JSC VTB Bank (Georgia)

Financial statements

For the year ended 31 December 2020
together with independent auditor's report

Contents

Independent auditor's report

Financial statement

Notes to the financial statements

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

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

Independent auditor's report

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

Opinion

We have audited the financial statements of JSC VTB Bank (Georgia) (hereinafter, the "Bank), which comprise the statement of financial position as at 31 December 2020, 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 Bank as at 31 December 2020 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board 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 Bank's 2020 Management Report

Other information consists of the information included in the Bank's 2020 Management Report, other than the financial statements and our auditor's report thereon. Management is responsible for the other information. The Bank's 2020 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 the 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 Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

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

Auditor's responsibilities for the audit of the financial statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with 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

2 April 2021

Statement of financial position

As of 31 December

(Thousands of Georgian lari)

	Notes	*2020*	*2019*
Assets			
Cash and cash equivalents	5	207,103	149,909
Amounts due from banks and international financial institutions	6	229,292	153,712
Trading securities	8	9,781	–
Loans and advances to customers	7	1,398,651	1,153,560
Investment securities at amortized cost	8	157,018	120,696
Property and equipment	9	42,662	43,565
Right-of-use assets	10	6,330	9,443
Investment property	11	26,474	18,689
Current income tax assets		1,302	1,417
Other assets	14	53,029	39,668
Total assets		**2,131,642**	**1,690,659**
Liabilities			
Amounts due to banks and international financial institutions	15	31,429	35,303
Amounts due to customers	16	1,336,855	1,075,454
Debt securities issued	17	161,860	85,818
Other borrowed funds	18	178,388	118,730
Deferred income tax liabilities	12	1,943	1,555
Other liabilities	14	31,921	26,738
Subordinated loan	27	80,253	63,448
Total liabilities		**1,822,649**	**1,407,046**
Equity			
Share capital	19	209,008	209,008
Land and buildings revaluation reserve		9,542	9,652
Perpetual subordinated loan	19	13,209	13,926
Retained earnings		77,234	51,027
Total equity		**308,993**	**283,613**
Total liabilities and equity		**2,131,642**	**1,690,659**

Signed and authorised for issue on behalf of the Management Board of the Bank on 2 April 2021:

Archil Kontselidze
Chief Executive Officer

Mamuka Menteshashvili
Chief Financial Officer

The accompanying selected explanatory notes on pages 9 to 64 are an integral part of these financial statements.

Statement of profit or loss

For the year ended 31 December

(Thousands of Georgian lari)

	Notes	*2020*	*2019*
Interest revenue calculated using effective interest rate			
Loans and advances to customers		137,921	120,782
Investment securities		13,884	8,613
Cash and cash equivalents		2,530	3,077
Amounts due from banks and international financial institutions		300	975
		154,635	**133,447**
Other interest revenue		31	–
		154,666	**133,447**
Interest expense			
Amounts due to customers		(53,295)	(47,499)
Amounts due to banks, international financial institutions and other borrowed funds		(13,714)	(9,253)
Subordinated loan		(6,127)	(6,283)
Debt securities issued		(9,675)	(3,680)
Lease liabilities		(479)	(594)
		(83,290)	**(67,309)**
Expense on assets with negative interest rates (NIR)		(626)	(176)
Payments to deposit insurance system		(619)	(527)
Net interest income		**70,131**	**65,435**
Credit loss (expense)/recovery	13	(6,832)	101
Net interest income after credit loss recovery/(expense)		**63,299**	**65,536**
Net fee and commission income	21	6,706	4,795
Net gains/(losses) from foreign currencies:			
Dealing		(8,950)	25,220
Translation differences		23,151	(10,692)
Net (losses)/recovery of losses on initial recognition of financial instruments, restructuring and other losses/gains on loans and advances to customers		(1,386)	473
Net gains from trading investment securities		15	–
Net gains on investment property revaluation	11	1,066	310
Other income	22	5,637	7,114
Non-interest income		**26,239**	**27,220**
Personnel expenses	23	(39,765)	(38,728)
Depreciation	9,10	(6,423)	(6,454)
Other operating expenses	23	(16,106)	(15,248)
Reversal of legal claims		–	59
Provision for credit related commitments	13	(142)	(289)
Non-interest expenses		**(62,436)**	**(60,660)**
Profit before income tax expense		**27,102**	**32,096**
Income tax expense	12	(388)	(2,341)
Profit for the year		**26,714**	**29,755**

The accompanying selected explanatory notes on pages 9 to 64 are an integral part of these financial statements.

Statement of comprehensive income

For the year ended 31 December

(Thousands of Georgian lari)

	Notes	*2020*	*2019*
Profit for the year		**26,714**	**29,755**
Other comprehensive income			
Other comprehensive income not to be reclassified to profit or loss in subsequent periods			
Revaluation of land and buildings	9	–	–
Income tax effect	12	–	–
Net other comprehensive income not to be reclassified to profit or loss in subsequent periods		**–**	**–**
Other comprehensive (loss)/income for the year, net of tax		**–**	**–**
Total comprehensive income for the year		**26,714**	**29,755**

The accompanying selected explanatory notes on pages 9 to 64 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*	*Perpetual subordinated loan*	*Retained earnings*	*Total equity*
As of 31 December 2018		**209,008**	**9,827**	**11,575**	**24,654**	**255,064**
Total comprehensive income for the year		–	–	–	29,755	**29,755**
Amounts paid on Perpetual Subordinated Loan (equity)		–	–	–	(1,206)	**(1,206)**
Foreign exchange translation on perpetual subordinated loan		–	–	2,351	(2,351)	**–**
Depreciation of revaluation reserve, net of tax		–	(175)	–	175	**–**
As of 31 December 2019	19	**209,008**	**9,652**	**13,926**	**51,027**	**283,613**
Net profit and total comprehensive income for the year		–	–	–	26,714	**26,714**
Amounts paid on Perpetual Subordinated Loan (equity)		–	–	–	(1,334)	**(1,334)**
Foreign exchange translation on perpetual subordinated loan		–	–	(717)	717	**–**
Depreciation of revaluation reserve, net of tax		–	(110)	–	110	**–**
As of 31 December 2020		**209,008**	**9,542**	**13,209**	**77,234**	**308,993**

Statement of cash flows

For the year ended 31 December

(Thousands of Georgian lari)

	Notes	2020	2019
Cash flows from operating activities			
Interest received		133,985	130,669
Interest paid		(76,384)	(67,116)
Fees and commissions received		14,973	17,717
Fees and commissions paid		(8,262)	(11,607)
Realised net gains from dealing in foreign currencies		1,303	6,996
Other income received		4,452	6,266
Realised gains less losses from trading securities		10	–
Personnel expenses paid		(37,975)	(39,203)
Other operating expenses paid		(12,772)	(14,329)
Cash flows from operating activities before changes in operating assets and liabilities		**19,330**	**29,393**
Net (increase)/decrease in operating assets			
Amounts due from banks and international financial institutions		(72,797)	7,908
Loans and advances to customers		(183,618))	(13,949)
Trading securities		(9,803)	–
Other assets		365	3,043
Net increase/(decrease) in operating liabilities			
Amounts due to banks and international financial institutions		(3,411)	(99,510)
Amounts due to customers		205,809	45,924
Debt securities issued		73,025	34,701
Other liabilities		5,102	(12,364)
Net cash flows from / (used in) operating activities before income tax		**34,001**	**(4,854)**
Income tax paid		(823)	(1,154)
Net cash from / (used in) operating activities		**33,178**	**(6,008)**
Cash flows from investing activities			
Acquisition of investment securities		(161,588)	(183,617)
Proceeds from sale and redemption of investment securities		126,615	176,838
Purchase of property, equipment and intangible assets		(14,623)	(8,501)
Proceeds from sale of property and equipment		–	877
Proceeds from disposal of investment property		1,004	4,017
Purchases of investment property		–	(1,549)
Net cash used in investing activities		**(48,592)**	**(11,935)**
Cash flows from financing activities			
Other borrowed funds received	28	4,731,000	988,646
Repayments of other borrowed funds	28	(4,677,274)	(1,003,393)
Proceeds from Subordinated loan		20,201	–
Dividends paid	19	–	(6)
Interest paid on perpetual subordinated loan	19	(1,334)	(1,206)
Repayment of lease liabilities	10	(2,589)	(2,392)
Net cash received from (paid in) financing activities		**70,004**	**(18,351)**
Effect of exchange rates changes on cash and cash equivalents		2,604	1,698
Net change in cash and cash equivalents		**57,194**	**(34,596)**
Cash and cash equivalents, beginning	5	149,909	184,505
Cash and cash equivalents, ending	5	**207,103**	**149,909**

The accompanying selected explanatory notes on pages 9 to 64 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 2020 the Bank has branches 17 (7 of them in Tbilisi) (2019: 17 branches (7 of them in Tbilisi)) and 10 service centres (2019: 18 service centres).

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

As of 31 December 2020 and 2019, the following shareholders owned more than 1% of the outstanding shares*:*

Shareholder	***2020, %***	***2019, %***
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 2020 (2019: 60.93%).

As of 31 December 2020 and 2019, none of the Supervisory Board and Management Board members owned shares of the Bank.

As of 31 December 2020, the Bank had 1,051 employees (2019: 1,043).

As of 31 December 2020, the Bank had an average number of employees as given below:

Average number of employees	***2020***	***2019***
Top management	6	6
Middle management	113	106
Other	927	943
Total	**1,046**	**1,055**
Including		
Permanent contract	1,035	1,045
Temporary contract	10	10
Total	**1,046**	**1,055**

As at 31 December 2020 and 2019, the Bank does not have any subsidiaries.

2. Basis of preparation and significant accounting policies

These financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) under the historical cost convention except for land and buildings, 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 the functional currency of the Bank. 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.

(Thousands of Georgian lari)

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

Changes in accounting policies

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

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

Effect of COVID-19 pandemic

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

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

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

To the extent that information is available as at 31 December 2020, the Bank has reflected revised estimates of expected future cash flows in its ECL assessment (Note 7).

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

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.

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.

A*mounts due from credit institutions, loans to customers, investments securities at amortised cost*

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).

(Thousands of Georgian lari)

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

Financial assets (continued)

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.

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.

Debt instruments at FVOCI

The Bank measures debt instruments at FVOCI when both of the following conditions are met:

- The instrument is held within a business model, the objective of which is achieved by both collecting contractual cash flows and selling financial assets;
- The contractual terms of the financial asset meet the SPPI test.

FVOCI debt instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value recognised in OCI. Interest revenue and foreign exchange gains and losses are recognised in profit or loss in the same manner as for financial assets measured at amortised cost. On derecognition, cumulative gains or losses previously recognised in OCI are reclassified from OCI to profit or loss.

The ECLs for debt instruments measured at FVOCI do not reduce the carrying amount of these financial assets in the statement of financial position, which remains at fair value. Instead, an amount equal to the allowance that would arise if the assets were measured at amortised cost is recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss. The accumulated loss recognised in OCI is recycled to the profit and loss upon derecognition of the asset.

(Thousands of Georgian lari)

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

Financial assets (continued)

Equity instruments at FVOCI

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.

Fair value measurement

The Bank measures financial instruments carried at FVPL and FVOCI and non-financial assets such as investment property and land and buildings at fair value at each balance sheet date.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

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

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

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

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

For assets and liabilities that are recognized in the financial statements on a recurring basis, the Bank determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

Reclassification of financial assets and liabilities

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

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.

(Thousands of Georgian lari)

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

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 the 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 comprise 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) Bank as a lessee

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

Right-of-use assets

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

Lease liabilities

At the commencement date of the lease, the Bank recognises lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments (including in-substance fixed payments) less any lease incentives receivable, variable lease payments that depend on an index or a rate, and amounts expected to be paid under residual value guarantees. The lease payments also include the exercise price of a purchase option reasonably certain to be exercised by the Bank and payments of penalties for terminating a lease, if the lease term reflects the Bank exercising the option to terminate. The variable lease payments that do not depend on an index or a rate are recognised as expense in the period on which the event or condition that triggers the payment occurs.

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

Short-term leases and leases of low-value assets

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

(Thousands of Georgian lari)

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

Leases (continued)

(ii) Operating − Bank as a lessor

Leases in which the Bank does not transfer substantially all the risks and rewards incidental to ownership of an asset are classified as operating leases. Rental income arising is accounted for on a straight-line basis over the lease terms and is included in revenue in the statement of profit or loss due to its operating nature. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the period in which they are earned.

(iii) Finance − Bank as a lessor

The Bank recognises lease receivables at value equal to the net investment in the lease, starting from the date of commencement of the lease term. Finance income is based on a pattern reflecting a constant periodic rate of return on the net investment outstanding. Initial direct costs are included in the initial measurement of the lease receivables.

Renegotiated loans

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

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

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

If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Bank records a modification gain or loss in 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.

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.

(Thousands of Georgian lari)

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

Derecognition of financial assets and liabilities (continued)

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

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.

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.

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.

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 an ECL provision.

(Thousands of Georgian lari)

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

Financial guarantees, letters of credit and undrawn loan commitments (continued)

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, 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. Valuations are performed regularly to ensure that the fair value of a revalued property does not differ materially from its carrying amount. Last valuation of the Bank’s property was made as of 31 December 2018. Additional details are provided in Note 9.

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.

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	4-8
Furniture, fixtures and office equipment	3-6
Motor vehicles	5
Leasehold improvements	Over the term of the underlying lease

(Thousands of Georgian lari)

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

Property and equipment (continued)

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

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

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.

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.

(Thousands of Georgian lari)

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

Equity (continued)

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

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. 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.

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.

(Thousands of Georgian lari)

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

Foreign currency translation (continued)

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 2020 and 2019 were 3.2766 GEL and 2.8677 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 to continue in business for the foreseeable future for at least twelve months since the date of the approval of these financial statements. 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 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. In addition, large-scale business disruptions may give rise to liquidity issues for some entities and consumers. Deterioration in credit quality of loan portfolios (amongst other items) as a result of the COVID-19 pandemic may have a significant impact on the Bank's ECL measurement.

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.

The Bank has a three-stage expected credit loss impairment model. 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).

(Thousands of Georgian lari)

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

Impairment losses on financial assets (continued)

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.

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.

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

As at 31 December 2020, in order to reflect the significant remaining uncertainty relating to the potential effect of the further economic disruption being caused by COVID 19 and prospects of future recovery, the Bank revised credit ratings of all borrowers based on new macroeconomic projections and borrower monitoring results.

The effect of the coronavirus pandemic began to affect the Bank's credit portfolio in the second quarter of 2020. Further credit quality deterioration remains to be seen, as the effect is currently limited and mitigated by the continued government support packages. Based on the measures taken by government across the country to contain the virus, economies are seeing lower activity in the short term, although especially in the emerging market economies, the activity in many sectors was back to a normal in the third quarter of 2020 after the reopening. However, in the fourth quarter of 2020 a second wave of the corona pandemic evolved and new lock-downs were introduced. The economies continue to be supported by government support packages. Significant uncertainty still remains as to the effectiveness of actions taken by governments to contain the virus and as to when the roll-out of vaccine programmes will have a sufficient coverage to limit the spread of the virus.

Notably, on 12 February 2021, Fitch Ratings affirmed Georgia's sovereign credit rating at BB, supported by strong governance and business environment indicators as well as consistent and credible policy framework underpinning Georgia's relative resilience to shocks. In 2021, projected economic growth in Georgia is expected to be driven by a gradual lifting of existing restrictions, a vaccination roll-out starting from March 2021, improved domestic and external sentiments, and continued fiscal stimulus.

(Thousands of Georgian lari)

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

Measurement of ECL (continued)

The economic activity is likely to be impacted in the shorter term and it is yet unknown to which extent governments will continue to support the economies. For most of the Bank's credit portfolio, the negative impact on individual customers of the corona crisis is expected to materialise over the coming quarters. Customer assessments were made on an ongoing basis since the second quarter of 2020, and ECL was revisited in light of the changed outlook. As a result, the financial consequences still remain to be seen when, for instance, government support comes to an end and as the pandemic evolves. Despite the associated uncertainty, the best estimate of the respective credit losses, whether or not crystallized as at the reporting date, has already been reflected in the Bank's ECL estimate as at 31 December 2020.

VTB's forbearance practices have been updated to pay particular attention to customers affected by the corona crisis. This includes additional guidance to ensure that concessions due to the corona crisis are considered forbearance only if they relate to customers that are not deemed creditworthy combined with the customer's long-term financial position being further weakened by the outbreak. For the majority of the credit portfolio, short-term concessions to otherwise creditworthy customers are not considered forbearance. In practice, there were 2 main options:
a) short-term concessions to customers with individual assessment in order to support their financial positions, whereas b) lower-rated customers are granted with grace periods.

Due to the continued significant uncertainty related to the magnitude of the pandemic and to the extent to which governments will continue to support the economies, management deemed it appropriate to increase the post-model adjustment related to the corona crisis during the second half of 2020. The corona crisis-related post-model adjustments relate to industries directly affected by the corona crisis and for which the macroeconomic scenarios themselves do not lead to a sufficient increase in expected credit losses. This includes expected, but not yet materialised, credit deterioration in relation to the private individuals and Commercial property industries in Georgia as government support ends. This also includes retail, hotels and restaurants (within the Hotels, restaurants and leisure industry), Real Estate Management and Development, construction, durable consumer goods, clothing and textile, auto& auto parts as well as wine products. The targeted post-model adjustment related to such sectors amounts to GEL 850.

In cooperation with the NBG, Bank has designed stress test model and defined main inputs for Small business lending and Corporate clients. According the industries, main inputs stressed were customers sales and EBITDA. The financial data used for the stress-testing was updated based on the available information. In case of corporate clients Bank used sales discount factor and in case of small business lending − EBITDA discount.

According to the Bank's definition of a significant increase in credit risk, the Bank defined criteria for keeping the borrower in the same stage or moving it into the other. The stage transfer decision was made based on the stressed ratios for the expected duration of the recovery period. While Debt service coverage ration ("DSCR") and interest coverage ratio ("ICR") were main drivers for defining the corporate clients' stage, in small business lending the equal driver was Debt/EBITDA Ratio. For the retail portfolio 3rd wave restructuring was considered a significant increase in credit risk event, and resulted in respective stage change.

The approach is based on gradually recovery strategy and gives the borrowers opportunity to improve their creditworthiness year by year. Recovery period was taken 2020-2022, what means that clients will recover step by step and in 2022 will reach the same results they had in 2019.

Based on the considerations outlined above, the management considers that the effect of COVID-19 crisis have been property reflected in the Bank's ECL estimate as at 31 December 2020. The cumulative amount of post-model and overlay adjustments to account for the effect of the crisis, recognized as credit loss expense in 2020 profit or loss, was GEL 3,100. Further information on ECL and credit quality is provided in Notes 7 and 24.

Revaluation of property

The Bank regularly reviews the valuation of its property (land, office buildings, and investment property) 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.

(Thousands of Georgian lari)

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

Revaluation of property (continued)

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. Investment properties have been revalued as at 31 December 2020.

The Bank's management believes that carrying value of land and buildings as of 31 December 2020 does not differ materially from their fair value. Additional details are provided in Note 9 and Note 11.

Leases − estimating the incremental borrowing rate

The Bank cannot readily determine the interest rate implicit in the lease, therefore, it uses its incremental borrowing rate (IBR) to measure lease liabilities. The IBR is the rate of interest that the Bank would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. The IBR therefore reflects what the Bank 'would have to pay', which requires estimation when no observable rates are available or when they need to be adjusted to reflect the terms and conditions of the lease. Please refer to Note 10.

The Bank estimates the IBR using observable inputs (such as market interest rates) when available and is required to make certain entity-specific estimates.

4. New accounting pronouncements

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

IFRS 17 Insurance contracts

In May 2017, the IASB issued IFRS 17 Insurance Contracts (IFRS 17), a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, IFRS 17 will replace IFRS 4 Insurance Contracts (IFRS 4) that was issued in 2005. IFRS 17 applies to all types of insurance contracts (i.e., life, non-life, direct insurance and re-insurance), regardless of the type of entities that issue them, as well as to certain guarantees and financial instruments with discretionary participation features. A few scope exceptions will apply. IFRS 17 introduces new accounting requirements for banking products with insurance features that may affect the determination of which instruments or which components thereof will be in the scope of IFRS 9 or IFRS 17.

Credit cards and similar products that provide insurance coverage: most issuers of these products will be able to continue with their existing accounting treatment as a financial instrument under IFRS 9. IFRS 17 excludes from its scope credit card contracts (and other similar contracts that provide credit or payment arrangements) that meet the definition of an insurance contract if, and only if, the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer.

When the insurance coverage is provided as part of the contractual terms of the credit card, the issuer is required to:

- Separate the insurance coverage component and apply IFRS 17 to it
- Apply other applicable standards (such as IFRS 9, IFRS 15 Revenue from Contracts with Customers or IAS 37 Provisions, Contingent Liabilities and Contingent Assets) to the other components

Loan contracts that meet the definition of insurance but limit the compensation for insured events to the amount otherwise required to settle the policyholder's obligation created by the contract: Issuers of such loans – e.g. a loan with waiver on death – have an option to apply IFRS 9 or IFRS 17. The election would be made at a portfolio level and would be irrevocable.

IFRS 17 is effective for reporting periods beginning on or after 1 January 2023, with comparative figures required. Early application is permitted, provided the entity also applies IFRS 9 and IFRS 15 on or before the date it first applies IFRS 17.

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

(Thousands of Georgian lari)

4. New accounting pronouncements (continued)

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

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

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

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

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

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

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

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

5. Cash and cash equivalents

	2020	***2019***
Cash on hand	61,045	54,510
Current accounts with credit institutions	76,649	45,795
Current accounts with the NBG	66,134	49,604
Time deposits with the NBG	3,275	–
Cash and cash equivalents	**207,103**	**149,909**

As of 31 December 2020, 64.81% of total current accounts with credit institutions are placed with two non-resident credit institutions (2019: 73.15%).

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

6. Amounts due from banks and international financial institutions

	2020	***2019***
Obligatory reserve with the NBG	229,128	153,569
Time deposits with credit institutions	164	143
Amounts due from banks and international financial institutions	**229,292**	**153,712**

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.

(Thousands of Georgian lari)

6. Amounts due from banks and international financial institutions (continued)

In 2020 the obligatory reserve on USD account bears interest of U.S. Federal Reserve System less 0.5% (2019: the rate of U.S. Federal Reserve System of less 0.5%) and on EUR account − the rate of the European Central Bank less 0.2% (2019: the rate of the European Central Bank of less 0.2%).

As of 31 December 2020, amount of 164 GEL (2019: GEL 143) 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.

7. Loans and advances to customers

	2020	*2019*
Consumer lending	625,301	495,435
Corporate lending	569,045	471,601
Small business lending	239,431	215,375
Loans to individuals secured by deposits	3,279	4,385
Gross loans and advances to customers	**1,437,056**	**1,186,796**
Less − allowance for impairment	(38,405)	(33,236)
Loans and advances to customers, net	**1,398,651**	**1,153,560**

The Loans to customers with total nominal value of GEL 57,493 (2019: GEL 24,302) pledged as collateral for the NBG loan. Please see Note 18.

An analysis of changes in the gross carrying value and corresponding ECL in relation to corporate lending during the year ended 31 December 2020 and 2019 are as follows:

Corporate lending	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2020	**433,755**	**17,543**	**20,303**	**471,601**
New assets originated or purchased	417,500	−	−	**417,500**
Assets repaid	(354,087)	(13,286)	(24,267)	**(391,640)**
Transfers to Stage 1	41,522	(41,522)	−	**−**
Transfers to Stage 2	(65,545)	68,697	(3,152)	**−**
Transfers to Stage 3	−	(13,061)	13,061	**−**
Unwinding of discount	−	−	521	**521**
Changes in models or risk parameters	−	9,589	4,769	**14,358**
Changes to contractual cash flows due to modifications	−	837	(1)	**836**
Reclass from/to exposure due to reclass of items from/to this category*	5,631	−	−	**5,631**
Recoveries	−	−	4,194	**4,194**
Amounts written off	−	−	(6,392)	**(6,392)**
Foreign exchange adjustments	46,505	2,257	3,674	**52,436**
At 31 December 2020	**525,281**	**31,054**	**12,710**	**569,045**

**These amounts represent transfers due to change in portfolio segmentation between Small business lending, Consumer lending and Corporate lending.*

(Thousands of Georgian lari)

7. Loans and advances to customers (continued)

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

Corporate lending	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2020	**(2,628)**	**(293)**	**(5,646)**	**(8,567)**
New assets originated or purchased	(3,065)	–	–	**(3,065)**
Assets repaid	1,647	421	8,676	**10,744**
Transfers to Stage 1	(1,106)	1,106	–	**–**
Transfers to Stage 2	541	(733)	192	**–**
Transfers to Stage 3	–	283	(283)	**–**
Impact on period end ECL of exposures transferred between stages during the period	642	(1,224)	(705)	**(1,287)**
Unwinding of discount (recognised in interest revenue)	(49)	–	(521)	**(570)**
Changes to models and inputs used for ECL calculations	(357)	(496)	(5,722)	**(6,575)**
Changes to contractual cash flows due to modifications	–	(44)	–	**(44)**
Recoveries	–	–	(4,194)	**(4,194)**
Amounts written off	–	–	6,392	**6,392**
Foreign exchange adjustments	(383)	(55)	(887)	**(1,325)**
At 31 December 2020	**(4,758)**	**(1,035)**	**(2,698)**	**(8,491)**

Corporate lending	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**373,933**	**23,314**	**13,516**	**410,763**
New assets originated or purchased	423,384	–	–	**423,384**
Assets repaid	(347,664)	(41,049)	–	**(388,713)**
Transfers to Stage 1	14,618	(6,309)	(8,309)	**–**
Transfers to Stage 2	(39,758)	40,267	(509)	**–**
Transfers to Stage 3	(8,529)	(507)	9,036	**–**
Unwinding of discount	–	–	183	**183**
Changes to contractual cash flows due to modifications	–	102	1	**103**
Recoveries	–	–	6,749	**6,749**
Amounts written off	–	–	(1,202)	**(1,202)**
Foreign exchange adjustments	17,771	1,725	838	**20,334**
At 31 December 2019	**433,755**	**17,543**	**20,303**	**471,601**

Corporate lending	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**(2,873)**	**(660)**	**(3,073)**	**(6,606)**
New assets originated or purchased	(2,439)	–	–	**(2,439)**
Assets repaid	2,901	1,002	–	**3,903**
Transfers to Stage 1	(2,145)	135	2,010	**–**
Transfers to Stage 2	299	(350)	51	**–**
Transfers to Stage 3	60	6	(66)	**–**
Impact on period end ECL of exposures transferred between stages during the period	1,122	(414)	(1,270)	**(562)**
Unwinding of discount (recognised in interest revenue)	–	–	(183)	**(183)**
Changes to models and inputs used for ECL calculations	539	31	2,623	**3,193**
Recoveries	–	–	(6,749)	**(6,749)**
Amounts written off	–	–	1,202	**1,202**
Foreign exchange adjustments	(92)	(43)	(191)	**(326)**
At 31 December 2019	**(2,628)**	**(293)**	**(5,646)**	**(8,567)**

(Thousands of Georgian lari)

7. Loans and advances to customers (continued)

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

An analysis of changes in the gross carrying value and corresponding ECL in relation to small business lending during the year ended 31 December 2020 and 2019 are as follows:

Small business lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2020	**212,221**	**188**	**2,966**	**215,375**
New assets originated or purchased	147,586	−	−	**147,586**
Assets repaid	(134,996)	(665)	(1,760)	**(137,421)**
Transfers to Stage 1	2,795	(1,326)	(1,469)	**−**
Transfers to Stage 2	(21,055)	21,055	−	**−**
Transfers to Stage 3	(686)	(2,028)	2,714	**−**
Unwinding of discount	−	−	(14)	**(14)**
Changes in models or risk parameters	−	11	216	**227**
Changes to contractual cash flows due to modifications	−	(502)	7	**(495)**
Reclass from/to exposure due to reclass of items from/to this category	(3,048)	36	−	**(3,012)**
Recoveries	−	−	125	**125**
Amounts written off	−	−	(192)	**(192)**
Foreign exchange adjustments	16,935	40	277	**17,252**
At 31 December 2020	**219,752**	**16,809**	**2,870**	**239,431**

Small business lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2020	**(925)**	**(5)**	**(932)**	**(1,862)**
New assets originated or purchased	(236)	−	−	**(236)**
Assets repaid	177	53	263	**493**
Transfers to Stage 1	(192)	43	149	**−**
Transfers to Stage 2	111	(111)	−	**−**
Transfers to Stage 3	68	98	(166)	**−**
Impact on period end ECL of exposures transferred between stages during the period	101	(239)	−	**(138)**
Unwinding of discount (recognised in interest revenue)	−	−	15	**15**
Changes to models and inputs used for ECL calculations	647	18	193	**858**
Changes to contractual cash flows due to modifications	−	1	−	**1**
Recoveries	−	−	(125)	**(125)**
Amounts written off	−	−	192	**192**
Foreign exchange adjustments	(22)	(1)	(40)	**(63)**
At 31 December 2020	**(271)**	**(143)**	**(451)**	**(865)**

Small business lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2019	**176,526**	**607**	**2,180**	**179,313**
New assets originated or purchased	166,018	−	−	**166,018**
Assets repaid	(134,394)	−	(1,454)	**(135,848)**
Transfers to Stage 1	2,992	(2,466)	(526)	**−**
Transfers to Stage 2	(4,543)	4,543	−	**−**
Transfers to Stage 3	(205)	(2,552)	2,757	**−**
Unwinding of discount	−	−	75	**75**
Changes to contractual cash flows due to modifications	−	17	16	**33**
Recoveries	−	−	67	**67**
Amounts written off	−	−	(282)	**(282)**
Foreign exchange adjustments	5,827	39	133	**5,999**
At 31 December 2019	**212,221**	**188**	**2,966**	**215,375**

(Thousands of Georgian lari)

7. 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 2019	**(1,138)**	**(174)**	**(1,133)**	**(2,445)**
New assets originated or purchased	(822)	–	–	**(822)**
Assets repaid	662	–	757	**1,419**
Transfers to Stage 1	(447)	127	320	**–**
Transfers to Stage 2	230	(230)	–	**–**
Transfers to Stage 3	82	631	(713)	**–**
Impact on period end ECL of exposures transferred between stages during the period	222	(249)	–	**(27)**
Unwinding of discount (recognised in interest revenue)	–	–	(75)	**(75)**
Changes to models and inputs used for ECL calculations	315	(101)	(245)	**(31)**
Changes to contractual cash flows due to modifications	–	(1)	(4)	**(5)**
Recoveries	–	–	(67)	**(67)**
Amounts written off	–	–	282	**282**
Foreign exchange adjustments	(29)	(8)	(54)	**(91)**
At 31 December 2019	**(925)**	**(5)**	**(932)**	**(1,862)**

An analysis of changes in the gross carrying value and corresponding ECL in relation to consumer lending during the year ended 31 December 2020 and 2019 are as follows:

Consumer lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2020	**467,099**	**4,809**	**23,527**	**495,435**
New assets originated or purchased	321,068	–	–	**321,068**
Assets repaid	(204,988)	(2,626)	(4,823)	**(212,437)**
Transfers to Stage 1	13,879	(11,001)	(2,878)	**–**
Transfers to Stage 2	(37,964)	39,989	(2,025)	**–**
Transfers to Stage 3	(172)	(11,838)	12,010	**–**
Unwinding of discount	–	–	575	**575**
Changes in models or risk parameters	–	3,730	434	**4,164**
Changes to contractual cash flows due to modifications	–	(1,672)	(39)	**(1,711)**
Reclass from/to exposure due to reclass of items from/to this category	(2,583)	(36)	–	**(2,619)**
Recoveries	–	–	412	**412**
Amounts written off	–	–	(1,804)	**(1,804)**
Foreign exchange adjustments	21,878	147	193	**22,218**
At 31 December 2020	**578,217**	**21,502**	**25,582**	**625,301**

(Thousands of Georgian lari)

7. Loans and advances to customers (continued)

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

Consumer lending	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2020	**(4,421)**	**(736)**	**(17,648)**	**(22,805)**
New assets originated or purchased	(3,524)	–	–	**(3,524)**
Assets repaid	2,610	179	3,659	**6,448**
Transfers to Stage 1	(2,223)	1,315	908	**–**
Transfers to Stage 2	1,965	(2,685)	720	**–**
Transfers to Stage 3	9	3,036	(3,045)	**–**
Impact on period end ECL of exposures transferred between stages during the period	1,700	(2,374)	(2,314)	**(2,988)**
Unwinding of discount (recognised in interest revenue)	19	–	(575)	**(556)**
Changes to models and inputs used for ECL calculations	(1,354)	(282)	(5,360)	**(6,996)**
Changes to contractual cash flows due to modifications	–	46	33	**79**
Recoveries	–	–	(413)	**(413)**
Amounts written off	–	–	1,804	**1,804**
Foreign exchange adjustments	(27)	(5)	(66)	**(98)**
At 31 December 2020	**(5,246)**	**(1,506)**	**(22,297)**	**(29,049)**

Consumer lending	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**499,186**	**8,967**	**20,541**	**528,694**
New assets originated or purchased	230,298	–	–	**230,298**
Assets repaid	(264,344)	(2,460)	(5,029)	**(271,833)**
Transfers to Stage 1	31,082	(26,584)	(4,498)	**–**
Transfers to Stage 2	(37,658)	42,139	(4,481)	**–**
Transfers to Stage 3	(878)	(17,689)	18,567	**–**
Unwinding of discount	–	–	907	**907**
Changes to contractual cash flows due to modifications	–	304	34	**338**
Recoveries	–	–	1,320	**1,320**
Amounts written off	–	–	(3,920)	**(3,920)**
Foreign exchange adjustments	9,413	132	86	**9,631**
At 31 December 2019	**467,099**	**4,809**	**23,527**	**495,435**

Consumer lending	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**(5,104)**	**(1,097)**	**(13,698)**	**(19,899)**
New assets originated or purchased	(2,253)	–	–	**(2,253)**
Assets repaid	2,925	247	5,184	**8,356**
Transfers to Stage 1	(3,540)	2,090	1,450	**–**
Transfers to Stage 2	2,101	(4,010)	1,909	**–**
Transfers to Stage 3	18	4,347	(4,365)	**–**
Impact on period end ECL of exposures transferred between stages during the period	2,533	(1,855)	(3,848)	**(3,170)**
Unwinding of discount (recognised in interest revenue)	–	–	(907)	**(907)**
Changes to models and inputs used for ECL calculations	(1,074)	(440)	(5,918)	**(7,432)**
Changes to contractual cash flows due to modifications	–	(11)	(15)	**(26)**
Recoveries	–	–	(1,320)	**(1,320)**
Amounts written off	–	–	3,920	**3,920**
Foreign exchange adjustments	(27)	(7)	(40)	**(74)**
At 31 December 2019	**(4,421)**	**(736)**	**(17,648)**	**(22,805)**

(Thousands of Georgian lari)

7. 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 2020 and 2019. An analysis of changes in the gross carrying value in relation to loans to individuals secured by deposits during the year ended 31 December 2020 and 2019 are as follows:

Loans to individuals secured by deposits	***Stage 1***
Gross carrying value as at 1 January 2020	**4,385**
New assets originated or purchased	7,546
Assets repaid	(9,206)
Foreign exchange adjustments	554
At 31 December 2020	**3,279**

Loans to individuals secured by deposits	***Stage 1***
Gross carrying value as at 1 January 2019	**7,397**
New assets originated or purchased	8,797
Assets repaid	(12,238)
Foreign exchange adjustments	429
At 31 December 2019	**4,385**

Modified and restructured loans

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

During 2020, the Bank has modified the terms and conditions of certain corporate and commercial loans, including introduction of payment holidays, as part of the measures introduced by the Government related to consequences of COVID-19 pandemic. The Bank considered these modifications to be non-substantial. The Bank recognized net modification loss in GEL 1,386 line in the statement of profit or loss for the year ended 31 December 2020.

Stage 2 and 3 assets that were modified during the period, with the related modification loss suffered by the Bank composed of loans with amortized cost before modification of 24,904 GEL and net modification loss of GEL 173 (2019: GEL 25,144 and gain of GEL 474).

Gross carrying amount of loans for which loss allowance has changed after the modification to 12-month measurement during the period amounted GEL 11,390 as of 31 December 2020 (2019: GEL 9,032).

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)

7. 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 2020	**41,162**	**–**	**–**	**26,368**	**17,956**	**(31,291)**	**13,033**	**28,129**	**25,446**
Consumer lending	**25,582**	–	–	6,612	–	(5,598)	**1,014**	**24,568**	22,297
Corporate lending	**12,710**	–	–	19,756	17,956	(25,693)	**12,019**	**691**	2,698
Small business lending	**2,870**	–	–	–	–	–	**–**	**2,870**	451

	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 2019	**46,796**	**30**	**–**	**28,100**	**22,873**	**(35,607)**	**15,396**	**31,400**	**24,226**
Consumer lending	**23,527**	30	–	5,212	–	(4,161)	**1,081**	**22,446**	17,648
Corporate lending	**20,303**	–	–	21,454	21,832	(29,560)	**13,726**	**6,577**	5,646
Small business lending	**2,966**	–	–	1,434	1,041	(1,886)	**589**	**2,377**	932

* *Movable property, equipment and inventories.*

The table above includes information only about collateral that is incorporated to ECL estimation. The Bank might hold other types of collateral which does not affect ECL estimates. Comparative information was represented to align with the current period presentation.

During 2020 the Bank repossessed collateral (land and buildings) with value as of repossession date of GEL 22,176 (2019: GEL 8,350), which were classified as investment property and inventories with the amount of GEL 6,007 and GEL 16,169 of repossessed collateral, respectively (2019: GEL 1,571 and GEL 6,779). Refer to Notes 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 2020, the Bank had a concentration of loans represented by GEL 268,916 due from the ten largest third party group of borrowers of 18.71% of gross loan portfolio (2019: GEL 219,127 or 18.46%). An allowance of GEL 2,490 (2019: GEL 1,267) was recognised against these loans.

Included in total loans to customers is an exposure to a group of borrower of GEL 38,851 or 2.7% of total loan portfolio (2019: GEL 28,112 or 2.37%), that bears an annual interest rate between 5% and 12% p.a. and matures on August 2026 (2019: an annual interest rate of 11.5% p.a. and matures on September 2028).

Loans have been issued to the following types of customers:

	2020	***2019***
Commercial legal entities	790,025	679,163
Individuals	628,580	499,820
State-owned companies	18,451	7,813
Gross loans and advances to customers	**1,437,056**	**1,186,796**

(Thousands of Georgian lari)

7. Loans and advances to customers (continued)

Concentration of loans and advances to customers (continued)

As of 31 December 2020, and 2019, loans and advances to customers are principally issued within Georgia and their allocation by industry sectors is as follows:

	2020	*2019*
Individuals	628,581	499,820
Trading and service enterprises	466,597	342,951
Agriculture and food processing	91,140	71,551
Manufacturing	86,053	86,788
Energy	53,818	50,439
Real estate construction	49,247	27,653
Telecommunication and transportation	16,706	14,697
Financial	2,576	36,911
Other	42,338	55,986
Gross loans and advances to customers	**1,437,056**	**1,186,796**

As at 31 December 2020, the Bank applied management overlays to reflect the significant uncertainty related to the potential severity and duration of the economic disruption and the heightened credit risk of specific sectors, such as retail, hotels and restaurants (within the hotels, restaurants and leisure industry), real estate management and development, construction, durable consumer goods, clothing and textile, auto and auto parts as well as wine products due to the impact of COVID-19 pandemic.

8. Investment and trading securities

Investment securities comprise:

	2020	*2019*
Debt securities at amortised cost		
Treasury bills of the Ministry of Finance	123,016	91,512
Treasury bills of the National Bank of Georgia	–	9,931
Corporate bonds	34,775	19,510
Less − allowance for impairment	(827)	(311)
Debt securities at amortised cost	**156,964**	**120,642**
Equity securities at FVOCI		
Corporate shares	54	54
Equity securities at FVOCI	**54**	**54**
Investment securities	**157,018**	**120,696**

All debt securities at amortised cost are allocated to Stage 1. ECL recognised as at 31 December 2020 was GEL 827 (2019: GEL 311) and the change during the year was GEL 516.

Trading securities comprise:

	2020	*2019*
Trading securities		
Treasury bills of the Ministry of Finance	9,781	–
Trading securities	**9,781**	**–**

The investment securities of Ministry of Finance of Georgia with total nominal value of GEL 71,618 (2019: GEL 27,000) were pledged under the loan received from NBG. Please see Note 18.

(Thousands of Georgian lari)

9. Property and equipment

The movements in property and equipment during 2020 and 2019 were as follows:

	Land and buildings	*Computers and communication equipment*	*Furniture, fixtures and office equipment*	*Utility systems and related features*	*Motor vehicles*	*Leasehold improvements*	*Total*
Cost or revalued amount							
31 December 2018	**33,170**	**12,879**	**9,792**	**1,938**	**2,074**	**1,891**	**61,744**
Additions	294	2,054	823	–	112	1,296	**4,579**
Transfer from Investment property (Note 11)	580	–	–	–	–	–	**580**
Disposals and write-offs	(682)	(896)	(491)	–	(198)	(93)	**(2,360)**
31 December 2019	**33,362**	**14,037**	**10,124**	**1,938**	**1,988**	**3,094**	**64,543**
Additions	76	3,108	114	–	–	75	**3,373**
Disposals and write-offs	–	–	–	–	–	(338)	**(338)**
31 December 2020	**33,438**	**17,145**	**10,238**	**1,938**	**1,988**	**2,831**	**67,578**
Accumulated depreciation and impairment							
31 December 2018	**–**	**(9,425)**	**(7,539)**	**(500)**	**(1,114)**	**–**	**(18,578)**
Depreciation charge	(619)	(1,689)	(713)	(68)	(310)	(601)	**(4,000)**
Disposals and write-offs	5	896	474	–	176	49	**1,600**
31 December 2019	**(614)**	**(10,218)**	**(7,778)**	**(568)**	**(1,248)**	**(552)**	**(20,978)**
Depreciation charge	(631)	(1,691)	(710)	(68)	(228)	(679)	**(4,007)**
Disposals and write-offs	–	–	–	–	–	69	**69**
31 December 2020	**(1,245)**	**(11,909)**	**(8,488)**	**(636)**	**(1,476)**	**(1,162)**	**(24,916)**
Net book value							
31 December 2018	**33,170**	**3,454**	**2,253**	**1,438**	**960**	**1,891**	**43,166**
31 December 2019	**32,748**	**3,819**	**2,346**	**1,370**	**740**	**2,542**	**43,565**
31 December 2020	**32,193**	**5,236**	**1,750**	**1,302**	**512**	**1,669**	**42,662**

Last valuation of the Bank's property was made as of 31 December 2018. 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 property.

The management concludes that fair values of the Bank's properties recognized in statement of financial position as at 31 December 2020 are within market ranges, as updated considering the impact of COVID-19 outbreak, and carrying value approximates fair value as at 31 December 2020. As such, no revaluation of land and building is required to be recognized in 2020 financial statements of the Bank.

If no revaluation of land and buildings had been performed, the original cost as of 31 December 2020 would have amounted to GEL 29,085 (2019: GEL 29,123) and accumulated depreciation would have amounted to GEL 8,497 (2019: GEL 7,849).

The total value of fully depreciated property and equipment in use as of 31 December 2020 and 2019, amounted to GEL 16,606 and GEL 15,177 respectively.

(Thousands of Georgian lari)

10. Leases

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

	Right-of-use assets *Buildings*	*Lease liabilities*
As at 1 January 2020	**9,443**	**10,143**
Additions	755	755
Depreciation expense	(2,416)	–
Interest expense	–	479
Payments	–	(3,067)
Termination	(1,452)	(1,746)
Translation difference	–	1,013
As at 31 December 2020	**6,330**	**7,577**

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

	Right-of-use assets *Buildings*	*Lease liabilities*
As at 1 January 2019	**9,632**	**9,638**
Additions	2,265	2,265
Depreciation expense	(2,454)	–
Interest expense	–	594
Payments	–	(2,955)
Translation difference	–	601
As at 31 December 2019	**9,443**	**10,143**

The Bank recognized rent expense from short-term leases of GEL 521 thousand for the period ended 31 December 2020 (2019: GEL 656). Please see Note 23. Total cash outflows for leases amounted to GEL 3,588 (2019: GEL 3,611).

11. Investment property

	2020	*2019*
Opening balance at 1 January	**18,689**	**20,271**
Additions	6,007	1,571
Disposals	(1,004)	(3,490)
Reclassified to property and equipment (Note 9)	–	(580)
Reclassified from Inventories of repossessed collateral	1,716	607
Gain on revaluation and sale of investment property	1,066	310
Closing balance at 31 December	**26,474**	**18,689**

Gain on revaluation and sale of investment property consisted of gain from sales in amount of GEL 170 (2019: GEL 898) and revaluation gain GEL 896 (2019: loss GEL 586).

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 7.

As of 31 December 2020, 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 (Note 25).

(Thousands of Georgian lari)

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 1 January 2019. On 27 December 2018 the effective date of the amendment for banks was revised to 1 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 latest amendment, the Bank recalculated its deferred tax assets at 31 December 2018, remeasured its deferred tax assets and liabilities for the periods after 1 January 2023 and made the relevant recognition of deferred tax expense in the profit and loss statement for 2018. 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.

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

The corporate income tax expense comprises:

	2020	*2019*
Current tax expense	−	(978)
Deferred expense − origination and reversal of temporary differences	(388)	(1,363)
Less: deferred tax recognised in other comprehensive income	−	−
Income tax expense	**(388)**	**(2,341)**

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:

	2020	*2019*
Income before income tax expense	**27,102**	**32,096**
Statutory tax rate	15%	15%
Theoretical income tax expense at the statutory rate	**(4,065)**	**(4,814)**
Change in unrecognized deferred tax assets	(2,387)	−
Tax exempt income less income recognized for tax purposes only	6,182	2,496
Non-deductible expenses	(118)	(23)
Income tax (expense)/benefit	**(388)**	**(2,341)**

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	*2018*	*In the statement of profit or loss*	*2019*	*In the statement of profit or loss*	*2020*
Allowances for impairment and provisions for other losses (DTA)	73	(14)	59	7	66
Tax losses carried forward	−	−	−	2,387	2,387
Financial instruments adjustment for effective interest rates	2,801	(729)	2,072	(290)	1,782
Accrued expenses	1,388	(82)	1,306	216	1,522
Other	22	(6)	16	(2)	14
Gross deferred tax asset	**4,284**	**(831)**	**3,453**	**2,318**	**5,771**
Unrecognized deferred tax asset	−	−	−	(2,387)	(2,387)
Deferred tax assets	**4,284**	**(831)**	**3,453**	**(69)**	**3,384**
Tax effect of taxable temporary differences					
Allowance for loan impairment	(3,784)	(528)	(4,312)	(565)	(4,877)
Property and equipment	(523)	(13)	(536)	304	(232)
Allowances for impairment and provision for other losses	(169)	46	(123)	(70)	(193)
Financial instruments adjustment for effective interest rates	−	(37)	(37)	12	(25)
Deferred tax liabilities	**(4,476)**	**(532)**	**(5,008)**	**(319)**	**(5,327)**
Net deferred tax (liabilities	**(192)**	**(1,363)**	**(1,555)**	**(388)**	**(1,943)**

The Bank's unrecognized deferred tax asset related to accumulated tax losses at 31 December 2020 equal GEL 2,387 which will expire in 2023 if not utilized.

(Thousands of Georgian lari)

13. Credit loss recovery/(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 2020:

	Note	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Cash and cash equivalents		(2)	–	–	**(2)**
Loans and advances to customers	7	(1,839)	(1,589)	(2,802)	**(6,230)**
Investment securities		(516)	–	–	**(516)**
Other financial assets		1	–	(85)	**(84)**
Credit loss recovery/(expense)		**(2,354)**	**(1,590)**	**(2,887)**	**(6,832)**
Financial guarantees		12	(18)	–	**(6)**
Loan commitments		(136)	–	–	**(136)**
Provision for credit related commitments		**(124)**	**(18)**	**–**	**(142)**

The table below shows the ECL charges on financial instruments recorded in the statement of profit or loss for the year ended 31 December 2019:

	Note	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Cash and cash equivalents		(1)	**–**	**–**	**(1)**
Amounts due from banks and international financial institutions		–	–	–	**–**
Loans and advances to customers	7	1,289	953	(2,141)	**101**
Investment securities		(32)	–	–	**(32)**
Other financial assets		(60)	–	93	**33**
Credit loss recovery/(expense)		**1,196**	**953**	**(2,048)**	**101**
Financial guarantees		100	5	1	**106**
Loan commitments		(397)	–	–	**(397)**
Letters of credit		2	–	–	**2**
Reversal of provision for credit related commitments		**(295)**	**5**	**1**	**(289)**

14. Other assets and liabilities

Other assets comprise:

	2020	*2019*
Financial assets		
Unsettled transactions on money transfers	3,838	3,405
Derivative financial assets	799	9,559
Other	187	227
Allowance for impairment of other financial assets	(85)	(84)
Total financial assets	**4,739**	**13,107**
Non-financial assets		
Inventories of repossessed collateral	22,981	10,099
Intangible assets	18,438	10,614
Advances paid	3,416	1,682
Prepaid expenses	3,015	3,308
Prepaid operational taxes	–	395
Inventories in stock	171	194
Other	269	269
Total non-financial assets	**48,290**	**26,561**
Other assets	**53,029**	**39,668**

(Thousands of Georgian lari)

14. Other assets and liabilities (continued)

The movement in intangible assets during 2020 and 2019 were as follows:

	Intangible assets
At cost	
31 December 2018	**13,038**
Additions	3,999
31 December 2019	**17,037**
Additions	9,809
Disposals and write-offs	(56)
31 December 2020	**26,790**
Accumulated amortisation and impairment	
31 December 2018	**(4,708)**
Amortization charge for the year (Note 23)	(1,715)
31 December 2019	**(6,423)**
Amortization charge for the year (Note 23)	(1,985)
Write-offs of fully amortised items	56
31 December 2020	**(8,352)**
Net book value	
31 December 2019	**10,614**
31 December 2020	**18,438**

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

Other liabilities comprise:

	2020	*2019*
Financial liabilities		
Accrued bonuses	8,944	7,421
Lease liabilities (Note 10)	7,577	10,143
Settlements on acquisition of intangible assets	3,822	–
Unsettled transactions on money transfers	1,720	534
Accrued expenses	1,639	1,408
Derivative financial liabilities	1,512	24
Payables for unused vacations	1,228	1,076
Provisions for credit related off balance commitments	924	706
Settlements on plastic cards	706	1,951
Other	10	300
Total financial liabilities	**28,082**	**23,563**
Non-financial liabilities		
Advances received	1,983	2,113
Dividends payable to shareholders of the Bank	1,061	1,062
Operational taxes payable	795	–
Total non-financial liabilities	**3,839**	**3,175**
Other liabilities	**31,921**	**26,738**

As of 31 December 2020 and 2019, 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:

	2020				*2019*			
	Notional amount		*Fair values*		*Notional amount*		*Fair values*	
	Asset	*Liability*	*Asset*	*Liability*	*Asset*	*Liability*	*Asset*	*Liability*
Foreign exchange contracts								
Forwards and swaps – foreign	249,320	248,028	799	1,512	294,196	281,741	9,559	24
Total derivative assets/liabilities	**249,320**	**248,028**	**799**	**1,512**	**294,196**	**281,741**	**9,559**	**24**

15. Amounts due to banks and international financial institutions

	2020	*2019*
Current accounts	17,524	2,480
Loans received from the Parent bank	12,696	13,380
Time deposits and loans	1,209	19,443
Amounts due to banks and international financial institutions	**31,429**	**35,303**

As of 31 December 2020, loans received from the Parent bank had maturity June 2021 (2019: June 2021) and bear annual interest rate 7.11% (2019: 7.11%).

16. Amounts due to customers

	2020	*2019*
Individuals		
Current/demand accounts	121,892	96,912
Term deposits	422,130	337,739
Total due to individuals	**544,022**	**434,651**
State and budgetary organisations		
Current/settlement accounts	24,778	25,148
Term deposits	–	1,846
Total due to state and budgetary organisations	**24,778**	**26,994**
Commercial legal entities		
Current/settlement accounts	515,198	446,659
Term deposits	252,857	167,150
Total due to commercial legal entities	**768,055**	**613,809**
Total due to legal entities	**792,833**	**640,803**
Total amounts due to customers	**1,336,855**	**1,075,454**
Held as security against undrawn loan facilities	714	212
Held as security against guarantees issued	13,115	21,275
Held as security against letters of credit issued	1,750	54
Total amounts of cash held as security against letters of credit, undrawn loan facility and guarantees issued	**15,579**	**21,541**
Held as security against settlement operations	1,135	1,014

At 31 December 2020, amounts due to customers of GEL 384,017 (28.73%) were due to the ten largest third-party customers (2019: GEL 275,577 (25.62%)).

(Thousands of Georgian lari)

16. Amounts due to customers (continued)

An analysis of customer accounts by industry follows:

	2020	*2019*
Individuals	544,022	434,651
Energy	242,394	128,861
Transport and communication	147,853	83,044
Real estate constructions	132,573	38,979
Finance	114,361	118,905
Manufacturing	51,979	33,868
Government	40,561	26,995
Trade and service	24,778	179,671
Agriculture	15,073	4,984
Education	5,173	9,629
Other	18,088	15,867
Amounts due to customers	**1,336,855**	**1,075,454**

17. Debt securities issued

Debt securities comprised of the following:

Certificates of deposit	*2020*	*2019*
Discount certificates	117,339	67,394
Coupon certificates	44,521	18,424
Debt securities issued	**161,860**	**85,818**

As of 31 December 2020, certificates of deposits comprised of discount certificates of deposits were maturing from January 2021 till February 2025 (2019: from January 2020 till October 2024) and coupon certificates of deposits from January 2021 till January 2028 (2019: January 2020 till December 2024).

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

18. Other borrowed funds

	2020	*2019*
Borrowings from NBG	116,287	45,057
Borrowings from the Parent bank	56,103	68,175
Borrowings from international financial institutions	5,564	4,816
Borrowings from government organizations	434	682
Other borrowed funds	**178,388**	**118,730**

As of 31 December 2020, maturities of borrowings from the Parent bank were ranging from March 2021 till May 2022 (2019: from April 2019 till May 2022), annual interest rates from 3.46% to 7.45% (2019: from 3.21% to 7.45%). Refer to Note 27.

As of 31 December 2020, GEL 116,287 (2019: GEL 45,057) borrowings from NBG were received under the securities of Ministry of Finance of Georgia with total nominal value of GEL 71,618 (2019: GEL 27,000) and under the Loans to customers with total nominal value of GEL 57,493 (2019: GEL 24,302) pledged as collateral. The borrowings were matured in January 2021 (2019: January 2020) and bears annual interest rates ranging from 8.04% to 8.07% (2019: 9.21%).

As of 31 December 2020 and 2019 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% (2019: 3%) with maturity of November 2021 (2019: 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 2018	209,008,277	209,008,277	209,008
31 December 2019	209,008,277	209,008,277	209,008
31 December 2020	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.

Perpetual subordinated loan

On 29 December 2016, the Bank received perpetual subordinated loan for RUB 300 mln (GEL 13,098). As at 31 December 2020, the carrying amount of the perpetual subordinated loan was GEL 13,209 (2019: GEL 13,926). During 2020 the Bank has made interest payment GEL 1,334 (2019: 1,206 GEL). 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 creditor before the payment date.

If the Bank's Common Tier 1 capital (CET1) ratio would decrease more than it is specified in the agreement, perpetual subordinated loan with the interest payables shall be written off to the extent necessary to restore to the common Tier 1 capital requirement specified in the agreement.

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.

No dividends were declared or paid to shareholders in 2019 and 2020, respectively.

20. Commitments and contingencies

Operating environment

In March 2020, Georgian Government introduced strict quarantine and self-isolation measures to prevent the spread of Coronavirus. Georgian borders were closed to foreign citizens and regular air flights were suspended. Markets, shops and entertainment venues were shut down except for grocery stores. The curfew imposed to restrict public and private transportation, including walking out between 9 p.m. − 5 a.m.

Restrictions have been gradually phased out since late May, with the exception of direct air travel and the opening of borders to foreign citizens. Due to the spread of the second wave of the Covid-19 pandemic, however, a number of restrictions have been reintroduced in rural areas since late November.

Real GDP growth in 2020 was negative and according to preliminary estimates amounted to 6.1% (2019: growth of 5.0%). The inflation rate in December was 2.4% (2019: 7%). The trade balance has shown a positive trend since the beginning of the year against the background of prevailing decline in imports as compared to decrease in exports.

According to the GEOSTAT, exports fell by 12.0% year-on-year to USD3.3 billion in 2020, and imports declined by 11.7% to USD8.0 billion. Consequently, the trade deficit reduced by 11.5% to USD4.6 billion.

In 2020, the net income from remittances to Georgia of the population working abroad amounted to USD1.639 million (an increase of 9.6% over the previous year).

The Georgian national currency devaluated to some extent over 2020, with a depreciation of 14.3%, while the exchange rate of GEL against the USD stood at 3.2766 as of 31 December.

(Thousands of Georgian lari)

20. Commitments and contingencies (continued)

Operating environment (continued)

The National Bank of Georgia has softened the refinancing rate in stages from 9% to 8% to stimulate reduced domestic demand amid the economic downturn associated with the pandemic. At the same time, it has been actively intervening in the foreign exchange market to neutralise the carry-over effect of national currency depreciation on inflation. Since the beginning of the year, the NBG has provided USD 873.2 million to the foreign exchange market.

In the present situation, the banking sector continues to finance the Georgian economy and to mitigate some of the decline in foreign direct investment and tourism revenues. By 2020, credit investments increased by 19.8% to GEL 6.3 billion.

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

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.

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

	2020	*2019*
Credit related commitments		
Undrawn loan facilities	137,741	89,602
Guarantees issued	78,797	75,960
Letters of credit	1,750	54
Other credit-related commitments	25	267
Financial commitments and contingencies (before deducting collateral)	**218,313**	**165,883**
Less − cash held as security against letters of credit, undrawn loan facility and guarantees issued (Note 16)	(15,579)	(21,541)
Financial commitments and contingencies	**202,734**	**144,342**

The commitments are mainly allocated to stage 1. There were no significant movements in ECL during the year.

21. Net fee and commission income

	2020	*2019*
Commission on settlements operations	11,576	12,401
Commission on guarantees and other credit related commitments	2,149	2,208
Commission on cash operations	1,170	1,443
Other	182	255
Fee and commission income	**15,077**	**16,307**
Commission on settlements operations	(7,138)	(9,745)
Commission on cash operations	(835)	(1,421)
Commission on guarantees and other credit related commitments	(385)	(330)
Other	(13)	(16)
Fee and commission expense	**(8,371)**	**(11,512)**
Net fee and commission income	**6,706**	**4,795**

(Thousands of Georgian lari)

22. Other income

	2020	2019
Penalties received from lending operations	3,190	4,687
Penalties received for deposit redemption before maturity	724	676
Reimbursement of integrated marketing communication campaign costs	616	948
Penalties received for lease liabilities redemption before maturity	295	–
Income from operating lease	146	167
Penalties received for debt securities issued redemption before maturity	140	3
Reimbursement of losses from insurance companies	–	265
Gain from disposal of property	–	166
Other	526	202
Other income	**5,637**	**7,114**

23. Personnel and other operating expenses

	2020	2019
Salaries	27,769	27,104
Bonuses and premiums	11,429	11,041
Defined contribution pension expense	567	583
Personnel expenses	**39,765**	**38,728**
Computer software maintenance	2,209	1,703
Amortisation of intangible assets (Note 14)	1,985	1,715
Marketing and advertising	1,286	2,217
Communications	1,229	1,112
Legal and consultancy	1,204	969
Office supplies	1,159	981
Repairs and maintenance of property and equipment	907	977
Operating taxes	891	627
Utilities	722	822
Occupancy and rent	521	656
Representation expenses	513	817
Insurance	495	385
Other operating expenses on plastic cards operation	434	362
Charity	332	65
Impairment of other non-financial assets	300	–
Write off of property and equipment	274	59
Professional service expenses	259	339
Security	102	114
Business travel and related expenses	86	380
Other	1,198	948
Other operating expenses	**16,106**	**15,248**

Auditor's remuneration

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

	2020	2019
Fees for the audit of the Bank's annual financial statements for the year ended 31 December	142	142
Expenditures for other assurance services	37	107
Expenditures for other professional services	6	6
Total fees	**185**	**255**

(Thousands of Georgian lari)

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 Supervisory Board 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.

In 2019, a Risk Committee was established under the Supervisory Board, consisting of three members of the Supervisory Board. The Risk Committee reviews the Bank's risk management issues in accordance with regulatory requirements.

Management Board

The Management Board has the responsibility to monitor the overall risk process within the Bank. In 2019, the Executive Management Risk Committee (EMRC) was created under the Management Board. The EMRC 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 asset-liability management committee (ALCO) provides management with market risks, liquidity risk and makes decisions on managing the Bank's assets and liabilities.

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 2020 Risk Department consisted of the following sub-divisions:

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

Risk Compliance Unit

The Risk Compliance 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.

(Thousands of Georgian lari)

24. Risk management (continued)

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, ALCO and EMRC, 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).

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

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.

(Thousands of Georgian lari)

24. Risk management (continued)

Credit risk (continued)

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.

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 (POCI) 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.

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.

(Thousands of Georgian lari)

24. Risk management (continued)

Credit risk (continued)

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.

PD for retail portfolio is determined by internal statistical data. 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 monthly 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+	Standard grade	2-15%
4	B		
5-6	B-		
7-9	CCC/C	Sub-standard grade	16-100%
10-11	CCC/C		
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.

(Thousands of Georgian lari)

24. Risk management (continued)

Credit risk (continued)

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.

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.

(Thousands of Georgian lari)

24. Risk management (continued)

Credit risk (continued)

Forward-looking information and multiple economic scenarios

The estimation of expected credit losses involves forecasting future economic conditions over the upcoming 2021-2022 years. Such forecasts are subject to management judgement and those judgements may be sources of measurement uncertainty that have significant risk of resulting in a material adjustment to a carrying amount in future periods. The incorporation of forward-looking elements reflects the expectations of the Bank's senior management and involves the creation of scenarios (base case, upside and downside), including an assessment of the probability for each scenario. The purpose of using multiple scenarios is to model the non-linear impact of assumptions about macroeconomic factors on the expected credit losses.

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.

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

- GDP growth rate;
- Unemployment rate.

The Bank's Credit Risk Department determine the weights attributable to the multiple scenarios. With the new suite of scenarios, the base case scenario enters with a probability of 50%, the upside scenario with a probability of 25% and the downside scenario with a probability of 25%.

Key drivers	*ECL scenario*	*Assigned probabilities, %*	*2020*	*2021*	*2022*
GDP growth					
	Upside	25%	-4.50%	6.00%	5.00%
	Base case	50%	-5.00%	5.00%	4.50%
	Downside	25%	-6.00%	1.00%	4.00%
Changes in unemployment rate					
	Upside	25%	3.50%	1.00%	-2.50%
	Base case	50%	4.00%	-0.50%	-2.00%
	Downside	25%	5.00%	0.00%	-2.00%

Considering increased uncertainty associated with timing and extend of economic recovery assumed in the forward-looking scenarios, the management applied an overlay adjustment to the coefficient that aligns point-in-time and through-the-cycle PD derived from the forecasts presented in the table above for the purpose of ECL estimation as at 31 December 2020.. The effect of increase due to the change in macro coefficient was following:

	Modelled ECL	*Post-model adjustments and management overlays*	*Total ECL*	*Adjustments as a % of total ECL*
Consumer lending	(27,593)	(1,490)	**(29,079)**	5.12%
Corporate lending	(7,888)	(610)	**(8,493)**	7.18%
Small business lending	(674)	(160)	**(832)**	19.23%
Total	**(36,155)**	**(2,250)**	**(38,405)**	**5.85%**

(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 as at 31 December 2020 and 31 December 2019.

	Notes	*Stages*	*High grade 2020*	*Standard grade 2020*	*Sub-standard grade 2020*	*Impaired 2020*	*Total 2020*
Cash and cash equivalents, except for cash on hand	5	Stage 1	146,058	–	–	–	**146,058**
Amounts due from banks and international financial institutions	6	Stage 1	229,292	–	–	–	**229,292**
Loans and advances to customers	7		779,232	542,038	74,624	41,162	**1,437,056**
- Corporate lending		Stage 1	142,343	350,549	32,389	–	**525,281**
		Stage 2	–	4,258	26,796	–	**31,054**
		Stage 3	–	–	–	12,710	**12,710**
- Small business lending		Stage 1	219,205	428	119	–	**219,752**
		Stage 2	3,058	11,984	1,767	–	**16,809**
		Stage 3	–	–	–	2,870	**2,870**
- Consumer lending		Stage 1	410,936	159,820	7,461	–	**578,217**
		Stage 2	411	14,999	6,092	–	**21,502**
		Stage 3	–	–	–	25,582	**25,582**
- Loans collateralized with deposits		Stage 1	3,279	–	–	–	**3,279**
		Stage 2	–	–	–	–	**–**
		Stage 3	–	–	–	–	**–**
Debt investment securities	8		157,791	–	–	–	**157,791**
- Measured at amortised cost		Stage 1	157,791	–	–	–	**157,791**
Undrawn loan commitments	20	Stage 1	86,042	51,392	–	–	**137,434**
		Stage 2	296	–	3	8	**307**
		Stage 3	–	–	–	–	–
Letters of credit	20	Stage 1	1,750	–	–	–	**1,750**
Financial guarantees	20	Stage 1	58,599	16,121	10	–	**74,730**
		Stage 2	–	4,057	10	–	**4,067**
Other assets	14	Stage 1	3	4,022	–	–	**4,025**
Total			**1,459,063**	**617,630**	**74,647**	**41,170**	**2,192,510**

(Thousands of Georgian lari)

24. Risk management (continued)

Credit risk (continued)

	Notes	*Stages*	*High grade 2019*	*Standard grade 2019*	*Sub-standard grade 2019*	*Impaired 2019*	*Total 2019*
Cash and cash equivalents, except for cash on hand	5	Stage 1	95,399	–	–	–	**95,399**
Amounts due from banks and international financial institutions	6	Stage 1	153,712	–	–	–	**153,712**
Loans and advances to customers	7		456,589	669,697	13,714	46,796	**1,186,796**
- Corporate lending		Stage 1	175,824	257,931	–	–	**433,755**
		Stage 2	3,652	9,437	4,454	–	**17,543**
		Stage 3	–	–	–	20,303	**20,303**
- Small business lending		Stage 1	210,985	977	259	–	**212,221**
		Stage 2	104	58	26	–	**188**
		Stage 3	–	–	–	2,966	**2,966**
- Consumer lending		Stage 1	61,561	399,655	5,883	–	**467,099**
		Stage 2	78	1,639	3,092	–	**4,809**
		Stage 3	–	–	–	23,527	**23,527**
- Loans collateralized with deposits		Stage 1	4,385	–	–	–	**4,385**
Debt investment securities	8		120,953	–	–	–	**120,953**
- Measured at amortised cost		Stage 1	120,953	–	–	–	**120,953**
Undrawn loan commitments	20	Stage 1	49,514	39,862	–	–	**89,376**
		Stage 2	6	–	–	–	**6**
		Stage 3	221	–	–	–	**221**
Letters of credit	20	Stage 1	54	–	–	–	**54**
Financial guarantees	20	Stage 1	64,357	11,732	138	–	**76,227**
Other assets	14	Stage 1	7	3,625	–	–	**3,632**
Total			**940,812**	**724,916**	**13,852**	**46,796**	**1,726,376**

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.

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 7.

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.

	2020	*2019*
Loans and advances to customers		
Consumer lending	31,067	20,822
Corporate lending	28,989	10,880
Small business lending	12,682	2,915
Total	**72,738**	**34,617**

(Thousands of Georgian lari)

24. Risk management (continued)

Credit risk (continued)

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).

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

	2020				*2019*			
	Georgia	*OECD*	*CIS and other foreign countries*	*Total*	*Georgia*	*OECD*	*CIS and other foreign countries*	*Total*
Assets								
Cash and cash equivalents	134,840	55,080	17,183	**207,103**	109,684	26,118	14,107	**149,909**
Amounts due from banks and international financial institutions	229,128	164	–	**229,292**	153,569	143	–	**153,712**
Loans and advances to customers	1,377,113	2,903	18,635	**1,398,651**	1,133,512	5,853	14,195	**1,153,560**
Investment securities	166,799	–	–	**166,799**	120,696	–	–	**120,696**
Equity securities at FVOCI	54	–	–	**54**	54	–	–	**54**
Debt securities at amortised cost	156,964	–	–	**156,964**	120,642	–	–	**120,642**
Debt securities at FVPL	9,781	–	–	**9,781**	–	–	–	**–**
Other financial assets	4,431	186	122	**4,739**	12,812	159	136	**13,107**
	1,912,311	**58,333**	**35,940**	**2,006,584**	**1,530,273**	**32,273**	**28,438**	**1,590,984**
Liabilities								
Amounts due to banks and international financial institutions	1,968	–	29,461	**31,429**	19,474	–	15,829	**35,303**
Amounts due to customers	1,197,217	46,666	92,972	**1,336,855**	952,068	41,773	81,613	**1,075,454**
Debt securities issued	129,912	10,663	21,285	**161,860**	66,687	3,477	15,654	**85,818**
Other borrowed funds	116,721	5,565	56,102	**178,388**	45,738	4,816	68,176	**118,730**
Subordinated loan	–	–	80,253	**80,253**	–	–	63,448	**63,448**
Other financial liabilities	27,878	197	7	**28,082**	22,587	271	705	**23,563**
	1,473,696	**63,091**	**280,080**	**1,816,867**	**1,106,554**	**50,337**	**245,425**	**1,402,316**
Net assets/(liabilities)	**438,615**	**(4,758)**	**(244,140)**	**189,717**	**423,719**	**(18,064)**	**(216,987)**	**188,668**
Net financial commitments	**215,256**	**21**	**2,110**	**217,387**	**161,942**	**14**	**3,221**	**165,177**

(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.

Under the requirement Banks must hold the liquid assets that can be used to meet their liquidity needs for upcoming 30-calendar days. As of 31 December 2020 and 2019 the ratio was as follows:

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.

	2020	***2019***
LK "Liquidity Coverage Ratio" in FC (hold high-quality liquid assets / Total net cash outflow)	187%	147%
LK "Liquidity Coverage Ratio" in NC (hold high-quality liquid assets / Total net cash outflow)	80%	82%
Total LK "Liquidity Coverage Ratio" (hold high-quality liquid assets / Total net cash outflow)	140%	112%

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

From 1 September 2019, NBG additionally introduced the minimum requirement for Net Stable Financing Ratio (NSFR) for commercial banks in Georgia, which should be at least 100%. As of 31 December 2020, the actual performance of the NSFR by the Bank was 123% (2019: 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 as at 31 December 2020 and 2019 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 2020	*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	18,734	226	12,858	–	–	**31,818**
Amounts due to customers	790,376	153,755	144,743	211,871	55,280	**1,356,025**
Debt securities issued	2,763	3,774	9,834	50,395	150,705	**217,471**
Other borrowed funds	117,111	15,198	6,211	20,130	42,995	**201,645**
Subordinated loan	152	1,790	1,924	3,857	124,914	**132,637**
Lease liabilities	269	494	740	1,183	5,812	**8,498**
Other financial liabilities, except lease liabilities	7,832	1,018	2,311	2,164	7,180	**20,505**
Total cash flow payable under non-derivative liabilities	**937,237**	**176,255**	**178,621**	**289,600**	**386,886**	**1,968,599**
Derivative financial instruments − gross settled						
Positive fair value of derivatives						
(Inflow)	(10,115)	–	–	(168)	(1,746)	**(12,029)**
Outflow	9,830	–	–	123	1,279	**11,232**
Derivative financial instruments − gross settled						
Negative fair value of derivatives						
(Inflow)	(133,867)	(11,972)	(55,479)	(35,973)	–	**(237,291)**
Outflow	134,669	12,460	54,490	35,177	–	**236,796**

Non-derivative liabilities as of 31 December 2019	*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	21,927	236	236	472	13,796	**36,667**
Amounts due to customers	682,969	93,934	90,018	110,491	117,822	**1,095,234**
Debt securities issued	1,820	5,830	12,796	36,786	35,578	**92,810**
Other borrowed funds	45,573	1,444	11,236	5,924	74,377	**138,554**
Subordinated loan	110	1,541	1,668	3,301	95,157	**101,777**
Lease liabilities	274	483	725	1,418	8,172	**11,072**
Other financial liabilities, except lease liabilities	3,453	3,868	4,242	1,453	404	**13,420**
Total cash flow payable under non-derivative liabilities	**756,126**	**107,336**	**120,921**	**159,845**	**345,306**	**1,489,534**
Derivative financial instruments − gross settled						
Positive fair value of derivatives						
(Inflow)	(240,382)	–	–	(139)	(39,337)	**(279,858)**
Outflow	235,286	–	–	116	31,967	**267,369**
Derivative financial instruments − gross settled						
Negative fair value of derivatives						
(Inflow)	(14,339)	–	–	–	–	**(14,339)**
Outflow	14,372	–	–	–	–	**14,372**

(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*
2020	61,169	18,571	9,854	41,587	87,132	**218,313**
2019	10,594	27,750	31,696	32,561	63,282	**165,883**

Commitments and contingencies may be callable on demand, however liquidation historically has taken place over a longer period.

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 2020*	*Sensitivity of profit before tax 2020*
RUB	0.77%	(101)
RUB	(0.77%)	101

Currency	*Increase in basis points 2019*	*Sensitivity of profit before tax 2019*
RUB	0.23%	(36)
RUB	(0.23%)	36

(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 2020 and 2019 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 % 2020*	*Effect on profit before tax 2020*	*Increase in currency rate in % 2019*	*Effect on profit before tax 2019*
USD	15.00%	966	10%	1,099
EUR	16.00%	(562)	11%	79
RUB	16.00%	(1,963)	13%	(1,812)

Currency	*Increase in currency rate in % 2020*	*Effect on profit before tax 2020*	*Increase in currency rate in % 2019*	*Effect on profit before tax 2019*
USD	(7.00%)	(451)	(5%)	(550)
EUR	(8.00%)	281	(6%)	(43)
RUB	(16.00%)	1,963	(13%)	1,812

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
2020	16,986
2019	14,028

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 2020, the Bank obtained Banker's Blanket Bond and Computer Crime insurance on a total insured sum of GEL 3,277 (2019: GEL 2,867) from "Euroins Georgia" (previously stated as "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 Management Board 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 Management Board. Selection criteria include market knowledge, reputation, independence and whether professional standards are maintained. The Management Board decides, after discussions with the Bank's external valuers, which valuation techniques and inputs to use for each case.

At each reporting date, the Management Board 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 management 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.

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 2020	***Level 1***	***Level 2***	***Level 3***	***Total***
Assets measured at fair value				
Equity securities at FVOCI	–	–	54	**54**
Debt securities at FVPL	–	9,781	–	**9,781**
Derivative financial assets	–	799	–	**799**
Total investment property	**–**	**–**	**26,474**	**26,474**
Land	–	–	1,072	**1,072**
Residential properties	–	–	13,825	**13,825**
Non-residential properties	–	–	11,577	**11,577**
Total land and buildings	**–**	**–**	**32,193**	**32,193**
Land	–	–	5,101	**5,101**
Office buildings	–	–	21,172	**21,172**
Service centres	–	–	5,920	**5,920**
Right-of-use assets	**–**	**–**	**6,330**	**6,330**
Assets for which fair values are disclosed				
Cash and cash equivalents	61,045	146,058	–	**207,103**
Amounts due from banks and international financial institutions	–	229,292	–	**229,292**
Loans and advances to customers	–	–	1,394,077	**1,394,077**
Debt securities at amortised cost	–	139,142	20,045	**159,187**
Liabilities measured at fair value				
Derivative financial liabilities	–	1,512	–	**1,512**
Liabilities for which fair values are disclosed				
Amounts due to banks and international financial institutions	–	31,429	–	**31,429**
Amounts due to customers	–	–	1,338,769	**1,338,769**
Debt securities issued	–	–	164,094	**164,094**
Other borrowed funds	–	177,999	–	**177,999**
Subordinated loan	–	82,989	–	**82,989**
Lease liabilities	–	–	7,886	**7,886**

(Thousands of Georgian lari)

25. Fair value measurements (continued)

Fair value hierarchy (continued)

As of 31 December 2019	*Level 1*	*Level 2*	*Level 3*	*Total*
Assets measured at fair value				
Equity securities at FVOCI	–	–	54	**54**
Derivative financial assets	–	9,559	–	**9,559**
Total investment property	**–**	**–**	**18,689**	**18,689**
Land	–	–	1,784	**1,784**
Residential properties	–	–	10,821	**10,821**
Non-residential properties	–	–	6,084	**6,084**
Total land and buildings	**–**	**–**	**32,748**	**32,748**
Land	–	–	5,101	**5,101**
Office buildings	–	–	19,726	**19,726**
Service centres	–	–	7,921	**7,921**
Right-of-use assets	**–**	**–**	**9,443**	**9,443**
Assets for which fair values are disclosed				
Cash and cash equivalents	54,510	95,399	–	**149,909**
Amounts due from banks and international financial institutions	–	153,712	–	**153,712**
Loans and advances to customers	–	–	1,157,110	**1,157,110**
Debt securities at amortised cost	–	100,541	19,317	**119,858**
Liabilities measured at fair value				
Derivative financial liabilities	–	24	–	**24**
Liabilities for which fair values are disclosed				
Amounts due to banks and international financial institutions	–	35,303	–	**35,303**
Amounts due to customers	–	–	1,075,929	**1,075,929**
Debt securities issued	–	–	87,200	**87,200**
Other borrowed funds	–	118,412	–	**118,412**
Subordinated loan	–	67,082	–	**67,082**
Lease liabilities	–	–	10,217	**10,217**

During the years ended 31 December 2020 and 2019, 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 2020	*Fair value 2020*	*Unrecognised gain/(loss) 2020*	*Carrying value 2019*	*Fair value 2019*	*Unrecognised gain/(loss) 2019*
Financial assets						
Debt securities at amortised cost	156,964	159,187	2,223	120,642	119,858	(784)
Amounts due from banks and international financial institutions	229,292	229,292	–	153,712	153,712	–
Loans and advances to customers	1,398,651	1,394,077	(4,574)	1,153,560	1,157,110	3,550
Financial liabilities						
Amounts due to banks and international financial institutions	31,429	31,429	–	35,303	35,303	–
Amounts due to customers	1,336,855	1,338,769	(1,914)	1,075,454	1,075,929	(475)
Debt securities issued	161,860	164,094	(2,234)	85,818	87,200	(1,382)
Other borrowed funds	178,388	177,999	389	118,730	118,412	318
Subordinated loan	80,253	82,989	(2,736)	63,448	67,082	(3,634)
Lease liabilities	7,577	7,886	(309)	10,143	10,217	(74)
Total unrecognised change in unrealised fair value			**(9,155)**			**(2,481)**

(Thousands of Georgian lari)

25. Fair value measurements (continued)

Fair value hierarchy (continued)

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.

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.

(Thousands of Georgian lari)

25. Fair value measurements (continued)

Fair value hierarchy (continued)

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 2020:

	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	**26,474**						
Land	1,072	Market approach	Price per square metre	0.05-632.61 (37.95) Georgian lari	Square metre	50-15,000 (2,204.33)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 100 Georgian lari
Residential properties	13,825	Market approach	Price per square metre	2.62-4,914.9 (678.92) Georgian lari	Square metre	26-4,500 (157.13)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 1,287 Georgian lari
Non-residential properties	**11,577**						
	11,577	Market approach	Price per square metre	1.64-4,486.42 (1,101.7) Georgian lari	Square metre	8-8,000 (712.59)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 1,213 Georgian lari
Revaluated land and buildings	**32,193**						
Land	5,101	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 510 Georgian lari
Office buildings	21,172	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 2,051.5 Georgian lari
Service centers / means of production	5,920						
	5,809	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 733.3 Georgian lari
	111	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 2019:

	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	**18,689**						
Land	1,784	Market approach	Price per square metre	0.05-343.22 (25.27) Georgian lari	Square metre	18-88,456 (5,675.1)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 163 Georgian lari
Residential properties	10,821	Market approach	Price per square metre	0.56-3,317.59 (702.89) Georgian lari	Square metre	27-14,500 (228)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 1,063 Georgian lari
Non-residential properties	**6,084**						
	6,084	Market approach	Price per square metre	0.97-3,823.6 (977.83) Georgian lari	Square metre	11-12,500 (677.95)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 595 Georgian lari
Revaluated land and buildings	**32,748**						
Land	5,101	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 510 Georgian lari
Office buildings	19,726	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 2,051.5 Georgian lari
Service centers / means of production	7,921						
	7,808	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 733.3 Georgian lari
	113	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)

26. Maturity analysis of financial assets and liabilities

The table below shows assets and liabilities at 31 December 2020 and 2019 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, 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.

	2020							
	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	207,103	–	–	–	–	–	–	**207,103**
Amounts due from banks and international financial institutions	37,420	32,291	29,506	51,432	78,643	–	–	**229,292**
Loans and advances to customers	56,477	141,563	88,549	208,111	875,959	27,992	–	**1,398,651**
Investment securities:								
- debt at amortised cost	16,890	37,005	2,524	8,756	91,789	–	–	**156,964**
- debt at FVPL	–	–	414	398	8,969	–	–	**9,781**
- FV through OCI	–	–	–	–	–	–	54	**54**
Other financial assets	2,850	9	–	1,270	610	–	–	**4,739**
Total	**320,740**	**210,868**	**120,993**	**269,967**	**1,055,970**	**27,992**	**54**	**2,006,584**
Financial liabilities								
Amounts due to banks and international financial institutions	18,733	59	12,637	–	–	–	–	**31,429**
Amounts due to customers	229,145	201,695	167,890	212,475	525,650	–	–	**1,336,855**
Debt securities issued	2,751	3,717	9,541	48,550	97,301	–	–	**161,860**
Other borrowed funds	116,849	14,624	5,698	19,476	21,741	–	–	**178,388**
Subordinated loan	92	343	–	–	79,818	–	–	**80,253**
Other financial liabilities	8,077	1,444	2,968	3,310	12,283	–	–	**28,082**
Total	**375,647**	**221,882**	**198,734**	**283,811**	**736,793**	**–**	**–**	**1,816,867**
Net	**(54,907)**	**(11,014)**	**(77,741)**	**(13,844)**	**319,177**	**27,992**	**54**	**189,717**
Cumulative gap	**(54,907)**	**(65,921)**	**(143,662)**	**(157,506)**	**161,671**	**189,663**	**189,717**	**–**

(Thousands of Georgian lari)

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

	2019							
	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	149,909	–	–	–	–	–	–	**149,909**
Amounts due from banks and international financial institutions	30,893	18,231	15,201	22,677	66,710	–	–	**153,712**
Loans and advances to customers	57,556	99,543	98,404	196,787	682,230	19,040	–	**1,153,560**
Investment securities:								
- debt at amortised cost	12,620	29,431	27,774	25,869	24,948	–	–	**120,642**
- FV through OCI	–	–	–	–	–	–	54	**54**
Other financial assets	8,079	17	–	200	4,811	–	–	**13,107**
Total	**259,057**	**147,222**	**141,379**	**245,533**	**778,699**	**19,040**	**54**	**1,590,984**
Financial liabilities								
Amounts due to banks and international financial institutions	21,923	57	–	–	13,323	–	–	**35,303**
Amounts due to customers	198,867	151,869	96,007	105,929	522,782	–	–	**1,075,454**
Debt securities issued	1,810	5,768	12,551	35,196	30,493	–	–	**85,818**
Other borrowed funds	45,546	783	10,290	4,305	57,806	–	–	**118,730**
Subordinated loan	93	341	–	–	63,014	–	–	**63,448**
Other financial liabilities	3,713	4,314	4,917	2,783	7,836	–	–	**23,563**
Total	**271,952**	**163,132**	**123,765**	**148,213**	**695,254**	**–**	**–**	**1,402,316**
Net	**(12,895)**	**(15,910)**	**17,614**	**97,320**	**83,445**	**19,040**	**54**	**188,668**
Cumulative gap	**(12,895)**	**(28,805)**	**(11,191)**	**86,129**	**169,574**	**188,614**	**188,668**	**–**

As of 31 December 2020, total amount of funding obtained from the Parent bank amounted to GEL 152,201 (2019: GEL 146,998). 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.

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 2020 and 2019, outstanding balances on related party transactions are as follows:

	2020			***2019***		
	The Parent bank	***Entities under common control***	***Key management personnel***	***The Parent bank***	***Entities under common control***	***Key management personnel***
Cash and cash equivalents	15,994	1,897	−	13,978	19,591	−
Loans and advances to customers, gross	−	17,701	142	−	9,648	196
Less: allowance for impairment	−	(927)	−	−	(234)	−
Loans and advances to customers, net	−	16,774	142	−	9,414	196
Other assets	2	118	−	9,287	−	−
Amounts due to banks and international financial institutions	15,845	13,203	−	15,375	267	−
Amounts due to customers	−	3,225	3,910	−	6,398	5,056
Debt securities issued	−	−	6,014	−	−	4,171
Other borrowed funds	56,103		−	68,175	−	−
Subordinated loan	80,253	−	−	63,448	−	−
Other liabilities	777	344	−	2	−	174
Commitments and guarantees issued	−	28	101	−	28	99

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. The carrying value as of 31 December 2020 was GEL 5,657 (2019: GEL 5,961), with interest rate of 11% payable quarterly and maturity on 13 October 2021. On 15 December 2020 subordinated loan was restructured with interest rate of 8.93% payable quarterly and maturity on 29 October 2027.

On 31 August 2018, the Bank entered into a subordinated loan agreement with the Parent bank for the total amount of RUB 816,985.The carrying value as of 31 December was 2020 GEL 36,293 (2019: GEL 38,243), with interest rate of 10.5% payable quarterly and maturity on 29 August 2025. On 31 August 2020 subordinated loan was restructured with interest rate of 10.5% payable quarterly and maturity on 29 August 2027.

On 31 December 2018, the Bank entered into a subordinated loan agreement with the Parent bank for the total amount of RUB 414,000. The carrying value as of 31 December was 2020 GEL 18,242 (2019: GEL 19,243) , with interest rate of 11.5% payable quarterly and maturity on 26 December 2025. On 15 December 2020 subordinated loan was restructured with interest rate of 8.99% payable quarterly and maturity on 1 December 2027.

On 29 December 2020, the Bank entered into a subordinated loan agreement with the Parent bank for the total amount of RUB 455,394. The carrying value as of 31 December 2020 was GEL 20,061 with interest rate of 8.92% payable quarterly and maturity on 17 December 2027.

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 2020 other liabilities to key management personnel comprised of accrued bonuses totalling GEL 4,564 (2019: GEL 3,803) and unpaid vacation of GEL182 (2019: GEL 163).

(Thousands of Georgian lari)

27. Related party disclosures (continued)

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

	2020			2019		
	The Parent bank	***Entities under common control***	***Key management personnel***	***The Parent bank***	***Entities under common control***	***Key management personnel***
Interest revenue calculated using effective interest rate	21	2,707	20	5	2,113	18
Interest expense	(11,072)	(771)	(600)	(13,306)	(1,026)	(417)
Expense due to assets with negative interest rates (NIR)	–	(14)	–	–	(13)	–
Credit loss recovery/(expense)	–	(693)	–	–	137	–
Fee and commission income	–	46	10	–	47	13
Fee and commission expense	(166)	(109)	–	(143)	(98)	–
Net gains from foreign currencies dealing	6,643	(110)	(7)	4,328	462	12
Other operating expenses	(12)	–	–	(14)	–	–

For the year ended 31 December 2020, remuneration of the members of the key management personnel comprised salaries, bonuses and other staff related expenses totalling GEL 8,787 (2019: GEL 7,638).

Key management personnel as of 31 December 2020 comprise 6 members of the Supervisory Board and 6 members of the Management Board of the Bank (2019: 8 members of the Supervisory Board and 6 members of the Management Board of the Bank).

The Bank had no significant transactions with members of the Supervisory Board in 2020 and 2019.

28. Changes in liabilities arising from financing activities

	Other borrowed funds	***Subordinated loans***	***Total liabilities from financing activities***
Carrying amount at 31 December 2018	**128,100**	**52,757**	**180,857**
Proceeds from issue	988,646	–	**988,646**
Redemption	(1,003,393)	–	**(1,003,393)**
Foreign currency translation	5,620	10,636	**16,256**
Non-cash transactions	(23)	–	**(23)**
Other	(220)	55	**(165)**
Carrying amount at 31 December 2019	**118,730**	**63,448**	**182,178**
Proceeds from issue	4,731,000	20,201	**4,751,201**
Redemption	(4,677,274)	–	**(4,677,274)**
Foreign currency translation	5,947	(3,397)	**2,550**
Other	(15)	1	**(14)**
Carrying amount at 31 December 2020	**178,388**	**80,253**	**258,641**

The “Other” line includes the effect of accrued but not paid interest on 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.

(Thousands of Georgian lari)

29. Capital adequacy (continued)

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.

NBG requires that all banks comply with Basel II regulations in their capital adequacy assessment. 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.

During 2020 the National Bank of Georgia has taken important measures to mitigate the negative impact of the COVID-19 pandemic on the banking sector. Banks were given relief on the capital requirements by reduction of the capital conservation buffer (2.5% of the risk weighted assets) and the portion of the pillar 2 buffer (2/3 of the currency induced credit risk buffer). In addition, HHI and Grape Buffer requirements on CET 1 and Tier 1 capital planned at the end of March 2020 postponed indefinitely. NBG has also put in place a moratorium on any regulatory breaches of commercial banks caused by external factors such as additional credit losses, foreign exchange rate fluctuations and so on. These alleviations have been put in effect for an indefinite period of time and their reversal will be carried out only within reasonable time frames that will be further suggested by NBG.

As at 31 December 2020 the NBG requires banks to maintain a minimum regulatory capital adequacy ratio, the core Tier 1 capital coefficient and Tier 1 coefficient of 14.21%, 5.67%, 7.56%, respectively (2019: Minimum regulatory capital adequacy ratio, the core Tier 1 capital coefficient and Tier 1 coefficient of 17.19%, 8.77% and 10.87%, respectively).

The Bank was in compliance with these capital adequacy ratios as of 31 December 2020 and 2019. The Bank's capital adequacy ratios on this basis were as follows:

	2020	*2019*
Common Equity Tier 1 capital	178,355	200,911
Additional Tier 1 capital	13,209	13,927
Tier 1 capital	**191,564**	**214,838**
Tier 2 capital	**100,842**	**80,286**
Total regulatory capital for ratio calculation	**292,406**	**295,124**
Risk weighted assets	**1,876,625**	**1,568,504**
Common Equity Tier 1 capital adequacy ratio	**9.50%**	**12.81%**
Tier 1 capital adequacy ratio	**10.21%**	**13.70%**
Total capital adequacy ratio	**15.58%**	**18.82%**