JSC VTB Bank (Georgia)

Financial statements

For the year ended 31 December 2018
together with independent auditor's report

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Independent auditor's report

To the shareholders and Supervisory Board of JSC VTB Bank (Georgia)

Opinion

We have audited the financial statements of JSC VTB Bank (Georgia) (hereinafter, the "Company"), which comprise the statement of financial position as at 31 December 2018, and the statement of profit or loss, the statement of comprehensive income, the statement of changes in equity and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2018 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (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 information included in the Company's 2018 Management Report

Other information consists of the information included in the Company's 2018 Management Report, other than the financial statements and our auditor's report thereon. Management is responsible for the other information. The Company's 2018 Management Report is expected to be made available to us after the date of this auditor's report.

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

In connection with our audit of the financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

Building a better working world

Responsibilities of management and Supervisory Board for the financial statements

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

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

Supervisory Board is responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company'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 Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

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

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

Marchello Gelashvili

On behalf of EY LLC

Tbilisi, Georgia

19 March 2019

Statement of financial position

As of 31 December

(Thousands of Georgian lari)

	Notes	2018	2017
Assets			
Cash and cash equivalents	6	184,505	211,642
Amounts due from banks and international financial institutions	7	160,013	230,470
Loans and advances to customers	8	1,097,216	950,476
Investment securities	9	114,581	120,724
Property and equipment	10	43,166	34,650
Investment property	11	20,271	24,556
Current income tax assets		1,958	–
Deferred income tax assets	12	–	1,189
Other assets	14	27,293	22,485
Total assets		**1,649,003**	**1,596,192**
Liabilities			
Amounts due to banks and international financial institutions	15	128,435	112,893
Amounts due to customers	16	1,005,563	895,757
Debt securities issued	17	51,007	38,193
Other borrowed funds	18	128,100	262,985
Current income tax liabilities		–	1,694
Deferred income tax liabilities	12	192	–
Other liabilities	14	27,885	19,503
Subordinated loan	27	52,757	37,362
Total liabilities		**1,393,939**	**1,368,387**
Equity			
Share capital	19	209,008	209,008
Land and buildings revaluation reserve		9,827	3,104
Perpetual subordinated loan	19	11,575	13,481
Unrealised gains on investment securities	9	–	568
Retained earnings		24,654	1,644
Total equity		**255,064**	**227,805**
Total liabilities and equity		**1,649,003**	**1,596,192**

Signed and authorised for issue on behalf of the Management Board of the Bank on 19 March 2019:

Archil Kontselidze
Chief Executive Officer

Mamuka Menteshashvili
Chief Financial Officer

The accompanying selected explanatory notes on pages 9 to 62 are an integral part of these financial statements.

Statement of profit or loss

For the year ended 31 December

(Thousands of Georgian lari)

	Notes	2018	2017
Interest revenue calculated using effective interest rate			
Loans and advances to customers		118,184	110,646
Investment securities		7,948	7,636
Cash and cash equivalents		2,370	2,898
Amounts due from banks and international financial institutions		1,883	1,722
		130,385	**122,902**
Interest expense			
Amounts due to customers		(42,011)	(43,338)
Amounts due to banks, international financial institutions and other borrowed funds		(14,307)	(13,889)
Interest expenses on debt securities issued		(2,393)	(1,612)
Subordinated loan		(3,355)	(2,937)
		(62,066)	**(61,776)**
Expense due to assets with negative interest rates (NIR)		(183)	(130)
Payments to deposit insurance system		(476)	(100)
Net interest income		**67,660**	**60,896**
Credit loss expense	13	(8,002)	1,650
Net interest income after credit loss expense		**59,658**	**62,546**
Net fee and commission income	21	5,200	6,540
Net gains/(losses) from foreign currencies:			
Dealing		(8,416)	16,132
Translation differences		21,153	(2,659)
Net gains/(losses) from investment securities	9	–	1,394
Net gains on investment property revaluation	11	1,169	2,430
Other income	22	13,111	6,568
Non-interest income		**32,217**	**30,405**
Personnel expenses	23	(39,118)	(37,734)
Depreciation	10	(3,714)	(3,571)
Other operating expenses	23	(18,792)	(15,706)
Reversal of legal claims	13	204	–
Reversal of provision for credit related commitments	13	229	438
Non-interest expenses		**(61,191)**	**(56,573)**
Profit before income tax expense		**30,684**	**36,378**
Income tax expense	12	(3,735)	(4,009)
Profit for the year		**26,949**	**32,369**

The accompanying selected explanatory notes on pages 9 to 62 are an integral part of these financial statements.

Statement of comprehensive income

For the year ended 31 December

(Thousands of Georgian lari)

	Notes	*2018*	*2017*
Profit for the year		**26,949**	**32,369**
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods			
Unrealised gains on investment securities	9	–	412
Realised gain on investment securities reclassified to the statement of profit or loss	9	–	(1,394)
Net other comprehensive (loss)/ income to be reclassified to profit or loss in subsequent periods		**–**	**(982)**
Other comprehensive income not to be reclassified to profit or loss in subsequent periods			
Revaluation of land and buildings	10	7,559	–
Income tax effect	12	(73)	–
Net other comprehensive income not to be reclassified to profit or loss in subsequent periods		**7,486**	**–**
Other comprehensive (loss)/income for the year, net of tax		**7,486**	**(982)**
Total comprehensive income for the year		**34,435**	**31,387**

The accompanying selected explanatory notes on pages 9 to 62 are an integral part of these financial statements.

Statement of changes in equity

For the year ended 31 December

(Thousands of Georgian lari)

	Notes	*Share capital*	*Land and buildings revaluation reserve*	*Unrealised gains on investment securities*	*Perpetual subordinated loan*	*Retained earnings*	*Total equity*
As of 31 December 2016		**191,293**	**3,160**	**1,550**	**12,900**	**(12,475)**	**196,428**
Total comprehensive income for the year		**–**	**–**	**(982)**	**–**	**32,369**	**31,387**
Amounts paid on Perpetual Subordinated Loan		–	–	–	–	(10)	**(10)**
Foreign exchange translation on perpetual subordinated loan		–	–	–	581	(581)	**–**
Issuance of share capital		17,715	–	–	–	–	**17,715**
Dividends declared		–	–	–	–	(17,715)	**(17,715)**
Transfer of premises revaluation reserve upon disposal or depreciation		–	(56)	–	–	56	**–**
As of 31 December 2017	19	**209,008**	**3,104**	**568**	**13,481**	**1,644**	**227,805**
Impact of adoption IFRS 9		–	–	(568)	–	(6,608)	**(7,176)**
Restated opening balance under IFRS 9		**209,008**	**3,104**	**–**	**13,481**	**(4,964)**	**220,629**
Total comprehensive income for the year		**–**	**7,486**	**–**	**–**	**26,949**	**34,435**
Foreign exchange translation on perpetual subordinated loan		–	–	–	(1,906)	1,906	**–**
Depreciation of revaluation reserve, net of tax		–	(763)	–	–	763	**–**
As of 31 December 2018		**209,008**	**9,827**	**–**	**11,575**	**24,654**	**255,064**

The accompanying selected explanatory notes on pages 9 to 62 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December

(Thousands of Georgian lari)

	Notes	*2018*	*2017*
Cash flows from operating activities			
Interest received		129,561	124,689
Interest paid		(63,348)	(59,267)
Fees and commissions received		14,709	17,972
Fees and commissions paid		(10,810)	(9,789)
Realised net gains from dealing in foreign currencies		1,519	14,740
Other income received		5,633	5,962
Personnel expenses paid		(38,721)	(38,309)
Other operating expenses paid		(17,506)	(18,526)
Cash flows from operating activities before changes in operating assets and liabilities		**21,037**	**37,472**
Net (increase)/decrease in operating assets			
Amounts due from banks and international financial institutions		(43,265)	(88,021)
Loans and advances to customers		(146,914)	(31,900)
Other assets		(2,239)	(835)
Net increase/(decrease) in operating liabilities			
Amounts due to banks and international financial institutions		12,020	(166,749)
Amounts due to customers		102,942	73,988
Debt securities issued		13,025	6,066
Other liabilities		1,043	(1,930)
Net cash flows from operating activities before income tax		**(42,351)**	**(171,909)**
Income tax paid		(6,194)	(3,443)
Net cash (used in) / received from operating activities		**(48,545)**	**(175,352)**
Cash flows from investing activities			
Acquisition of investment securities		(125,813)	(196,952)
Proceeds from sale and redemption of investment securities		132,020	155,496
Purchase of property, equipment and intangible assets		(7,088)	(5,348)
Proceeds from sale of property and equipment		11,589	26
Proceeds from disposal of investment property		1,635	4,833
Purchases of investment property		(456)	(2,072)
Net cash used in investing activities		**11,887**	**(44,017)**
Cash flows from financing activities			
Proceeds from issuance of share capital	19	–	17,715
Other borrowed funds received		1,143,613	1,615,546
Repayments of other borrowed funds		(1,151,199)	(1,501,531)
Proceeds from Subordinated loan		46,882	–
Repayments of Subordinated loan		(30,947)	–
Dividends paid	19	(7)	(17,246)
Interest paid on perpetual subordinated loan	19	–	(10)
Net cash received from financing activities		**8,342**	**114,474**
Effect of exchange rates changes on cash and cash equivalents		1,178	201
Net change in cash and cash equivalents		**(27,138)**	**(104,694)**
Cash and cash equivalents, beginning	6	**211,642**	**316,336**
Cash and cash equivalents, ending	6	**184,505**	**211,642**

The accompanying selected explanatory notes on pages 9 to 62 are an integral part of these financial statements.

(Thousands of Georgian lari)

1. Introduction

JSC VTB Bank (Georgia) (hereafter the "Bank") was formed as a joint stock company on 7 April 1995 under the laws of Georgia under the name of United Georgian Bank. Tbilisi Chugureti District Court gave the Bank registration number 202906427. The Bank changed its name to VTB Bank (Georgia) on 7 December 2006. The Bank operates under a general banking licence issued by the National Bank of Georgia (the "NBG") on 19 May 1995.

The Bank accepts deposits from the public and extends credit, transfers payments in Georgia and abroad, exchanges currencies and provides other banking services to its corporate and retail customers. Its main office is in Tbilisi, Georgia. As of 31 December 2018 and 2017, the Bank has 20 branches (10 of them in Tbilisi) and 18 service centres.

The Bank's registered legal address is 14, Chanturia str., Tbilisi, Georgia.

As of 31 December 2018 and 2017, the following shareholders owned more than 1% of the outstanding shares:

Shareholder	***2018 %***	***2017 %***
VTB Bank OJSC	97.38	97.38
Lacarpa Enterprises Limited	1.47	1.47
Other	1.14	1.14
Total	**100.00**	**100.00**

VTB Bank OJSC ("the Parent bank") is the immediate parent of the Bank. The ultimate controlling party for the Group is the Government of the Russian Federation ("RF"), acting through the Federal Property Agency, which holds 60.93% of issued and outstanding shares of the Parent bank as of 31 December 2018 (2017: 60.93%).

As of 31 December 2018 and 2017, none of the Supervisory Board and Management Board members owned shares of the Bank.

As of 31 December 2018, the Bank had 1,154 employees (2017: 1,209).

As at 31 December 2018, the Bank does not have any subsidiaries. On 8 November 2018 Georgian Fund Company LLC, the wholly owned dormant subsidiary of the Bank, went into liquidation.

2. Basis of preparation and significant accounting policies

Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention except for land and buildings, leasehold improvements, investment property, derivative financial instruments and equity investment securities carried at fair value.

These financial statements are presented in thousands of Georgian lari ("GEL"), unless otherwise indicated. GEL is utilised as the functional currency as the majority of the Bank's transactions are denominated or funded in GEL. Transactions in other currencies are treated as transactions in foreign currencies.

The principal accounting policies applied in the preparation of these financial statements are set out below.

Changes in presentation

Reclassifications

Following adoption of IFRS 9 (Note 3), the Bank updated presentation of statement of profit or loss to present impairment losses determined in accordance with IFRS 9 as 2 line items – Credit loss expense and Reversal of provision for credit related commitments (impairment related to off-balance items). Accordingly, the following reclassifications of impairment charges on loans and advances to customers, other financial assets and financial guarantees, letters of credit and undrawn loan commitments have been made to 2017 statement of profit or loss to conform to the 2018 presentation.

	As previously reported	***Reclassification***	***As adjusted***
Reversal of allowance/(allowance) for impairment	1,653	(1,653)	–
Other impairment and provision reversal/(charge)	435	(435)	–
Reversal of provision for credit related commitments	–	438	438
Credit loss expense	–	1,650	1,650

(Thousands of Georgian lari)

2. Basis of preparation and significant accounting policies (continued)

Financial assets

Initial recognition

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments. Financial instruments are initially measured at their fair value and, except in the case of financial assets and financial liabilities recorded at FVPL, transaction costs are added to, or subtracted from, this amount. The Bank determines the classification of its financial assets upon initial recognition and subsequently can reclassify financial assets in certain cases as described below.

Measurement categories of financial assets and liabilities

From 1 January 2018, the Bank classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms, measured at either:

- Amortized cost;
- FVOCI;
- FVPL.

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

Before 1 January 2018, the Bank classified its financial assets as loans and receivables (amortised cost), FVPL, available-for-sale or held-to-maturity (amortised cost).

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

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

Before 1 January 2018, amounts due from credit institutions and loans to customers included non-derivative financial assets with fixed or determinable payments that were not quoted in an active market.

From 1 January 2018, the Bank only measures amounts due from credit institutions, loans to customers and other financial investments at amortized cost if both of the following conditions are met:

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

Business model assessment

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

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

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

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

(Thousands of Georgian lari)

2. Basis of preparation and significant accounting policies (continued)

Financial assets (continued)

The SPPI test

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

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

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

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

Equity instruments at FVOCI

From 1 January 2018, upon initial recognition, the Bank occasionally elects to classify irrevocably some of its equity investments as equity instruments at FVOCI when they meet the definition of equity under IAS 32 Financial Instruments: Presentation and are not held for trading. Such classification is determined on an instrument-by-instrument basis.

Gains and losses on these equity instruments are never recycled to profit or loss. Dividends are recognised in profit or loss as other income when the right of the payment has been established, except when the Bank benefits from such proceeds as a recovery of part of the cost of the instrument, in which case, such gains are recorded in OCI. Equity instruments at FVOCI are not subject to an impairment assessment. Upon disposal of these instruments, the accumulated revaluation reserve is transferred to retained earnings.

Loans and receivables

Before 1 January 2018, loans and receivables were non-derivative financial assets with fixed or determinable payments that were not quoted in an active market. They were not entered into with the intention of immediate or short-term resale and were not classified as trading securities or designated as investment securities available-for-sale. Such assets were carried at amortised cost using the effective interest method. Gains and losses were recognised in profit or loss when the loans and receivables were derecognised or impaired, as well as through the amortisation process.

Available-for-sale financial assets

Before 1 January 2018, available-for-sale financial assets were those non-derivative financial assets that were designated as available-for-sale or were not classified in any of the three preceding categories. After initial recognition available-for sale financial assets were measured at fair value with gains or losses being recognised in other comprehensive income until the investment was derecognised or until the investment was determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income was reclassified to the statement of profit or loss. However, interest calculated using the effective interest method was recognised in profit or loss.

Determination of fair value

When financial instruments are recognized initially, they are measured at fair value, adjusted, in the case of instruments not at fair value through profit or loss, for directly attributable fees and costs.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price. If the Bank determines that the fair value at initial recognition differs from the transaction price, then:

- If the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e., a Level 1 input) or based on a valuation technique that uses only data from observable markets, the Bank recognises the difference between the fair value at initial recognition and the transaction price as a gain or loss;
- In all other cases, the initial measurement of the financial instrument is adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the Bank recognises that deferred difference as a gain or loss only when the inputs become observable, or when the instrument is derecognized.

(Thousands of Georgian lari)

2. Basis of preparation and significant accounting policies (continued)

Reclassification of financial assets and liabilities

From 1 January 2018, the Bank does not reclassify its financial assets subsequent to their initial recognition, apart from the exceptional circumstances in which the Bank changes the business model for managing financial assets. Financial liabilities are never reclassified. The Bank did not reclassify any of its financial assets and liabilities in 2017.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the NBG, excluding obligatory reserves, and amounts due from banks that mature within ninety days of the date of origination and are free from contractual encumbrances.

Derivative financial instruments

In the normal course of business, the Bank enters into certain derivative financial instruments contracts primarily including foreign exchange forwards and swaps. Such financial instruments are recorded at fair value. The fair values are estimated based on pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in net gains/(losses) from foreign currency dealing in statement of profit or loss.

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to banks and international financial institutions, amounts due to customers, other borrowed funds and subordinated loans. These are initially recognized at fair value of the consideration received less directly attributable transaction costs. After initial recognition, borrowings are measured at amortised cost using the effective interest method. Gains and losses are recognised in the Statement of profit or loss when the borrowings are derecognised as well as through the amortisation process.

Amounts due to banks and international financial institutions represent funds attracted to manage the Bank's liquidity, while other borrowed funds comprises funds received for general capital working purposes and under basic agreements with international credit institutions to finance activities of the Bank's customers.

Leases

i. *Operating − Bank as lessee*

Leases of assets under which the risks and rewards of ownership are effectively retained by the lessor are classified as operating leases. Lease payments under an operating lease are recognised as expenses on a straight-line basis over the lease term and included into other operating expenses.

ii. *Operating − Bank as lessor*

The Bank presents assets subject to operating leases in the statement of financial position according to the nature of the asset. Lease income from operating leases is recognised in profit or loss on a straight-line basis over the lease term. The aggregate cost of incentives provided to lessees is recognised as a reduction of rental income over the lease term on a straight-line basis. Initial direct costs incurred specifically to earn revenues from an operating lease are added to the carrying amount of the leased asset.

Impairment of financial assets under IAS 39

Before 1 January 2018, The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

(Thousands of Georgian lari)

2. Basis of preparation and significant accounting policies (continued)

Impairment of financial assets under IAS 39 (continued)

Loans and advances to customers, amounts due from banks and international financial institutions

For assets carried at amortised cost, the Bank first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risks characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised, are not included in a collective assessment of impairment.

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the Statement of profit or loss. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Bank's internal credit grading system that considers credit risk characteristics such as asset type, industry, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year. The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Information on impairment assessment under IFRS 9 is presented in Note 24.

Renegotiated loans

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

From 1 January 2018, the Bank derecognises a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognised as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognised loans are classified as Stage 1 for ECL measurement purposes, unless the new loan is deemed to be POCI. When assessing whether or not to derecognise a loan to a customer, amongst others, the Bank considers the following factors:

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

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

For modifications not resulting in derecognition, the Bank also reassesses whether here has been a significant increase in credit risk or whether the assets should be classified as credit-impaired. Once an asset has been classified as credit-impaired as the result of modification, it will remain in Stage 3 for a minimum 3-month probation period. In order for such restructured loan to be reclassified out of Stage 3 to Stage 2, regular payments of principal or interest have been made during the probation period in accordance with the modified payment schedule.

(Thousands of Georgian lari)

2. Basis of preparation and significant accounting policies (continued)

Derecognition of financial assets and liabilities

Financial assets

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

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

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

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Bank's continuing involvement is the amount of the transferred asset that the Bank may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Bank's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Non-performing loans

According to the Bank's policy, non-performing loans are derecognized as follows:

- Individually significant loans are being written off based on respective decision of the Bank's Credit committee;
- Uncollectible loans are written-off against the related allowance for impairment after all necessary procedures to recover the loans have been completed and the amount of the irretrievable loss has been determined.

In case the Bank receives any amounts from the borrower subsequently to the loan write off, respective amounts are recognized within allowance for loan impairment as recoveries.

Write-off

From 1 January 2018, financial assets are written off either partially or in their entirety only when the Bank has stopped pursuing the recovery. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to credit loss expense. A write-off constitutes a derecognition event.

Financial liabilities

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

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

Offsetting of financial instruments

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

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

(Thousands of Georgian lari)

2. Basis of preparation and significant accounting policies (continued)

Offsetting of financial instruments (continued)

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

Financial guarantees, letters of credit and undrawn loan commitments

The Bank issues financial guarantees, letters of credit and loan commitments.

Financial guarantees are initially recognized in the financial statements at fair value, being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amount initially recognized less cumulative amortization recognized in the statement of profit or loss, and – under IAS 37 (before 1 January 2018) – the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee, or – under IFRS 9 (from 1 January 2018) – an ECL provision.

Undrawn loan commitments and letters of credits are commitments under which, over the duration of the commitment, the Bank is required to provide a loan with pre-specified terms to the customer. Similar to financial guarantee contracts, under IAS 39, a provision was made if they were an onerous contract but, from 1 January 2018, these contracts are in the scope of the ECL requirements.

The Bank occasionally issues loan commitments at below market interest rates drawdown. Such commitments are initially recognized at fair value and subsequently measured at the higher of the amount of the ECL allowance and the amount initially recognized less, when appropriate, the cumulative amount of income recognized.

Taxation

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

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

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

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

Property and equipment

Property and equipment, except for land and buildings, are carried at cost, excluding costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met. Buildings are measured at fair value less depreciation and impairment charged subsequent to the date of the revaluation. Land is measured at fair value and not depreciated. As of 31 December 2018, an independent appraiser determined the fair value of the Bank's property. Additional details are provided in Note 10.

Any revaluation surplus is credited to the revaluation reserve for land and buildings included in other comprehensive income, except to the extent that it reverses a revaluation decrease of the same asset previously recognised in the statement of profit or loss, in which case the increase is recognised in the statement of profit or loss. A revaluation deficit is recognised in the statement of profit or loss, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the revaluation reserve for property and equipment.

An annual transfer from the revaluation reserve for property and equipment to retained earnings is made for the difference between depreciation based on the revalued carrying amount of the assets and depreciation based on the assets original cost. Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

Construction in progress is carried at cost, less provision for impairment where required. Upon completion, assets are transferred to office premises or other premises at their carrying amount. Construction in progress is not depreciated until the asset is available for use.

(Thousands of Georgian lari)

2. Basis of preparation and significant accounting policies (continued)

Property and equipment (continued)

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

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

	Years
Buildings	30-50
Utility systems and related features	10-40
Computers and communication equipment	4
Furniture, fixtures and office equipment	2-8
Motor vehicles	5
Leasehold improvements	Over the term of the underlying lease

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

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

Investment property

Investment property is land or building or a part of a building held to earn rental income or for capital appreciation and which is not used by the Bank or held for sale in the ordinary course of business.

Investment property is initially recognized at cost, including transaction costs, and subsequently remeasured at fair value reflecting market conditions at the end of the reporting period. Fair value of the Bank's investment property is determined on the basis of various sources including reports of independent appraisers, who hold a recognized and relevant professional qualification and who have recent experience in valuation of property of similar location and category.

Revaluation of investment property is performed on each reporting date and recognised in the statement of profit or loss as gains/losses on investment property revaluation. Rental income earned is recorded in the statement of profit or loss within other operating income.

Repossessed assets

Repossessed collateral represents non-financial assets acquired by the Bank in settlement of overdue loans. The assets are initially recognised at fair value when acquired and included in premises and equipment, investment property or inventories within other assets depending on their nature and the Bank's intention in respect of recovery of these assets and are subsequently re-measured and accounted for in accordance with the accounting policies for these categories of assets. Inventories of repossessed collateral are recorded at the lower of cost or net realisable value.

Intangible assets

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic lives of 2 to 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The Bank does not have any intangible assets with indefinite useful lives.

Provisions

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

(Thousands of Georgian lari)

2. Basis of preparation and significant accounting policies (continued)

Equity

Share capital

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

Dividends

Dividends are recognised as a liability and deducted from equity at the reporting date only if they are declared before or on the reporting date. Dividends are disclosed when they are proposed before the reporting date or proposed or declared after the reporting date but before the financial statements are authorised for issue.

Perpetual subordinated loan

Due to undefined maturity and an option for non-cumulative cancellation of coupon payments, the Bank accounts the Perpetual Subordinated Loan as an equity instrument and as a Tier I eligible instrument for the purpose of capital adequacy ratio calculation. The Bank accounts for the Perpetual Subordinated Loan denominated in the RUB in the amount equivalent of GEL, using the foreign exchange rate at the reporting date with foreign exchange translation effects recorded in retained earnings.

Contingencies

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

Recognition of income and expenses

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

Interest revenue and expense

From 1 January 2018, the Bank calculates interest revenue on debt financial assets measured at amortized cost by applying the EIR to the gross carrying amount of financial assets other than credit-impaired assets (before 1 January 2018: by applying EIR to the amortized cost of financial assets). EIR is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest revenue or expense.

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

For purchased or originated credit-impaired (POCI) financial assets, the Bank calculates interest revenue by calculating the credit-adjusted EIR and applying that rate to the amortised cost of the asset. The credit-adjusted EIR is the interest rate that, at original recognition, discounts the estimated future cash flows (including credit losses) to the amortised cost of the POCI assets.

Fee and commission income

The Bank earns fee and commission income from a diverse range of services it provides to its customers.
Loan commitment fees for loans that are likely to be drawn down and other credit related fees, including fee on guarantees and letters of credit issued, are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

(Thousands of Georgian lari)

2. Basis of preparation and significant accounting policies (continued)

Recognition of income and expenses (continued)

Dividend income

Revenue is recognised when the Bank's right to receive the payment is established.

Foreign currency translation

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

Differences between the contractual exchange rate of a transaction in a foreign currency and the NBG exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies. The official NBG exchange rates at 31 December 2018 and 2017 were 2.6766 GEL and 2.5922 GEL to 1 USD, respectively.

3. Critical accounting estimates and judgements in applying accounting policies

The Bank makes estimates and assumptions that affect the amounts recognised in the financial statements and the carrying values of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on Management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Going concern

The Bank's management has made an assessment of the Bank's ability to continue as a going concern and is satisfied that the Bank has the resources and the financial support of the Parent bank to continue in business for the foreseeable future. Furthermore, the Management is not aware of any material uncertainties that may cast significant doubt upon the Bank's ability to continue as a going concern. Therefore, the financial statements continue to be prepared on the going concern basis.

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. Additional details are provided in Note 25.

Impairment losses on financial assets

The measurement of impairment losses both under IFRS 9 and IAS 39 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances. The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- The Bank's internal credit grading model, which assigns PDs to the individual grades;
- The Bank's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a LTECL basis and the qualitative assessment;
- The segmentation of financial assets when their ECL is assessed on a collective basis;
- Incorporation of forward-looking information by establishing multiple macroeconomic scenarios, determining the probability of their occurrence and assessing the effect of the changes in observable macroeconomic factors on ECLs;
- Development of ECL models, including the various formulae and the choice of inputs.

(Thousands of Georgian lari)

3. Critical accounting estimates and judgements in applying accounting policies (continued)

Allowance for loan impairment

From 1 January 2018, the Bank implemented the three-stage expected credit loss impairment model in IFRS 9. The impairment charge for expected credit losses depends on whether the credit risk has increased significantly since initial recognition. If the credit risk has not increased significantly, the impairment charge equals the expected credit losses resulting from default events that are possible within the next 12 months (stage 1). If the credit risk has increased significantly, the loan is more than 30 days past due, or the loan is in default or otherwise impaired, the impairment charge equals the lifetime expected credit losses (stages 2 and 3).

The financial assets recorded in each stage have the following characteristics:

- Stage 1: unimpaired and without significant increase in credit risk on which a 12-month allowance for ECL is recognised;
- Stage 2: a significant increase in credit risk has been experienced since initial recognition on which a lifetime ECL is recognised;
- Stage 3: objective evidence of impairment, and are therefore considered to be in default or otherwise credit impaired on which a lifetime ECL is recognised; and
- Purchased or originated credit impaired ('POCI'): purchased or originated at a deep discount that reflects the incurred credit losses on which a lifetime ECL is recognised.

The expected credit loss is calculated for all individual facilities as a function of probability of default (PD), exposure at default (EAD) and loss given default (LGD) and incorporates forward-looking information. The estimation of expected credit losses involves forecasting future economic conditions over a number of years.

Measurement of ECL

The assessment of credit risk and the estimation of ECL are unbiased and probability-weighted, and incorporate all available information that is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. In general, Bank calculates ECL using three main components: a probability of default, a loss given default ('LGD') and the exposure at default ('EAD').
The 12-month ECL is calculated by multiplying the 12-month PD, LGD and EAD. Lifetime ECL is calculated using the lifetime PD instead. The 12-month and lifetime PDs represent the probability of default occurring over the next 12 months and the remaining maturity of the instrument respectively. The EAD represents the expected balance at default, taking into account the repayment of principal and interest from the balance sheet date to the default event together with any expected drawdowns of committed facilities. The LGD represents expected losses on the EAD given the event of default, taking into account, among other attributes, the mitigating effect of collateral value at the time it is expected to be realised and the time value of money.

Revaluation of property

The Bank regularly reviews the value of its property (land, office buildings, leasehold improvements and investment property) for compliance with fair value and performs revaluation to ensure that the current carrying value of property does not materially differ from its fair value. The Bank performs revaluation using special valuation techniques and information about real estate transactions entered into in the local market.

Land and buildings have been revalued to market value at 31 December 2018. Revalued buildings are depreciated in accordance with their remaining useful life since 1 January 2019.

As of 31 December 2018, an independent appraiser determined the fair value of the Bank's property. The market value of the property was determined based on market data. Additional details are provided in Note 10 and Note 11.

Taxation

The current income tax expense is calculated in accordance with the regulations in force in Georgia where the Bank operates.

The recognised deferred tax asset represents income taxes recoverable through future deductions from taxable profits and is recorded in the statement of financial position. Deferred income tax assets are recorded to the extent that realisation of the related tax benefit is probable. The future taxable profits and the amount of tax benefits that are probable in the future are based on management expectations that are believed to be reasonable under the circumstances. Refer to Note 12.

(Thousands of Georgian lari)

4. Changes in accounting policies and adoption of new or revised standards and interpretations

The Bank applied *IFRS 15* and *IFRS 9* for the first time. The nature and effect of the changes as a result of adoption of these new accounting standards are described below.

The Bank applied for the first time certain amendments to the standards, which are effective for annual periods beginning on or after 1 January 2018. The Bank has not early adopted any standards, interpretations or amendments that have been issued but are not yet effective. The nature and the impact of each amendment is described below:

IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement* for annual periods on or after 1 January 2018. The Bank has not restated comparative information for 2017 for financial instruments in the scope of IFRS 9. Therefore, the comparative information for 2017 is reported under IAS 39 and is not comparable to the information presented for 2018. Differences arising from the adoption of IFRS 9 have been recognised directly in retained earnings as of 1 January 2018 and are disclosed below.

(a) Classification and measurement

Under IFRS 9, all debt financial assets that do not meet a “solely payment of principal and interest” (SPPI) criterion, are classified at initial recognition as fair value through profit or loss (FVPL). Under this criterion, debt instruments that do not correspond to a “basic lending arrangement”, such as instruments containing embedded conversion options or “non-recourse” loans, are measured at FVPL. For debt financial assets that meet the SPPI criterion, classification at initial recognition is determined based on the business model, under which these instruments are managed:

- Instruments that are managed on a “hold to collect” basis are measured at amortized cost;
- Instruments that are managed on a “hold to collect and for sale” basis are measured at fair value through other comprehensive income (FVOCI);
- Instruments that are managed on other basis, including trading financial assets, will be measured at FVPL.

Equity financial assets are required to be classified at initial recognition as FVPL unless an irrevocable designation is made to classify the instrument as FVOCI. For equity investments classified as FVOCI, all realized and unrealized gains and losses, except for dividend income, are recognized in other comprehensive income with no subsequent reclassification to profit and loss.

The classification and measurement of financial liabilities remain largely unchanged from the current IAS 39 requirements. Derivatives will continue to be measured at FVPL.

The Bank expects to continue measuring financial assets currently classified as loans and receivables at amortised cost as vast majority of the instruments satisfied the SPPI criterion. The Bank does not expect any non-derivative financial assets to be measured at FVPL.

Debt securities currently classified as available-for-sale are expected to be measured at amortized cost under IFRS 9 as the Bank expects to hold these assets only to collect contractual cash flows. Equity securities will be measured at FVOCI.

(b) Impairment

IFRS 9 requires the Bank to record an allowance for expected credit losses (ECL) on all of its debt financial assets at amortised cost or FVOCI, as well as loan commitments and financial guarantees. The allowance is based on the ECL associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case the allowance is based on the ECL over the life of the asset. If the financial asset meets the definition of purchased or originated credit impaired, the allowance is based on the change in the lifetime ECL.

According to the new model for the recognition of impairment losses, introduced by IFRS 9, there is “three stage” approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired. Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL.

The adoption of IFRS 9 has fundamentally changed the Bank’s accounting for loan impairment by replacing IAS 39 incurred loss approach with a forward-looking expected credit loss (ECL) approach. From 1 January 2018, the Bank has been recording the allowance for expected credit losses for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts. Equity instruments are not subject to impairment under IFRS 9.

(Thousands of Georgian lari)

4. Changes in accounting policies and adoption of new or revised standards and interpretations (continued)

IFRS 9 Financial Instruments (continued)

(b) Impairment (continued)

The allowance is based on the ECLs associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination. If the financial asset meets the definition of purchased or originated credit impaired (POCI), the allowance is based on the change in the ECLs over the life of the asset. Details of the Bank's impairment method are disclosed in Note 24.

The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in section (c) below.

(c) Effect of transition to IFRS 9

The following tables set out the impact of adopting IFRS 9 on the statement of financial position and retained earnings as at 1 January 2018 including the effect of replacing IAS 39 incurred credit loss calculations with IFRS 9 ECL.

A reconciliation between the carrying amounts under IAS 39 to the balances reported under IFRS 9 as at 1 January 2018 is as follows:

	IAS 39 measurement		***Reclassi-***	***Remasurement***		***IFRS 9***	
Financial assets	***Category***	***Amount***	***fication***	***ECL***	***Other***	***Amount***	***Category***
Cash and cash equivalents	L&R[1]	211,642	–	(10)	–	211,632	Amortised cost
Amounts due from banks and credit institutions	L&R	230,470	–	(29)	–	230,441	Amortised cost
Loans to customers – amortised cost	L&R	950,476	(1,245)	(32,600)	26,433	943,064	Amortised cost
Investment securities available-for-sale	AFS[3]	120,724	(120,724)	–	–		
investment securities – amortised cost	AFS[3]	–	121,915	(354)	(353)	121,208	Amortised cost
Investment securities – FVOCI	AFS[3]	–	54	-	–	54	FVOCI (equity)
Other financial assets – amortised cost	L&R	3,557	–	(142)	–	3,415	Amortised cost
Non-financial assets			–				
Deferred tax assets		1,189	–	-	101	1,290	
Total assets		**1,596,192**	–	**(33,135)**	**26,181**	**1,589,238**	
Financial liabilities							
Provisions for CRC off-BS commitments		(424)		(222)		(646)	
Total liabilities		**(1,368,387)**		**(222)**		**(1,368,609)**	

1 L&R: Loans and receivables.

2 FVOCI: fair value through other comprehensive income

3 AFS: Available-for-sale.

As of 1 January 2018, the Bank's analysis highlighted that all loans to customers met the SPPI criterion and are classified by Bank at amortised cost category.

As of 1 January 2018, the Bank has classified its previous AFS debt instruments portfolio as debt instruments at amortised cost. These instruments met the SPPI criterion, were not actively traded and were held with the intention to collect cash flows and without the intention to sell.

The Bank has elected the option to irrevocably designate its previous AFS equity instruments as Equity instruments at FVOCI.

(Thousands of Georgian lari)

4. Changes in accounting policies and adoption of new or revised standards and interpretations (continued)

IFRS 9 Financial Instruments (continued)

The impact of transition to IFRS 9 on reserves and retained earnings is as follows:

	Reserves and retained earnings
Fair value reserve	
Closing balance under IAS 39 (31 December 2017)	568
Reclassification of debt investment securities from available-for-sale to amortised cost	(568)
Restated opening balance under IFRS 9 (1 January 2018)	**–**
Retained earnings	
Closing balance under IAS 39 (31 December 2017)	1,644
Recognition of IFRS 9 ECLs	(6,924)
Remeasurement of investment securities at amortised cost reclassified from available for sale category by IAS 39	215
Deferred tax in relation to the above	101
Restated opening balance under IFRS 9 (1 January 2018)	**(4,964)**
Total change in equity due to adopting IFRS 9	**(7,176)**

The following table reconciles the aggregate opening loan loss allowances under IAS 39 and provisions for loan commitments and financial guarantee contracts in accordance with IAS 37 Provisions Contingent Liabilities and Contingent Assets to the ECL allowances under IFRS 9.

	Loan loss allowance/ provision under IAS 39 / IAS 37 at 31 December 2017	***Reclassification***	***Remeasurement***	***Other***	***ECL under IFRS 9 at 1 January 2018***
Impairment allowance for					
Loans and receivables at amortised cost	(31,329)	14	(6,348)	(26,433)	**(64,096)**
Available-for-sale debt investment securities per IAS 39 / Investment securities at amortised cost under IFRS 9	–	(14)	(354)	–	**(368)**
	(31,329)	**–**	**(6,702)**	**(26,433)**	**(64,464)**
Financial guarantees and other credit-related commitments	(190)	–	(226)	–	**(416)**
Letters of credit	(91)	–	2	–	**(89)**
Other commitments	(143)	–	2	–	**(141)**
	(424)	–	**(222)**	**–**	**(646)**
	(31,753)	–	**(6,924)**	**(26,433)**	**(65,110)**

IFRS 15 Revenue from Contracts with Customers

IFRS 15, issued in May 2014, and amended in April 2016, establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. However, the standard does not apply to revenue associated with financial instruments and leases, and therefore, does not impact the majority of the Bank's revenue including interest revenue, gains/(losses) on operations with securities, lease income which are covered by IFRS 9 Financial Instruments and IAS 17 Leases. As a result, the adoption of IFRS 15 has no significant impact on the Bank's financial statements.

(Thousands of Georgian lari)

4. Changes in accounting policies and adoption of new or revised standards and interpretations (continued)

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Considerations

The Interpretation clarifies that, in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine the date of the transactions for each payment or receipt of advance consideration. This Interpretation does not have any impact on the Bank's financial statements.

Amendments to IAS 40 Transfers of Investment Property

The amendments clarify when an entity should transfer property, including property under construction or development into, or out of investment property. The amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use. These amendments do not have any impact on the Bank's financial statements.

5. New accounting pronouncements

Up to the date of approval of the financial statements, certain new standards, interpretations and amendments to existing standards have been published that are not yet effective for the current reporting period and which the Bank has not early adopted. Such standards that are expected to have an impact on the Bank, or the impacts of which are currently being assessed, are as follows:

IFRS 16 Leases

IFRS 16 was issued in January 2016 and it replaces IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement Contains a Lease*, SIC-15 *Operating Leases – Incentives* and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

Lessor accounting under IFRS 16 is substantially unchanged from today's accounting under IAS 17. Lessors will continue to classify all leases using the same classification principle as in IAS 17 and distinguish between two types of leases: operating and finance leases.

IFRS 16, which is effective for annual periods beginning on or after 1 January 2019, requires lessees and lessors to make more extensive disclosures than under IAS 17.

The Bank plans to adopt IFRS 16 retrospectively with the cumulative effect of initially applying IFRS 16 recognised at the date of initial application. The Bank will elect to apply the standard to contracts that were previously identified as leases applying IAS 17 and IFRIC 4. The Bank will therefore not apply the standard to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4.

The Bank will elect to use the exemptions proposed by the standard on lease contracts for which the lease terms ends within 12 months as of the date of initial application, and lease contracts for which the underlying asset is of low value. The Bank has leases of certain office equipment (i.e., personal computers, printing and photocopying machines) that are considered of low value.

(Thousands of Georgian lari)

5. New accounting pronouncements (continued)

Annual improvements 2015-2017 cycle (issued in December 2017)

IAS 12 Income Taxes

The amendments clarify that the income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, an entity recognises the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognised those past transactions or events.

An entity applies those amendments for annual reporting periods beginning on or after 1 January 2019, with early application is permitted. When an entity first applies those amendments, it applies them to the income tax consequences of dividends recognised on or after the beginning of the earliest comparative period. The Bank is assessing the impact of the standard adoption on the financial statements.

6. Cash and cash equivalents

	2018	*2017*
Current accounts with credit institutions	87,199	56,502
Cash on hand	48,740	52,690
Current accounts with the NBG	48,567	52,786
Time deposits with credit institutions	–	49,664
Less – allowance for impairment	(1)	–
Cash and cash equivalents	**184,505**	**211,642**

As of 31 December 2018, 81.24% of total current accounts with credit institutions are placed with two non-resident credit institutions (2017: 75.24%).

All balances of cash equivalents are allocated to Stage 1; there were no significant movements in ECL during the year.

7. Amounts due from banks and international financial institutions

	2018	*2017*
Obligatory reserve with the NBG	159,879	116,302
Time deposits with credit institutions	134	162
Restricted nostro accounts	–	114,006
Amounts due from banks and international financial institutions	**160,013**	**230,470**

Credit institutions are required to maintain an interest earning cash deposit (obligatory reserve) with the NBG, the amount of which depends on the level of funds attracted by the credit institution. The Bank's ability to withdraw such deposit is restricted by the statutory legislation.

In 2018 the obligatory reserve on USD account bears interest of U.S. Federal Reserve System less 2%, but not less than 0% (2017 – the rate of U.S. Federal Reserve System of less 0.5%) and on EUR account – the rate of the European Central Bank less 2%, but not less than -0.6% (2017 – the rate of the European Central Bank of less 0.2%).

As of 31 December 2018, amount of GEL 134 (2017: GEL 162) included in time deposits was placed on long term deposits and pledged as security for settlement operations to the international financial institutions.

All balances of due from credit institutions are allocated to Stage 1; there were no significant movements in ECL during the year.

(Thousands of Georgian lari)

8. Loans and advances to customers

	2018	*2017*
Consumer lending	528,694	433,614
Corporate lending	410,763	369,015
Small business lending	179,313	169,939
Loans to individuals secured by deposits	7,397	9,234
Gross loans and advances to customers	**1,126,167**	**981,802**
Less – allowance for impairment	(28,951)	(31,326)
Loans and advances to customers, net	**1,097,216**	**950,476**

Allowance for impairment of loans to customers at amortised cost

An analysis of changes in the gross carrying value and corresponding ECL in relation to corporate lending during the year ended 31 December 2018 is as follows:

Corporate lending	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**332,416**	**9,110**	**53,567**	**395,093**
New assets originated or purchased	248,787	3,970	594	**253,351**
Assets repaid	(186,657)	(12,809)	(7,168)	**(206,634)**
Transfers to Stage 2	(24,068)	24,068		–
Transfers to Stage 3	–	(1,699)	1,699	–
Unwinding of discount	–	–	119	**119**
Recoveries	–	–	529	**529**
Amounts written off	–	–	(36,222)	**(36,222)**
Foreign exchange adjustments	3,455	674	398	**4,527**
At 31 December 2018	**373,933**	**23,314**	**13,516**	**410,763**

Corporate lending	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	**(3,658)**	**(265)**	**(39,375)**	**(43,298)**
New assets originated or purchased	(1,781)	(166)	(217)	**(2,164)**
Assets repaid	1,957	230	1,438	**3,625**
Transfers to Stage 2	403	(403)	–	**–**
Transfers to Stage 3	–	62	(62)	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	(20)	64	**44**
Unwinding of discount (recognised in interest revenue)	–	–	(119)	**(119)**
Changes to models and inputs used for ECL calculations	271	(42)	(719)	**(490)**
Recoveries	–	–	(529)	**(529)**
Amounts written off	–	–	36,222	**36,222**
Foreign exchange adjustments	(65)	(56)	224	**103**
At 31 December 2018	**(2,873)**	**(660)**	**(3,073)**	**(6,606)**

An analysis of changes in the gross carrying value and corresponding ECL in relation to small business lending during the year ended 31 December 2018 is as follows:

Small business lending	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**168,043**	**376**	**1,817**	**170,236**
New assets originated or purchased	109,934	(72)	760	**110,622**
Assets repaid	(100,878)	(630)	(548)	**(102,056)**
Transfers to Stage 2	(1,053)	1,053	–	**–**
Transfers to Stage 3	(1,153)	(142)	1,295	**–**
Unwinding of discount	–	–	(261)	**(261)**
Recoveries	–	–	33	**33**
Amounts written off	(43)	–	(956)	**(999)**
Foreign exchange adjustments	1,676	22	40	**1,738**
At 31 December 2018	**176,526**	**607**	**2,180**	**179,313**

(Thousands of Georgian lari)

8. Loans and advances to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

Small business lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2018	**(1,189)**	**(40)**	**(1,155)**	**(2,384)**
New assets originated or purchased	(691)	18	(196)	**(869)**
Assets repaid	612	26	265	**903**
Transfers to Stage 2	24	(24)	–	**–**
Transfers to Stage 3	50	4	(54)	**–**
Impact on period end ECL of exposures transferred between stages during the period	1	(209)	(505)	**(713)**
Unwinding of discount (recognised in interest revenue)	–	–	261	**261**
Changes to models and inputs used for ECL calculations	(47)	50	(635)	**(632)**
Recoveries	–	–	(33)	**(33)**
Amounts written off	43	–	956	**999**
Foreign exchange adjustments	59	1	(37)	**23**
At 31 December 2018	**(1,138)**	**(174)**	**(1,133)**	**(2,445)**

An analysis of changes in the gross carrying value and corresponding ECL in relation to consumer lending during the year ended 31 December 2018 is as follows:

Consumer lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2018	**411,278**	**6,146**	**16,251**	**433,675**
New assets originated or purchased	301,533	5,107	4,699	**311,339**
Assets repaid	(204,620)	(3,279)	(5,052)	**(212,951)**
Transfers to Stage 2	(4,434)	4,434	–	**–**
Transfers to Stage 3	(7,237)	(3,464)	10,701	**–**
Unwinding of discount	–	–	1	**1**
Recoveries	–	–	809	**809**
Amounts written off	(4)	(2)	(6,917)	**(6,923)**
Foreign exchange adjustments	2,670	25	49	**2,744**
At 31 December 2018	**499,186**	**8,967**	**20,541**	**528,694**

Consumer lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2018	**(4,596)**	**(1,057)**	**(12,576)**	**(18,229)**
New assets originated or purchased	(3,723)	5	(3,449)	**(7,167)**
Assets repaid	2,722	189	974	**3,885**
Transfers to Stage 2	85	(85)	–	**–**
Transfers to Stage 3	285	114	(399)	**–**
Impact on period end ECL of exposures transferred between stages during the period	324	(156)	(4,196)	**(4,028)**
Unwinding of discount (recognised in interest revenue)	–	–	(1)	**(1)**
Changes to models and inputs used for ECL calculations	(191)	(103)	(158)	**(452)**
Recoveries	–	–	(809)	**(809)**
Amounts written off	4	2	6,917	**6,923**
Foreign exchange adjustments	(14)	(6)	(1)	**(21)**
At 31 December 2018	**(5,104)**	**(1,097)**	**(13,698)**	**(19,899)**

(Thousands of Georgian lari)

8. Loans and advances to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

Loans to individuals secured by the deposits are allocated to Stage 1; there were no significant movements in ECL during 2018. An analysis of changes in the gross carrying value in relation to loans to individuals secured by deposits during the year ended 31 December 2018 is as follows:

Loans to individuals secured by deposits	***Stage 1***
Gross carrying value as at 1 January 2018	**9,234**
New assets originated or purchased	4,386
Assets repaid	(6,316)
Foreign exchange adjustments	93
At 31 December 2018	**7,397**

A reconciliation of the allowance for impairment of loans and advances to customers by class is as follows:

	Corporate lending 2017	***Consumer lending 2017***	***Small business lending 2017***	***Total 2017***
At 1 January 2017	**23,797**	**6,334**	**1,015**	**31,146**
Net charge/(reversal) for the year	(7,213)	6,338	(779)	**(1,654)**
Foreign currencies translation	(236)	(96)	14	**(318)**
Recoveries of previously written off loans and advances	1,676	1,143	362	**3,181**
Amounts written off	(627)	(372)	(30)	**(1,029)**
At 31 December 2017	**17,397**	**13,347**	**582**	**31,326**
Individual impairment	11,575	21	99	**11,695**
Collective impairment	5,822	13,326	483	**19,631**
	17,397	**13,347**	**582**	**31,326**
Gross amount of loans and advances, individually determined to be impaired, before deducting any individually assessed impairment allowance	**20,117**	**–**	**450**	**20,567**

Individually impaired loans

Interest income of loans and advances, which individual impairment allowances have been recognized, as at 31 December 2018, comprised GEL 939 (2017: GEL 1,019).

Collateral and other credit enhancements

The amount and type of required collateral depends on the counterparty Credit Risk assessment, for which the Bank has implemented guidelines and policies defining valuation parameters and acceptability of the collateral.

Accepted collateral types are as follows:

- For commercial lending: Real estate properties, inventories, bank deposits, trade receivables and bank guarantees;
- For Retail lending: bank deposits, mortgages over residential properties, inventories, household assets and third party personal guarantees.

(Thousands of Georgian lari)

8. Loans and advances to customers (continued)

Collateral and other credit enhancements (continued)

The below tables provide an analysis of the current fair values of collateral held and credit enhancements for credit-impaired (stage 3) assets. Dependent on the level of collateral, some Stage 3 exposures may not have individual ECLs when the expected value of the collateral is greater than the LGD, even in if the future value of collateral is forecast using multiple economic scenarios. However, the Stage 3 ECL can be higher than net exposure show below.

	Maximum exposure to credit risk	*Fair value of collateral held under the base scenario*						*Net exposure*	*Associa-ted ECL*
		Cash/ deposits	*Securities*	*Property*	*Other**	*Surplus collateral*	*Total collateral*		
31 December 2018	**36,237**	**22**	**2,516**	**55,367**	**19,943**	**(60,146)**	**17,702**	**18,535**	**17,904**
Consumer lending	20,541	22	–	11,009	475	(7,710)	3,796	16,747	13,697
Corporate lending	13,516	-	2,516	39,441	18,681	(48,849)	11,789	1,726	3,073
Small business lending	2,180	–	–	4,917	787	(3,587)	2,117	62	1,134

* *Movable property, third party guarantees and equipment*

During 2018 the Bank repossessed collateral (land and buildings) with value as of repossession date of GEL 4,774 (2017: GEL 10,404), which were classified as investment property and inventories with the amount of GEL 456 and GEL 4,318 of repossessed collateral, respectively (2017: GEL 7,245 and GEL 3,159). Refer to Note 11 and 14.

It is the Bank's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Bank does not occupy repossessed properties for business use.

Concentration of loans and advances to customers

As of 31 December 2018, the Bank had a concentration of loans represented by GEL 196,549 due from the ten largest third party borrowers of 17.45% of gross loan portfolio (2017: GEL 180,590 or 18.39%). An allowance of GEL 1,822 (2017: GEL 1,841) was recognised against these loans.

Included in total loans to customers is an exposure to a single borrower of GEL 24,367 or 2.16% of total loan portfolio (2017: GEL 26,384 or 2.69%), that bears an annual interest rate of 7.5% p.a. and matures on June 2028 (2017: an annual interest rate of 10% p.a. and matures in May 2018).

Loans have been issued to the following types of customers:

	2018	***2017***
Commercial legal entities	589,326	525,179
Individuals	536,091	442,847
State-owned companies	750	13,776
Gross loans and advances to customers	**1,126,167**	**981,802**

As of 31 December 2018 and 2017, loans and advances to customers are principally issued within Georgia and their allocation by industry sectors is as follows:

	2018	***2017***
Individuals	536,092	442,847
Trading and service enterprises	280,504	245,793
Manufacturing	68,766	83,816
Agriculture and food processing	52,739	47,366
Energy	38,877	64,415
Telecommunication and transportation	35,831	12,824
Financial	35,228	18,108
Real estate construction	29,023	42,097
Other	49,107	24,536
Gross loans and advances to customers	**1,126,167**	**981,802**

(Thousands of Georgian lari)

9. Investment securities

Investment securities comprise:

	2018	*2017*
Debt securities at amortised cost (previously classified as available-for-sale)		
Treasury bills of the Ministry of Finance	94,007	107,437
Treasury bills of the National Bank of Georgia	9,094	13,233
Corporate bonds	10,511	-
Less – allowance for impairment	(333)	-
Debt securities at amortised cost (previously classified as available-for-sale)	**113,279**	**120,670**
Debt securities at amortised cost (previously classified as loans and advances to customers)		
Corporate bonds	1,259	-
Less – allowance for impairment	(11)	-
Debt securities at amortised cost (previously classified as Loans and receivables)	**1,248**	-
Equity securities at FVOCI (previously classified as available-for-sale)		
Corporate shares	54	54
Equity securities at FVOCI (previously classified as available-for-sale)	**54**	**54**
Investment securities	**114,581**	**120,724**

All debt securities at amortised cost are allocated to Stage 1. ECL recognised as at 31 December 2018 was GEL 344 and the change during the year was not material.

(Thousands of Georgian lari)

10. Property and equipment

The movements in property and equipment during 2018 and 2017 were as follows:

	Land and buildings	*Computers and communication equipment*	*Furniture, fixtures and office equipment*	*Utility systems and related features*	*Motor vehicles*	*Leasehold improvements*	*Construction in progress*	*Total*
Cost or revalued amount								
31 December 2016	**26,014**	**11,472**	**9,898**	**1,938**	**1,811**	**2,343**	**–**	**53,476**
Additions	–	743	827	–	280	9	950	2,809
Transfer	322	–	–	–	–	628	(950)	–
Disposals	–	(316)	(134)	–	(185)		–	(635)
31 December 2017	**26,336**	**11,899**	**10,591**	**1,938**	**1,906**	**2,980**	**–**	**55,650**
Additions	3,024	2,432	583	–	638	237	–	6,914
Transfer from Investment property (Note11)	4,250	–	–	–	–	–	–	4,250
Disposals and write-offs	(6,527)	(1,452)	(1,382)	–	(470)	(25)	–	(9,856)
Effect of revaluation	6,087	–	–	–	–	(1,301)	–	4,786
31 December 2018	**33,170**	**12,879**	**9,792**	**1,938**	**2,074**	**1,891**	**–**	**61,744**
Accumulated depreciation and impairment								
31 December 2016	**(532)**	**(8,360)**	**(7,094)**	**(364)**	**(1,309)**	**(383)**	**–**	**(18,042)**
Depreciation charge	(553)	(1,292)	(1,045)	(68)	(213)	(400)	–	(3,571)
Disposals	–	295	133	–	185	–	–	613
31 December 2017	**(1,085)**	**(9,357)**	**(8,006)**	**(432)**	**(1,337)**	**(783)**	**–**	**(21,000)**
Depreciation charge	(513)	(1,521)	(904)	–	(247)	(528)	–	(3,713)
Disposals and write-offs	338	1,453	1,303	–	470	10	–	3,574
Effect of revaluation	1,260	–	–	–	–	1,301	–	2,561
31 December 2018	**–**	**(9,425)**	**(7,607)**	**(432)**	**(1,114)**	**–**	**–**	**(18,578)**
Net book value								
31 December 2016	**25,482**	**3,112**	**2,804**	**1,574**	**502**	**1,960**	**–**	**35,434**
31 December 2017	**25,251**	**2,542**	**2,585**	**1,506**	**569**	**2,197**	**–**	**34,650**
31 December 2018	**33,170**	**3,454**	**2,185**	**1,506**	**960**	**1,891**	**–**	**43,166**

As of 31 December 2018, an independent appraiser determined the fair value of the Bank's land and buildings. The appraiser is an industry specialist in valuing these types of property and equipment. The market value of the property was determined based on market data. The market approach was used to determine the fair value, and the income approach was used to validate the obtained value estimates, where lease rates for similar properties within the same area was available. Refer to Note 25 for details on fair value measurements of the Bank’s land and buildings.

As a result of revaluation of land and building, their value increased by GEL 7,347, from which GEL 7,559 were recognized in other comprehensive income and GEL 211 loss were recognized in other operating expenses.

If no revaluation of land and buildings had been performed, the original cost as of 31 December 2018 and 31 December 2017, would have amounted to GEL 30,072 (2017: GEL 32,597) and accumulated depreciation would have amounted to GEL 7,308 (2017: GEL 11,330).

The total value of fully depreciated property and equipment in use as of 31 December 2018 and 2017, amounted to GEL 12,290 and GEL 13,358 respectively.

(Thousands of Georgian lari)

11. Investment property

	2018	2017
Opening balance at 1 January	**24,556**	**20,336**
Additions	456	7,245
Disposals	(1,660)	(5,455)
Reclassified to PPE (Note 10)	(4,250)	–
Gain on revaluation	1,169	2,430
Closing balance at 31 December	**20,271**	**24,556**

Investment property is a real estate property comprised of land and buildings, which was obtained by the Bank through repossession of collateral on defaulted loans. Refer to Note 8.

As of 31 December 2018, an independent appraiser determined the fair value of the Bank's investment properties. The appraiser is an industry specialist in valuing these types of investment properties. The fair value represents the amount at which the asset could be exchanged between knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction at the date of valuation, in accordance with International Valuation Standards Committee standards.

The fair value of investment property was determined based on market data. The market approach was used to determine the fair value.

12. Taxation

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

Following the enactment of the initial 2016 amendment, as at 31 December 2017 the Bank remeasured its deferred tax assets and liabilities for the periods after 1 January 2019. As IAS 12 Income Taxes requires, the Bank used 0% tax rate applicable for undistributed profits in respect of assets and liabilities expected to be realized or settled in the periods when the new regulation becomes effective.

Following the enactment of the latest amendment, the Bank recalculated its deferred tax assets at 31 December 2018 and made the relevant recognition of deferred tax expense in the profit and loss statement for 2018.
In 2018 and 2017 the income tax rate applicable to the Bank's income is 15%. The effective income tax rate differs from the statutory income tax rate. A reconciliation of the income tax benefit expense on statutory rates with actual is as follows:

The corporate income tax expense comprises:

	2018	2017
Current tax expense	(2,326)	(3,979)
Deferred expense – origination and reversal of temporary differences	(1,482)	(30)
Less: deferred tax recognised in other comprehensive income	73	–
Income tax (expense)/ benefit	**(3,735)**	**(4,009)**

(Thousands of Georgian lari)

12. Taxation (continued)

The effective income tax rate differs from the statutory income tax rates. A reconciliation of the income tax expense based on statutory rates with actual is as follows:

	2018	*2017*
Income before income tax expense	**30,684**	**36,378**
Statutory tax rate	15%	15%
Theoretical income tax expense at the statutory rate	**(4,603)**	**(5,457)**
Non-deductible expenses	(563)	(39)
Tax exempt income less income recognized for tax purposes only	2,073	1,631
Effect of change in tax legislation	(642)	(144)
Income tax (expense)/benefit	**(3,735)**	**(4,009)**

Deferred tax assets and liabilities as of 31 December and their movements for the respective years comprise:

		Origination and reversal of temporary differences					
Tax effect of deductible temporary differences	***2016***	***In the Statement of profit or loss***	***2017***	***Remeasurement (IFRS 9) Statement of profit or loss***	***Directly in Other comprehensive income***	***In the Statement of profit or loss***	***2018***
Allowances for impairment and provisions for other losses (DTA)	–	–	–	81	–	(8)	**73**
Financial instruments adjustment for effective interest rates	1,468	(102)	1,366		–	1,435	**2,801**
Accrued expenses	1,440	(80)	1,360		–	28	**1,388**
Other	12	15	27		–	(5)	**22**
Deferred tax assets	**2,920**	**(167)**	**2,753**	81	–	1,450	**4,284**
Tax effect of taxable temporary differences							
Allowance for loan impairment	(1,129)	(135)	(1,264)	17	–	(2,537)	**(3,784)**
Property and equipment	(343)	168	(175)		(73)	(275)	**(523)**
Allowances for impairment and provision for other losses (DTL)	(229)	104	(125)	3	–	(47)	**(169)**
Deferred tax liabilities	**(1,701)**	**137**	**(1,564)**	**20**	**(73)**	**(2,859)**	**(4,476)**
Net deferred tax assets/ (liabilities)	**1,219**	**(30)**	**1,189**	**101**	**(73)**	**(1,409)**	**(192)**

13. Credit loss expense and other impairment and provisions

The table below shows the ECL charges on financial instruments recorded in the statement of profit or loss for the year ended 31 December 2018:

	Note	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Cash and cash equivalents		9	–	–	**9**
Amounts due from banks and international financial institutions		27	–	–	**27**
Loans and advances to customers	8	296	(510)	(7,850)	**(8,064)**
Investment securities		24	–	–	**24**
Other financial assets		2	–	–	**2**
Credit loss expense		**358**	**(510)**	**(7,850)**	**(8,002)**
Financial guarantees		(32)	(5)	–	**(37)**
Loan commitments		182	1	–	**183**
Letters of credit		83	–	–	**83**
Reversal of provision for credit related commitments		**233**	**(4)**	–	**229**

(Thousands of Georgian lari)

13. Credit loss expense and other impairment and provisions (continued)

The movements in other impairment allowances and provisions were as follows:

	Legal claims
1 January 2017	**(102)**
Reversal (charge)	–
Write-offs	–
Recoveries of amounts previously written off	–
31 December 2017 (Note 14)	**(102)**
Reversal (charge)	204
Write-offs	–
Recoveries of amounts previously written off	(102)
31 December 2018	–

14. Other assets and liabilities

Other assets comprise:

	2018	*2017*
Financial assets		
Unsettled transactions on money transfers	3,145	3,490
Receivables from insurance company	2,509	–
Derivative financial assets	87	1,290
Other	160	70
Allowance for impairment of other financial assets	(144)	(3)
Total financial assets	**5,757**	**4,847**
Non-financial assets		
Intangible assets	8,330	8,183
Inventories of repossessed collateral	7,303	3,159
Prepaid expenses	3,679	3,734
Advances paid	1,085	1,472
Prepaid operational taxes	360	301
Inventories in stock	357	633
Other	422	156
Total non-financial assets	**21,536**	**17,638**
Other assets	**27,293**	**22,485**

Receivable from insurance company represents the Bank's claim to insurance company for the disposed asset. The claim was settled in the subsequent period and fully covered by insurance company on 26 February 2019. The loss related to the asset disposal and the reimbursement gain are recognised on a net basis in the statement of profit or loss.

(Thousands of Georgian lari)

14. Other assets and liabilities (continued)

The movement in intangible assets during 2018 and 2017 were as follows:

	Intangible assets
At cost	
31 December 2016	**10,352**
Additions	1,528
Disposals and write-offs	(333)
31 December 2017	**11,547**
Additions	1,491
31 December 2018	**13,038**
Accumulated amortisation and impairment	
31 December 2016	**(2,425)**
Amortization charge for the year	(1,270)
Amortization charge for disposals and write-offs	331
31 December 2017	**(3,364)**
Amortization charge for the year	(1,344)
31 December 2018	**(4,708)**
Net book value	
31 December 2017	**8,183**
31 December 2018	**8,330**

All other financial assets are allocated to stage 1 and there were no significant movements in ECL during the year.

Other liabilities comprise:

	2018	*2017*
Financial liabilities		
Derivative financial liabilities	8,769	38
Accrued bonuses	7,926	7,528
Unsettled transactions on money transfers	3,444	1,435
Settlements on plastic cards	2,109	3,373
Accrued expenses	1,872	1,502
Payables for unused vacations	1,040	1,044
Provisions for CRC off-BS commitments	416	424
Other	456	35
Total financial liabilities	**26,032**	**15,379**
Non-financial liabilities		
Dividends payable to shareholders of the Bank	1,068	1,075
Advances received	785	2,947
Provisions for legal claims (Note 13)	–	102
Total non-financial liabilities	**1,853**	**4,124**
Other liabilities	**27,885**	**19,503**

As of 31 December 2018 and 2017, the Bank's derivative financial instruments comprised of foreign exchange forwards and swaps and were attributable to the Level 2 of fair value hierarchy.

(Thousands of Georgian lari)

14. Other assets and liabilities (continued)

Derivatives are valued using a valuation technique with market observable inputs. The applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates and interest rate curves. Derivatives comprise:

	2018				*2017*			
	Notional amount		*Fair values*		*Notional amount*		*Fair values*	
	Asset	*Liability*	*Asset*	*Liability*	*Asset*	*Liability*	*Asset*	*Liability*
Foreign exchange contracts								
Forwards and Swaps – foreign	143,616	141,983	87	8,769	141,642	140,210	1,290	38
Total derivative assets/liabilities	**143,616**	**141,983**	**87**	**8,769**	**141,642**	**140,210**	**1,290**	**38**

15. Amounts due to banks and international financial institutions

	2018	*2017*
Loans received from the Parent bank	95,649	85,518
Time deposits and loans	31,586	26,039
Current accounts	1,200	1,336
Amounts due to banks and international financial institutions	**128,435**	**112,893**

As of 31 December 2018, loans received from the Parent bank had maturities ranging from August 2019 till July 2021 (2017: August 2018 till January 2020) and bear annual interest rates from 3.31% to 7.12% (2017: from 2.89% to 3.73%).

As of 31 December 2018, time deposits and loans had maturities ranging from January 2019 till November 2019 (2017: time deposits and loans had maturities ranging from January 2018 till December 2018) and bear annual interest rates from 1% to 7.1% (2017 : from 4% to 7%, and one time loan bearing annual interest at 18%).

16. Amounts due to customers

	2018	*2017*
Individuals		
Current/demand accounts	102,641	102,611
Term deposits	289,552	265,890
Total due to individuals	**392,193**	**368,501**
State and budgetary organisations		
Current/settlement accounts	19,460	28,083
Term deposits	4,702	4,702
Total due to state and budgetary organisations	**24,162**	**32,785**
Commercial legal entities		
Current/settlement accounts	457,045	371,087
Term deposits	132,163	123,384
Total due to commercial legal entities	**589,208**	**494,471**
Total due to legal entities	**613,370**	**527,256**
Total amounts due to customers	**1,005,563**	**895,757**
Held as security against undrawn loan facilities	427	104
Held as security against guarantees issued	12,523	12,491
Held as security against letters of credit issued	5,609	84
Total amounts of cash held as security against letters of credit, undrawn loan facility and guarantees issued	**18,559**	**12,679**
Held as security against settlement operations	1,155	510

At 31 December 2018, amounts due to customers of GEL 277,784 (27.62%) were due to the ten largest third party customers (2017: GEL 305,127 (34.06%)).

(Thousands of Georgian lari)

16. Amounts due to customers (continued)

An analysis of customer accounts by industry follows:

	2018	*2017*
Individuals	392,193	368,501
Energy	177,048	142,547
Trade and service	169,109	96,908
Transport and communication	75,851	92,896
Finance	61,065	86,663
Real estate constructions	47,980	40,866
Manufacturing	39,266	18,399
Government	24,162	32,785
Education	9,213	7,004
Agriculture	2,342	1,301
Other	7,334	7,887
Amounts due to customers	**1,005,563**	**895,757**

17. Debt securities issued

Debt securities comprised of the following:

Certificates of deposit	*2018*	*2017*
Discount certificates	40,804	27,167
Coupon certificates	10,203	11,026
Debt securities issued	**51,007**	**38,193**

From July 2016, Bank had started issuance of certificates of deposit. As of 31 December 2018, certificates of deposits comprised of discount certificates of deposits were maturing from 4 January 2019 till 24 December 2023 (2017: from 3 January 2018 till 17 December 2022) and coupon certificates of deposits from 29 January 2019 till 31 October 2023 (2017: 3 January 2018 till 31 October 2022).

Certificates of deposits may be freely resold or otherwise assigned to any third party without prior notification of the Bank.

18. Other borrowed funds

	2018	*2017*
Borrowings from the Parent bank	70,221	203,537
Borrowings from NBG	48,365	45,393
Borrowings from international financial institutions	8,549	12,377
Borrowings from government organizations	965	1,678
Other borrowed funds	**128,100**	**262,985**

As of 31 December 2018, maturities of borrowings from the Parent bank were ranging from July 2019 till May 2022 (2017: from February July 2019 till May 2022), annual interest rates from 3.21% to 6.28% (2017: from 3.21% to 8.84%). Refer to Note 27.

As of 31 December 2018, GEL 48,365 (2017: GEL 45,393) borrowings from NBG were received under the securities of Ministry of Finance of Georgia with total nominal value of GEL 33,248 (2017: GEL 42,350) and under the Loans to customers with total nominal value of GEL 21,020 (2017: 6,709) pledged as collateral. The borrowings were matured in January 2019 (2017: January 2018) and bears annual interest rates 7% to 7.13% (2017: from 7.25% to 7.43%).

As of 31 December 2018 borrowings from international financial institutions included facilities in U.S. dollars and Euro with maturities ranging from January 2020 to December 2032 (2017: from FFebruary 2018 to December 2032) and interest rates from Libor + 5% and one loan bearing annual interest at 0.75% (2017: from Libor + 5% to CD rate of NBG + margin 1.2% + TCX spread 0.13%; 0.75%).

As of 31 December 2018 and 2017 borrowings from government organizations contained facilities received from Municipal Development Fund of Georgia to finance energy sector companies. The borrowing is denominated in EUR, bear annual interest rate of 3% (2017: 3%) with maturity of November 2021 (2017: from May 2018 to November 2021).

(Thousands of Georgian lari)

19. Equity

Share capital

Movements in ordinary shares authorized and fully paid were as follows:

	Number of shares authorized	*Number of shares fully paid*	*Nominal amount, GEL*
31 December 2016	**191,292,701**	**191,292,701**	**191,293**
Increase in share capital	17,715,576	17,715,576	17,715
31 December 2017	**209,008,277**	**209,008,277**	**209,008**
31 December 2018	**209,008,277**	**209,008,277**	**209,008**

The share capital of the Bank was contributed by the shareholders in Georgian lari and they are entitled to dividends and any capital distribution in Georgian lari.

On 2 June 2017 the Shareholders made a decision to increase the number of authorized ordinary shares by 17,715,576. Related share issue prospectus was approved by the NBG on 4 July 2017. The consideration received for these shares comprised of cash for the total amount of GEL 17,715.

Perpetual subordinated loan

On 29 December 2016, the Bank received perpetual subordinated loan for RUB 300 mln. As at 31 December 2018, the carrying amount of the perpetual subordinated loan was GEL 11,575 (2017: GEL 13,481). During 2018 the Bank has not made any interest payment (2017: GEL 10). The perpetual subordinated loan has an unlimited term and are redeemable at the Bank's option. Coupon rate comprises Central Bank of Russia key rate + 2.5%. The Bank has, at its sole discretion, an unconditional right to cancel interest payments by giving notice to the issuer before the payment date.

Dividends

In accordance with the Georgian legislation, dividends may only be declared to the shareholders of the Bank from the net income as shown in the Bank's separate financial statements prepared in accordance with the NBG requirements. The NBG shall be informed regarding declaration of dividends and also shall be authorized to suspend or restrict payment of dividends, if a commercial bank has violated regulatory requirements of the NBG.

On 19 June 2017, the annual general meeting of shareholders of the Bank declared 2016 dividends comprising GEL 17,715 or Georgian lari 0.09 per share, based on 2016 separate financial statements prepared in accordance with the NBG requirements. Dividends in the amount of GEL 17,246 were paid to shareholders in 2017.

20. Commitments and contingencies

Operating environment

As a small-scale and open economy, the Georgian Economy is sensitive to regional and global challenges. Reduced exports to Georgia's main trading partners, combined with falling remittances, cause income and domestic demand to decline, which puts pressure on the exchange rate. The economic growth rate is still low in the region, mainly effected by the global economic situation.

From the start of year 2018 the National Bank of Georgia has been gradually tightening requirements towards commercial banks on crediting individual borrowers. The new stricter requirements led to change of operational environment of the Bank resulting in slowing down the growth rate of retail loan portfolio.

However, over the last few years the Georgian government has made a number of developments that positively affect the overall investment climate of the country, specifically implementing the reforms necessary to create banking, judicial, taxation and regulatory systems. This includes the adoption of a new body of legislation (including new Tax Code started from 2017 and procedural laws).

In year 2018, economic of Georgia experienced growth of 4.8% (2017: 4.4%), and inflation rate ended up at 2.2% (2017: 6.7%).

(Thousands of Georgian lari)

20. Commitments and contingencies (continued)

Legal

From time to time and in the normal course of business, claims against the Bank are received. At the reporting date the Bank had several unresolved legal claims. However, Management is of the opinion that there would be no outflow of resources and accordingly no provisions have been made in these financial statements. Refer to Note 14.

As of 31 December, the Bank's financial commitments and contingencies comprised the following:

	2018	*2017*
Credit related commitments		
Guarantees issued	74,606	61,672
Undrawn loan facilities	69,688	47,136
Other credit-related commitments	1,613	11,854
Letters of credit	5,607	1,705
Financial commitments and contingencies (before deducting collateral)	**151,514**	**122,367**
Less – cash held as security against letters of credit, undrawn loan facility and guarantees issued (Note 16)	(18,559)	(12,679)
Financial commitments and contingencies	**132,955**	**109,688**
Operating lease commitments		
Not later than 1 year	1,206	1,274
Later than 1 year but not later than 5 years	3,617	4,171
Later than 5 years	715	1,179
	5,538	**6,624**

All commitments are allocated to stage 1 and there were no significant movements in ECL during the year.

21. Net fee and commission income

	2018	*2017*
Commission on settlements operations	11,438	10,132
Commission on guarantees and other credit related commitments	2,523	3,818
Commission on cash operations	1,848	2,174
Other	239	254
Fee and commission income	**16,048**	**16,378**
Commission on settlements operations	(8,771)	(7,518)
Commission on cash operations	(1,713)	(1,893)
Commission on guarantees and other credit related commitments	(348)	(306)
Other	(16)	(121)
Fee and commission expense	**(10,848)**	**(9,838)**
Net fee and commission income	**5,200**	**6,540**

22. Other income

	2018	*2017*
Gain from disposal of property	5,488	26
Penalties received from lending operations	4,427	5,041
Penalties received for debt securities issued redemption before maturity	1,207	19
Penalties received for deposit redemption before maturity	789	815
Reimbursement of integrated marketing communication campaign costs	356	177
Income from operating lease	178	426
Other	666	64
Other income	**13,111**	**6,568**

(Thousands of Georgian lari)

23. Personnel and other operating expenses

	2018	*2017*
Salaries	27,588	26,683
Bonuses and premiums	11,530	11,051
Personnel expenses	**39,118**	**37,734**
Occupancy and rent	3,798	3,194
Marketing and advertising	2,405	1,950
Computer software maintenance	1,563	1,261
Legal and consultancy	1,390	1,173
Amortisation of intangible assets	1,344	1,270
Repairs and maintenance of property and equipment	1,139	1,090
Communications	993	831
Office supplies	990	906
Utilities	950	941
Representation expenses	939	738
Operating taxes	627	610
Other operating expenses on plastic cards operation	477	315
Business travel and related expenses	433	463
Professional service expenses	430	364
Loss on revaluation of property and equipment	211	
Insurance	159	156
Security	122	105
Charity	74	91
Loss on disposal of property and equipment	36	–
Impairment charge for property and equipment	34	–
Other	678	248
Other operating expenses	**18,792**	**15,706**

Auditor's remuneration

Remuneration of the Bank's auditor for the years ended 31 December 2018 and 2017 comprises (net of VAT):

	2018	*2017*
Fees for the audit of the Group's annual financial statements for the year ended 31 December	164	153
Expenditures for other assurance services	142	144
Expenditures for other professional services	419	38
Total fees	**725**	**335**

Fees payable to the auditors in respect of the audit of the Bank's annual financial statements comprised GEL 8 (2017: GEL 10) and in respect of other professional services GEL 210 (2017: GEL 11), net of VAT.

24. Risk management

Risk is an integral part of the Bank's activities and is managed through a continuous process of identification, measurement, monitoring, risk control and other risk control measures. The Bank's risk position includes credit risk, liquidity risk, market risk and operational risk.

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

Risk management structure

The Bank's Board of Directors is ultimately responsible for identifying and controlling risks of the Bank; however, there are separate independent bodies responsible for managing and monitoring risks.

Supervisory Board

The Supervisory Board is responsible for the overall risk management approach and for approving the risk strategies and principles.

(Thousands of Georgian lari)

24. Risk management (continued)

Management Board

The Management Board has the responsibility to monitor the overall risk process within the Bank. The Asset – liability and Risk management Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

The Risk Management Unit (Risk Department) – is responsible for implementing and maintaining risk related procedures to ensure an independent control process. As at the end of 2017 Risk Department consisted of the following sub-divisions:

- Consolidated risk analysis division;
- Corporate credit risk division;
- Retail credit risk division;
- Market and operational risks division;
- Collateral evaluation and monitoring group;
- Credit deals monitoring group.

Risk Controlling Unit

The Risk Controlling Unit is responsible for monitoring compliance with risk principles, policies and limits, across the Bank. Each business Bank has a decentralised unit which is responsible for the independent control of risks, including monitoring the risk of exposures against limits and the assessment of risks of new products and structured transactions. This unit also ensures the complete capture of the risks in risk measurement and reporting systems.

Bank Treasury

Bank Treasury is responsible for managing the Bank's assets and liabilities. It is also primarily responsible for the funding and liquidity risks of the Bank.

Internal Audit

Risk management processes throughout the Bank are audited annually by the internal audit function that examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Supervisory Board through the Audit Committee.

Risk measurement and reporting systems

The Bank's risks are measured using a method which reflects both the expected losses likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also runs worst case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

Information compiled from all the business divisions is examined and processed to analyse, control and identify risks timely. This information is provided to the Management Board, the Asset – liability and Risk management Committee, and the head of each business division. The report includes aggregate credit exposure, credit metric forecasts, liquidity ratios and risk profile changes. On a monthly basis detailed reporting of industry, customer and geographic risks takes place. Risk management department assesses the appropriateness of the allowance for credit losses on a monthly basis.

A daily summary on liquidity utilisation is provided to the Management Board and all other relevant employees of the Bank.

Risk mitigation

As part of its overall risk management, the Bank uses various mitigation instruments to manage exposures, including the use of collateral to reduce its credit risks (see below for more detail).

(Thousands of Georgian lari)

24. Risk management (continued)

Credit risk

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

Credit-related commitments risks

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

The maximum exposure to credit risk for the components of the statement of financial position, including derivatives, before the effect of mitigation through the use of master netting and collateral agreements, is best represented by their carrying amounts.

Where financial instruments are recorded at fair value, the carrying value represents the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

Impairment assessment

From 1 January 2018, the Bank calculates ECL based on several probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the EIR. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive. The mechanics of the ECL calculations are outlined below and the key elements are as follows:

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

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

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

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss or LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss (12mECL). The 12mECL is the portion of LTECL that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Both LTECL and 12mECL are calculated on either an individual basis or a collective basis, depending on the nature of the underlying portfolio of financial instruments.

(Thousands of Georgian lari)

24. Risk management (continued)

Credit risk (continued)

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

Stage 1:	When loans are first recognised, the Bank recognises an allowance based on 12mECL. Stage 1 loans also include facilities where the credit risk has improved and the loan has been reclassified from Stage 2.
Stage 2:	When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECL. Stage 2 loans also include facilities, where the credit risk has improved and the loan has been reclassified from Stage 3.
	Key Criteria for the transition to Stage 2: Overdue amounts of loan principal and/or interest payable to the Bank at the reporting date, as well as other contractual payments on any counterparty's instrument that are 31 to 90 days overdue; Downgrade of the internal rating by more than 5 notches for A-ratings, by more than 4 notches for B-ratings, and for more than 3 notches for other ratings since initial recognition of the instrument; Any instrument of a counterparty has a status of a potentially problem transaction.
Stage 3:	The criteria for the transition to Stage 3 are the criteria defining credit impairment, equivalent to indications of default under Bank's Methodology. The Bank records an allowance for the LTECL.
POCI:	For purchased or originated credit-impaired (POSI) financial assets, the calculation of an effective interest rate adjusted for the credit risk should take into account ECL at the initial recognition date; no impairment allowances for such financial instruments are made. At the consecutive reporting dates, the calculation of impairment allowances requires only the measurement of accumulated lifetime movements of credit losses.

Definition of default and cure

The Bank considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments. In addition, there are the following default factors for corporate borrowers: default restructuring, written-off or sale of a deals, bankruptcy or liquidation of the counterparty, problem loans. The Bank considers amounts due from banks defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements.

As a part of qualitative assessment process of whether a counterparty is default, the Bank also considers a variety of instances that may indicate unlikeliness to meet its debt obligations and are relevant to the risk of default occurring.

Other financial assets are automatically allocated to Stage 3 when the customer becomes 14 days past due on its contractual payments. As a part of a qualitative assessment of whether a customer is in default, the Bank also considers a variety of events that may indicate unlikeliness to pay, such as:

- ► External rating of the borrower indicating default;
- ► Bankruptcy or liquidation of the counterparty;
- ► Recall of the customer's license.

The financial assets cannot be reclassified out of Stage 3, unless the financial assets represent renegotiated loans.

When restructuring of a creditor's debt commitments is done by replacing the original loan (with more than 90 days past) with a new loan with different economic terms (often referred to as a debt exchange), it is the Banks policy to consider financial instrument as "cured" when none of the listed above default criteria have been present for at least three consecutive months before reporting date. When this condition is satisfied, the new loan is reclassified out of Stage 3 to Stage 2. In case when the initial loan that was restructured was less than 90 days past due, after three month probation period the new loan is reclassified out of Stage 2 to Stage 1.

Internal rating and PD estimation process

The Bank independent Credit Risk unit operates its internal rating models. The Bank runs separate models for its key portfolios in which its customers are rated from 1 to 13 using internal grades (A1,A2,A3,B1,B2,B3,C1,C2,C3,D1,D2, D3,E (Default)). The models incorporate both qualitative and quantitative information and, in addition to information specific to the borrower, utilise supplemental external information that could affect the borrower's behaviour. Where practical, they also build on information from international external rating agencies. PDs, incorporating forward looking information and the IFRS 9 stage classification of the exposure, are assigned for each grade. This is repeated for each economic scenario as appropriate.

(Thousands of Georgian lari)

24. Risk management (continued)

Credit risk (continued)

PD for retail portfolio is determined by statistical data of the Group. One-year PD is estimated at the level of segments (One-year PD is estimated at the segment level). Instruments in each segments are assigned days past due groups (Group 1- 0 days past due, Group 2- one to 30 days past due, Group 3-31 to 60 days past due, Group 4-61 to 90 days past due, Group 5- over 90 days overdue). The calculation of one-year PD for a group i requires the estimation of an initial transition matrix. For this purpose, an analysis is performed on the consecutive one-quarter periods of the loan portfolio based on history (all homogeneous statistical data available is used, with the time horizon limited to 10 years). Resulting matrix is an average one-year TTC PD column ($PD\,TTC$). For the estimation of one-year PIT PD taking into account macroeconomic forecasts for this segment, each element of vector $PD\,TTC$ is adjusted to a calibration ratio.

Treasury and interbank relationships

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

Corporate and small business lending

For corporate loans, specialised credit risk employees of the Bank assess the borrowers. The credit risk assessment is based on a credit scoring/rating model that takes into account various historical, current and forward-looking information in accordance with the Bank rating methodology.

The complexity and granularity of the rating techniques varies based on the exposure of the Bank and the complexity and size of the customer. Some of the less complex small business loans are rated within the Bank's models for retail products.

Consumer lending and residential mortgages

Consumer lending comprises unsecured personal loans, credit cards and overdrafts. These products along with residential mortgages and some of the less complex small business lending are rated by an automated scorecard tool primarily driven by days past due.

The Bank's internal credit rating grades for loans to customers are as follows

Internal rating grade (in Number)	***International external rating agency (Fitch) rating***	***Internal rating description***	***Lifetime PD***
1-2	BB- to BBB-	High grade	0-2%
3	B+		
4	B	Standard grade	2-15%
5-6	B-		
7-9	CCC/C	Sub-standard grade	
10-11	CCC/C		16-100%
12-13	D	Impaired	100%

Exposure at default

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

The Bank determines EADs by modelling the range of possible exposure outcomes at various points in time, corresponding the multiple scenarios. The IFRS 9 PDs are then assigned to each economic scenario based on the outcome of Bank's models.

Loss given default

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

(Thousands of Georgian lari)

24. Risk management (continued)

Credit risk (continued)

The Bank segments its retail lending products into smaller homogeneous portfolios, based on key characteristics that are relevant to the estimation of future cash flows. The applied data is based on historically collected loss data and involves a wider set of transaction characteristics (e.g., product type, wider range of collateral types) as well as borrower characteristics.

LGD rates are estimated for the Stage 1, Stage 2, Stage 3 and POCI segment of each asset class. The inputs for these LGD rates are estimated and, where possible, calibrated through back testing against recent recoveries. These are repeated for each economic scenario as appropriate.

Significant increase in credit risk

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

The Bank applies a qualitative method for triggering a significant increase in credit risk for an asset, such as moving a customer/facility to the watch list, or the account becoming restructured due to credit event. In certain cases, the Bank may also consider that events explained in “Definition of default” section above are a significant increase in credit risk as opposed to a default. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.
When estimating ECLs on a collective basis for a group of similar assets, the Bank applies the same principles for assessing whether there has been a significant increase in credit risk since initial recognition.

Grouping financial assets measured on a collective basis

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

A decision to estimate an instrument on an individual basis is made based on expert judgments, which, inter alia, take into account the following factors:

- The amount of all exposures of the borrower exceeds GEL 200;
- All Stage 3 assets, regardless of the class of financial assets;
- Stage 2 and Stage 3 corporate lending portfolio;
- The large and unique exposures of the small business lending portfolio;
- The treasury and interbank relationships (such as amounts due from banks, cash equivalents and debt investment securities at amortised cost and FVOCI);
- Exposures that have been classified as POCI when the original loan was derecognised and a new loan was recognised as a result of a credit driven debt restructuring.

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

- The smaller and more generic balances of the Bank’s small business lending;
- Stage 1 and 2 retail mortgages and consumer lending and Stage 1 corporate lending portfolio;
- Purchased POCI exposures managed on a collective basis.

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

Forward-looking information and multiple economic scenarios

In order to consider forward-looking information when estimating ECL, the influence of macroeconomic factors on PD is determined at the level of the aggregate share of overdue debts in the total loan portfolio of the Georgian banking sector (according to the NBG).

The functional relationship between the credit risk and macroeconomic factors is established in consideration of forward-looking information. Variables include centered and normalized shares of overdue debts (or possible transformations of those, including absolute variations and relative gains) in the total loan portfolio of the Georgian banking sector (according to the NBG). Explanatory variables include centered and normalized values of macroeconomic factors: the logarithm of the GDP growth rate and the t-2 lag of the absolute change in export growth (over the period under review), and the effect on PDs.

(Thousands of Georgian lari)

24. Risk management (continued)

Credit risk (continued)

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank internal credit ratings, as described above. The table below shows the credit quality by class of asset for loan-related lines in the statement of financial position, based on the Bank's credit rating system.

	Notes	*Stages*	*High grade 2018*	*Standard grade 2018*	*Sub-standard grade 2018*	*Impaired 2018*	*Total 2018*
Cash and cash equivalents, except for cash on hand	6	Stage 1	**135,766**	**–**	**–**	**–**	**135,766**
Amounts due from banks and international financial institutions	7	Stage 1	**160,013**	**–**	**–**	**–**	**160,013**
Loans and advances to customers	8		**353,079**	**702,414**	**35,009**	**35,665**	**1,126,167**
- Corporate lending		Stage 1	191,495	175,427	7,011	–	**373,933**
		Stage 2	–	5,606	17,708	–	**23,314**
		Stage 3	–	–	–	13,516	**13,516**
- Small business lending		Stage 1	43,294	132,859	373	–	**176,526**
		Stage 2	–	87	520	–	**607**
		Stage 3	–	–	572	1,608	**2,180**
- Consumer lending		Stage 1	110,721	383,131	5,334	–	**499,186**
		Stage 2	172	5,304	3,491	–	**8,967**
		Stage 3	–	–	–	20,541	**20,541**
- Loans collateralized with deposits		Stage 1	7,397	–	–	–	**7,397**
		Stage 2	–	–	–	–	**–**
		Stage 3	–	–	–	–	**–**
Debt investment securities	9		**114,871**	**–**	**–**	**–**	**114,871**
- Measured at amortised cost		Stage 1	114,871	–	–	–	**114,871**
Undrawn loan commitments	20	Stage 1	**48,819**	**20,870**	**–**	**–**	**69,689**
Letters of credit	20	Stage 1	**5,607**	**–**	**–**	**–**	**5,607**
Financial guarantees	20	Stage 1	**46,161**	**27,572**	**232**	**–**	**73,965**
		Stage 2	**312**	**1,941**	**–**	**–**	**2,253**
Other assets	14	Stage 1	**92**	**5,809**	**–**	**–**	**5,901**
Total			**864,720**	**758,606**	**35,241**	**35,665**	**1,694,232**

(Thousands of Georgian lari)

24. Risk management (continued)

Credit risk (continued)

The table below shows gross balances under IAS 39 as at 31 December 2017 based on the Bank's internal credit rating system:

		Neither past due nor impaired				
	Notes	***High grade 2017***	***Standard grade 2017***	***Sub-standard grade 2017***	***Past due or individually impaired 2017***	***Total 2017***
Cash in credit organisations	6	152,440	6,512	–	–	**158,952**
Amounts due from banks and international financial institutions	7	116,432	114,038	–	–	**230,470**
Investment securities	9	120,670	–	–	–	**120,670**
Loans and advances to customers	8					
Consumer lending		369,517	26,444	13,802	10,504	**420,267**
Corporate lending		111,396	203,795	24,462	11,965	**351,618**
Small business lending		164,338	–	4,156	863	**169,357**
Loans to individuals secured with deposits		9,234	–	–	–	**9,234**
		654,485	**230,239**	**42,420**	**23,332**	**950,476**
Other financial assets	14	–	4,838	–	9	**4,847**
Total		**1,044,027**	**355,627**	**42,420**	**23,341**	**1,465,415**

It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business geographic regions and products. The rating system is supported by a variety of financial analytics combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Bank's rating policy. The attributable risk ratings are assessed and updated regularly.

Overdue but not impaired loans and advances include solely loans and advances that are not individually significant. The tables below show aging analysis of overdue loans.

Aging analysis of past due but not individually impaired loans per class of financial assets.

As of 31 December 2018	***Less than 30 days***	***31 to 60 days***	***61 to 90 days***	***More than 90 days***	***Total***
Loans and advances to customers					
Consumer lending	9,386	2,071	1,076	5,412	**17,945**
Corporate lending	12,790	–	–	1,698	**14,488**
Small business lending	409	195	335	339	**1,278**
Total	**22,585**	**2,266**	**1,411**	**7,449**	**33,711**

As of 31 December 2017	***Less than 30 days***	***31 to 60 days***	***61 to 90 days***	***More than 90 days***	***Total***
Loans and advances to customers					
Consumer lending	5,041	1,461	984	3,017	**10,503**
Corporate lending	1,583	1,118	–	723	**3,424**
Small business lending	248	73	111	102	**534**
Total	**6,872**	**2,652**	**1,095**	**3,842**	**14,461**

For the purpose of these financial statements a loan is considered overdue when the borrower fails to make any payment due under the loan agreement at the reporting date. In this case the aggregate amount of all amounts due from borrower under the respective loan agreement including accrued interest and commissions is recognised as overdue.

Loans and advances to customers have been assessed for impairment on the collective basis. Details of loan loss allowance of loan portfolio are disclosed in Note 8.

(Thousands of Georgian lari)

24. Risk management (continued)

Credit risk (continued)

Carrying amount per class of financial assets whose terms have been renegotiated

The table below shows the carrying amount for renegotiated (restructured or refinanced) financial assets, by class.

	2018	*2017*
Loans and advances to customers		
Consumer lending	18,648	12,245
Corporate lending	12,534	6,896
Small business lending	3,792	4,948
Total	**34,974**	**24,089**

Individually assessed allowances

The measurement of expected credit losses on an individual basis is performed taking into account time value of money, as well as information about the past, current and forecast economic conditions that is reasonably available. When measuring a provision for each financial instrument on an individual basis, possible scenarios of cash inflows to settle the debt are determined. For each financial instrument measured on an individual basis, the provision is calculated as the difference between the current gross carrying amount and present value of cash flows weighted by the probability of the respective scenario. Scenarios of cash flows are based on the settlement strategies, which are applied/are planned to be applied/may be applied to the borrower. Probabilities of scenarios, amounts and timing of cash inflows are determined by expert judgment.

Collectively assessed allowances

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

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

ECL for exposures in Stage 1 is calculated by multiplying the 12-month PD by LGD and EAD. For Stage 2 and Stage 3 LTECL is calculated by multiplying the lifetime PD by LGD and EAD.

ECL calculates for the following assets:

- Corporate customers;
- SMEs;
- Amounts due from banks and international financial institutions;
- Guarantees and letters of credit;
- Securities portfolio;
- Individuals (by products).

(Thousands of Georgian lari)

24. Risk management (continued)

Credit risk (continued)

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

	2018				*2017*			
	Georgia	*OECD*	*CIS and other foreign countries*	*Total*	*Georgia*	*OECD*	*CIS and other foreign countries*	*Total*
Assets								
Cash and cash equivalents	106,449	69,739	8,317	**184,505**	153,722	31,952	25,968	**211,642**
Amounts due from banks and international financial institutions	159,879	134	–	**160,013**	116,302	130	114,038	**230,470**
Loans and advances to customers	1,078,075	2,493	16,648	**1,097,216**	924,791	2,678	23,007	**950,476**
Investment securities								
Investment assets at FVOCI	54	–	–	**54**	54	–	–	**54**
Investment assets at amortised cost	114,527	–	–	**114,527**	120,670	–	–	**120,670**
Other financial assets	5,501	168	88	**5,757**	3,084	472	1,291	**4,847**
	1,464,485	**72,534**	**25,053**	**1,562,072**	**1,318,623**	**35,232**	**164,304**	**1,518,159**

	2018				*2017*			
	Georgia	*OECD*	*CIS and other foreign countries*	*Total*	*Georgia*	*OECD*	*CIS and other foreign countries*	*Total*
Liabilities								
Amounts due to banks and international financial institutions	31,509	–	96,926	**128,435**	26,760	–	86,133	**112,893**
Amounts due to customers	879,226	45,675	80,662	**1,005,563**	737,940	35,737	122,080	**895,757**
Debt securities issued	33,949	1,888	15,170	**51,007**	28,431	104	9,658	**38,193**
Other borrowed funds	49,330	8,548	70,222	**128,100**	47,071	12,377	203,537	**262,985**
Subordinated loan	–	–	52,757	**52,757**	–	–	37,362	**37,362**
Other financial liabilities	17,110	185	8,737	**26,032**	14,890	442	47	**15,379**
	1,011,124	**56,296**	**324,474**	**1,391,894**	**855,092**	**48,660**	**458,817**	**1,362,569**
Net assets/ (liabilities)	**453,361**	**16,238**	**(299,421)**	**170,178**	**463,531**	**(13,428)**	**(294,513)**	**155,590**
Net financial commitments	**145,758**	**28**	**5,312**	**151,098**	**119,867**	**17**	**2,483**	**122,367**

ECL for credit related commitments and financial guarantees are recorded within other financial liabilities for both comparative years. Refer to Note 14.

(Thousands of Georgian lari)

24. Risk management (continued)

Credit risk (continued)

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are in place covering the acceptability and valuation of each type of collateral. Management monitors the market value of collateral and may request additional collateral in accordance with the underlying agreement. It is the Bank policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim.

The list of acceptable forms of credit support is subject to periodical review. The Bank has a set of requirements applicable to each from of credit support. The value of the pledged property is determined by reference to its market value taking into account a liquidity margin.

Collateral is taken to enhance an acceptable credit proposal, rather than being used as the sole rationale for any credit approval. Where facilities are approved against security, full details, including the type, value, and the frequency of review of the security should be detailed in the Application for Credit Facility Form. Where practical, a bank officer conducts inspection the physical existence of collateral offered.

The Bank reassesses the fair value of pledged property with frequency stated for each from of pledge and, if necessary, requires additional collateral or acceptable forms of credit support.

Liquidity risk and funding management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, the Bank's Management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Bank maintains a portfolio of state securities that can be pledged to the NBG to obtain financing in the event of demand. The Bank also has committed lines of credit that it can assess to meet liquidity needs.

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on certain liquidity ratio established by the NBG. As of 31 December 2018 and 2017 the ratio was as follows:

	2018	***2017***
LK “Average Liquidity Ratio” (average monthly volume of liquid assets / Average monthly volume of liabilities)	35%	40%

In 2018 minimum limit of average liquidity ratio is 30% (2017: 30%)

From 1 September 2017 NBG additionally introduced minimum requirement of liquidity Coverage Ratio (LCR) for the Georgian commercial banks. Under the requirement Banks must hold the liquid assets that can be used to meet their liquidity needs for upcoming 30-calendar days.

The Banks are obliged to keep LCR at least equal to 100%, 75% and 100% in foreign currency (“FC”), national currency (“NC”) and in total, respectively.

	2018	***2017***
LK “Liquidity Coverage Ratio” in FC (hold high-quality liquid assets / Total net cash outflow)	159%	158%
LK “Liquidity Coverage Ratio” in NC (hold high-quality liquid assets / Total net cash outflow)	77%	84%
Total LK “Liquidity Coverage Ratio” (hold high-quality liquid assets / Total net cash outflow)	109%	113%

(Thousands of Georgian lari)

24. Risk management (continued)

Liquidity risk and funding management (continued)

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December 2018 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

Non-derivative liabilities As of 31 December 2018	*On demand and less or equal 1 month*	*More than 1 month and less or equal 3 months*	*More than 3 months and less or equal 6 months*	*More than 6 months and less or equal 1 year*	*More than 1 year*	*Total*
Amounts due to banks and international financial institutions	35,585	480	491	35,049	67,238	**138,843**
Amounts due to customers	666,324	91,347	87,819	121,648	53,717	**1,020,855**
Debt securities issued	957	1,190	14,281	27,043	10,669	**54,140**
Other borrowed funds	49,980	446	1,111	28,207	54,220	**133,964**
Subordinated loan	91	1,269	1,387	2,783	84,600	**90,130**
Other financial liabilities	7,772	3,606	4,307	1,574	8,773	**26,032**
Total cash flow payable under non-derivative liabilities	**760,709**	**98,338**	**109,396**	**216,304**	**279,217**	**1,463,964**
Derivative financial instruments-gross settled						
Positive fair value of derivatives						
(Inflow)	(463)	(15,435)	–	–	–	**(15,898)**
Outflow	460	15,351	–	–	–	**15,811**
Derivative financial instruments-gross settled						
Negative fair value of derivatives						
(Inflow)	(30,697)	(4,596)	–	–	(92,424)	**(127,717)**
Outflow	30,783	4,605	–	–	90,784	**126,172**

Non-derivative liabilities As of 31 December 2017	*On demand and less or equal 1 month*	*More than 1 month and less or equal 3 months*	*More than 3 months and less or equal 6 months*	*More than 6 months and less or equal 1 year*	*More than 1 year*	*Total*
Amounts due to banks and international financial institutions	27,342	856	774	42,629	45,800	**117,401**
Amounts due to customers	565,850	60,013	91,692	123,097	67,796	**908,448**
Debt securities issued	693	2,270	7,659	14,297	18,310	**43,229**
Other borrowed funds	50,124	5,592	9,142	2,905	227,012	**294,775**
Subordinated loan	772	–	755	1,535	41,098	**44,160**
Other financial liabilities	5,684	3,728	4,094	1,656	217	**15,379**
Total cash flow payable under non-derivative liabilities	**650,465**	**72,459**	**114,116**	**186,119**	**400,233**	**1,423,392**
Derivative financial instruments-gross settled						
Positive fair value of derivatives						
(Inflow)	(139,661)	–	–	–	–	**(139,661)**
Outflow	138,188	–	–	–	–	**138,188**
Derivative financial instruments-gross settled						
Negative fair value of derivatives						
(Inflow)	(1,981)	–	–	–	–	**(1,981)**
Outflow	2,022	–	–	–	–	**2,022**

ECL for credit related commitments and financial guarantees are recorded within other financial liabilities for both comparative years. Refer to Note 14.

(Thousands of Georgian lari)

24. Risk management (continued)

Liquidity risk and funding management (continued)

The table below shows the contractual expiry by maturity of the Bank's financial commitments and contingencies.

	On demand and less or equal 1 month	***More than 1 month and less or equal 3 months***	***More than 3 months and less or equal 6 months***	***More than 6 months and less or equal 1 year***	***More than 1 year***	***Total***
2018	11,493	24,751	22,163	47,121	45,986	**151,514**
2017	26,128	15,147	22,752	26,632	31,708	**122,367**

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

Management believes that this level of funding will remain with the Bank for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment.

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 above.

Market risk

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

Market risk – trading

The Management Board has set limits on the level of risk that may be accepted. The Bank's activity in market risks area is limited by NBG Deposit certificates, Ministry of Finance of Georgia Treasury Bills, CDs operations, also interbank loans and deposits, and exchange operations. The Bank does not perform derivative trading.

Market risk – non-trading

Interest rate risk

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

The sensitivity of the Statement of profit or loss includes the effect of the reasonably possible changes in interest rates on the net interest income for one year based on the assumption that there are parallel shifts in the yield curve.

Currency	***Increase in basis points 2018***	***Sensitivity of profit before tax 2018***
USD	0.16%	(6)
USD	(0.16%)	6
RUB	0.60%	(76)
RUB	(0.60%)	76

Currency	***Increase in basis points 2017***	***Sensitivity of profit before tax 2017***
USD	0.14%	(53)
USD	(0.14%)	53
RUB	0.3%	(46)
RUB	(0.3%)	46

(Thousands of Georgian lari)

24. Risk management (continued)

Market risk (continued)

Currency risk

The Bank is exposed to currency risk. Currency risk arises from open position in foreign currencies and adverse movements of market exchange rates that may have a negative impact on financial performance of the Bank. The Management Board has set limits on positions by currency based on the NBG's regulations. Positions are monitored on a daily basis.

The tables below indicate the currencies to which the Bank had significant exposure at 31 December 2018 and 2017 on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the national currency, with all other variables held constant on the Statement of profit or loss (due to the fair value of currency sensitive non-trading monetary assets and liabilities). The effect on statement of comprehensive income does not differ from the effect on the Statement of profit or loss. A negative amount in the table reflects a potential net reduction in Statement of profit or loss or statement of comprehensive income, while a positive amount reflects a net potential increase.

Currency	*Increase in currency rate in % 2018*	*Effect on profit before tax 2018*	*Increase in currency rate in % 2017*	*Effect on profit before tax 2017*
USD	11%	2,094	13.5%	3,724
EUR	11%	22	16%	75
RUB	15%	(1,764)	17%	(2,287)

Currency	*Decrease in currency rate in % 2018*	*Effect on profit before tax 2018*	*Decrease in currency rate in % 2017*	*Effect on profit before tax 2017*
USD	(11%)	(2,094)	(9.5%)	(2,620)
EUR	(11%)	(22)	(12%)	(56)
RUB	(15%)	1,764	(17%)	2,287

Prepayment risk

Prepayment risk is the risk that the Bank will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected, such as fixed rate mortgages when interest rates fall.

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

	Effect on net interest income
2018	13,446
2017	11,546

Operational risk

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

As of 31 December 2018, the Bank obtained Banker's Blanket Bond and Computer Crime insurance on a total insured sum of GEL 2,677 (2017: GEL 2,592) from "IC-Group" insurance company. Total sum of insurance was reinsured by "AIG Europe" insurance company.

(Thousands of Georgian lari)

25. Fair value measurements

The Bank's Board of directors determines the policies and procedures for recurring fair value measurement, such as investment property and buildings.

External valuers are involved for valuation of significant assets, such as investment property and buildings. Involvement of external valuers is decided upon annually by the Board of directors. Selection criteria include market knowledge, reputation, independence and whether professional standards are maintained. The Board of directors decides, after discussions with the Bank's Bank's external valuers, which valuation techniques and inputs to use for each case.

At each reporting date, the Board of directors analyses the movements in the values of assets and liabilities which are required to be re-measured or re-assessed as per the Bank's accounting policies. For this analysis, the board of directors in conjunction with Bank's external valuers verifies the major inputs applied in the latest valuation by agreeing the information in the valuation computation to contracts and other relevant documents.

(Thousands of Georgian lari)

25. Fair value measurements (continued)

Fair value hierarchy

For the purpose of fair value disclosures, the Bank's has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability. The following tables show analysis of assets and liabilities measured at fair value or for which fair values are disclosed by level of the fair value hierarchy:

As of 31 December 2018	*Level 1*	*Level 2*	*Level 3*	*Total*
Assets measured at fair value				
Equity securities at FVOCI	–	–	54	**54**
Total investment property	**–**	**–**	**20,271**	**20,271**
Land	–	–	2,523	**2,523**
Residential properties	–	–	10,444	**10,444**
Non-residential properties	–	–	7,304	**7,304**
Total revalued land and buildings	**–**	**–**	**33,170**	**33,170**
Land	–	–	5,126	**5,126**
Office buildings	–	–	12,125	**12,125**
Service centres/means of production	–	–	15,919	**15,919**
Derivative financial assets	**–**	**87**	**–**	**87**
Assets for which fair values are disclosed				
Cash and cash equivalents	48,740	135,765	–	**184,505**
Amounts due from banks and international financial institutions	–	160,013	–	**160,013**
Loans and advances to customers	–	–	1,102,227	**1,102,227**
Debt securities at amortised cost	–	102,941	11,633	**114,574**
Liabilities measured at fair value				
Derivative financial liabilities	–	8,769	–	**8,769**
Liabilities for which fair values are disclosed				
Amounts due to banks and international financial institutions	–	128,435	–	**128,435**
Amounts due to customers	–	–	1,003,363	**1,003,363**
Debt securities issued	–	–	51,516	**51,516**
Other borrowed funds	–	127,154	–	**127,154**
Subordinated loan	–	52,757	–	**52,757**
Assets measured at fair value as of December 2017				
Investment securities	–	120,670	54	**120,724**
Total investment property	**–**	**–**	**24,556**	**24,556**
Land	–	–	3,349	**3,349**
Residential properties	–	–	11,548	**11,548**
Non-residential properties	–	–	9,659	**9,659**
Total revalued land and premises	**–**	**–**	**25,251**	**25,251**
Land	–	–	186	**186**
Office buildings	–	–	17,008	**17,008**
Service centres/means of production	–	–	8,057	**8,057**
Derivative financial assets	**–**	1,290	**–**	**1,290**
Assets for which fair values are disclosed				
Cash and cash equivalents	52,690	158,952	–	**211,642**
Amounts due from banks and international financial institutions	–	230,470	–	**230,470**
Loans to customers	–	–	964,010	**964,010**
Liabilities measured at fair value				
Derivative financial liabilities	–	38	–	**38**
Liabilities for which fair values are disclosed				
Amounts due to banks and international financial institutions	–	112,893	–	**112,893**
Amounts due to customers	–	–	898,083	**898,083**
Debt securities issued	–	–	39,064	**39,064**
Other borrowed funds	–	262,196	–	**262,196**
Subordinated loan	–	37,362	–	**37,362**

(Thousands of Georgian lari)

25. Fair value measurements (continued)

Fair value hierarchy (continued)

During the years ended 31 December 2018 and 2017, there have been no transfers between levels of fair value hierarchy.

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

Set out below is a comparison by class of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the statement of financial position, except for assets for which fair value approximates carrying value – those assets that are liquid or have a short term maturity (less than three months or bear floating interest rate).

	Carrying value 2018	*Fair value 2018*	*Unrecog-nised gain/(loss) 2018*	*Carrying value 2017*	*Fair value 2017*	*Unrecog-nised gain/(loss) 2017*
Financial assets						
Debt securities at amortised cost	114,527	114,574	47	–	–	–
Amounts due from banks and international financial institutions	160,013	160,013	–	230,470	230,470	–
Loans and advances to customers	1,097,216	1,102,227	5,011	950,476	964,010	13,534
Financial liabilities						
Amounts due to banks and international financial institutions	128,435	128,435	–	112,893	112,893	–
Amounts due to customers	1,005,563	1,003,363	2,200	895,757	898,083	(2,326)
Debt securities issued	51,007	51,516	(509)	38,193	39,064	(871)
Other borrowed funds	128,100	127,154	946	262,985	262,196	789
Subordinated loan	52,757	52,757	–	37,362	37,362	–
Total unrecognised change in unrealised fair value			**7,695**			**11,126**

The following describes the methodologies and assumptions used to determine fair values for the financial instruments.

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or have a short term maturity (less than three months) or bear floating interest rate, it is assumed that the carrying amounts approximate to their fair value.

Fixed rate financial instruments

The fair value of fixed rate financial assets and liabilities carried at amortised cost are estimated by comparing market interest rates when they were first recognised with current market rates offered for similar financial instruments. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and maturity.

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are already recorded at fair value in the financial statements.

Equity securities at FVOCI

Equity securities at FVOCI are valued using valuation technique. These securities are valued using models which incorporate data observable in the market and at other times use both observable and non-observable data. The non-observable inputs to the models include assumptions regarding the future financial performance of the investee, its risk profile, and economic assumptions regarding the industry and geographical jurisdiction in which the investee operates.

(Thousands of Georgian lari)

25. Fair value measurements (continued)

Fair value hierarchy (continued)

Derivatives

Derivatives valued using a valuation technique with market observable inputs are mainly interest rate swaps, currency swaps and forward foreign exchange contracts. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates and interest rate curves.

Property and equipment (buildings and land) and investment property

The market value of the property is determined based on the market data. The market approach is used to determine the fair value, the income approach is used to validate the obtained value estimates, and the cost approach is used to determine the value of real property where no information on recent sales or lease rates for similar properties within the same area is available.

Description of significant unobservable inputs to valuations of non-financial assets

The following tables show descriptions of significant unobservable inputs to level 3 valuations of investment properties and revalued properties and equipment as of 31 December 2018:

	Amount	*Valuation technique*	*Significant unobservable inputs*	*Range (weighted average) in*	*Other key information*	*Range (weighted average)*	*Sensitivity of the input to fair value*
Investment property	**20,271**						
Land	2,523	Market approach	Price per square metre	0.20-468.87 (48.95) Georgian lari	Square metre	34-25,600 (3,216)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 238 Georgian lari
Residential properties	10,444	Market approach	Price per square metre	1-3,675 (665) Georgian lari	Square metre	18-5,400 (191)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 1,354 Georgian lari
Non-residential properties	**7,304**						
	7,304	Market approach	Price per square metre	6-21,000 (1,865) Georgian lari	Square metre	4-2,000 (186)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 742 Georgian lari
Revaluated land and buildings	**33,170**						
Land	5,126	Market approach	Price per square metre	72.27-2,384.85 (1,153.61) Georgian lari	Square metre	900-7,665 (4,857)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 512 Georgian lari
Office buildings	12,125	Market approach	Price per square metre	3,504.37-4,014.90 (3,689.1) Georgian lari	Square metre	3,000-7,500 (4,767)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 1,261 Georgian lari
Service centers / means of production	15,919						
	15,811	Market approach	Price per square metre	414.87-15,967.15 (2,043.58) Georgian lari	Square metre	13-1,200 (153)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 1,485 Georgian lari
	107	Income approach	Cap. rate	12.00%	Square metre		10% increase (decrease) in the cap. rate would result in increase (decrease) in fair value by 4 Georgian lari

(Thousands of Georgian lari)

25. Fair value measurements (continued)

Fair value hierarchy (continued)

The following tables show descriptions of significant unobservable inputs to level 3 valuations of investment properties and revalued properties and equipment as of 31 December 2017:

	Amount	*Valuation technique*	*Significant unobservable inputs*	*Range (weighted average) in*	*Other key information*	*Range (weighted average)*	*Sensitivity of the input to fair value*
Investment property	**24,556**						
Land	3,349	Market approach	Price per square metre	0.21-367.5 (42.41) Georgian lari	Square metre	61-2,500 (382)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 343 Georgian lari
Residential properties	11,548	Market approach	Price per square metre	0.6-3,675 (676.89) Georgian lari	Square metre	23-5,400 (194)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 1,227 Georgian lari
Non-residential properties	**9,659**						
	9,659	Market approach	Price per square metre	6.02-21,000 (1,711.13) Georgian lari	Square metre	4-2,000 (156)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 995 Georgian lari
Revaluated land and buildings	**25,251**						
Land	186	Market approach	Price per square metre	0.21-367.5 (42.41) Georgian lari	Square metre	61-2,500 (382)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 19 Georgian lari
Office buildings	17,008	Market approach	Price per square metre	2,380-2,666 (2,475.2) Georgian lari	Square metre	2,000-2,500 (2,333)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 1,651 Georgian lari
Service centers / means of production	8,057						
	7,894	Market approach	Price per square metre	216-11,965 (2,822.92) Georgian lari	Square metre	61-1,100 (196)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 410 Georgian lari
	163	Income approach	Cap. rate	13.25%	Square metre		10% increase (decrease) in the cap. rate would result in increase (decrease) in fair value by 12 Georgian lari

(Thousands of Georgian lari)

26. Maturity analysis of financial assets and liabilities

The table below shows assets and liabilities at 31 December 2018 by their remaining expected maturity. Refer to Note 24 for the Bank's contractual undiscounted repayment obligations.

Following principles underlying gap analysis presentation and the Bank liquidity risk management are based on the mix of NBG approach and the Bank's practice:

- Cash and cash equivalents represent highly liquid assets and are classified as "On demand and less or equal 1 month";
- Loans and advances to customers, investment securities, amounts due from banks and international financial institutions (except of restricted cash on nostro account that is presented per expected time of funds inflow in the maturity gap analysis), other assets, amounts due to banks and international financial institutions, debt securities issued, other borrowed funds, Subordinated debt and other liabilities are included into gap analysis table based on remaining contractual maturities;
- Diversification of customer deposits of the bank by number and type of depositors and the past experience of the Bank indicate that such accounts and deposits provide a long-term and stable source of funding, and as a result they are allocated per expected time of funds outflow in the gap analysis table on the basis of statistical data accumulated by the Bank during the previous periods and assumptions regarding the "stable part" of current account balances.

	2018							
	On demand and less or equal 1 month	***More than 1 month and less or equal 3 months***	***More than 3 months and less or equal 6 months***	***More than 6 months and less or equal 1 year***	***More than 1 year***	***Overdue***	***No stated maturity***	***Total***
Financial assets								
Cash and cash equivalents	184,505	–	–	–	–	–	–	**184,505**
Amounts due from banks and international financial institutions	25,925	19,707	20,184	41,879	52,318	–	–	**160,013**
Loans and advances to customers	46,565	82,024	87,408	185,407	675,835	19,977	–	**1,097,216**
Investment securities:								
debt at amortised cost	32,678	15,680	24,435	29,458	12,276	–	–	**114,527**
FV through OCI	–	–	–	–	–	–	54	**54**
Other financial assets	2,983	2,599	–	173	2	–	–	**5,757**
Total	**292,656**	**120,010**	**132,027**	**256,917**	**740,431**	**19,977**	**54**	**1,562,072**
Financial liabilities								
Amounts due to banks and international financial institutions	32,981	598	-	33,573	61,283	–	–	**128,435**
Amounts due to customers	190,388	139,065	95,928	130,328	449,854	–	–	**1,005,563**
Debt securities issued	951	1,180	14,016	26,022	8,838	–	–	**51,007**
Other borrowed funds	50,105	734	1,254	28,697	47,310	–	–	**128,100**
Subordinated loan	77	301	-	-	52,379	–	–	**52,757**
Other financial liabilities	7,772	3,606	4,307	1,574	8,773	–	–	**26,032**
Total	**282,274**	**145,484**	**115,505**	**220,194**	**628,437**	**–**	**–**	**1,391,894**
Net	**10,382**	**(25,474)**	**16,522**	**36,723**	**111,994**	**19,977**	**54**	**170,178**
Cumulative gap	**10,382**	**(15,092)**	**1,430**	**38,153**	**150,147**	**170,124**	**170,178**	**–**

(Thousands of Georgian lari)

26. Maturity analysis of financial assets and liabilities (continued)

	2017							
	On demand and less or equal 1 month	***More than 1 month and less or equal 3 months***	***More than 3 months and less or equal 6 months***	***More than 6 months and less or equal 1 year***	***More than 1 year***	***Overdue***	***No stated maturity***	***Total***
Financial assets								
Cash and cash equivalents	211,642	–	–	–	–	–	–	**211,642**
Amounts due from banks and international financial institutions	23,894	11,982	20,267	152,004	22,323	–	–	**230,470**
Loans and advances to customers	38,062	67,819	112,797	165,443	554,625	11,730	–	**950,476**
Investment securities - available-for-sale	21,895	29,136	17,947	35,193	16,499	–	54	**120,724**
Other financial assets	4,695	2	–	149	1	–	–	**4,847**
Total	**300,188**	**108,939**	**151,011**	**352,789**	**593,448**	**11,730**	**54**	**1,518,159**
Financial liabilities								
Amounts due to banks and international financial institutions	27,240	393	–	41,193	44,067	–	–	**112,893**
Amounts due to customers	170,274	80,160	96,686	120,798	427,839	–	–	**895,757**
Debt securities issued	438	2,262	7,495	13,850	14,148	–	–	**38,193**
Other borrowed funds	47,165	2,953	1,394	3,247	208,226	–	–	**262,985**
Subordinated loan	576	–	–	–	36,786	–	–	**37,362**
Other financial liabilities	5,684	3,728	4,094	1,656	217	–	–	**15,379**
Total	**251,377**	**89,496**	**109,669**	**180,744**	**731,283**	**–**	**–**	**1,362,569**
Net	**48,811**	**19,443**	**41,342**	**172,045**	**(137,835)**	**11,730**	**54**	**155,590**
Cumulative gap	**48,811**	**68,254**	**109,596**	**281,641**	**143,806**	**155,536**	**155,590**	**–**

As of 31 December 2018, total amount of funding obtained from the Parent bank amounted to GEL 219,469 (2017: GEL 326,733). Management believes that this level of funding will remain with the Bank for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment. Refer to Note 27.

ECL for credit related commitments and financial guarantees are recorded within other financial liabilities for both comparative years. Refer to Note 14.

Long-term loans are generally not available in Georgia. However, in the Georgian marketplace, many short-term credits are granted with the expectation of renewing the loans at maturity. As such, the ultimate maturity of assets may be different from the analysis presented above.

(Thousands of Georgian lari)

27. Related party disclosures

As of 31 December 2018 and 2017, outstanding balances on related party transactions are as follows:

	2018			2017		
	The Parent bank	Entities under common control	Key management personnel	The Parent bank	Entities under common control	Key management personnel
Cash and cash equivalents	8,298	1,393	–	18,800	234	–
Amounts due from banks and international financial institutions	–	–	–	–	114,006	–
Loans and advances to customers, gross	–	15,598	171	–	–	476
Less: allowance for impairment	–	(97)	–	–	–	–
Loans and advances to customers, net	–	15,501	171	–	–	476
Other assets	85	-	174	1,271	–	–
Amounts due to banks and international financial institutions	96,491	86	–	85,834	139	–
Amounts due to customers	–	27,636	4,817	–	10,053	8,250
Debt securities issued	–	–	3,993	–	–	147
Other borrowed funds	70,221	–	–	203,537	–	–
Subordinated loan	52,757	–	–	37,362	–	–
Other liabilities	8,763	–	174	42	–	3,897
Commitments and guarantees issued	–	704	91	–	28	58

Entities under common control are companies that directly or indirectly through one or more intermediaries control or are controlled by or are under common control with the Bank (this includes holding companies subsidiaries and fellow subsidiaries). In these financial statements included into entities under common control are the members of VTB Group and other legal entities controlled by the Russian Federation.

On 13 October 2014, the Bank entered into a subordinated loan agreement with the Parent bank for the total amount of RUB 126,400, with interest rate of 11% payable quarterly and maturity on 13 October 2021. On 31 July 2018 subordinated loan was restructured with interest rate of 7.5% payable quarterly and maturity on 14 October 2025.

On 31 August 2018, the Bank entered into a subordinated loan agreement with the Parent bank for the total amount of RUB 816,985, with interest rate of 10.5% payable quarterly and maturity on 29 August 2025.

On 31 December 2018, the Bank entered into a subordinated loan agreement with the Parent bank for the total amount of RUB 414,000, with interest rate of 11.5% payable quarterly and maturity on 26 December 2025.

In the case of a liquidation of the Bank, these loans are only repayable after all the obligations to the Bank senior creditors have been met.

As of 31 December 2018 other liabilities to key management personnel comprised of accrued bonuses totalling GEL 4,023 (2017: GEL 3,755) and unpaid vacation of GEL 144 (2017: GEL 142).

The income and expense arising from related party transactions are presented in the table below:

	2018			2017		
	The Parent bank	Entities under common control	Key manage-ment personnel	The Parent bank	Entities under common control	Key management personnel
Interest revenue calculated using effective interest rate	5	2,983	109	13	2,174	1,449
Interest expense	(14,346)	(596)	(325)	(13,127)	(544)	(288)
Expense due to assets with negative interest rates (NIR)	–	(17)	–	–	(17)	–
Credit loss expense	–	(111)	(15)	–	–	–
Fee and commission income	–	34	5	–	34	5
Fee and commission expense	(190)	(86)	-	(186)	(67)	–
Net gains from foreign currencies dealing	1,230	166	2	7,220	610	11
Other operating expenses	(41)	-	–	(11)	(42)	–

(Thousands of Georgian lari)

27. Related party disclosures (continued)

For the year ended 31 December 2018, remuneration of the members of the key management personnel comprised salaries, bonuses and other staff related expenses totalling GEL 7,503 (2017: GEL 7,173).

Key management personnel as of 31 December 2018 comprise 6 members of the Supervisory Board and 6 members of the Management Board of the Bank (2017: 5 members of the Supervisory Board and 6 members of the Management Board).

The Bank had no significant transactions with members of the Supervisory Board in 2018 and 2017.

28. Changes in liabilities arising from financing activities

	Other borrowed funds	***Subordinated loans***	***Total liabilities from financing activities***
Carrying amount at 31 December 2016	**139,022**	**37,759**	**176,780**
Proceeds from issue	1,615,546	–	1,615,546
Redemption	(1,501,531)	–	(1,501,531)
Foreign currency translation	9,159	(410)	8,750
Non-cash transactions	10	–	10
Other	779	13	792
Carrying amount at 31 December 2017	**262,985**	**37,362**	**300,347**
Proceeds from issue	1,143,613	46,882	1,190,495
Redemption	(1,151,199)	(30,947)	(1,182,146)
Foreign currency translation	(11,758)	(343)	(12,101)
Non-cash transactions	(114,469)	–	(114,469)
Other	(1,072)	(197)	(1,269)
Carrying amount at 31 December 2018	**128,100**	**52,757**	**180,857**

The “Other” line includes the effect of accrued but not paid interest on perpetual subordinated loans, other borrowed funds and subordinated loans.

29. 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 to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders’ value.

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 return capital to shareholders or issue capital securities.

Capital adequacy ratio

Regulatory capital consists of Tier 1 capital, which comprises common shares, reserve fund and retained earnings excluding current year profit or loss less amount of property revaluation reserve transferred to authorised capital, and intangible assets. The other component of regulatory capital is Tier 2 capital, which includes profit or loss of current year, general reserves (not more than 1.25% of risk weighted assets) and subordinated long-term debt.

Starting from 30 June 2014 the NBG requires that all banks comply with Basel II regulations in their capital adequacy assessment. In December 2017, the NBG adopted amendments to the regulations introduced amendment relating to capital adequacy requirements, including amendments to the regulation on capital adequacy requirements for commercial banks, and introduced new requirements on the determination of the countercyclical buffer rate, on the identification of systematically important banks, on determining systemic buffer requirements and on additional capital buffer requirements for commercial banks within Pillar II.

As at 31 December 2018 the NBG requires banks to maintain a minimum regulatory capital adequacy ratio, the core Tier 1 capital coefficient and Tier 1 coefficient of 17.23%, 8.85% and 10.97%, respectively (December 2017: Minimum regulatory capital adequacy ratio, the core Tier 1 capital coefficient and Tier 1 coefficient of 12.47%, 8.10% and 9.98%, respectively).

(Thousands of Georgian lari)

29. Capital adequacy (continued)

Capital adequacy ratio (continued)

The Bank was in compliance with these capital adequacy ratios as of 31 December 2018 and 2017. The Bank's capital adequacy ratios on this basis were as follows:

	2018	*2017*
Common Equity Tier 1 capital	189,346	160,969
Additional Tier 1 capital	11,576	13,481
Tier 1 capital	200,922	174,450
Tier 2 capital	68,767	23,698
Total regulatory capital for ratio calculation	**269,689**	**198,148**
Risk weighted assets	**1,503,903**	**1,315,638**
Common Equity Tier 1 capital adequacy ratio	**12.59%**	**12.24%**
Tier 1 capital adequacy ratio	**13.36%**	**13.26%**
Total capital adequacy ratio	**17.93%**	**15.06%**