Loans to customers at amortised cost – Mortgage loans	***2020***				***2019***			
	Stage 1	***Stage 2***	***Stage 3***	***Total***	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Balance at 1 January	**87,833**	**1,918**	**1,629**	**91,380**	**87,125**	**912**	**897**	**88,934**
Transfer to Stage 1	–	–	–	**–**	–	–	–	**–**
Transfer to Stage 2	(7,845)	7,845	–	**–**	(1,276)	1,276	–	**–**
Transfer to Stage 3	(136)	(224)	360	**–**	(642)	(142)	784	**–**
New financial assets originated or purchased	37,428	–	–	**37,428**	28,236	–	–	**28,236**
Transfer to Stage 2	(1,638)	1,638	–	**–**	(133)	133	–	**–**
Transfer to Stage 3	(91)	–	91	**–**	(146)	–	146	**–**
Repayments and other movements (including foreign currency revaluations)	(15,446)	331	(259)	**(15,374)**	(25,331)	(261)	(173)	**(25,765)**
Unwinding	–	–	64	**64**	–	–	–	**–**
Write-offs	–	–	–	**–**	–	–	(25)	**(25)**
Balance at 31 December	**100,105**	**11,508**	**1,885**	**113,498**	**87,833**	**1,918**	**1,629**	**91,380**

Loans to customers at amortised cost – Pawn loans	***2020***				***2019***			
	Stage 1	***Stage 2***	***Stage 3***	***Total***	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Balance at 1 January	**31,046**	**–**	**18,996**	**50,042**	**36,336**	**–**	**22,177**	**58,513**
Transfer to Stage 1	138	–	**(138)**	–	–	–	–	**–**
Transfer to Stage 2	–	–	**–**	–	–	–	–	**–**
Transfer to Stage 3	–	–	**–**	–	–	–	–	**–**
New financial assets originated or purchased	12,901	–	**–**	12,901	5,358	–	–	**5,358**
Repayments and other movements (including foreign currency revaluations)	(14,032)	–	**(15,553)**	(29,585)	(10,648)	–	(2,929)	**(13,577)**
Write-offs	–	–	**(3,305)**	(3,305)	–	–	(252)	**(252)**
Balance at 31 December	**30,053**	**–**	**–**	**30,053**	**31,046**	**–**	**18,996**	**50,042**

Credit quality analysis

The following table provides information on the credit quality of loans to customers as at 31 December 2020 and 31 December 2019:

Loans to customers at amortised cost – Business loans	***31 December 2020***				***31 December 2019***			
	Stage 1	***Stage 2***	***Stage 3***	***Total***	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Not overdue	503,541	142,919	8,412	**654,872**	489,051	11,369	7,050	**507,470**
Overdue less than 30 days	6,796	6,943	1,043	**14,782**	8,282	2,138	1,321	**11,741**
Overdue 30-90 days	–	4,000	2,749	**6,749**	–	3,774	1,874	**5,648**
Overdue more than 90 days	–	4	14,482	**14,486**	–	–	11,983	**11,983**
Total business loans, gross	**510,337**	**153,866**	**26,686**	**690,889**	**497,333**	**17,281**	**22,228**	**536,842**
Loss allowance	(3,364)	(19,539)	(8,472)	**(31,375)**	(2,876)	(3,763)	(7,075)	**(13,714)**
Carrying amount	**506,973**	**134,327**	**18,214**	**659,514**	**494,457**	**13,518**	**15,153**	**523,128**

(in thousands of Georgian lari, unless otherwise stated)

4. Financial risk review (continued)

Credit quality analysis

Loans to customers at amortised cost – Consumer loans	***31 December 2020***				***31 December 2019***			
	Stage 1	***Stage 2***	***Stage 3***	***Total***	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Not overdue	86,771	8,203	1,630	**96,604**	86,676	2,496	1,861	**91,033**
Overdue less than 30 days	767	351	256	**1,374**	1,614	201	994	**2,809**
Overdue 30-90 days	–	828	487	**1,315**	–	448	288	**736**
Overdue more than 90 days	–	–	2,761	**2,761**	–	–	1,985	**1,985**
Total consumer loans, gross	**87,538**	**9,382**	**5,134**	**102,054**	**88,290**	**3,145**	**5,128**	**96,563**
Loss allowance	(650)	(1,255)	(2,226)	**(4,131)**	(691)	(441)	(2,359)	**(3,491)**
Carrying amount	**86,888**	**8,127**	**2,908**	**97,923**	**87,599**	**2,704**	**2,769**	**93,072**

Loans to customers at amortised cost – Mortgage loans	***31 December 2020***				***31 December 2019***			
	Stage 1	***Stage 2***	***Stage 3***	***Total***	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Not overdue	98,526	10,866	747	**110,139**	86,077	1,456	869	**88,402**
Overdue less than 30 days	1,579	237	77	**1,893**	1,756	178	310	**2,244**
Overdue 30-90 days	–	405	163	**568**	–	284	20	**304**
Overdue more than 90 days	–	–	898	**898**	–	–	430	**430**
Total mortgage loans, gross	**100,105**	**11,508**	**1,885**	**113,498**	**87,833**	**1,918**	**1,629**	**91,380**
Loss allowance	(264)	(1,022)	(890)	**(2,176)**	(249)	(172)	(677)	**(1,098)**
Carrying amount	**99,841**	**10,486**	**995**	**111,322**	**87,584**	**1,746**	**952**	**90,282**

Loans to customers at amortised cost – Pawn loans	***31 December 2020***				***31 December 2019***			
	Stage 1	***Stage 2***	***Stage 3***	***Total***	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Not overdue	30,053	–	–	**30,053**	31,046	–	225	**31,271**
Overdue less than 30 days	–	–	–	**–**	–	–	–	**–**
Overdue 30-90 days	–	–	–	**–**	–	–	–	**–**
Overdue more than 90 days	–	–	–	**–**	–	–	18,771	**18,771**
Total pawn loans, gross	**30,053**	**–**	**–**	**30,053**	**31,046**	**–**	**18,996**	**50,042**
Loss allowance	–	–	–	**–**	–	–	(12,805)	**(12,805)**
Carrying amount	**30,053**	**–**	**–**	**30,053**	**31,046**	**–**	**6,191**	**37,237**

Explanation of the terms: Stage 1, Stage 2, Stage 3, are included in Note 3(e)(iv).

The following table sets out information on loans to customers that are credit-impaired and have considered collateral in LGD, in absence of this collateral or other credit enhancements, ECL as at 31 December 2020 and 2019 would have been higher by:

	2020	***2019***
Business loans	15,220	8,960
Consumer loans	1,639	1,826
Mortgage loans	514	488
Total ECL	**17,373**	**11,274**

(in thousands of Georgian lari, unless otherwise stated)

5. Cash and cash equivalents

	2020	*2019*
Cash on hand	**43,743**	**32,713**
Nostro accounts with the NBG	**16,673**	**16,397**
Current accounts with other credit institutions		
- rated A- to A+	263	194
- rated BBB to BBB+	17,793	1,220
- rated below B+	2,464	5,615
- not rated	1,022	849
Total current accounts with other credit institutions	**21,542**	**7,878**
Total cash and cash equivalents	**81,958**	**56,988**

No cash and cash equivalents are past due or impaired. As at 31 December 2020 the Group has one bank (2019: one bank), whose balance exceeds 10% of equity. The gross value of the balance as at 31 December 2020 was GEL 17,222 thousand (2019: GEL 16,397 thousand). As at 31 December 2020 the Group allocates cash equivalents under Stage 1 for the purposes of identifying expected credit loss under IFRS 9 (31 December 2019: Stage 1). Management estimates that ECL is immaterial at reporting dates.

6. Investment securities

	2020	*2019*
Held by the Bank		
Investment securities measured at amortized cost		
- Government securities of the Ministry of Finance of Georgia	68,520	57,052
- Certificates of deposit of the National Bank of Georgia	13,843	1,992
- Corporate securities	5,017	–
Total gross carrying value	**87,380**	**59,044**
Expected credit losses	(69)	(35)
Total net investment securities	**87,311**	**59,009**

The Group holds a portfolio of debt securities issued by the Government of Georgia, the National Bank of Georgia and corporate issuers.

Investment Securities with carrying value of GEL 29,550 thousand (2019: nil) are used as collateral for loans from the National Bank of Georgia (Note 12).

All investment securities are denominated in GEL and their contractual interest rates and maturities are as follows:

	31 December 2020		*31 December 2019*	
	Nominal interest rate, %	*Maturity*	*Nominal interest rate, %*	*Maturity*
Investment securities	7-11	2021-2028	7-14	2020-2023

No investment securities are past due or impaired. As at 31 December 2020 the Group allocates investment securities under Stage 1 for the purposes of identifying expected credit loss under IFRS 9 (31 December 2019: Stage 1).

Movements in the credit loss allowance of investment securities measured at amortized cost for the year ended 31 December 2020 was GEL 34 thousand.

(in thousands of Georgian lari, unless otherwise stated)

7. Loans to customers

	2020	**2019**
Business loans	690,889	536,842
Consumer loans	102,054	96,563
Mortgage loans	113,498	91,380
Gold pawn loans	30,053	50,042
Gross loans to customers	**936,494**	**774,827**
Less: allowance for impairment (Note 4)	(37,682)	(31,108)
Net loans to customers	**898,812**	**743,719**

(a) Industry and geographical analysis of the loan portfolio

Loans to customers were issued primarily to customers located within Georgia who operate in the following economic sectors:

	2020	**2019**
Trading and service	362,712	297,338
Individuals	215,552	187,943
Construction	195,792	136,191
Agriculture and food processing	62,028	46,809
Gold pawn	30,053	50,042
Energy	23,286	23,339
Healthcare	21,729	17,445
Financial institutions	5,060	3,463
Other	20,282	12,257
Gross loans to customers	**936,494**	**774,827**

Loans of GEL 46,622 thousand (2019: GEL 10,021 thousand) are pledged under the loans received from the NBG. See Note 12.

(b) Significant credit exposures

As at 31 December 2020 three of the Group's borrowers' balances exceeds 10% of equity each (2019: none). The gross carrying value of the loans issued to that borrowers amounts to GEL 57,648 thousand as at 31 December 2020. An allowance of GEL 76 thousand was recognised against these loans.

As at 31 December 2020, the Group had a concentration of loans represented by GEL 121,584 thousand due from the ten largest borrowers (2019: GEL 74,998 thousand). An allowance of GEL 253 thousand (2019: GEL 6,958 thousand) was recognised against these loans.

(c) Analysis of collateral and other credit enhancements

The general creditworthiness of a customer tends to be the most relevant indicator of credit quality of the loan extended to it. However, collateral provides additional security and the Bank generally requests borrowers to provide it.

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. The Bank has implemented the guidelines regarding the acceptability of types of collateral and valuation parameters.

Management ensures, that major part of the business loans, gold pawn loans and mortgage loans are fully covered by the market value of the collateral.

(in thousands of Georgian lari, unless otherwise stated)

7. Loans to customers (continued)

(c) Analysis of collateral and other credit enhancements (continued)

The following tables provide information on collateral and other credit enhancements securing loans to customers, net of impairment, by types of collateral:

	Net exposures					
At 31 December 2020	***Real estate***	***Cash collateral***	***Other***	***Precious metals***	***No collateral***	***Total***
Business	624,899	11,803	16,783	3,031	2,998	**659,514**
Consumer	42,326	14,962	897	–	39,738	**97,923**
Mortgage	110,213	1,108	1	–	–	**111,322**
Gold pawn	–	–	2,815	27,238	–	**30,053**
Total	**777,438**	**27,873**	**20,496**	**30,269**	**42,736**	**898,812**

	Net exposures					
At 31 December 2019	***Real estate***	***Cash collateral***	***Other***	***Precious metals***	***No collateral***	***Total***
Business	463,198	9,170	13,329	43	37,388	**523,128**
Consumer	44,155	8,062	886	–	39,969	**93,072**
Mortgage	89,548	732	–	–	2	**90,282**
Gold pawn	80	–	–	37,157	–	**37,237**
Total	**596,981**	**17,964**	**14,215**	**37,200**	**77,359**	**743,719**

The tables above excludes overcollateralization. For loans secured by multiple types of collateral, collateral that is most relevant for impairment assessment is disclosed. The majority of the loans with no collateral represents payroll loans, which include loans secured with personal guarantees.

(d) Repossessed collateral

Repossessed property mainly represents real estate and gold assets acquired by the Group in settlement of overdue loans. These assets are treated as inventories, are recognized at net book value of the respective loan when acquired and subsequently measured at the lower of cost and net realizable value. The Group's policy is to sell the repossessed property as soon as it is practicable.

During 2020, the Group has an addition of repossessed property, represented by real estate and precious metals, with the value of GEL 7,541 thousand (2019: GEL 2,327 thousand) and sales of repossessed property with the value of GEL 1,234 thousand (2019: GEL 2,550 thousand). The Group incurred GEL 1,600 thousand loss on sale and revaluation of repossessed assets (2019: GEL 1,366 thousand).

(in thousands of Georgian lari, unless otherwise stated)

8. Premises and equipment

	Land	*Premises*	*Office and computer equipment*	*Vehicles*	*Furniture, fixtures and other fixed assets*	*Leasehold improvements*	*Right of use assets*	*Total*
Cost								
As at 1 January 2019	**449**	**15,559**	**7,260**	**717**	**9,440**	**3,535**	**8,667**	**45,627**
Additions	764	358	42	291	575	113	–	**2,143**
Disposals	–	–	–	–	–	(92)	(854)	**(946)**
As at 31 December 2019	**1,213**	**15,917**	**7,302**	**1,008**	**10,015**	**3,556**	**7,813**	**46,824**
As at 1 January 2020	**1,213**	**15,917**	**7,302**	**1,008**	**10,015**	**3,556**	**7,813**	**46,824**
Additions	–	2	52	6	2,772	428	945	**4,205**
Disposals	–	–	(1)	(52)	(125)	–	(450)	**(628)**
As at 31 December 2020	**1,213**	**15,919**	**7,353**	**962**	**12,662**	**3,984**	**8,308**	**50,401**
Accumulated depreciation								
As at 1 January 2019	**–**	**4,104**	**5,134**	**529**	**6,703**	**2,030**	**–**	**18,500**
Depreciation charge	–	277	471	87	824	257	1,452	**3,368**
Disposals	–	–	–	–	–	(45)	(158)	**(203)**
As at 31 December 2019	**–**	**4,381**	**5,605**	**616**	**7,527**	**2,242**	**1,294**	**21,665**
As at 1 January 2020	**–**	**4,381**	**5,605**	**616**	**7,527**	**2,242**	**1,294**	**21,665**
Depreciation charge	–	287	533	104	1,053	274	1,313	**3,564**
Disposals	–	–	(1)	(52)	(57)	–	(201)	**(311)**
As at 31 December 2020	**–**	**4,668**	**6,137**	**668**	**8,523**	**2,516**	**2,406**	**24,918**
Net book value								
1 January 2019	**449**	**11,455**	**2,126**	**188**	**2,737**	**1,505**	**8,667**	**27,127**
31 December 2019	**1,213**	**11,536**	**1,697**	**392**	**2,488**	**1,314**	**6,519**	**25,159**
31 December 2020	**1,213**	**11,251**	**1,216**	**294**	**4,139**	**1,468**	**5,902**	**25,483**

Fully depreciated assets' book value was GEL 10,562 thousand as at 31 December 2020 and GEL 9,617 thousand as at 31 December 2019.

(in thousands of Georgian lari, unless otherwise stated)

9. Goodwill

Goodwill of GEL 20,374 thousand fully relates to the acquisition of JSC Standard Bank in 2008.

The Group is considered as a one cash-generating unit (CGU) for the impairment test purposes. The recoverable amount of the CGU is based on the value in use, estimated using discounted cash flows.

The key assumptions used in the estimation of the recoverable amount are set out below. The values assigned to the key assumptions represented management's assessment of future trends in the banking industry, projected growth rate of the country's economy and were based on historical data from both external and internal sources.

In percent	*2020*	*2019*
Discount rate	15.6%	11.2%
Terminal value growth rate	5.0%	4.8%
Budgeted growth rate of free cash flows (average of next five years)	4.8%	4.8%

The discount rate reflects the required rate of return for the cash flows on the invested capital of similar companies denominated in USD. The growth in discount rate in 2020 is derived by increased market rates due to COVID-19 related risks.

The estimated recoverable amount of the CGU exceeded its carrying amount. Management believes that no reasonably possible change in any of the key assumptions would cause the carrying amount of the CGU to exceed its recoverable amount.

10. Other assets

	2020	*2019*
Guarantee deposits placed in banks	4,020	3,312
Settlements on plastic cards	118	307
Financial liabilities at fair value through profit and loss (Note 17)	–	229
Receivables	368	742
Other	55	45
Total other financial assets	**4,561**	**4,635**
Prepayments for the purchase of fixed assets	1,591	1,085
Other	1,062	1,027
Total other assets	**7,214**	**6,747**

Management estimates that ECL is immaterial as at 31 December 2020 and 2019.

11. Taxation

	2020	*2019*
Current tax expense		
Current year	–	(2,810)
Movement in temporary differences due to origination and reversal of temporary differences	71	880
Total income tax expense	**71**	**(1,930)**

In 2020, the applicable tax rate for current and deferred tax is 15% (2019: 15%).

Reconciliation of effective tax rate

	2020	*%*	*2019*	*%*
Profit before tax	**3,848**		**21,960**	
Income tax at the applicable tax rate	577	15	3,294	15
Change in unrecognised deferred tax liabilities due to change in the legislation (Note 3)	359	9	(760)	(4)
Net non-taxable income	(1,007)	(26)	(604)	(3)
	(71)	**(2)**	**1,930**	**8**

(in thousands of Georgian lari, unless otherwise stated)

11. Taxation (continued)

Movement in temporary differences during the year

	1 January 2020	*Recognised in profit or loss*	*31 December 2020*
Loans to customers	(396)	(813)	(1,209)
Intangible assets	(26)	179	153
Tax loss carry-forwards	–	557	557
Other	(421)	148	(273)
	(843)	**71**	**(772)**

	1 January 2019	*Recognised in profit or loss*	*31 December 2019*
Loans to customers	(481)	85	(396)
Goodwill and other intangible assets	118	(144)	(26)
Other	(1,360)	939	(421)
	(1,723)	**880**	**(843)**

According to Georgian government's latest announcements, the banking sector's transition to the new profit tax model (Note 3) will be effective after 1 January 2023.

12. Loans from financial institutions and lease liabilities

	Currency	*Year of maturity*	*31 December 2020*	*31 December 2019*
Black Sea Trade and Development Bank (BSTDB)	USD	2021	16,875	14,830
Nederlandse FinancieringsMaatschappij Voor Ontwikkelingslanden N.V. (FMO)	GEL	2023	18,825	25,117
ResponsAbility SICAV (Lux)	USD	2023	3,940	4,606
Deutsche Investitions- und Entwicklungsgesellschaft (DEG)	EUR	2025	55,781	44,358
COMMERZBANK	EUR	2021	8,196	6,505
Loans from the NBG	GEL	2021	76,016	10,015
Lease liabilities	GEL	2030	83	–
Lease liabilities	USD	2021-2028	7,578	7,201
Total			**187,294**	**112,632**

Loan from the NBG with original maturities of less than 3 months is an instrument used for liquidity management purposes. The loans are secured by loans to customers with carrying value of GEL 46,622 thousand (2019: GEL 10,021 thousand) and investment securities with carrying value of GEL 29,550 thousand (2019: nil). See Notes 6 and 7.

13. Subordinated loans

	Currency	*Interest rates*	*Year of maturity*	*31 December 2020*	*31 December 2019*
Loan 1	USD	11%	2025	4,940	5,189
Loan 2	USD	11%	2026	3,970	4,053
Loan 3	USD	6%	2025	24,583	30,121
Loan 4	USD	4%	2024	9,832	8,605
Loan 5	EUR	6.5%	2027	12,252	–
Loan 6	USD	7.3%-8.5%	2025	3,900	3,413
Loan 7	EUR	6%	2025	2,012	1,605
Total				**61,489**	**52,986**

In case of bankruptcy, the repayment of the subordinated borrowings will be made after repayment in full of all other liabilities of the Group.

(in thousands of Georgian lari, unless otherwise stated)

13. Subordinated loans (continued)

None of the subordinated loans are secured by the Group's assets.

No conversion features are present in the subordinated debt agreements as at 31 December 2020 and 2019.

14. Reconciliation of movements of liabilities to cash flows arising from financing activities

The table below sets out an analysis of the movements in liabilities that are reported as financing in the consolidated statement of cash flows for the period presented.

	Loans from financial institutions	***Lease liabilities***	***Subordinated loans***	***Total***
Balance at 1 January 2020	**105,431**	**7,201**	**52,986**	**165,618**
Cash flow from financing activities	58,167	(1,974)	(708)	**55,485**
Receipts of loans	*81,533*	–	*9,210*	***90,743***
Repayment of the loans	*(23,366)*	–	*(9,918)*	***(33,284)***
Payment of lease liabilities	–	*(1,974)*	–	***(1,974)***
Foreign exchange adjustments	15,768	1,055	9,031	**25,854**
Net movement on interest including foreign currency gain/(loss)	267	661	180	**1,108**
Addition	–	751	–	**751**
Modification on lease liabilities	–	(33)	–	**(33)**
Balance at 31 December 2020	**179,633**	**7,661**	**61,489**	**248,783**

	Loans from financial institutions	***Lease liabilities***	***Subordinated loans***	***Total***
Balance at 1 January 2019	**71,805**	**8,667**	**46,115**	**126,587**
Cash flow from financing activities	31,455	(2,023)	3,456	**32,888**
Receipts of loans	*50,552*	–	*4,917*	***55,469***
Repayment of the loans	*(19,097)*	–	*(1,461)*	***(20,558)***
Payment of lease liabilities	–	*(2,023)*	–	***(2,023)***
Dividend paid	–	–	–	***(8,508)***
Foreign exchange adjustments	1,803	741	3,414	**5,958**
Net movement on interest including foreign currency gain/(loss)	368	519	1	**888**
Disposals	–	(323)	–	**(323)**
Modification on lease liabilities	–	(380)	–	**(380)**
Balance at 31 December 2019	**105,431**	**7,201**	**52,986**	**165,618**

15. Deposits and balances from credit institutions

	2020	***2019***
Time deposits from credit institutions	10,873	5,457
Short-term placements of other credit institutions	65	65
Total deposits and balances from credit institutions	**10,938**	**5,522**

Time deposits from banks in 2020 and 2019 are denominated in EUR.

(in thousands of Georgian lari, unless otherwise stated)

16. Current accounts and deposits from customers

	2020	*2019*
Current accounts	220,866	206,210
Time deposits	640,620	496,938
Total current account and deposits from customers	**861,486**	**703,148**
Held as a security against guarantees and letters of credit issued	*18,905*	*10,692*

As at 31 December 2020, the Group has 8 customers (2019: 4 customers), whose balances individually exceed 10% of equity. These balance as at 31 December 2020 are GEL 201,759 thousand (2019: GEL 98,634 thousand).

	2020	*2019*
Private enterprises	323,187	301,999
Individuals	410,426	371,383
State and budgetary organizations	127,873	29,766
Total current account and deposits from customers	**861,486**	**703,148**

An analysis of amounts due to customers by economic sector is as follows:

	2020	*2019*
Individuals	410,426	371,383
Trade and service	137,021	100,350
Construction	54,077	58,285
State and budgetary organizations	127,873	29,766
Insurance	–	7,180
Non-banking credit organizations	–	5,439
Energy	50	1,321
Mining	2	698
Transport and communication	751	315
Other	131,286	128,411
Total current account and deposits from customers	**861,486**	**703,148**

17. Other liabilities

	2020	*2019*
Financial liabilities due to clients' loan facilities	3,786	–
Accrued employee benefit costs	2,215	3,757
Settlements on plastic cards and money transfer operations	1,269	1,566
Financial liabilities from services received	752	625
Financial liabilities at fair value through profit and loss	449	–
Other	125	160
Total other financial liabilities	**8,596**	**6,108**
Provisions for guarantees and credit related commitments	431	472
Other provisions	2,076	2,691
Other	487	365
Total other liabilities	**11,590**	**9,636**

The table below shows the fair values of foreign currency forward contracts, recorded as assets or liabilities (31 December 2020: included in other liabilities, 31 December 2019: included in other assets), together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying asset reference rate, 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.

	31 December 2020		***31 December 2019***	
Foreign currency forward contract	***Notional amount***	***Fair value***	***Notional amount***	***Fair value***
Sell USD buy GEL	11,774	72	10,723	458
Sell EUR buy USD	65,871	(521)	36,691	(229)

(in thousands of Georgian lari, unless otherwise stated)

18. Equity

	Ordinary shares	
Number of shares	***2020***	***2019***
In issue at 1 January and 31 December, fully paid	**1,213,720**	**1,213,720**
Authorised shares – par value (in GEL)	**100**	**100**

All ordinary shares rank equally with regard to the Bank's residual assets.

Ordinary shares

On 17 September 2020 one of the shareholders of the Bank H.H Sheikh Hamdan Bin Zayed Bin Sultan Al-Nahyan transferred and H.H Sheikh Nahayan Mabarak Al Nahayan acquired 20% of the Bank's shares (242,744 shares). As a result of this transaction Sheikh Nahayan Mabarak Al Nahayan become owner of 65% of the Bank's shares.

The holders of ordinary shares are entitled to receive dividends as declared from time to time, and are entitled to one vote per share at general meetings of the Bank. In 2020 the Group has not declared payment of dividends (2019: GEL 8,508 thousand, GEL 7.01 per share).

19. Net interest income calculated using the effective interest method

	2020	***2019***
Loans to customers	81,438	76,064
Investment securities	6,440	4,332
Cash and cash equivalents	916	1,503
Total interest income	**88,794**	**81,899**
Amounts due to customers	31,578	27,223
Loans from financial institutions and lease liabilities	11,965	7,666
Subordinated debts	3,917	3,129
Total interest expense	**47,460**	**38,018**
Net interest income	**41,334**	**43,881**

20. Fee and commission income and expenses

	2020	***2019***
Plastic card transactions	2,519	3,251
Settlement transactions	1,243	1,630
Servicing of current accounts	794	934
Cash transactions	527	654
Other	170	251
Total fee and commission income from contracts with customers	**5,253**	**6,720**
Financial guarantee contracts	1,021	1,140
Total fee and commission income	**6,274**	**7,860**
Plastic card transactions	2,428	2,601
Settlement transactions	415	411
Cash transactions	142	309
Other	402	335
Total fee and commission expenses	**3,387**	**3,656**
Net fee and commission income	**2,887**	**4,204**

(in thousands of Georgian lari, unless otherwise stated)

20. Fee and commission income and expenses (continued)

Performance obligations and revenue recognition policies

Fee and commission income from contracts with customers is measured based on the consideration specified in a contract with a customer. The Group recognises revenue when it transfers control over a service to a customer.

The following table provides information about the nature and timing of the satisfaction of performance obligations in contracts with customers, including significant payment terms, and the related revenue recognition policies.

Type of service	***Nature and timing of satisfaction of performance obligations, including significant payment terms***	***Revenue recognition under IFRS 15***
Retail and corporate banking service	The Group provides banking services to retail and corporate customers, including account management, provision of overdraft facilities, foreign currency transactions, credit cards and servicing fees. Fees for ongoing account management are charged to the customer's account on a monthly basis. Transaction-based fees for interchange, foreign currency transactions and overdrafts are charged to the customer's account when the transaction takes place. Servicing fees are charged on a monthly basis and are based on fixed rates reviewed annually by the Group.	Revenue from account service and servicing fees is recognised over time as the services are provided. Revenue related to transactions is recognised at the point in time when the transaction takes place.

21. Net gain from foreign exchange transactions

	2020	***2019***
Net gain from trading in foreign currencies	3,016	3,719
Net gain from foreign exchange translation	3,647	83
Net gain from foreign currency forward contracts	1,335	1,601
Total net gain from foreign exchange transactions	**7,998**	**5,403**

Net loss from foreign currency forward contracts in 2020 includes GEL 5,177 thousand (GEL 2,298 thousand in 2019) settled in cash for a negative difference between spot and agreed forward rates at the settlement date, which is also part of net gain from trading in foreign currencies in cash flow statement.

22. Other operating expenses

	2020	***2019***
Professional services	1,604	1,283
Advertising and marketing services	1,018	1,380
Lease expenses	746	636
Taxes other than on income	692	719
Security expense	480	497
Transportation and cash collection	447	519
Communications	415	399
Repair and maintenance	363	419
Insurance	359	323
Representative expenses	268	436
Office supply	234	249
Plastic card expenses	97	99
Business trip expenses	41	80
Other	694	867
Total other operating expenses	**7,458**	**7,906**

For 2020 and 2019, lease expenses include expenses under low value and short-term lease contracts.

For 2020, professional fees paid to financial auditors comprised GEL 249 thousand (2019: GEL 147 thousand).

(in thousands of Georgian lari, unless otherwise stated)

22. Other operating expenses (continued)

The following table presents average number of employees in 2020 and 2019.

	2020	*2019*
Top management	5	6
Middle management	44	43
Other permanent staff	375	376
Total permanent staff	**424**	**425**
Total temporary staff	**68**	**73**
	492	**498**

23. Credit related commitments

The Group has outstanding credit related commitments to extend loans. These credit related commitments take the form of approved loans and credit card limits and overdraft facilities. The Group provides financial guarantees and letters of credit to guarantee the performance of customers to third parties. These agreements have fixed limits and generally extend for a period of up to three years.

The Group applies the same credit risk management policies and procedures when granting credit commitments, financial guarantees and letters of credit as it does for granting loans to customers.

The contractual amounts of credit related commitments are set out in the following table by category. The amounts reflected in the table for credit related commitments assume that amounts are fully advanced. The amounts reflected in the table for guarantees and letters of credit represent the maximum accounting loss that would be recognised at the reporting date if the counterparties failed completely to perform as contracted.

	2020	*2019*
Credit related commitments		
Financial guarantees	44,975	37,347
Letters of credit	–	300
Total credit related commitments	**44,975**	**37,647**
Less: cash held as security against guarantees and letters of credit	(18,905)	(10,692)
Net exposure to guarantees and letters of credit	**26,070**	**26,955**
Undrawn loan commitments	**25,002**	**24,631**

As at 31 December 2020 the Group allocates undrawn loan commitments mostly under Stage 1 for the purposes of identifying expected credit loss under IFRS 9 (31 December 2019: Stage 1). As at 31 December 2020 the respective ECL amount is GEL 151 thousand (31 December 2019: GEL 281 thousand).

As at 31 December 2020 the Group allocates financial guarantees under Stage 1 for the purposes of identifying expected credit loss under IFRS 9 (31 December 2019: Stage 1). As at 31 December 2020 the respective ECL amount is GEL 280 thousand (31 December 2019: GEL 201 thousand).

24. Risk management

Management of risk is fundamental to the business of banking and forms an essential element of the Group's operations. The major risks faced by the Group are those related to market risk, credit risk, liquidity risk, and operational, legal and reputational risks.

The risk management policies aim to identify, analyse and manage the risks faced by the Group, to set appropriate risk limits and controls, and to continuously monitor risk levels and adherence to limits. Risk management policies and procedures are reviewed regularly to reflect changes in market conditions, products and services offered and emerging best practice. The Group has developed a system of reporting on significant risks and capital.

As at 31 December 2020, the Group's internal documentation establishing the procedures and methodologies for identification, managing and stress-testing the Group's significant risks, was approved by the authorized management bodies of the Group in accordance with regulations and recommendations issued by the NBG.

The Management Board with Risk Committee has overall responsibility for the oversight of the risk management framework, overseeing the management of key risks and reviewing its risk management policies and procedures as well as approving significantly large exposures.

(in thousands of Georgian lari, unless otherwise stated)

24. Risk management (continued)

The management is responsible for monitoring and implementing risk mitigation measures, and ensuring that the Group operates within established risk parameters. The Chief Risk Officer is responsible for the overall risk management, ensuring the implementation of common principles and methods for identifying, measuring, managing and reporting both financial and non-financial risks, although financial risk department is under supervision of the Chief Financial Officer. The CRO and the CFO report directly to the Chief Executive Officer.

The Risk Committee under Supervisory Board has responsibility for controlling the Group's compliance with risk limits and capital adequacy ratios as established by the Group's internal documentation. With the view of controlling effectiveness of the Group's risk management procedures and their consistent application the Supervisory Board, Risk Committee and management bodies of the Bank periodically receive reports prepared by the internal audit function and the Risk department, discuss the contents of these reports and consider proposed corrective actions.

Credit, market and liquidity risks, both at the portfolio and transactional levels, are managed and controlled through a system of Credit Committees and an Asset and Liability Management Committee (ALCO). In order to facilitate efficient and effective decision-making, the Group established a hierarchy of credit committees, depending on the type and amount of the exposure.

Both external and internal risk factors are identified and managed throughout the organisation. Particular attention is given to identifying the full range of risk factors and determining the level of assurance over current risk mitigation procedures. Apart from the standard credit and market risk analysis, the Risk Department monitors financial and non-financial risks by holding regular meetings with operational units in order to obtain expert judgments in their respective areas of expertise.

Credit risk

The Group takes on exposure to credit risk, which is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Exposure to credit risk arises primary as a result of the Group's lending and other transactions with counterparties giving rise to financial assets.

The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers. The Bank further established 3 levels of credit committees which are responsible for approving credit limits for individual borrowers. Review and approval limits for each credit committee differs per loan type. Only retail loans with the maximum amount of GEL 10 thousand and sanctioned retail loans (payroll/credit card/overdraft) with the maximum amount of GEL 20 thousand are issued on branch level. Loan applications originated by the relevant client relationship managers are passed on to the relevant credit committee for approval of credit limit.

In order to monitor credit risk exposures, regular reports are produced by the portfolio analysis manager and reviewed by the credit risk department. Monitoring includes review of the customer's financial performance.

The Group is also exposed to credit risk arising from guarantees and letters of credit. Credit risk for off-balance sheet financial instruments is defined as the possibility of sustaining a loss as a result of another party to a financial instrument failing to perform in accordance with the terms of the contract. The Bank uses the same credit policies in assuming conditional obligations as it does for on-balance sheet financial instruments, through established credit approvals, risk control limits and monitoring procedures.

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

	2020				*2019*			
	Georgia	*OECD*	*CIS and other foreign countries*	*Total*	*Georgia*	*OECD*	*CIS and other foreign countries*	*Total*
Assets								
Cash and cash equivalents	62,880	17,485	1,593	**81,958**	55,032	1,023	933	**56,988**
Mandatory reserves with the NBG	150,957	–	–	**150,957**	115,597	–	–	**115,597**
Loans to customers	896,354	1,857	601	**898,812**	742,201	896	622	**743,719**
Investment securities	87,311	–	–	**87,311**	59,009	–	–	**59,009**
Other financial assets	4,561	–	–	**4,561**	4,635	–	–	**4,635**
	1,202,063	**19,342**	**2,194**	**1,223,599**	**976,474**	**1,919**	**1,555**	**979,948**

(in thousands of Georgian lari, unless otherwise stated)

24. Risk management (continued)

Liquidity risk and funding management

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. It refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments as they actually fall due. Liquidity risk exists when the maturities of assets and liabilities do not match. The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of financial institutions.

In order to manage liquidity risk, the Bank performs daily monitoring of future expected cash flows on clients' and banking operations, which is part of the assets/liabilities management process. The Management Board set limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals under both normal and stressed conditions. They also set parameters for the risk diversification of the liability base.

The Bank's liquidity policy is comprised of the following:

- Projecting cash flows and maintaining the level of liquid assets necessary to ensure liquidity in various time-bands;
- Maintaining a funding plan commensurate with the bank's strategic goals;
- Maintaining a diverse range of funding sources thereby increasing the bank's borrowing capacity, domestically as well as from foreign sources;
- Maintaining highly liquid and high-quality assets;
- Adjusting its product base by time bands against available funding sources;
- Daily monitoring of liquidity ratios against regulatory requirements; and
- Constant monitoring of asset and liability structures by time-bands.

Treasury function within the Bank is charged with the following responsibilities:

- Compliance with the liquidity requirements of the NBG as well as with the liquidity requirement covenants contained in the agreements with foreign lending sources;
- Daily reports to management, including reporting to management on the levels of liquid assets in the main currencies (GEL, USD, EUR), cash positions;
- Weekly reports to management on the forecasted levels of cash flows in the main currencies (GEL, USD, EUR);
- Constantly controlling/monitoring the level of liquid assets;
- Monitoring of deposit and other liability concentrations; and
- Maintaining a plan for the instant increase of cash to provide liquidity under stressed conditions.

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on certain liquidity ratios established by the NBG. According to the NBG regulation monthly average Liquidity Coverage Ratio (LCR) should not be less than 100%. ALCO is responsible for ensuring that Treasury properly manages the Bank's liquidity position. The Financial Risk Management Department is responsible for controlling these activities. Decisions on liquidity positions and management are made by ALCO.

(in thousands of Georgian lari, unless otherwise stated)

24. 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. 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 tables below. These balances are included in amounts due in less than three months in the tables below:

As at 31 December 2020	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Non-derivative financial liabilities					
Loans from financial institutions and lease liabilities and deposits and balances from banks	99,881	38,631	75,349	898	**214,759**
Current accounts and deposits from customers	521,303	229,790	114,331	22,335	**887,759**
Other financial liabilities	5,939	–	2,657	–	**8,596**
Subordinated loans	1,254	4,690	61,119	14,038	**81,101**
Derivative financial liabilities					
Inflow	77,645	–	–	–	**77,645**
Outflow	(78,094)	–	–	–	**(78,094)**
Total undiscounted financial liabilities	**627,928**	**273,111**	**253,456**	**37,271**	**1,191,766**

As at 31 December 2019	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Financial liabilities					
Loans from financial institutions and deposits and balances from banks	22,715	31,428	68,330	11,581	**134,054**
Current accounts and deposits from customers	445,132	187,280	89,355	1,114	**722,881**
Other financial liabilities	6,108	–	–	–	**6,108**
Subordinated loans	512	3,831	54,907	7,395	**66,645**
Derivative financial liabilities					
Inflow	47,413	–	–	–	**47,413**
Outflow	(47,102)	–	–	–	**(47,102)**
Total undiscounted financial liabilities	**474,778**	**222,539**	**212,592**	**20,090**	**929,999**

The Group considers the maximum liquidity risk of all its financial guarantees and undrawn loan commitments as less than 3 months, as this is the earliest period when the guarantees can be called or the loan commitments can be drawn. However, based on the past experience, the management believes, that the Group is exposed to liquidity risk from its financial commitments and contingencies according to their contractual expiry dates:

	Less than 3 months	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
31 December 2020	28,184	11,951	29,697	115	**69,947**
31 December 2019	29,453	12,526	20,239	35	**62,253**

The Group expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

(in thousands of Georgian lari, unless otherwise stated)

24. Risk management (continued)

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises currency risk, interest rate risk and other price risks. Market risk mainly arises from open positions in interest rate financial instruments, which are exposed to general and specific market movements and changes in the level of volatility of market prices and foreign currency rates. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

The Group manages its market risk by following NBG's prudential ratio requirements on open currency position limits. These limits are monitored on a daily basis and the monitoring process is supervised by the Management Board.

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The portion of the Group's borrowings bears floating interest rate, while the Group's deposits and majority of loan portfolios are at fixed interest rate, NBG pays floating interest rate on minimum reserves that the Group holds with the NBG. The Group also holds a portfolio of loans to customers earning a floating interest income, these financial assets have counter effect to offset possible losses on negative movements of the interest rates of borrowings.

The table below summarizes impact of the 100 basis points interest rate change on the market to the Groups equity (net of tax):

	2020	*2019*
Financial assets	603,589	392,651
Financial liabilities	(78,086)	(73,723)
Net interest sensitivity position	**525,503**	**318,928**
100 Basis points increase of market interest rates	**4,467**	**2,711**
100 Basis points decrease of market interest rates	**(4,467)**	**(2,711)**

Currency risk

The Group has assets and liabilities denominated in several foreign currencies. Currency risk is the risk that the fair value or the future cash flows of a financial instrument will fluctuate because of changes in foreign currency exchange rates.

The following tables show the foreign currency exposure structure of financial assets and liabilities as at 31 December 2020 and 2019:

31 December 2020	*GEL*	*USD*	*EUR*	*Other currencies*	*Total*
Assets					
Cash and cash equivalents	16,771	17,080	3,686	678	**38,215**
Mandatory reserves with the NBG	–	115,255	35,702	–	**150,957**
Loans to customers	336,603	340,506	221,703	–	**898,812**
Investment securities	87,311	–	–	–	**87,311**
Other financial assets	496	253	3,811	1	**4,561**
Total assets	**441,181**	**473,094**	**264,902**	**679**	**1,179,856**
Liabilities					
Loans from financial institutions and lease liabilities and deposits and balances from banks	95,238	27,793	75,201	–	**198,232**
Current accounts and deposits from customers	282,087	460,073	118,238	1,088	**861,486**
Subordinated loans	–	47,120	14,369	–	**61,489**
Other financial liabilities	7,631	314	643	8	**8,596**
Total liabilities	**384,956**	**535,300**	**208,451**	**1,096**	**1,129,803**
Net balance sheet position	**56,225**	**(62,206)**	**56,451**	**(417)**	**50,053**
Effect of derivatives	11,774	54,097	(65,871)	–	**–**
Net position	**67,999**	**(8,109)**	**(9,420)**	**(417)**	**50,053**

(in thousands of Georgian lari, unless otherwise stated)

24. Risk management (continued)

Currency risk (continued)

31 December 2019	*GEL*	*USD*	*EUR*	*Other currencies*	*Total*
Assets					
Cash and cash equivalents	16,456	5,886	1,381	552	**24,275**
Mandatory reserves with the NBG	–	90,688	24,909	–	**115,597**
Loans to customers	272,194	316,591	154,934	–	**743,719**
Investment securities	59,009	–	–	–	**59,009**
Other financial assets	368	835	3,089	343	**4,635**
Total assets	**348,027**	**414,000**	**184,313**	**895**	**947,235**
Liabilities					
Loans from financial institutions and lease liabilities and deposits and balances from banks	35,145	26,648	56,361	–	**118,154**
Current accounts and deposits from customers	232,258	375,968	93,654	1,268	**703,148**
Subordinated loans	–	51,381	1,605	–	**52,986**
Other financial liabilities	4,143	1,688	246	31	**6,108**
Total liabilities	**271,546**	**455,685**	**151,866**	**1,299**	**880,396**
Net balance sheet position	**76,481**	**(41,685)**	**32,447**	**(404)**	**66,839**
Effect of derivatives	10,723	25,968	(36,691)	–	**–**
Net position	**87,204**	**(15,717)**	**(4,244)**	**(404)**	**66,839**

A (weakening)/strengthening of the GEL, as indicated below, against USD at 31 December 2020 and 2019, would have affected equity and profit or loss by the amounts shown below. This analysis is on a net-of-tax basis and is based on foreign currency exchange rate variances that the Group considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant.

	2020	*2019*
10% weakening of USD against GEL	689	1,336
10% strengthening of USD against GEL	(689)	(1,336)

The following significant exchange rates applied during the year:

in GEL	*Average rate 2020*	*Average rate 2019*	*Reporting date spot rate 31 December 2020*	*Reporting date spot rate 31 December 2019*
USD 1	3.1097	2.8192	3.2766	2.8677
EUR 1	3.5519	3.1553	4.0233	3.2095

25. Fair value measurements

Fair values are categorised into different levels in a fair value hierarchy based on the inputs used in the valuation techniques as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices);
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

If the inputs used to measure the fair value of an asset or a liability might be categorised in different levels of the fair value hierarchy, then the fair value measurement is categorised in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.

The estimated fair values of all financial instruments except for disclosed below as at 31 December 2020 and 31 December 2019 approximate their carrying amounts.

(in thousands of Georgian lari, unless otherwise stated)

25. Fair value measurements (continued)

The estimates of fair value are intended to approximate 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. However, given the uncertainties and the use of subjective judgment, the fair value should not be interpreted as being realizable in an immediate sale of the assets or transfer of liabilities.

		Fair value measurement using			
At 31 December 2020	***Date of valuation***	***(Level 1)***	***(Level 2)***	***(Level 3)***	***Total***
Assets for which fair values are disclosed					
Loans to customers	31 December 2020	–	872,061	–	**872,061**
Investment securities	31 December 2020	–	88,193	–	**88,193**
		–	**960,254**	**–**	**960,254**

26. Maturity analysis of financial assets and liabilities

The table below shows an analysis of financial assets and liabilities according to when they are contractually due to be recovered or settled.

	2020			*2019*		
	Within one year	***More than one year***	***Total***	***Within one year***	***More than one year***	***Total***
Cash and cash equivalents	81,958	–	**81,958**	56,988	–	**56,988**
Mandatory reserve deposit with the NBG	150,957	–	**150,957**	115,597	–	**115,597**
Loans to customers	224,786	674,026	**898,812**	177,912	565,807	**743,719**
Investment securities	40,840	46,471	**87,311**	37,582	21,427	**59,009**
Other financial assets	4,268	293	**4,561**	4,320	315	**4,635**
Total	**502,809**	**720,790**	**1,223,599**	**392,399**	**587,549**	**979,948**
Loans from financial institutions and lease liabilities and deposits and balances from banks	133,644	64,588	**198,232**	46,279	71,875	**118,154**
Current accounts and deposits from customers	738,872	122,614	**861,486**	605,823	97,325	**703,148**
Subordinated loans	1,894	59,595	**61,489**	1,511	51,475	**52,986**
Other financial liabilities	5,939	2,657	**8,596**	6,108	–	**6,108**
Total	**880,349**	**249,454**	**1,129,803**	**659,721**	**220,675**	**880,396**
Net gap	**(377,540)**	**471,336**	**93,796**	**(267,322)**	**366,874**	**99,552**

The Group's capability to discharge its liabilities relies on its ability to realize an equivalent amount of assets within the same period of time.

As at 31 December 2020, total amounts due to customers amounted to GEL 861,486 thousand (2019: GEL 703,148 thousand). The Group conducts analysis of the stability of the customer accounts within amounts due to customers for the period of the preceding two years on a monthly basis. Current accounts end-of-month balances have not fallen on average below GEL 200,439 thousand (2019: GEL 205,037 thousand) for the preceding 24 months. Significant part of total current accounts represents current accounts from legal entities, which historically are of long-term nature. As such, it is reasonable to treat these funds for estimation of liquidity position of the Group as with maturity of more than one year.

(in thousands of Georgian lari, unless otherwise stated)

27. Related party disclosures

(a) Control relationships

Ultimate controlling party of the Bank is Sheikh Nahayan Mubarak Al Nahyan. The shareholding structure of the Bank is disclosed in note 1 of these consolidated financial statements.

(b) Transactions with key management

Total remuneration included in personnel expenses for the years ended 31 December 2020 and 2019 is as follows:

	2020	***2019***
Salaries and other benefits	1,462	3,146

As at 31 December 2020 the Group has issued loans of GEL 112 thousand (2019: GEL 60 thousand) to its key management. The loans are mainly long-term and bear average interest rate of 15%. In 2020 interest income accrued on the loans to the key management is GEL 20 thousand (2019: GEL 8.5 thousand).

As at 31 December 2020 the key management placed deposits of GEL 2,197 thousand with the Bank (2019: GEL 2,050 thousand). The deposits bear average interest rate of 5% and mature within 1 year from the reporting date. In 2020 interest expense accrued on the term deposits from the key management is GEL 105 thousand (2019: GEL 8.3 thousand).

(c) Transactions with entities under common control

	Transaction value 2020	***Outstanding balance 2020***	***Transaction value 2019***	***Outstanding balance 2019***
Subordinated loan from an entity under common control	(8,342)	34,415	–	38,726
Current accounts and term deposits of entities under common control	1,879	3,443	(1,694)	4,856

Terms and conditions of the subordinated loan is disclosed in Note 13. In 2020 interest expense of GEL 1,869 thousand was accrued on subordinated loan from the related party (2019: GEL 1,806 thousand). The current accounts and term deposits mainly do not bear interest rate and are on demand. Interest expense of GEL 78 thousand was accrued on terms deposits from related parties (2019: GEL 7 thousand).

28. 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, (ii) to safeguard the Bank's ability to continue as a going concern and is monitored monthly with reports outlining their calculation reviewed and subsequently submitted to the NBG.

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. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

The Group complied with all its externally imposed capital requirements at 31 December 2020 and as at 31 December 2019.

The NBG capital adequacy ratio

According to the NBG regulations about capital adequacy (Decree N100/04) on 18 December 2017 the minimum capital requirement ratios have been revised. As at 31 December 2020 Common Equity Tier 1 Capital (CET I), Tier I Capital (Tier I) and Total Capital ratios is set at 4.50%, 6.00% and 8.00%, respectively. Capital Conservation and Countercyclical buffers were set at 0%.

(in thousands of Georgian lari, unless otherwise stated)

28. Capital adequacy (continued)

The NBG capital adequacy ratio (continued)

In response to COVID-19 and to neutralize possible loan losses recorded on the banks' books pursuant to the request of the National Bank of Georgia (NBG), the NBG has changed regulatory capital requirements for the banks in 2020, it eliminated Conservation buffer, which was 2.5% and decreased the risk weight of unhedged currency position from 75% to 25% and thereby decreased the respective percentage buffer requirement in regulatory capital. Also the NBG postponed phase-in process of net GRAPE buffer, that was scheduled at the end of the first quarter of 2020. All of these had a positive impact on the Bank's capital adequacy position.

As at 31 December 2020, the Bank had to maintain the currency induced credit risk (CICR) buffer, Risk buffer for credit portfolio concentration and net GRAPE buffer, the sum of all these indicators is 4.71% (2019: 6.74%). All the rest Pillar II buffers were to preserve at nil percent (2019: nil). Under total Basel III requirements the Bank was required to maintain a minimum regulatory capital ratio, Common Equity Tier 1 capital adequacy ratio and Tier 1 capital adequacy ratio of 5.60%, 7.47% and 12.71%, respectively (2019: 9.26%, 11.52% and 17.24%, respectively). The Bank was in compliance with these capital adequacy ratios as at 31 December 2020 and as at 31 December 2019.

The calculation of the capital adequacy ratios in accordance with the NBG accounting rules and capital adequacy Basel III framework for 31 December 2020 and 31 December 2019:

	2020	***2019***
Core capital	102,542	116,132
Supplementary capital	57,989	56,857
Total regulatory capital	**160,531**	**172,989**
Risk weighted assets	**1,059,976**	**898,693**
Minimum total capital adequacy requirements	12.71%	17.24%
Total capital adequacy ratio	15.14%	19.25%
Minimum Tier 1 capital adequacy requirements	7.47%	11.52%
Tier 1 capital adequacy ratio	9.67%	12.92%

29. Contingencies

Operating environment

The Group's operations are located in Georgia. Consequently, the Group is exposed to the economic and financial markets of Georgia, which display characteristics of an emerging market. The legal, tax and regulatory frameworks continue development, but are subject to varying interpretations and frequent changes which together with other legal and fiscal impediments contribute to the challenges faced by entities operating in Georgia. The consolidated financial statements reflect management's assessment of the impact of the Georgian business environment on the operations and the financial position of the Group. The future business environment may differ from management's assessment.

Litigation

In the ordinary course of business, the Group 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.

Taxation contingencies

The taxation system in Georgia is relatively new and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are sometimes unclear, contradictory and subject to varying interpretation. In the event of a breach of tax legislation, no liabilities for additional taxes, fines or penalties may be imposed by the tax authorities after three years have passed since the end of the year in which the breach occurred.

These circumstances may create tax risks in Georgia that are more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Georgian tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on these consolidated financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

(in thousands of Georgian lari, unless otherwise stated)

30. Events after the reporting date

The Group has started process of liquidation of its subsidiary Standard Insurance LLC, which does not have operations in last few years. The subsidiary does not have any tax liabilities to the tax authorities. All required documentations are submitted to the Public Registry and the Bank is waiting official confirmation for its liquidation.