საქართველოს ეროვნული ბანკი
National Bank of Georgia

ANNUAL REPORT
2021

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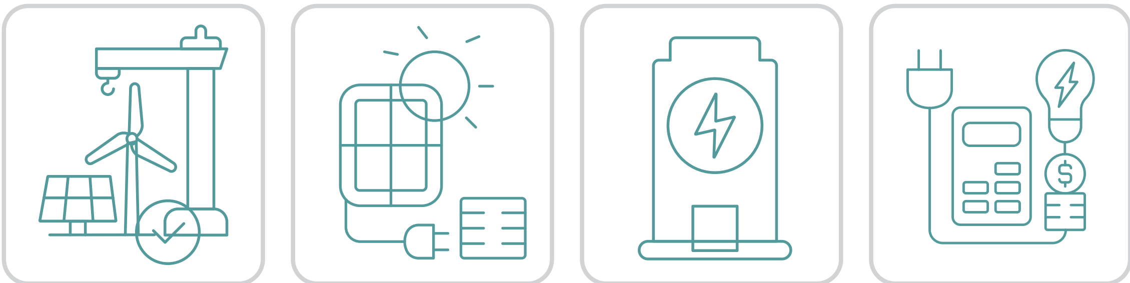

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DIAGRAMS

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ABBREVIATIONS

ACAG - Association of Communication Agencies of Georgia
ADR - Average Daily Rate
AML/CFT - Anti-Money Laundering/Combating the Financing of Terrorism
API - Application Programming Interface
ARA - Assessing Reserve Adequacy
BI - Business Intelligence
BIS - Bank for International Settlements
BISIP - BIS Investment Pool
BMatch - Bloomberg Foreign Exchange trading platform
CFA - Chartered Financial Analyst
CICR - Currency Induced Credit Risk
CIF - Cost, Insurance and Freight
CPMI - Committee on Payments and Market Infrastructures
CRA - Credit Risk Adjustment buffer
CRD IV - Directive on Activities of, and Regulation for, Credit Institutions operating in the European Union
CRX - Cyber Range Exercises
CSR - Corporate Social Responsibility
DDoS - Distributed Denial-of-Service attack
DPM - Data Point Model - A data dictionary containing the harmonized data requirements developed by the EBA and included in its technical standards and manual
DSCR - Debt-Service Coverage Ratio
DSIK - German Sparkassenstiftung for International Cooperation
EAD - Exposure at Default
EBA - European Banking Authority
EBITDA - Earnings Before Interest, Taxes, Depreciation and Amortization
EBRD - European Bank for Reconstruction and Development
ECB - European Central Bank
EFF - Extended Fund Facility
EFSE DF - Development Facility of the European Fund for Southeast Europe
EMV - Europay, Mastercard and Visa
ESG - Environmental, Social, and Governance
ETL - Extract, Transform, Load - General procedure for importing, converting and storing data from various sources (MS SQL, MS Excel, etc.)
EVE - Economic Value of Equity
FAO - Food and Agriculture Organization
FID - Financial Indicator Daily
FinEdu - The first Georgian Financial Education
Webportal - www.finedu.gov.ge
FINREP - Financial Reporting (a European regulation that applies to credit institutions)
FOB - Free on Board
FSAP - Financial Sector Assessment Program
FSI - Financial Stability Indicators
GAN - General Adversarial Networks
GCSD - Georgian Center for Strategy and Development
GET - German Economic Team
GFIN - Global Financial Innovation Network
GGF - Green for Growth Fund
GRAPE - General Risk Assessment Program
GSSS - Georgian Securities Settlement System
HHI - Herfindahl-Hirschman Index
HR - Human Resources
HRMS - Human Resources Management System
IFC - International Finance Corporation
IFRS - International Financial Reporting Standards
IMF - International Monetary Fund
IOSCO - Technical Committee of the International Organization of Securities Commissions
IT - Information Technology
LCR - Liquidity Coverage Ratio
LGD - Loss Given Default
NGFS - Network for Greening the Financial System
NII - Net Interest Income
NPL - Non-Performing Loan
NSDP - National Summary Data Page
NSFR - Net Stable Funding Ratio
OECD - Organization for Economic Cooperation and Development
OECD/INFE - International Network on Financial Education of the Organization for Economic Co-operation and Development
OSINT - Open-Source Intelligence
PD - Probability of Default
PTI - Payment-to-income ratio
ROA - Return on Assets
ROE - Return on Equity
RTGS - Real Time Gross Settlement
SAA - Strategy of Asset Allocation
SBFN - Sustainable Banking and Finance Network
SDR - Special Drawing Rights - The form of international money created by the International Monetary Fund and defined as the weighted average of the various convertible currencies
SDMX - Statistical Data and Metadata Exchange
SECO - State Secretariat for Economic Affairs
SWIFT - Society for Worldwide Interbank Financial Telecommunication
TIBR - Tbilisi Interbank Rate
TMS - Taxonomy Management System
USAID - United States Agency for International Development
WB - World Bank
XBRL - Extensible Business Reporting Language

INTRODUCTION

The 2021 Annual Report of the National Bank of Georgia (NBG) has been prepared in accordance with Articles 60 and 61 of the Organic Law of the NBG and includes a review of monetary, foreign exchange and supervisory policies and audited financial statements.

According to the Organic Law of Georgia on the NBG, ensuring price stability is the focal task of the NBG.[1] Besides this, the NBG is missioned to foster stability and transparency of the financial system and to promote sustainable economic growth in the country so as not to jeopardize its core objectives. Price stability, in turn, implies having a level of inflation in the medium term that is optimal for high and sustainable economic growth. Focusing on the medium term is particularly important as inflation may deviate from the current or short-term target (in both upward and downward directions). However, the NBG's monetary policy ensures that it will return to the target in the medium term, thus achieving price stability.

To ensure price stability, the NBG implements monetary policy using an inflation-targeting regime. Globally considered to be the most effective model, this regime implies announcing an inflation target in advance and implementing policies in a manner so that inflation comes close to the target level in the medium term. The key instrument of the NBG's monetary policy is the monetary policy rate, which changes according to the inflation forecast. If the forecast inflation rate is higher than targeted, the NBG will tighten its monetary policy, and, conversely, if the inflation forecast is below the target, the National Bank will loosen the monetary policy. This tactic safeguards price stability and the lowest long-term interest rates as compared to other alternative approaches.

With the development of monetary policy instruments and transmission mechanisms, public spending is also reduced to ensure price stability; the NBG is thus persistently seeking to improve its monetary policy instruments and increasing the efficiency of the monetary policy transmission mechanism. The NBG first embarked on the inflation-targeting regime in 2009, and, since then (2009-2021), the average annual inflation rate in Georgia has been 4.3%. Before the adoption of the inflation-targeting regime, inflation averaged 6.6% (in 2000-2008). When inflation targeting was initially introduced, the inflation target was set at 6%, but this gradually declined in the following years and was subsequently reduced to 3% in 2018 – which remains the long-term target for annual inflation.

Because exogenous shocks (those that are independent of monetary policy) are inevitable for Georgia, as well as for other open economies, it is possible for inflation to deviate from the target. As monetary policy is a tool to influence demand, central banks largely only respond to demand shocks, as responding to supply shocks (e.g., excise taxes, rising international transportation costs, and fuel prices) is likely to cause high costs for the economy, leading to economic growth fluctuations and reduced employment in the long run. Studies show that it takes some time for monetary policy changes to be transmitted to the economy, and it is therefore advisable to allow deviations from the inflation target in the short run, if, in the medium term, inflation is projected to return to its target.[2] However, if this type of shock raises medium-term inflation expectations and forecasts, then the NBG will change its policy accordingly.

1. Paragraph 1, Article 3 of the Organic Law of the National Bank of Georgia.
2. Bernanke & Blinder (1992) "The Federal Funds Rate and the Channels of Monetary Transmission", *American Economic Review;* Vol. 82, Issue 4, pp. 901-21; Bernanke & Gertler (1995) "Inside the Black Box: The Credit Channel of Monetary Policy Transmission", *The Journal of Economic Perspectives*, Vol. 9, No. 4 (Autumn, 1995), pp. 27-48.

Inflationary pressures intensified worldwide in 2021, including in Georgia. The reason for the high inflation was the extraordinary situation caused by the COVID-19 pandemic, with several factors simultaneously pushing inflation upwards. Global inflation was a hot topic in the various reviews of the International Monetary Fund, the World Bank and other international organizations. High inflation was fueled by a global price rise for consumer goods, which was triggered by a rise in food prices. World average food prices were at their highest levels in ten years in 2021 as consequence of pandemic-related delays, poor harvests, and increased transportation costs. Moreover, with the steady restoration of mobility, demand for oil rose and prices in international markets have climbed. The steady rise in global oil prices over the years have of course affected fuel prices in the local market.

Restrictions introduced against the spread of COVID-19, alongside the subsequent intensification of the economic recovery process and accompanying rising demand, have led to a bottleneck of transportation channels, dramatically increasing worldwide transport costs and other operating costs. These, in turn, have affected the final prices of almost all products.

Inflation is a problem not just for developing but also for developed countries. Inflation in the US was 7.0% in December 2021, which was the highest level in 40 years, and that of the eurozone was at a record level of 5.0%. High inflation was also recorded in the Baltic states: in December 2021, Estonia had inflation of 12.2%, Lithuania 10.6% and Latvia 7.9%. In early 2022, the rate of price growth accelerated even further, with inflation reaching 8.5% in the US in March and that of the eurozone rising to a record 7.5%. The same trend was observed in the Baltic states: in March 2022, it was 12.0% in Estonia and rose to 15.7% in Lithuania and 11.5% in Latvia.

Influenced by the factors described above, inflation in Georgia also showed a growth trend in 2021. Although relatively low, at 2.8%, in January 2021 due to subsidies on utility bills, it gradually picked up in the following months, reaching a peak of 13.9% in December. Average inflation over the year was 9.6%. Of this, 3.1 percentage points (pp) came from food, particularly food that was imported or dependent on imported raw materials. Fuel inflation averaged 1.4 pp during the year. In addition, utility bills had a significant impact on the inflation rate, which included both the increase in utility bills and the statistical effect.[3]

Following a 6.8% decline in 2020, economic activity continued to be weak in the first quarter of 2021. However, pandemic-related restrictions were gradually eased from the second quarter of the year, changing the economic picture significantly. Most of the restrictions on international mobility were lifted, helping a partial recovery of tourism. The flow of international travelers to Georgia thus started to gradually recover, positively impacting tourism revenues and related business activities. In the second quarter of 2021, GDP in real terms increased by 28.9% compared to the same period of the previous year. The high growth was due the base effect, as the severe pandemic-related restrictions that had initially been imposed in the second quarter of 2020 had led to a significant economic downturn during that period. However, the growth subsequently continued in the following periods and, according to preliminary data, real GDP in 2021 increased by 10.4%. In addition to the base effect, the high growth observed in 2021 was boosted by awakened pent-up demand that had been accumulated over months of restrictions, fiscal stimulus and lending to the economy. The volume of GDP in 2021 in real terms exceeded the level of 2019 by 2.9%.

3. Due to government subsidies, utility bills in December 2020 decreased compared to November of that same year, while in March 2021 these indices increased only slightly compared to the November level. However, in percentage terms, the increase came out much higher than the decrease. Given the unchanged weight of utility bills, this difference increased the annual inflation rate by about 1.2 pp over the next year. From June, this effect increased by an additional 0.1 pp to 1.3 pp, along with an increase in natural gas tariffs. In December, due to the base effect, the annual contribution of utility bills increased by an additional 2.0 pp to 3.6 pp.

Given that supply factors in 2021 were still strong, and that maintaining a high inflation rate relative to the target presented the risk of raising inflation expectations, the monetary policy rate was gradually increased from 8.0% to 10.5% during the year.

In 2021, as pandemic-related restrictions started to ease on the global scale, external demand began to recover. The current account deficit for 2021 was 9.8% of GDP, 2.6 pp lower than the previous year. In absolute terms, the current account deficit improved by USD 131 million to USD 1,834 million. As domestic demand picked up, the import of goods increased by 23.8% compared to the previous year, while export growth was 27.4%. With the gradual recovery of revenues from international travelers (annual growth of 129.8%, although still down by 61.9% compared to 2019), the trade surplus in services increased, improving the current account deficit. The growing dynamics of money transfers continued in 2021 as well.

In 2021, as in previous years, net foreign direct investment remained a significant source of financing for the current account deficit. Foreign direct investment in Georgia amounted to USD 1.15 billion, which was an increase of 101.6% over the previous year, while the volume of net foreign investment increased by USD 128 million (by 23.3%). The increase in foreign direct investment was largely due to an increase in reinvestment. Most of the investments were made in the financial, energy and manufacturing sectors, while, compared to the previous year, investments increased mostly in the hotels, restaurants, and energy and manufacturing sectors.

Given the increased current account deficit and reduced private sector inflows into the financial account in 2021, it was important for the government to continue receiving external funding from international organizations to make up for this shortfall. Public sector net inflows (in the form of loans and grants) amounted to USD 1,532 million in 2021, a significant portion of which were reflected in the National Bank's accounts. In addition, the NBG was provided SDR 78 million in the final portion of the International Monetary Fund's Extended Facility[4] (equating to USD 112.5 million). Within the framework of the new rule for the redistribution of the International Monetary Fund's Special Drawing Rights (SDRs), which served to strengthen countries' external buffers, Georgia received SDR 202 million (USD 286 million). As for portfolio investments in financial accounts, the decrease was mostly related to the non-banking sector.

In 2021, official reserve assets increased by USD 361.4 million to USD 4.27 billion. This growth in reserves was impacted by the money received from the International Monetary Fund, the funds raised by the government from other international institutions (most of which go to the NBG government accounts), and foreign exchange swaps. Meanwhile, external debt service, other government foreign exchange expenditures and foreign exchange interventions were acting to reduce international reserves. In 2021, government debt service in foreign currency and government foreign exchange expenditures on goods and services totaled approximately USD 856 million. Through foreign exchange interventions, the National Bank provided USD 354.9 million to the foreign exchange market.

Promoting financial stability as a prerequisite for sustainable economic growth is one of the most important tasks of the NBG. In recent years, the world has seen increased urgency and the rising significance of financial stability and macroprudential policies, which has been further evidenced by the 2020 pandemic and the resulting global economic crisis. The NBG implements a macroprudential policy to ensure financial stability. As a result of this, the financial sector was able to successfully pass the severe phase of the pandemic-driv-

4. Special Drawing Rights are special rights on borrowings, additional international reserve assets set by the IMF.

en shock and was able to continue to smoothly lend to the economy even in the face of the pandemic. Prior to the pandemic, the NBG had imposed additional capital requirements, enacted a responsible lending regulation, and had taken a number of macroprudential actions to reduce the dollarization of loans, contributing to the sustainable quality of assets and the accumulation of sufficient capital buffers. In addition, the introduction of the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) in recent years has led to the stability of banks' funding sources and the improvement of the liquidity buffer. As a result, as of December 2021, banks maintained sound capital and liquidity ratios, and enjoying improved asset quality compared to the previous year. Commercial banks ended 2021 with solid profits, fueled by high lending activity and declining credit losses, which in turn led to the buildup of loan loss reserves in 2020 (economic growth turned out to be better than expected, which helped improve previously challenged borrowers, and thereby reduced the reserve). According to the decision of the Financial Stability Committee, banks were given until 1 January 2023 to restore the currency induced credit risk (CICR) buffer, and until 1 January 2024 to meet the capital conservation buffer requirement. However, as a result of improved financial performance, a significant portion of banks have already restored their released capital buffers. The Financial Stability Committee estimates that the banking sector will remain resilient, continuing to lend to the economy smoothly in 2022.

Dollarization remains a major challenge for the financial sector, despite recent significant declines. Reducing dollarization is necessary for reducing macro-financial risks and improving resilience to external vulnerabilities. Accordingly, the NBG prioritizes increasing larization (de-dollarization) and aims to implement incentive reforms in phases.

Following the tightening of monetary policy from the second half of 2021, as GEL resources became more expensive, the contribution of foreign currency loans increased, acting to increase the dollarization of loans. During the year, the dollarization of loans, excluding the exchange rate effect, decreased by 3.3 pp (without excluding the exchange rate effect, it decreased by 4.7 pp), amounting to 50.6% in December. The dollarization rate of retail loans decreased from 40.2% to 36.6% in 2021, excluding the exchange rate effect (by 4.9 pp, without excluding the exchange rate effect). Dollarization of total deposits, excluding the exchange rate effect, decreased by 0.1 pp (without excluding the exchange rate effect, it decreased by 1.4 pp) reaching 60.2%.

In the pre-crisis period, the NBG took a number of macroprudential actions to reduce the dollarization of loans, which served to help significantly reduce underlying vulnerabilities. With the share of foreign currency loans in the loan portfolio remaining high, dollarization remains a major risk for non-hedged borrowers and for the overall financial system. According to the decision of the Financial Stability Committee, the method for calculating the currency induced credit risk (CICR) buffer was changed, with it becoming dependent on the level of dollarization of the commercial bank loan portfolio. This change is expected to motivate banks towards loan larization. Another important decision was made at the end of 2021: from 2022, the maximum term of foreign currency mortgage loans was reduced from 15 to 10 years. Most borrowers are unhedged, which indicates high vulnerability, and, given the size of the portfolio, contributes to the accumulation of systemic risks in the financial sector, which also threaten the sustainability of the real estate market. Most mortgage loans have variable rates which implies that these loans carry interest rate risk in addition to exchange rate risk. This needs special consideration as world markets currently have historically low interest rates in both US dollars and euros, and there are preconditions for possible interest rate hikes.

In 2021, the National Bank published the 2021 edition of the Supervisory Strategy for 2020-2022.[5] The NBG's

5. For details, refer to Supervisory Strategy 2021 Edition.

supervisory priorities in the strategy have remained unchanged. The annual strategy paper places particular emphasis on the key objectives and changes to the supervision priorities planned for the next 12-18 months. Significantly, collaboration with various public institutions within the country was enhanced in 2021. A memorandum of understanding was signed between the supervisory and regulatory agencies of Georgia, with the purpose of cooperating on reporting issues.

During 2021, the NBG continued to work to improve the supervisory framework, bringing it closer to best international practice and strengthening a number of supervisory areas. The year was important in terms of drafting special legislation governing competition issues (under the NBG's auspices) and strengthening supervision. The NBG's powers were specified in the 2020 amendments to the Law of Georgia on Competition and the Organic Law of the NBG. In line with the obligations set out in these amendments, in 2021 the NBG approved by-laws regulating competition policy for regulated entities. These were based on the Law of Georgia on Competition, the secondary legislation of the Competition Agency and best international practices for the industry. Along with the involvement of the Competition Agency, and in consultation with the financial sector, the NBG enjoyed expert assistance from representatives of the World Bank in drafting the by-laws. Although there was a temporary moratorium announced on the development and implementation of new regulatory requirements as part of the COVID-19 supervision plan, in 2022 the National Bank will continue to bring its capital adequacy standards closer to the EU regulations.

As of 31 December 2021, there were 14 commercial banks operating in the banking sector. During the same period, the share of non-resident owners in the assets of banks, by ultimate ownership, was 86.7%, and 86.2% in the share of capital.

By the end of 2021, the total loan portfolio of the banking system reached GEL 43 billion; its annual growth, excluding the exchange rate effect, was 18.2%. In 2021, compared to 2020, the ratio of banking sector loans to GDP decreased to 71.4% at the end of the year. The composition of the loan portfolio (excluding interbank loans) did not change significantly in terms of segments. The volume of deposits increased by GEL 2.6 billion (by 7.6%, or by 11.3% without the effect of the exchange rate) in 2021 and amounted to GEL 37.2 billion by December (61.8% of GDP).

The loan portfolio shows sectoral diversification. At the end of December 2021, the total share of economically vulnerable sectors (real estate development, real estate management, hotels and tourism, restaurants and food outlets, and car dealers) in the portfolio was 18.1%, which was 1.1% less than in December of the previous year. The high volume of reserves created for possible losses in some sectors is mainly due to the additional reserves created as part of the actions taken against COVID-19.

Despite the COVID-19 pandemic, the quality of the loan portfolio of the microfinance sector is better than in 2020: the share of nonperforming loans in the total portfolio decreased from 7.5% to 5.9%, while the share of overdue portfolios decreased from 9.3% to 8%. This was affected by both the reduction of non-performing loans and new disbursements. The total portfolio reserve is within a moderate 6%.

The NBG took substantial supervisory actions in 2021 in an effort to mitigate the negative impact of the COVID-19 pandemic on the financial sector and to stimulate the national economy. Under the supervisory plan, commercial banks had their capital requirements eased by temporarily reducing the capital conservation buffer (by 2.5% of risk-weighted assets) and two thirds of the CICR buffer – part of the Pillar 2 requirements – (1.6% of risk-weighted assets). Over the course of 2021, the exchange rate appreciated and was less volatile than in the previous year, while banks continued to operate in stable currency positions.

The share of foreign currency assets and liabilities in the banking system remains high, and hence the currency risk factor still matters for Georgian banks. The NBG continues work on improving current methods of foreign exchange risk management, including fine-tuning the ways foreign currency asset reserves are reflected in the open currency position. The NBG adheres to its schedule in this direction, and considerable attention is paid to the assessment of structural position risks and commercial banks developing in-house currency risk models.

In terms of profit decomposition in 2021, several important factors affecting the profitability of the banking system are worthy of mention. Net interest margins and non-interest income increased during the year, mainly due to increased lending activity. The growth of operating expenses was less than that of revenues, which led to increased efficiency, and, despite a 15.8% increase in non-interest expenses, the cost-to-income ratio fell from 48.3% to 41.4%. The cost-to-asset ratio is stable at 2.6%. The NBG continues to review the profitability forecasts of banks, to analyze the business models and strategies of individual institutions, and to assess the appropriate mitigation of profitability risk. Significant attention is devoted to the scale effect, market niche or other competitive advantage, and projected credit loss factors. Pricing models for bank products are being developed and their upgrade is being monitored.

The volume of liquid assets remained high in 2021. Liquid assets account for 21% of total assets, enough to cover up to 34% of non-bank deposits. Following the emergence of COVID-19 pandemic-related risks, the NBG immediately implemented significant measures to support lari liquidity, making it possible to attract additional GEL liquidity and significantly reduce underlying risks. Following these measures, sufficient lari resources were accumulated by the end of the first half of the year, and the Liquidity Coverage Ratio (LCR) significantly exceeded the pre-pandemic level. The Net Stable Funding Ratio (NSFR) also remained high. The Liquidity Coverage Ratio (LCR) was stable overall in 2021. Fluctuations between the GEL and foreign currency ratios are caused by transactions related to currency derivatives.

Macroprudential supervision continued in key areas. The NBG maintained a prudent approach to credit risk caused by currency mismatches. There was a requirement for additional capital for foreign currency loans to non-hedged borrowers, while more conservative credit standards were additionally set for individuals. The NBG supported the larization of liabilities by using beneficial requirements for liquidity and minimum reserves in the national currency. In terms of mitigating the risks related to high dollarization with macroprudential instruments, one must keep in mind that there is only a limited ability to use bank liquidity contingency plans, other mitigation measures or NBG foreign currency support instruments. This, along with global trends and regional risks, confirms the need for minimal foreign exchange reserves and high liquidity requirements.

The COVID-19 pandemic has had a far-reaching impact on the world, posing new challenges for the financial sector in terms of operational risk. The role of operational risk is becoming more significant as reliance on electronic information systems is progressively increasing. This process is driven by the digital transformation of financial institutions, the introduction of new financial technologies, and the establishment of more complex operations and sophisticated financial services. The pandemic has accelerated the digital transformation of financial institutions. As a result, cyber risks and challenges related to cybersecurity management are key in terms of operational risk management.

The NBG devotes considerable attention to raising awareness of operational risk, expanding its operational risk management and developing supervisory principles in the financial sector of Georgia.

Due to the pandemic and macroeconomic circumstances, having in place expanded operational risk forecasting tools has gained more relevance. In this regard, stress tests for operational risk are being researched to be able to determine the expected impact of an event on an organization's capital and financial stance in the event of a negative scenario being realized. Therefore, it is of the utmost importance to be able to maintain accurate and complete records of historic data related to potential or actual operational risk losses, to perform a cause-and-effect analysis of operational risk events, and to be able to assess systemic impacts.

According to the Supervisory Strategy of the NBG for 2020-2022, harmonizing supervisory reports with international standards is one of the most important priorities. Implemented with the support of the World Bank, the project involves local and international experts with diverse experiences, who consult with working groups on the project and discuss the best practices implemented by advanced economies.

In 2021, work was completed on updating the reporting forms to be submitted to the NBG in accordance with IFRS 9 requirements, a draft IFRS-9 asset provisioning regulation was developed, and an initial version of an equity-related methodology was developed.

Work also continued on the introduction of FINREP reporting forms, which is one of the most important parts of the IFRS 9 transition project. These forms have been filled out by commercial banks in a test mode since 2018; however, after the full transition to IFRS 9, FINREP reporting forms will be submitted on a monthly basis.

In 2021, an important step was taken to improve the efficiency of communication with auditors. In accordance with the Guidelines for Effective Communication between Audit Firms and the NBG, meetings were held between representatives of the NBG and audit firms to discuss the complex issues raised in audited reports and letters of recommendation. These guidelines will acquire greater significance as we fully transition to the IFRS 9 standard.

The NBG has been working on the implementation of the Commercial Bank Recovery and Resolution Framework since 2021. The so-called planning component is fully operational, acting as a kind of crisis preparation exercise for the better organization and management of processes when needed. The first recovery plans for 2021 were developed by all participants in the banking sector. The plans include the actions to be taken by commercial banks to improve their financial stances and to restore or maintain critical functions in the event of significant financial difficulties or impediments to their critical functions. The banks maintained communication with the regulator as they worked on their recovery plans. Having examined the documents of all banks in accordance with the regulatory procedures and international good practice, the NBG provided the banks with the necessary feedback.

We are witnessing a growing number of innovations and innovative organizations in the financial sector, which brings about both new opportunities and new risks. The financial sector remains the most regulated sector of the economy worldwide, and this regulation shows a growing tendency. The modern-day supervisory framework is vast, technical and complex, especially for new financial startups. With that in mind, encouraging innovators with Fintech ideas and promoting the transformation of these ideas into viable financial models represent significant challenges for financial sector regulators. To address this, the NBG is developing a variety of supervisory tactics and facilitating the establishment of core infrastructure for Fintech operations.

The NBG continued to work on Open Banking issues during 2021. Following the successful implementation of the first phase of Open Banking, the exchange of information between commercial banks through Open Banking became available on 31 March 2021. This involves the exchange of detailed information on account balances and account statements. From 1 December 2021, banks have made the payment API available to individuals. In 2022, it is planned to involve legal entities in the part of initiating payments, and to introduce the process of remote identification and exchange of information on standard products. Non-banking institutions will also be able to use these services as the legislative changes are enacted.

In 2021, the National Bank began collecting Credit Registry data in a test mode. The Credit Registry was established in consultation with the World Bank working group. The Credit Registry is a database that allows the collection of comprehensive information about credit risk. Improving information and the launch of parallel reporting is planned, and we expect to eliminate the gaps related to data accuracy by the end of 2022.

The non-banking sector was well prepared to meet the negative consequences of the COVID-19 pandemic. The experience gained in 2020 proved to be effective in 2021 as well. Despite the underlying risks and challenges, the growth of the sector has not slowed down. While the share of the non-bank financial sector in the total financial sector was 3.3% in 2020, it went up to 3.4% in 2021. We are enjoying increased trust and interest in the non-banking sector, including in terms of increased funding from non-resident institutional lenders. As of 31 December 2021, the non-bank financial sector is represented by 38 microfinance institutions (385 branches), 183 lending entities (345 branches), 561 currency exchange bureaus (732 branches) and one credit union. The total assets of the non-bank financial sector are in the range of GEL 2 billion, of which the largest share, GEL 1.6 billion, belongs to the microfinance sector. The microfinance sector maintains a high level of capital and liquidity buffers.

The NBG was granted permanent IOSCO[6] (International Organization of Securities Commissions) membership status in August 2021. The bank has been an associated IOSCO member from 2018 and applied for permanent membership in the fall of 2019. Obtaining the status of a permanent member of the IOSCO emphasizes the fact that the regulatory framework of the Georgian securities market, taking into account its level of development, is closer to the industry's international standards. Permanent membership of this organization will increase investor confidence and interest in the Georgian securities market, and expand Georgia's ability to integrate into international markets, while also enhancing the reputation of the NBG as a regulator of the market.

The local bond market has grown dramatically in recent years. However, the pandemic and its economic effects have had a mixed effect on the rapid growth dynamics of the securities market. The bond market grew by 8.8%[7] in 2021, amounting to 3.67% of GDP. Some 68% of the bonds issued were GEL-denominated bonds of international financial institutions. The offers of international financial institutions increased significantly, while the corporate bonds segment decreased slightly.

The NBG continued supervising the Pension Agency. In 2021, the initial process of the Strategic Asset Allocation (SAA) was completed, defining the benchmark portfolio for the low-risk investment portfolio and updating the investment policy document. The benchmark portfolio is a long-term strategy for allocating assets of the Investment Board, considering risk appetite, investment objectives and investment horizon. In 2021, the Pension Agency completed the selection process for a Specialized Depository. The Specialized Depository plays an important role in the proper functioning of the pension scheme. Its work is regulated by the NBG and it is a legal entity with a fiduciary duty. The appointment of a Specialized Depository has allowed the Pension Agency to start investing in local and international securities.

As of 31 December 2021, the size of the pension fund amounted to GEL 1.98 billion, fully denominated in GEL.

6. The IOSCO is an international organization that facilitates regulation and mutual cooperation in securities markets and brings together securities regulators from over 130 countries.
7. These data do not include non-government securities and securities of deposits on the dual listing of the Georgian Stock Exchange.

Some 67.3% of pension assets were held in certificates of deposit and term deposits, while 32.7% were used in interest-bearing current accounts. Total net income generated in 2021 was GEL 161 million, equivalent to approximately 9.5% of annual returns.

Consumer protection and financial education remain priority issues for the NBG. As in previous years, the NBG took a number of important actions in this area in 2021. These included the upgrade of the current legal framework and the introduction of international best practices in the sector, which involved consultations and workshops with the sector. A Code of Ethics related to loan collections by financial institutions was developed and amendments were made to the regulation on the protection of consumer rights as financial institutions provide their services. The code allows financial institutions to conduct business relationships based on the principles of good faith, transparency and fairness. Changes in the regulation will ensure greater transparency in banking products and services, including demand deposits and overdrafts, and, consequently, better-informed consumer decisions. The NBG has monitored compliance with the requirements on an ongoing basis.

Training for practicing judges was conducted. In addition, the FinEdu financial education portal operated successfully, and various webinars, online meetings and competitions were held for different target groups. Traditional, annual awareness-raising events were also celebrated during the year.

The fight against money laundering and terrorism financing is another of the NBG's areas of work. In accordance with the levels of supervisory attention set out in the NBG Supervisory Framework for Combating Money Laundering and Terrorism Financing, risk-appropriate effective supervisory actions for supervised entities were established in 2021. Determining the appropriate levels of supervisory attention was backed by the ongoing process of off-site identification and assessment of risks. The reports of lending entities were reviewed for the first time in 2021. The supervisory actions implemented during 2021 included complex, thematic, special and control on-site inspections.

The NBG attaches special importance to the implementation of preventive supervisory actions, which ensure that the financial sector is well informed about supervisory expectations and that their level of compliance is adequate. For this purpose, guidelines were developed in 2021, and online training seminars were conducted to introduce them and put them into practice.

The smooth and efficient functioning of payment systems is an essential factor for the stability of the financial sector and the development of the national economy. The number and amount of transactions made through payment systems continues to grow both worldwide and in Georgia. Consequently, their safe, sustainable and efficient operation has become critical to the stability of the financial system and to meeting the demands of households and businesses for electronic payments. The changes prompted by the pandemic have clearly highlighted the importance of the digitalization of services for both consumers and the country's economy in general. To prevent potential malfunctions of payment systems, it is required that their design and operation be based on internationally recognized and widely accepted standards.

The statistical work of the National Bank continued to be successful in 2021, despite the global delays caused by the pandemic. Several projects tailored to users' interests were successfully implemented. We also managed to build a technical base for the implementation of further plans.

Despite the negative impact of the pandemic on the national economy, we continued working to ensure the uninterrupted supply of lari banknotes and coins. We also took care of improving the quality of the banknotes and coins in circulation, processing the currency units and those received from circulation in the prescribed manner, upgrading the work of experts and improving the legislative framework.

The NBG also continued to issue collector coins during the reporting period, with the purpose of promoting the national currency and the country. The coins issued during the reporting period were highly appreciated by the public, as evidenced by the results of their sale.
In 2021, we continued developing and improving our legislative framework. The draft law of Georgia on the Ownership of Dematerialized Securities (and entailing amendments) was developed by the NBG in co-operation with the Georgian Ministry of Economy and Sustainable Development. The package of legislative changes was initiated in the Parliament of Georgia and its committee discussions began. In addition, important legal acts were published on the basis of the Law of Georgia on Competition.

In 2021, important draft legal acts came into force in many different areas, including the following issues:

- Regulation of competition in the financial sector
- Protection of consumer rights
- Banking supervision
- Lending to individuals
- Non-banking supervision
- Setting up and use of a credit register
- Securities market supervision and investment funds
- Legislation regulating the prevention of money laundering and the financing of terrorism
- Regulations on imposing fines
- Regulations on deeming information confidential and relating to its disclosure.

In 2021, while still dealing with the negative consequences of the pandemic, the effective response of the NBG's macroeconomic policies was reflected in the maintenance of Georgia's credit ratings by international rating agencies. In February, the international rating agency Standard & Poor's (S&P) confirmed Georgia's sovereign rating at "BB" with a negative outlook. In August, Fitch Ratings upgraded Georgia's outlook from negative to stable while maintaining its sovereign rating at BB. While in September, the international rating agency Moody's confirmed Georgia's rating at Ba2, with a stable outlook. The basis for these ratings was the structural reforms implemented within the framework of the International Monetary Fund's four-year extended facility and the promotion of the economy's resilience to shocks.

As in previous years, the work accomplished by the NBG in 2021 gained recognition from a number of reputable international organizations, including the International Monetary Fund, the World Bank, the European Investment Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, and ratings agencies. Global Finance, a reputable international publication, named the Governor of the NBG, for the fourth successive year, among the best governors of central banks.

As the IMF noted in a press release, "The NBG continues to be appropriately focused on bringing inflation to target and we expect significant progress this year and next as global factors that are contributing to the surge in prices subside. The inflation-targeting framework combined with the flexible exchange rate regime has served Georgia well. The authorities are committed to exchange rate flexibility, which acts as a shock absorber, and interventions will be limited to smoothing excessive volatility and preventing disorderly market conditions."

8. For more information, see https://www.imf.org/en/News/Articles/2022/04/01/pr22101georgia-and-imf-conclude-staff-level-agreement-on-a-three-year-us-289-million-sba

01

MACROECONOMIC ENVIRONMENT

1.1 GLOBAL ECONOMY

Amid Russia's invasion of Ukraine in February 2022 and the tense geopolitical situation surrounding the resulting conflict, global macroeconomic challenges increased on international commodity markets, especially in a supply-side direction, which will trigger price hikes.

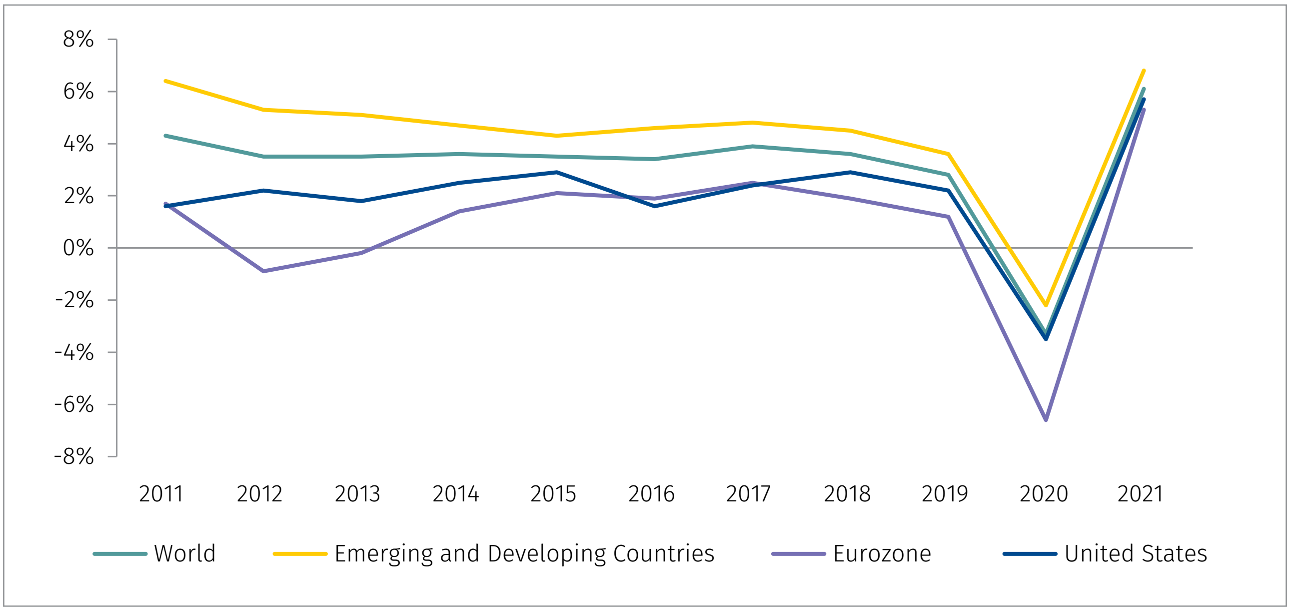
Following the deep economic crisis of 2020 resulting from the COVID-19 pandemic, global economic activity recovered considerably in 2021. This was facilitated by a gradual easing of pandemic-related restrictions and large-scale vaccination programs around the world. At the same time, countries enacted unprecedentedly high fiscal and monetary stimulus. However, the emergence of a new variants of COVID-19 (Delta and then Omicron) posed additional risks, causing a number of countries to continue to tighten restrictions, which in turn significantly hampered economic activity. In total, according to the April 2022 forecast of the International Monetary Fund (IMF)[9], global economic growth was 6.1% in 2021. Since the beginning of 2021, consumer prices were sharply increasing in developed as well as in emerging and developing countries. This was mostly due to the supply-side disruptions during the pandemic, as well as to the upward dynamics of commodity prices on international markets. Compared to 2020, the global food price index (FAO)[10] increased by around 28% in 2021, while the international oil prices almost doubled.

Economic activity improved in the eurozone and the UK amid the gradual easing of pandemic-related restrictions. Consumer and business confidence increased, while activity in the manufacturing and industrial sectors partially recovered. The volume of investments and the tourism sector started to recover in the second half of the year as vaccination rates picked up. However, inflationary pressures also emerged. Amid the pandemic, the European Central Bank (ECB) extended its broader quantitative easing program until March 2022. Economic activity also recovered in emerging and developing economies, albeit at a slower pace than in developed countries. This was related to lower vaccination rates in such countries and fairly high infection rates. However, both consumer and business sentiment improved in such countries amid an easing of restrictions. Along with the increase of production, sales improved. Amid a rise of oil prices, the volume of exports and investments increased in oil-exporting countries. The tourism sector also improved since the second half of the year. However, the high inflationary environment forced central banks to begin monetary policy tightening.

Together with the easing of pandemic-related restrictions, growth rates in the United States improved significantly in the first half of 2021. In particular, external demand recovered and, along with a declining unemployment rate, consumer spending and consumer sentiment increased. Business sentiment also improved. Following a mass vaccination campaign, as well as a strong fiscal and monetary stimulus, the improvements in economic activity continued into the second half of the year, although the emergence of new variants of COVID-19 became a significant challenge. According to the IMF's April estimates, real economic growth in the US was 5.7% in 2021, while annual inflation averaged 4.7%. Although the annual inflation rate increased considerably in 2021, the Federal Reserve kept the federal funds rate at a lower range (of 0-0.25%).

9. International Monetary Fund. 2022. World Economic Outlook: War Sets Back the Global Recovery. Washington, D.C., April.
10. UN Food and Agriculture Organization

DIAGRAM N 1.1 REAL GDP GROWTH IN THE WORLD



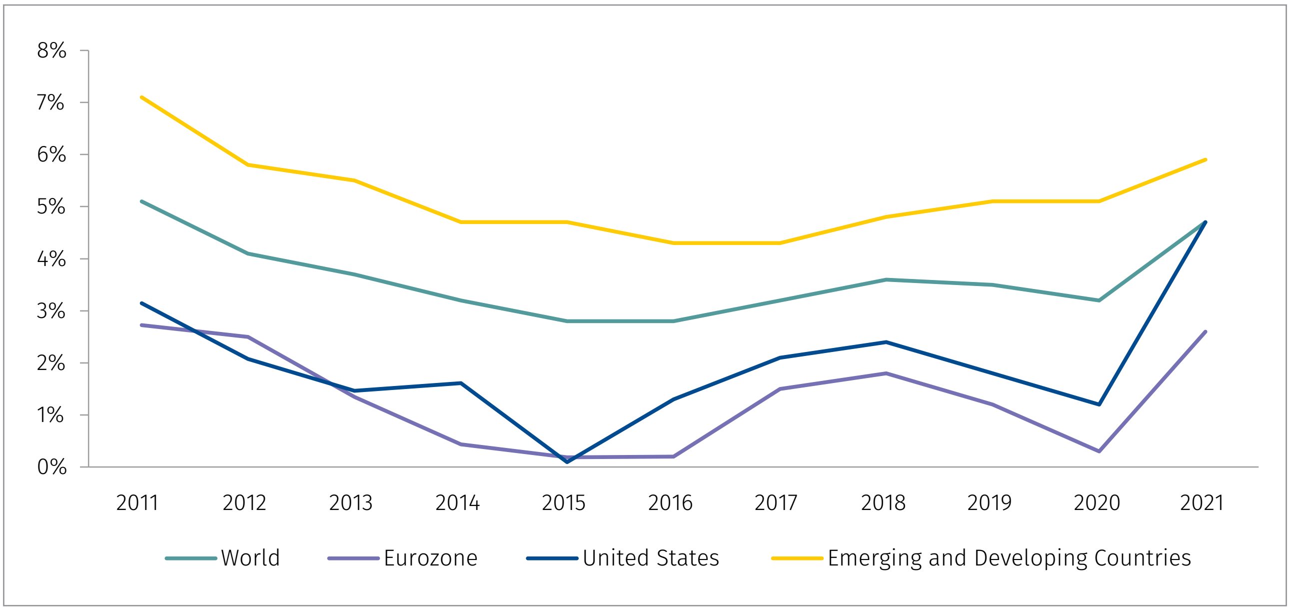
Source: IMF

The easing of pandemic-related restrictions, as well as a high fiscal and monetary stimulus, helped Georgia's trading partner countries boost their economic activity amid improvements in consumer and business sentiment. The manufacturing and industrial sectors recovered and tourism and investment partially improved. Growth in developed countries accelerated in 2021 in parallel with mass vaccination efforts, which was also supported by the baseline effect. The production process in Germany picked up and retail sales increased. Consumer and business sentiment improved with the increase in exports and investments. According to the IMF, real economic growth in Germany was 2.8% in 2021. After a severe crisis, economic activity also improved in Italy, where the vaccination process was proceeding at a high pace. As a result, Italy's real economy grew by 6.6% in 2021. Economic activity also picked up in France, where both consumer and business sentiment were amplified. According to the IMF, the real economic growth in France was 7% in 2021. A recovery of economic activity was also observed in Spain, amid a high rate of vaccination and a strong fiscal stimulus. Spain's real economic growth was 5.1% in 2021. Notably, inflation expectations increased in 2021, as did the annual inflation rate. The annual inflation of the eurozone in 2021 averaged 2.6% (note that the same indicator was 1.2% in 2019 and 0.3% in 2020).

In the first half of 2021, economic activity recovered significantly in Turkey, where the business climate and manufacturing sector improved, and exports increased. Amid higher credit growth, consumer spending also increased. The tourism sector, as well as investments, recovered slightly. However, at the end of 2021, the growth rate of economic activity slowed down, which was mostly due to the depreciation of the Turkish lira – a development that caused even higher inflationary pressures. According to the IMF's April forecast, real economic growth in Turkey was 11% in 2021 and inflation averaged 19.6%.

Economic activity in Russia improved significantly in the first half of 2021, mainly due to the easing of the COVID-19 pandemic restrictions and global vaccination, which in turn increased consumer spending and retail sales, and improved consumer and business sentiment. With the rise in oil prices, the foreign sector was also improving. However, the annual inflation rate increased significantly in the second half of the year. The Central Bank of Russia tightened monetary policy several times in response to increased expectations. According to the IMF, the real economy in Russia grew by 4.7 percent in 2021, while the average inflation rate was 6.7 percent.

DIAGRAM N 1.2. CPI INFLATION IN THE WORLD



Source: IMF

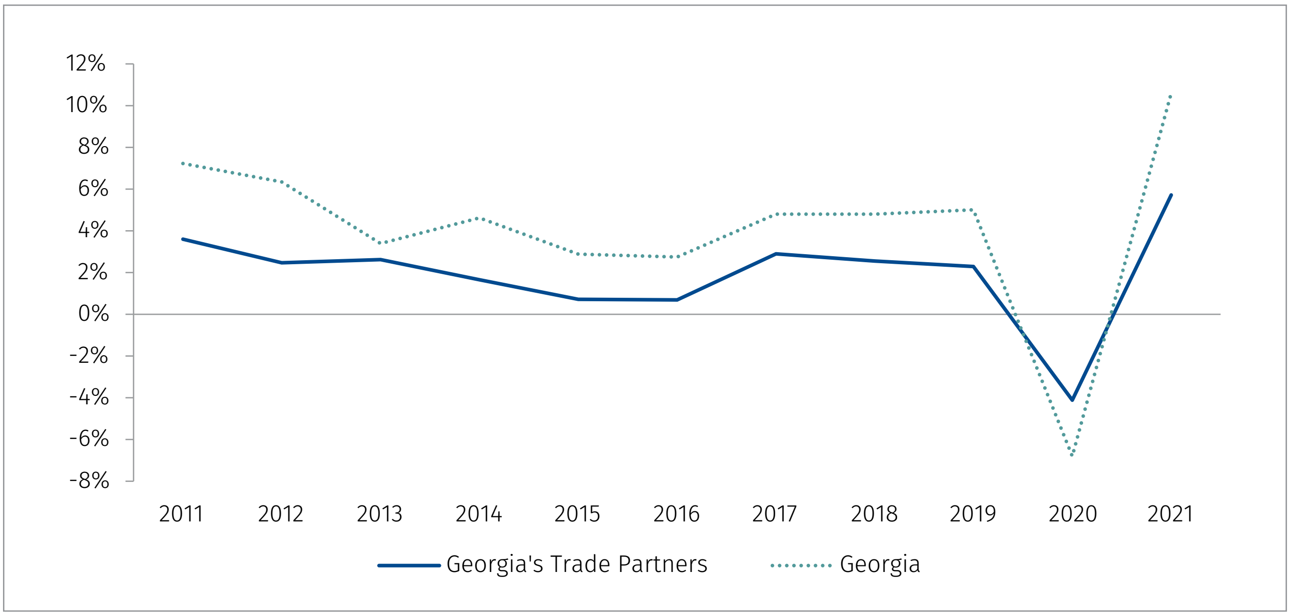
Ukraine also showed high economic activity, where industrial sector performance improved along with consumer and business sentiment. Following the easing of pandemic-related restrictions, consumer spending and retail sales went up, while the global trade balance stabilized slightly amid improving activity. However, inflation expectations increased during the year, and so the inflationary pressure intensified. According to the IMF, Ukraine's real economy grew by 3.4 percent in 2021, while the inflation rate averaged at 9.4 percent.

In 2021, growth rates stabilized in Armenia as well, driven by easing pandemic-related restrictions. As a result, the manufacturing sector and consumer spending increased. In the second half of the year, consumer and business sentiments increased and so did remittances. However, by 2021, average annual inflation went up to 7.2 percent (2020: 1.2 percent), quite a high figure for the country. Against this backdrop, the Central Bank of Armenia has tightened the monetary policy rate several times. The IMF estimated Armenia's real GDP to grow by 5.7 percent in 2021.

The growth rates of Azerbaijan oil as well as non-oil sector improved in 2021, largely due to the growing dynamics of oil prices in the international market and the improvement of the industrial and manufacturing sector. Oil production and refining increased during the year, helping the foreign sector to stabilize. However, the inflation rate also went up. According to the IMF, Azerbaijan's real GDP grew by 5.6 percent in 2021, while annual inflation averaged 6.7 percent.

The economies of Georgia's trading partner countries grew by 5.7 percent in 2021, while in 2020, they shrank by an average of 4.1 percent. As for Georgia, real GDP increased by 10.6 percent in 2021, according to preliminary data, after the 6.8 percent decrease in 2020 (see Diagram 1.3). Inflation in 2021 averaged 9.6 percent.

DIAGRAM N 1.3 REAL GDP GROWTH IN GEORGIA AND WEIGHTED AVERAGE GROWTH OF TRADING PARTNER COUNTRIES



Source: IMF

The central banks of Georgia's trading partner countries increased their monetary policy rates several times in 2021 in response to higher inflationary pressures and rising inflation expectations. Turkey was an exception to this trend, where the monetary policy rate decreased in the second half of the year, despite the high inflation. The US Federal Reserve kept the federal funds rate at 0-0.25% in 2021. However, the market started to expect an earlier rise of US interest rates than had been previously anticipated. The European Central Bank kept interest rates unchanged at 0%, although it extended its broader quantitative easing program into 2022 to mitigate the negative effects of the pandemic.

1.2 EXTERNAL SECTOR AND BALANCE OF PAYMENTS

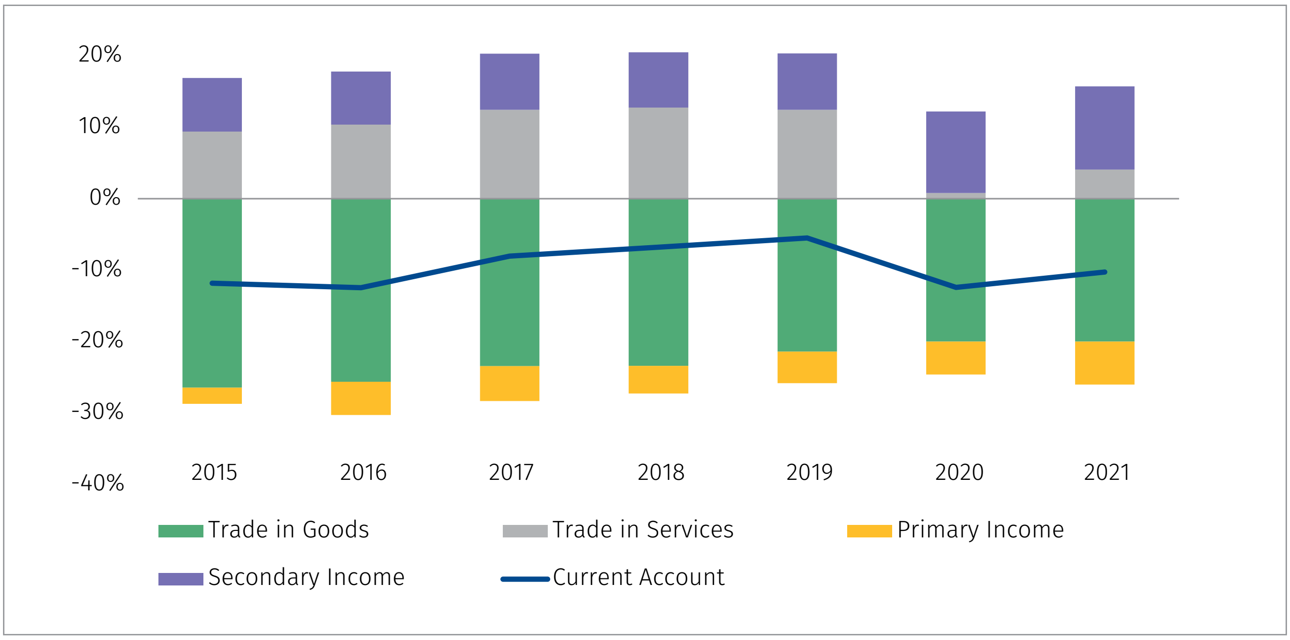
In 2021, the adverse impact of the pandemic on the Georgian economy still prevailed; however, foreign demand increased and made a positive contribution to economic growth.

The beginning of international vaccination programs to defeat COVID-19 partially reduced economic uncertainty, although manufacturing processes have not yet returned to pre-pandemic levels. Along with the economic recovery process, inflation in many countries has reached record highs, largely due to the pressure coming from commodity markets. As most of the restrictions on international mobility were lifted, tourism was partially restored. The number of international travelers to Georgia picked up a little, having a positive impact on tourism revenues and related business activity. The country started to recover economically, as aggregate demand was boosted and business expectations improved. External demand for goods gradually increased, although exports of services, especially tourism, remained low. Stimulated domestic demand increased imports of goods. The growing dynamics of money transfers also continued in 2021. As a result of these factors, the current account deficit improved slightly in 2021 (see Diagram N 1.4).

The current account deficit for 2021 is 9.8% of GDP, 2.6 percentage points lower than the previous year. In absolute terms, the current account deficit improved by USD 131 million to USD 1,834 million (see Table N 1.1). The trade deficit in goods in 2021 relative to GDP remained at almost the same level (20.1% of GDP). With the gradual recovery of revenues from international travelers (129.8% annual growth, although still

representing a decrease of 61.9% compared to 2019), the trade surplus in services increased and the current account deficit thus improved. In 2021, the current account balance was negatively affected by the primary income deficit, which was mainly due to the outflow of investment income. Moreover, the volume of both dividends and reinvested earnings was high, as in previous years, which increases the current account deficit.

DIAGRAM N 1.4 CURRENT ACCOUNT COMPONENTS TO GDP



Source: NBG

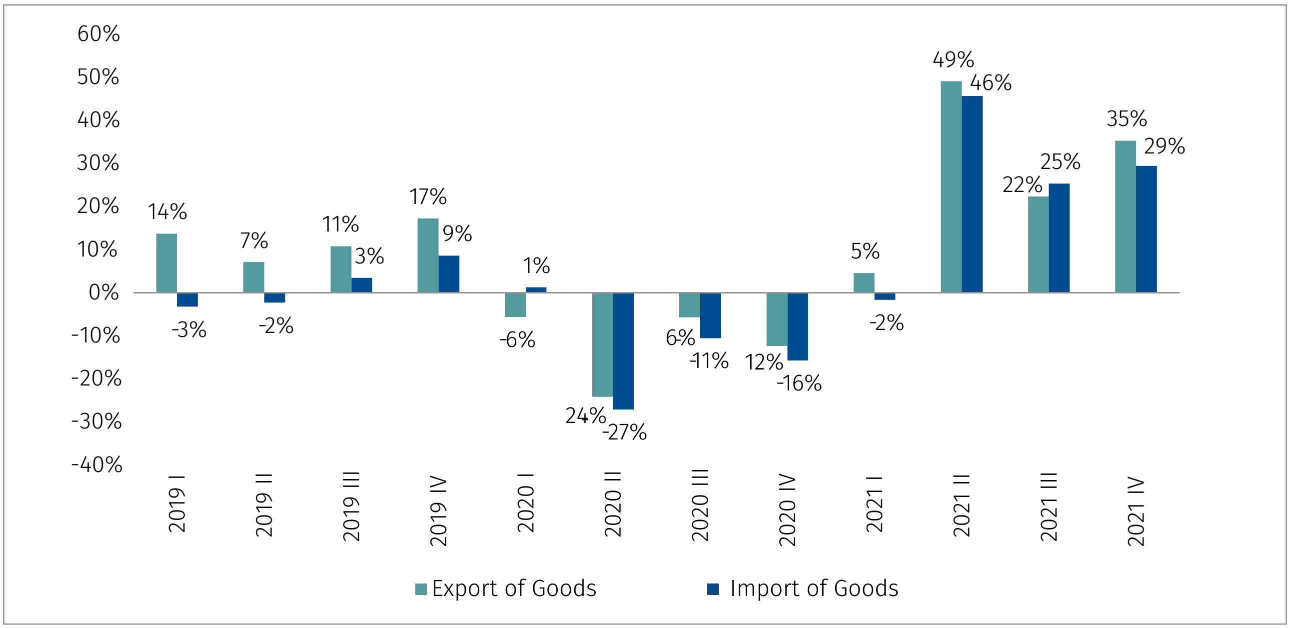
Trade in goods is still the most negative component of the current account. The volume of the trade deficit in goods increased in 2021, but remained the same in relation to GDP. Exports of goods increased significantly over the year. That increase, both in the region and around the world, in the first half of the year, was due to the beginning of vaccination campaigns against COVID-19 and the easing of restrictions on economic activity. Export growth continued to accelerate in the second half of the year, mostly due to the lifting of restrictions and faster-than-expected economic recovery. Overall exports of goods increased by 27.4% annually.

Imports of goods gradually increased from the second quarter of 2021 due to the recovery of production processes and increased domestic demand, recording annual growth of 23.8% overall. As a result, the nominal volume of the trade deficit increased and contributed more to the widening of the current account deficit than in the previous year (see Diagram N 1.5).

Exports of goods from Georgia increased to almost all trade partner countries. In 2021, exports to both regional and other countries were higher. The increase in exports to regional countries was mainly due to the increase in exports to Russia (up by 38.3%), Turkey (by 69.1%) and Azerbaijan (by 20.5%). Italy (up by 68.4%) and Romania (by 64.1%) were at the top of exports to EU countries, while those to Bulgaria saw a significant decline (-18.8%). In terms of other countries, exports to China (up by 29.0%) and the United States (143.2%) were also higher.

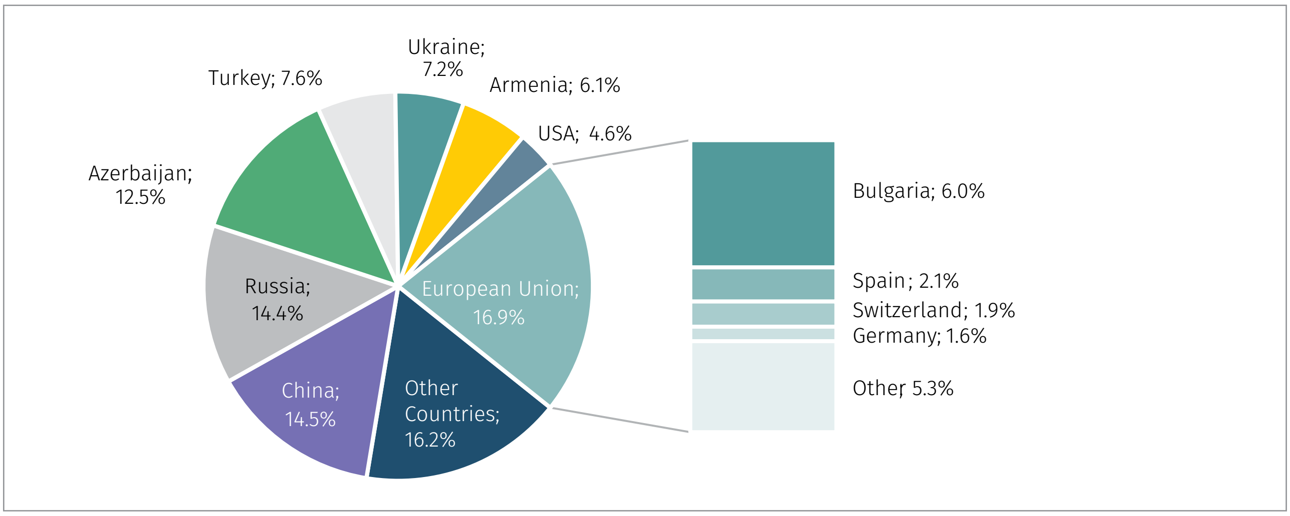
According to 2021 data, Georgia's largest export partner is the EU, which accounts for 16.9% of total exports. Other notable countries include Russia (14.4%), Azerbaijan (12.5%), Turkey (7.6%) and Ukraine (7.2%). In addition, exports to China accounted for 14.5% of total exports, which showed an annual growth of 29%. The majority of these exports (88%) are still related to the re-export of precious metals as well as copper ores and concentrates.

DIAGRAM N 1.5 ANNUAL CHANGE IN COMMODITY EXPORTS AND IMPORTS (2019-2021)[11]



Source: NBG

DIAGRAM N 1.6 EXPORTS STRUCTURE BY COUNTRY, 2021

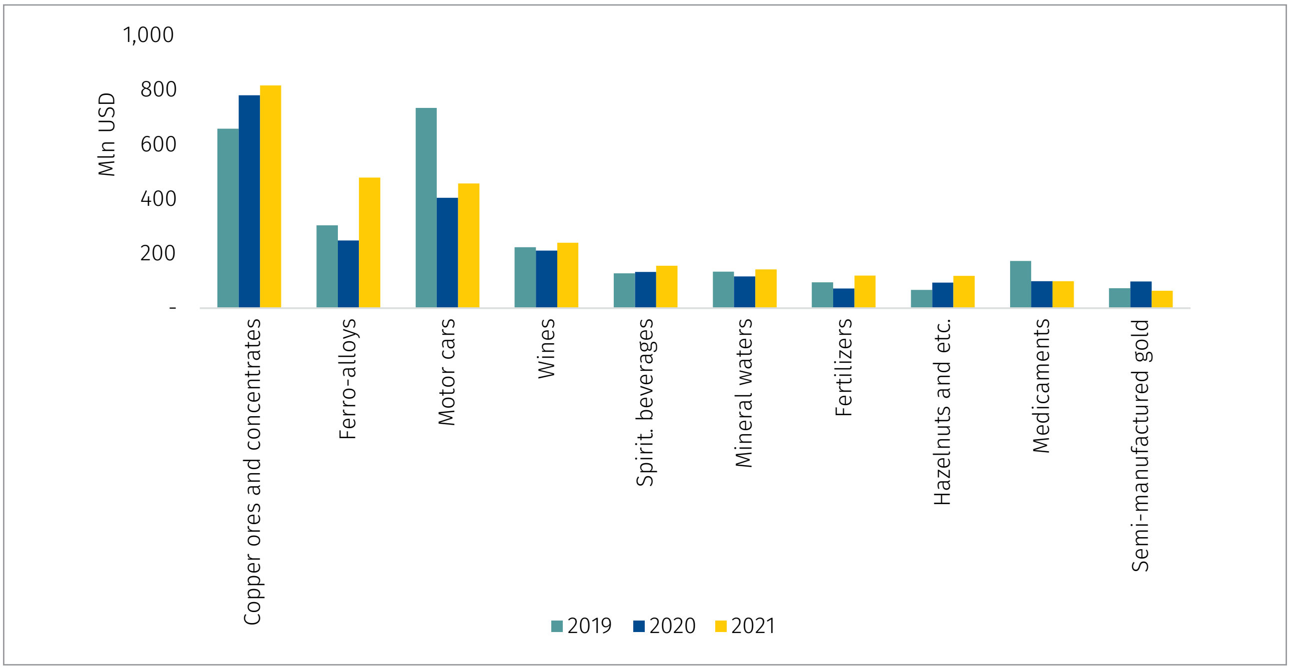


Source: GeoStat

11. Exports of goods in the balance of payments (BOP). The external trade data, as provided by GeoStat, and the data on exports/imports by the BOP are different concepts that rely on different methodological frameworks. Foreign trade statistics are based on the principle of crossing a border, whereas the main principle of trade of goods in the BOP is a change of ownership between residents and non-residents. Moreover, in external trade statistics, exports are presented in FOB price, while imports are presented in CIF price. In contrast, export/import of goods are presented in FOB prices in the BOP.

Re-exports of copper ores and concentrates accounted for a significant share of commodity exports in 2021. These were up by 4.7% from a year earlier and accounted for 19.2% of total exports. Exports of motor cars also had a high share, growing by 13.0% annually, although such exports were still low compared to pre-pandemic levels. Exports of ferroalloys, natural grape wines, alcoholic beverages and mineral waters maintained their leading positions in the group of locally produced goods, with volumes increasing by 93.0%, 13.8%, 17.7% and 21.6% respectively. Exports of chemical fertilizers, walnuts and medicaments also increased considerably. In contrast, exports of semi-manufactured gold fell slightly. Overall, exports of goods increased by 26.9% in 2021, while the increase without including re-export categories was 29.9%. Despite such an impressive increase in exports of goods, real exports decreased slightly compared to 2019, while exports became more diversified.

DIAGRAM N 1.7 TOP 10 EXPORT COMMODITIES, 2019-2021



Source: GeoStat

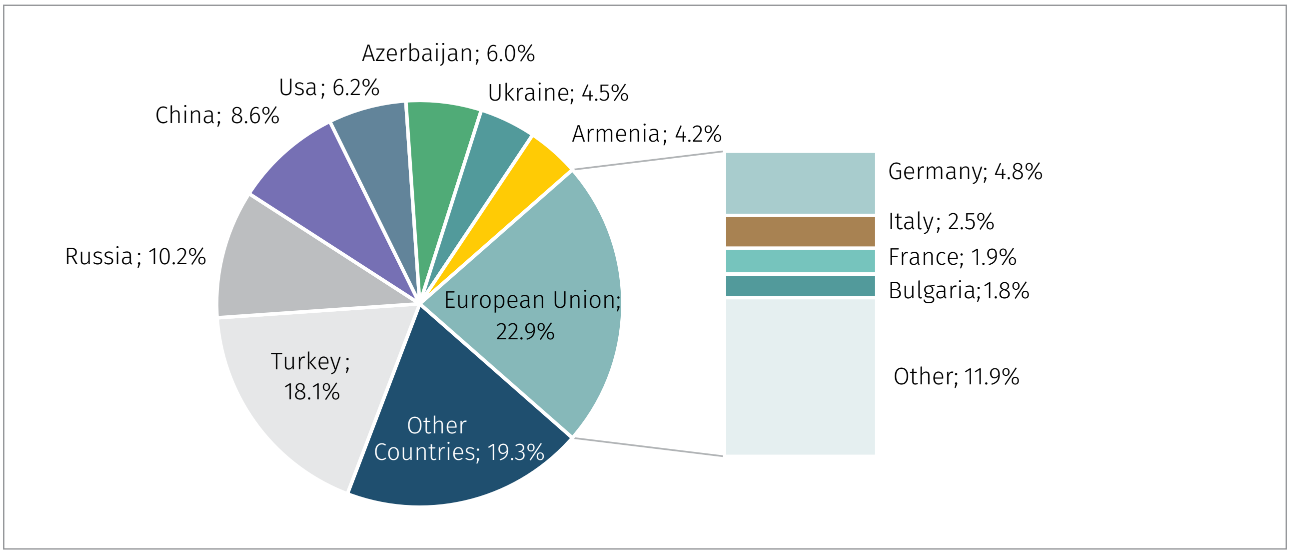
In 2021, consumer goods made the largest contribution to the growth of imports of goods. That was due to strong domestic demand and the reactivation of re-exports, particularly those of motor cars, which increased significantly. Imports of petroleum and petroleum products (8.2% of total imports), which is one of the largest categories of imported consumer goods, increased significantly. This was greatly affected by the rise in international petroleum prices during the year. Spending on imports of petroleum and petroleum products increased by 65.0% in 2021, of which the price effect accounted for 58.2 percentage points, while real consumption increased by 6.7%. The increase in imports of intermediate goods was largely due to the increased imports of copper ores and concentrates, as well as immune serums and petroleum gas. Motor cars, copper ores and concentrates and medicaments, as the leading re-export commodity groups, contributed significantly to the increase in total imports of goods (4.0 pp) as compared to the previous year. In terms of investment goods, data processing machines and their units, as well as large construction machinery and special-purpose vehicles all made high contributions to the growth of imports.

The high growth of imports of goods in 2021 was also facilitated by an increase in the prices of imported goods in US dollars. In nominal terms, imports of goods also increased compared to 2019 (by 11.7%), although real imports are still lagging behind the pre-pandemic period. Imports by commodities also showed greater diversity in 2021.

A regional analysis of imports shows that in 2021 imports increased from both the EU (by 24.7%) and other countries (by 25.2%). The increase in imports of registered goods amounted to 25.1% annually. Turkey (5.2 pp), China (1.9 pp) and Russia (1.7 pp) each made high contributions to that growth. Increased imports from Germany (1.0 pp) and Bulgaria (0.8 pp) made a large contribution to the growth of total imports from EU countries. Meanwhile, a substantial growth in imports from Turkmenistan was driven by purchases of petroleum and petroleum products.

Turkey remained the leader among importing countries after the European Union, as in previous years. Imports from Turkey in 2021 increased by 29.6% annually. Imports from Russia increased by 15.8% and accounted for 10.2% of total imports. Those from China also increased, mainly due to an increase in purchases of construction machinery and immune serums, and increased imports of motor cars were observed from the US (see Diagram N 1.8)

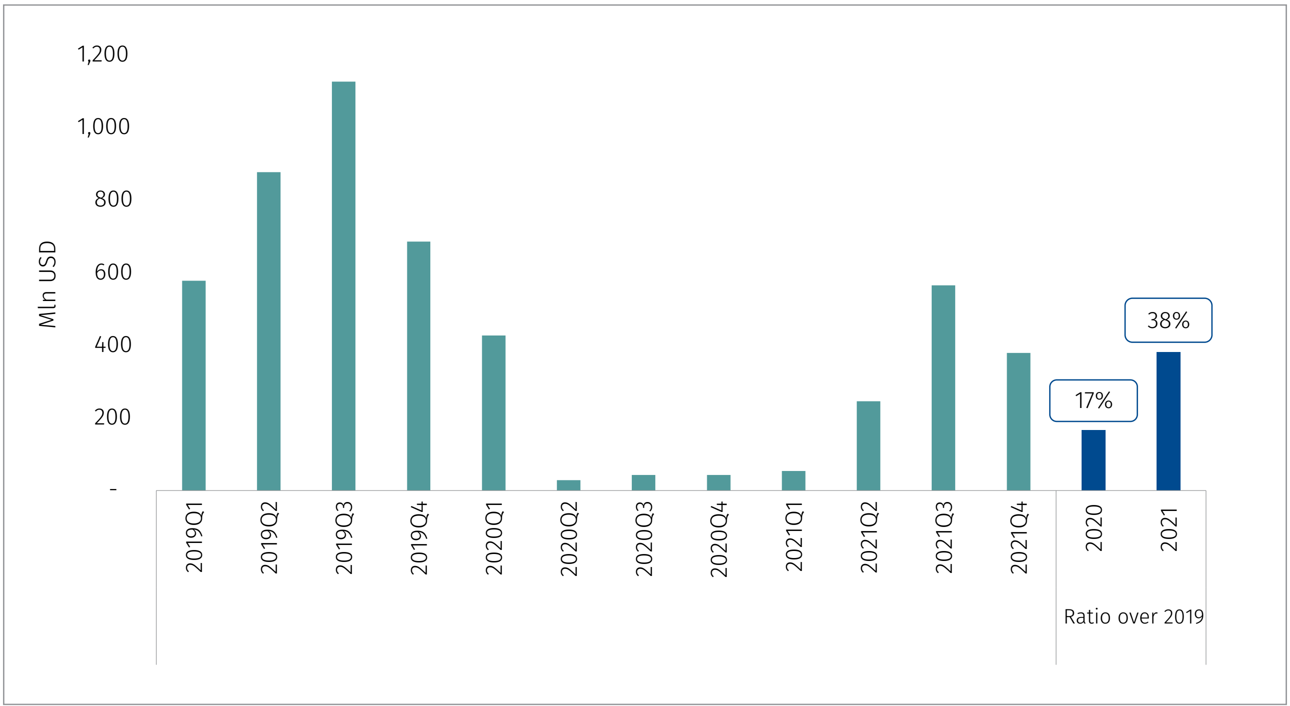
DIAGRAM N 1.8 IMPORT STRUCTURE BY COUNTRY, 2021



Source: GeoStat

The balance of trade in services had a positive impact on the current account in 2021: the ratio of service trade surplus to GDP was 3.9%, 3.1 GDP percentage points higher than the previous year. In absolute terms, the positive balance of trade in services in 2021, compared to the previous year, increased by USD 600 million and amounted to USD 724 million. The start of COVID-19 vaccinations and the gradual easing of global restrictions (including the renewal of international air and land mobility) had a positive effect on the export of services, especially tourism and related businesses. As a result, revenues from international travelers, which account for the majority of services exports, stood at USD 1,245 million in 2021, up by 129.8% from the previous year (see Diagram N 1.9). However, revenues were still lower (by 61.9%) compared to 2019. It should be noted that prior to the pandemic the income received from international travelers was one of the most important sources of financing the trade deficit.

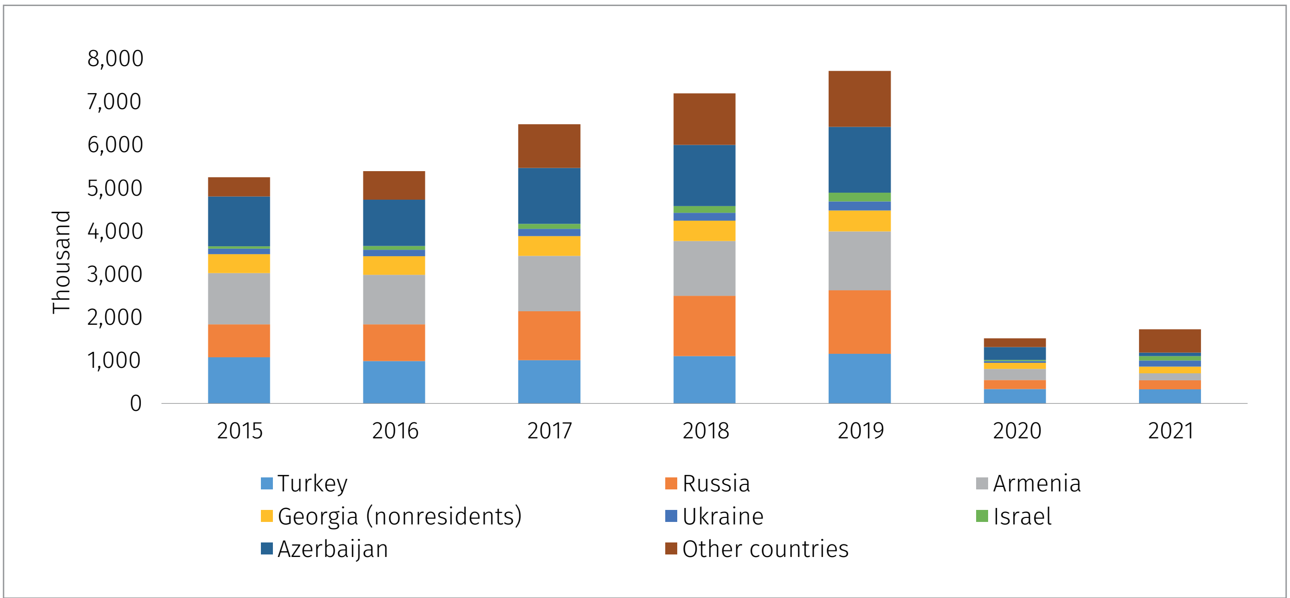
DIAGRAM N 1.9 REVENUES FROM TOURISM EXPORTS (2019-2021)



Source: GeoStat

In light of the resurgence of international mobility and the relative revival of tourism in 2021, the number of international visitors increased by 13.7% YoY; although that number remains small compared to pre-pandemic levels (down by -77.7%). The increase was largely due to a growth in visitors from Ukraine (241.6%), Israel (291.3%), Saudi Arabia (1,179.0%) and Kazakhstan (384.7%). There was also notable growth in the number of visits made by Georgian residents abroad.

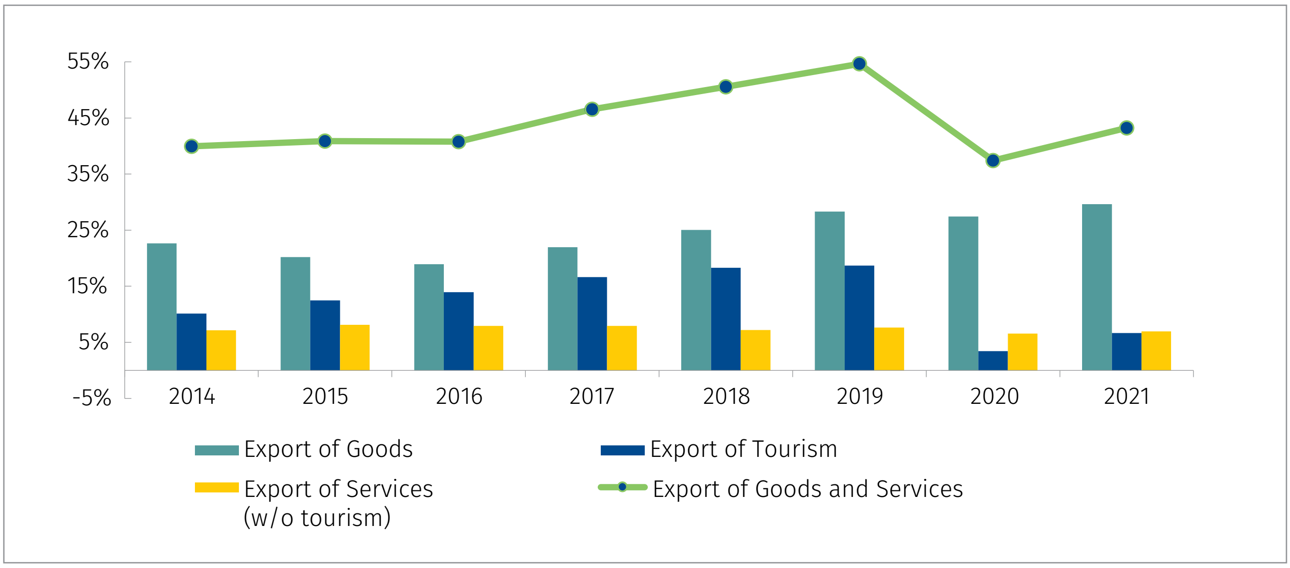
DIAGRAM N 1.10 NUMBER OF INTERNATIONAL VISITORS BY COUNTRY



Source: NBG

Unlike in pre-pandemic years, revenues from tourism were substantially lower in 2021 than those from exports of goods (see Diagram N 1.11), which in turn induced a high current account deficit.

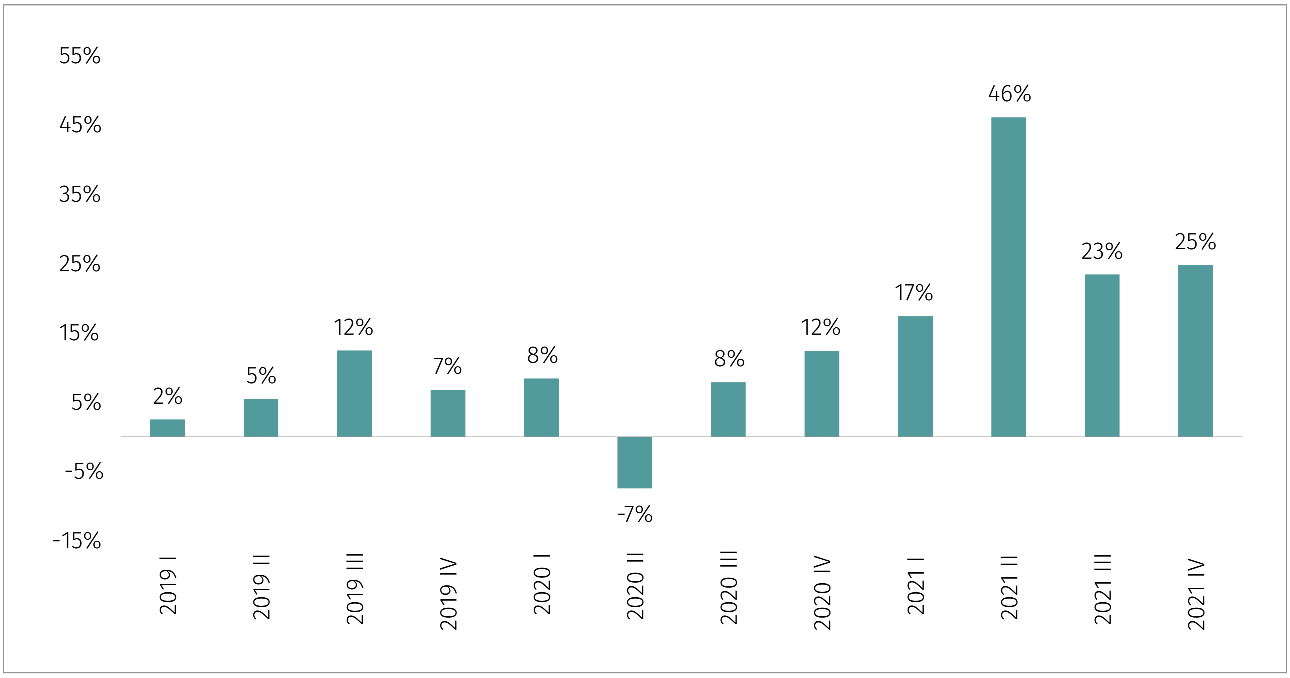
DIAGRAM N 1.11 REVENUES FROM EXPORTS OF GOODS AND SERVICES TO GDP



Source: NBG

The deficit in the primary income account increased by USD 368 million in 2021 compared to the previous year and amounted to USD 1,103 million. The main reason for this high deficit is still the negative balance of investment income, which increased by USD 387 million in 2021 and amounted to USD 1.6 billion. The high deficit in investment income is due to the increase in the income account (both dividends paid and reinvestments) in the part of direct and other foreign investments. Although the latter negatively affects the current account balance, as it is recorded in the foreign direct investment inflows of the financial accounts, it has no impact on the outflow of capital from the country. As for the balance of compensation of employees, in 2021 this component was only reduced by USD 3 million to USD 486 million. Such low levels of compensation of employees are, to some extent, due to the still-not-fully-scaled functional economies in the region and other negative consequences resulting from the pandemic.

DIAGRAM N 1.12 ANNUAL GROWTH RATE OF PERSONAL REMITTANCES

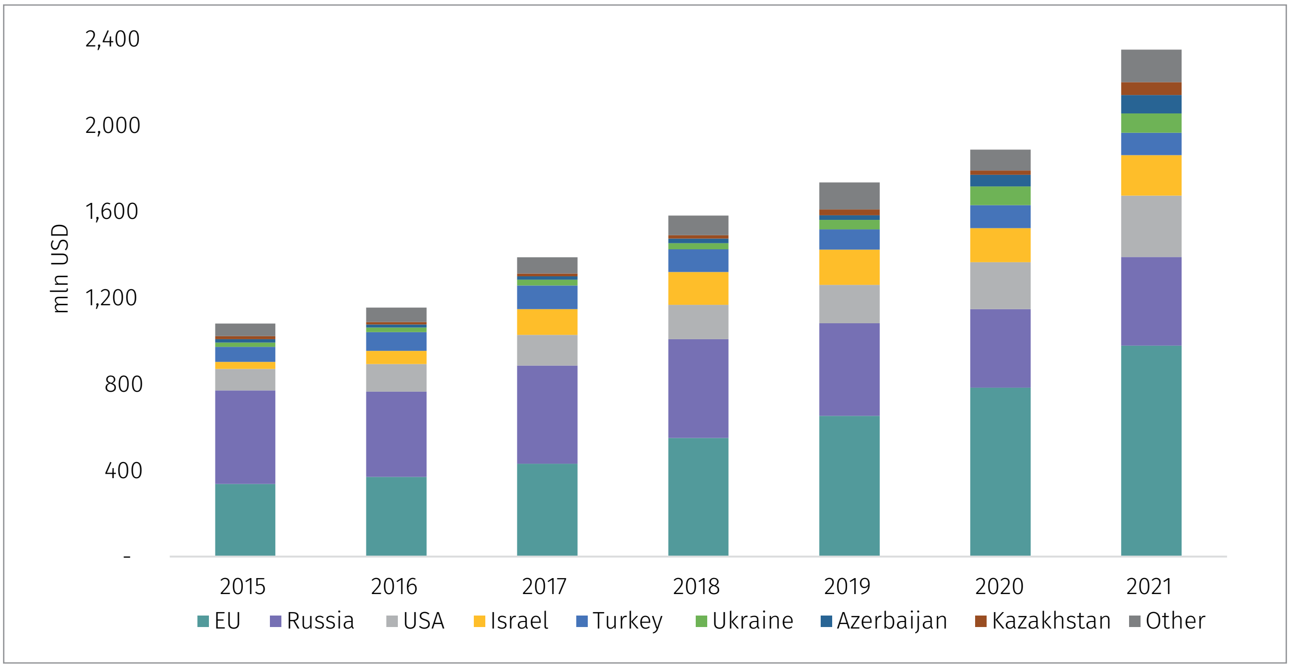


Source: NBG

In 2021, secondary income[12] increased significantly (by 20.2%) at the expense of increased remittances from workers from abroad. Personal remittances, which are usually the largest part of secondary income, increased by 24.8% annually (see Diagram N 1.12). Significantly, instant money transfers have been steadily increasing throughout the year, partly due to a switch to digital channels. Increased remittances from Italy, the US, Russia and Germany all made a significant contribution to the increase in remittances during 2021 (see Diagram N 1.13). As Russia's share in remittances has been declining in recent years, funds received from the European Union have taken the lead in total remittances. The volume of fast remittances received from Turkey has been gradually declining since May and contributed negatively to the growth of annual money transfers.

12. Secondary income is a current account item that records current transfers between residents and non-residents (except capital transfers), such as personal transfers, international cooperation aid and grants, social assistance, etc.

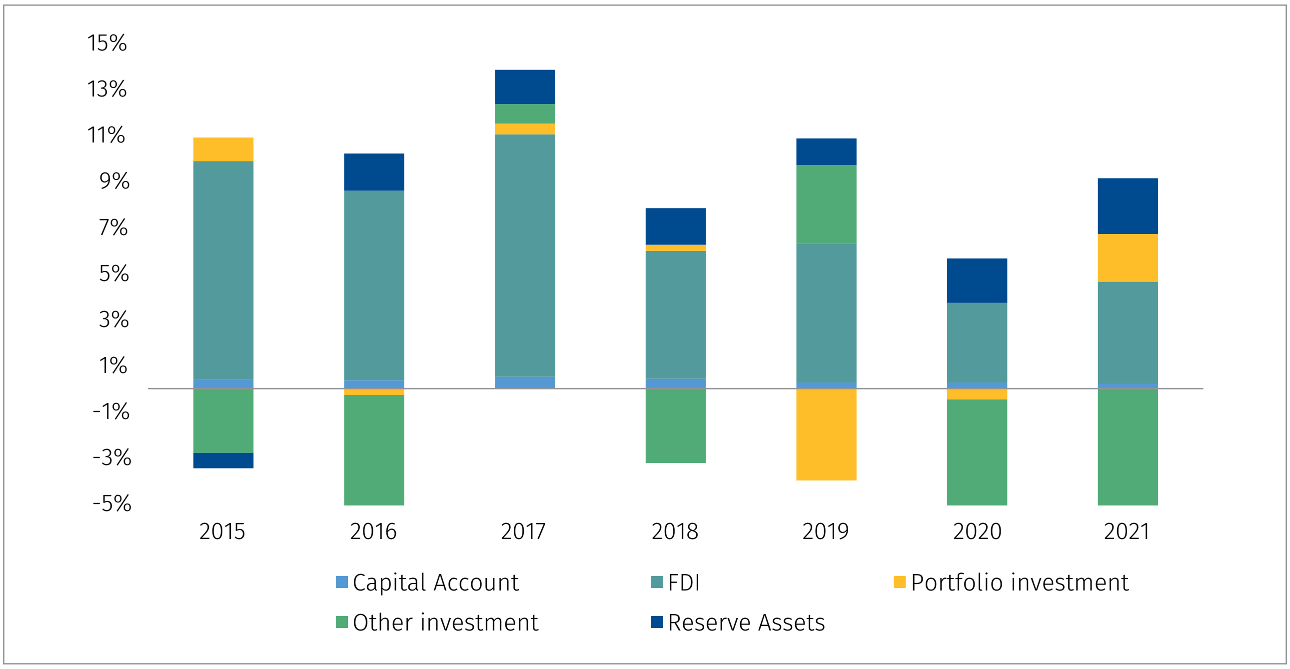
DIAGRAM N 1.13 REMITTANCES BY COUNTRY



Source: NBG

In 2021, as in previous years, net foreign direct investment was an important source of financing the current account deficit (see Diagram N 1.14). Foreign direct investment in Georgia amounted to USD 1.15 billion, which was 101.6% more than in 2020, while the volume of net foreign investment increased by USD 128 million (by 23.3%). The increase in foreign direct investment was mostly due to a growth in reinvestments. Most of the investments were made in the financial, energy and manufacturing sectors. Compared to the previous year, investments increased mostly in the hotels, restaurants, energy and manufacturing sectors.

DIAGRAM N 1.14 FINANCING THE CURRENT ACCOUNT DEFICIT (IN % OF GDP)



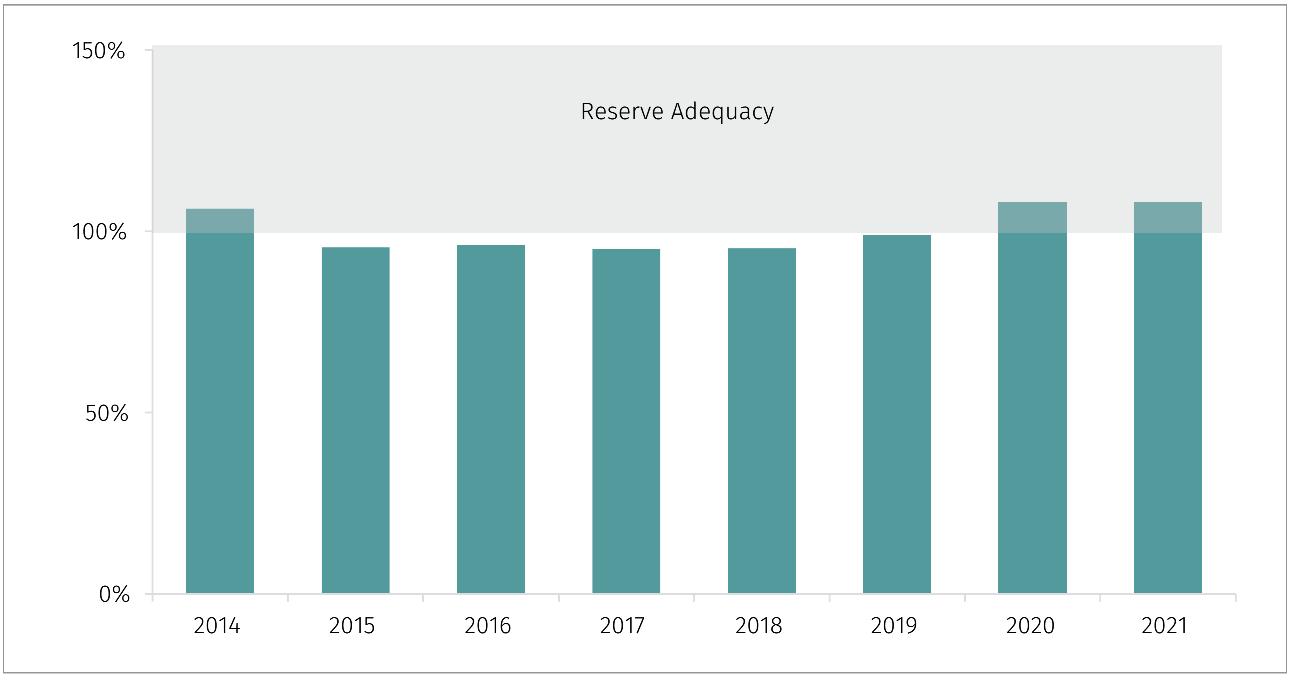
Source: NBG

Given the increased current account deficit and reduced private sector inflows into financial accounts in 2021, it was important for the government to continue to receive external funding from international institutions to make up this shortfall. Net inflows of the public sector (in the form of loans and grants) amounted to USD 1,532 million in 2021, a significant portion of which were reflected in the NBG's accounts. In addition, the NBG was allocated SDR 78 million in the final part of the International Monetary Fund's Extended Facility[13] (amounting to USD 112.5 million). Following the new rule for the allocation of the International Monetary Fund's Special Drawing Rights (SDR), which served to strengthen the country's external buffers, Georgia received SDR 202 million (USD 286 million). The decrease in the portfolio investments in the financial account is mostly related to the non-banking sector.

In 2021, official reserve assets increased by USD 361.4 million to USD 4.27 billion. In addition to FX swaps, this increase was due to the funds raised from the International Monetary Fund and those raised by the government from other international institutions. Most of these go to the government's accounts at the NBG. Foreign debt service, other government foreign exchange expenditures and foreign exchange interventions each had an impact on the decline in international reserves. In 2021, government debt service in foreign currency and government foreign exchange expenditures on goods and services totaled nearly USD 856 million. Through foreign exchange interventions, the NBG provided USD 354.9 million to the foreign exchange market.

According to the IMF's ARA metrics[14] in the reserve adequacy assessment, by the end of 2021, the level of Georgia's international reserves was about 108%, which, according to this methodology, is within the level required (from 100% to 150%) to ensure protection against external and liquidity shocks. Also, by the end of 2021, the ratio of reserves to months of imports (as forecast for 2022) was around 5.0 months.

DIAGRAM N 1.15 ASSESSMENT OF THE ADEQUACY OF OFFICIAL INTERNATIONAL RESERVES ACCORDING TO THE IMF'S METHODOLOGY (ARA METRICS)



Source: NBG

13. Special Drawing Rights are special borrowing rights, an additional international reserve asset defined by the IMF.
14. For more details on the IMF's ARA methodology, see https://www.imf.org/external/np/spr/ara/

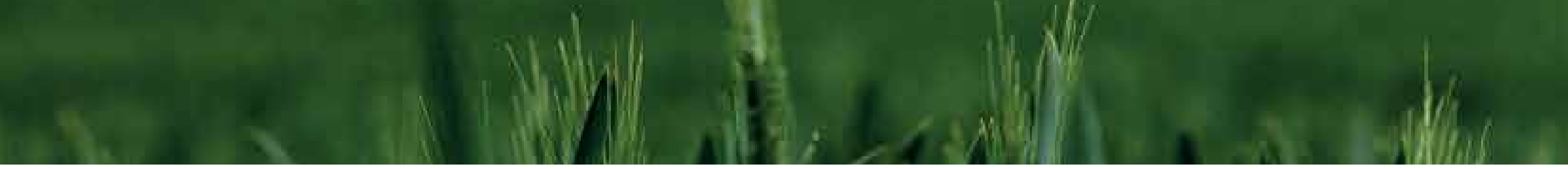


TABLE N 1.1 BALANCE OF PAYMENTS, 2017-2021 (MILLION USD)[15]

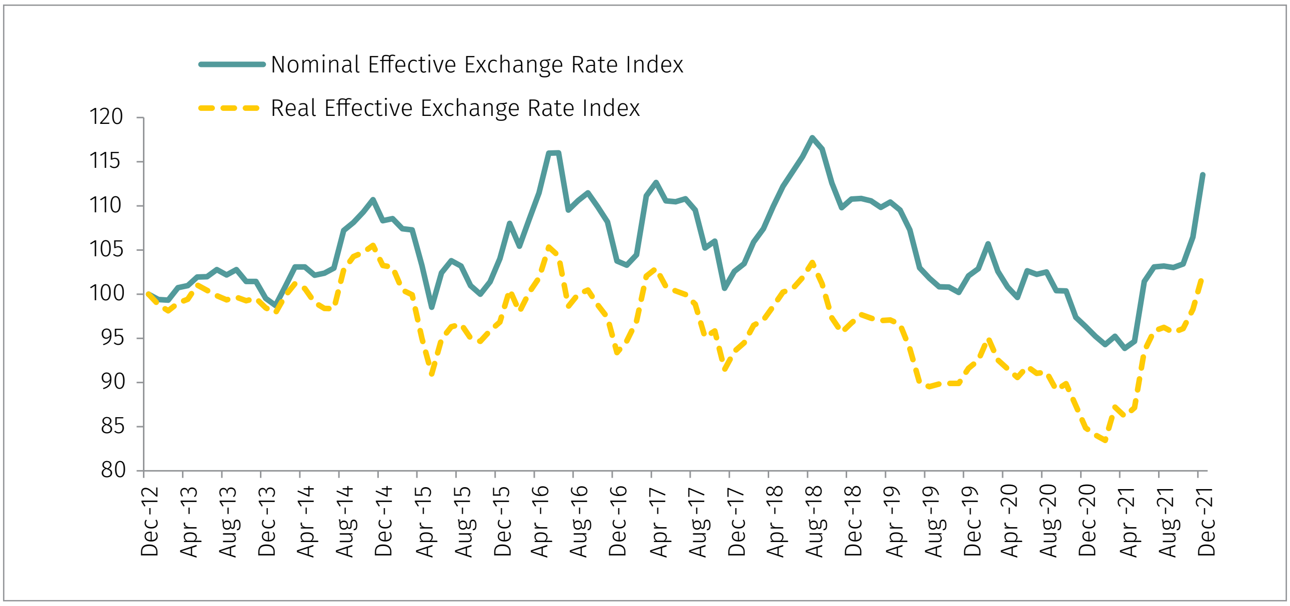
	2017	2018	2019	2020	2021
Current account	**-1,306**	**-1,191**	**-960**	**-1,966**	**-1,834**
Goods	-3,809	-4,116	-3,736	-3,165	-3,758
Export	3,570	4,407	4,944	4,347	5,539
Import	7,379	8,522	8,681	7,512	9,297
Services	2,024	2,244	2,176	124	724
Credit	3,990	4,490	4,600	1,580	2,547
Of this: Revenues from international travelers	2,704	3,222	3,269	542	1,245
Debit	1,966	2,246	2,425	1,456	1,823
Primary income (net)	-794	-683	-774	-734	-1,103
Of this: Investment income	-1,416	-1,381	-1,581	-1,223	-1,565
Of this: Compensation of employees: Remuneration	623	697	807	488	463
Secondary income (net)	1,273	1,364	1,375	1,810	2,302
Of this: Public Sector	233	173	133	256	199
Of this: The other sectors	1,040	1,190	1,242	1,553	2,104
Capital account	**83**	**76**	**47**	**41**	**38**
Financial account	**-1,255**	**-1,218**	**-958**	**-2,005**	**-1,773**
Direct investment (net)	1,711	977	1,054	549	831
Of this: Direct investments in Georgia	1,921	1,270	1,366	534	1,178
Portfolio investment (net)	76	48	-698	-75	387
Financial Derivatives (net of reserves) and employees' options on shares	0	1	-4	-27	-1
Other investments (net)	-138	569	-595	1,659	1,781
Of this: Public sector	432	351	346	1,445	1,333
Of this: Private sector	-570	218	-941	214	448
Reserve assets	-242	-278	-202	-305	-453
Net errors and omissions	**-29**	**-92**	**-45**	**-77**	**94**
Important ratios					
Reserve assets in next year's import months (month)	3.6	3.5	3.5	5.1	5.0
Export / Import (goods and services)	-81%	-83%	-86%	-66%	-73%
Current account/GDP	-8.0%	-6.8%	-5.5%	-12.4%	-9.8%
Foreign direct investment/GDP	11.8%	7.2%	7.8%	3.4%	6.3%
Travel revenues/GDP	16.6%	18.3%	18.7%	3.4%	6.7%
Personal remittances/GDP	9.5%	9.9%	10.7%	12.4%	13.4%

Source: NBG

The real effective exchange rate is an important indicator of the country's external competitiveness (see Diagram N 1.16). In 2021, this figure increased by 20.4%, while the nominal effective exchange rate appreciated by 17.9%, indicating a decrease in external competitiveness. The currencies of Turkey and the eurozone (see Table N 1.2) were strong contributors to the appreciation of the real effective exchange rate in 2021.

15. According to the IMF's Balance of Payments and International Investment Position Manual (sixth edition).

DIAGRAM N 1.16 INDICES OF REAL AND NOMINAL EFFECTIVE EXCHANGE RATES (DEC. 2012=100)



Source: NBG

TABLE N 1.2 ANNUAL CHANGES IN EFFECTIVE EXCHANGE RATES IN 2021

	Nominal effective exchange rate change, percentage	Real effective exchange rate change, percentage	Share in real effective exchange rate
Effective Exchange Rate	**17.9**	**20.4**	**20.4**
Eurozone	14.1	23.8	4.3
Turkey	85.3	55.2	9.7
Ukraine	2.5	6.1	0.4
Armenia	-0.6	5.2	0.3
USA	6.1	12.9	0.9
Russia	5.6	11.0	1.6
Azerbaijan	6.1	7.9	0.8
China	3.3	15.9	2.1
All other	15.1	21.4	0.3

Source: NBG

In 2021, while still dealing with the negative consequences of the ongoing pandemic, the effective macroeconomic policy response of the NBG was reflected in Georgia maintaining its credit ratings with the international rating agencies. In February, the international rating agency Standard & Poor's (S&P) confirmed Georgia's sovereign rating at "BB" with a negative outlook. In August, Fitch Ratings upgraded Georgia's outlook from 'negative' to 'stable', while maintaining its sovereign rating at BB. Also in September, the international rating agency Moody's confirmed Georgia's rating at Ba2, with a stable outlook. The maintenance of these ratings was backed by the structural reforms implemented within the framework of the International Monetary Fund's four-year Extended Fund Facility and the resilience of the economy to shocks. As a Fitch press release of August 2021 stated, "Georgia's small and highly dollarized economy [is] vulnerable to external shocks. However, these risks have been well managed throughout the pandemic; reflecting strong donor support to meet nearly all of the government's external financing needs, and a credible macroprudential and monetary framework that has supported stability in the banking sector and managed lari volatility."

1.3 ECONOMIC GROWTH

According to preliminary data, the Georgian economy grew by 10.4% in 2021. This growth was fueled by an intensification of demand as accumulated during the severe pandemic restrictions; a gradual improvement of the foreign sector, which includes increased exports of goods and remittances and a partial recovery of income from international tourists; as well as fiscal stimulus and high credit activity. Notably, GDP actually exceeded the level of 2019 by 2.9%.

The economic growth rate was uneven in 2021. In the first quarter, significant pandemic-related restrictions were still in effect, causing GDP to shrink by 4.1% YoY. The base effect was the main reason for the high economic growth seen in the remainder of the year, as the anti-COVID restrictions that were initially imposed in the second quarter of 2020 were in force with varying intensities until the end of 2021. However, the restrictions gradually eased from the beginning of the second quarter of 2021, considerably changing the economic picture.

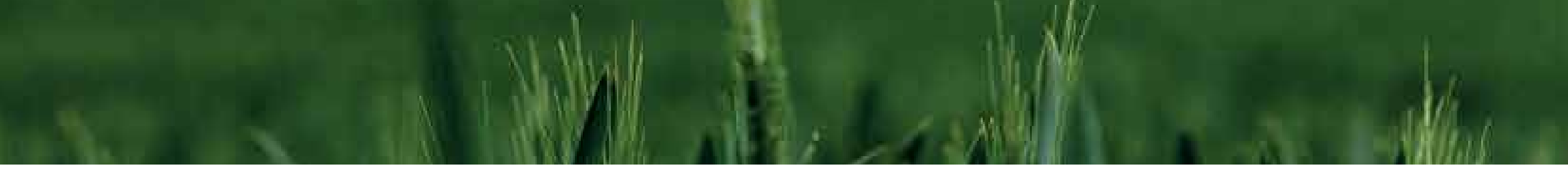
The gradual opening of the country's borders was important in terms of foreign tourism. International tourists once again visited Georgia after a year-long pause, with their number steadily growing from the beginning of the second quarter. This fact had a particularly positive impact on those tourism-related areas that had been most affected by the pandemic. Accommodation and catering (mainly restaurants and hotels), transport (with a large share of tourism), real estate, and arts, entertainment and leisure recreation (each with a high participation of international visitors) contributed a combined 3.6 pp to the total GDP. As the economy recovered, trade – the largest sector – grew by 19.9%, while contributing 2.6 pp to overall growth. Of the industrial sectors, the processing industry stands out in terms of the high weight of enterprises manufacturing export products (9.0% growth, making a 0.8 pp contribution to overall growth). In contrast, there was a significant decline in construction (a 21.8% decrease, making a -1.7 pp contribution to growth), and agriculture shrank by 1.4%, making a negative 0.1 pp contribution to the growth (see Table N 1.3).

16. See https://www.fitchratings.com/research/sovereigns/fitch-revises-georgia-outlook-to-stable-affirms-at-bb-06-08-2021

TABLE N 1.3 GDP BY ECONOMIC ACTIVITIES

	2021Q1		2021Q2		2021Q3		2021Q4		2021	
	Real growth	Contribution to growth	Real growth	Contribution to growth	Real growth	Contribution to growth	Real growth	Contribution to growth	Real growth	Contribution to growth
Agriculture, forestry and fishing	0.2%	0.0%	-3.4%	-0.3%	-2.9%	-0.2%	1.9%	0.1%	-1.4%	-0.1%
Mining and quarrying	48.3%	0.6%	15.9%	0.3%	2.2%	0.0%	1.6%	0.0%	13.5%	0.2%
Manufacturing	-3.0%	-0.2%	36.2%	3.2%	7.3%	0.7%	0.2%	0.0%	9.0%	0.8%
Supply of electricity, gas, steam and air conditioning	-9.4%	-0.2%	16.1%	0.4%	78.8%	1.3%	56.5%	1.1%	33.5%	0.7%
Water supply; Sewerage, waste management and remediation activities	24.3%	0.2%	43.4%	0.3%	35.1%	0.2%	54.5%	0.2%	38.9%	0.2%
Construction	-22.1%	-1.4%	17.2%	1.0%	-29.7%	-2.5%	-33.4%	-3.1%	-21.8%	-1.7%
Wholesale and retail trade; Repair of cars and motorcycles	6.2%	0.8%	58.9%	6.9%	12.3%	1.7%	11.2%	1.6%	19.9%	2.6%
Transport and storage	-5.9%	-0.3%	45.5%	2.5%	29.0%	1.4%	40.6%	2.2%	27.6%	1.5%
Accommodation and catering	-50.1%	-1.8%	99.4%	2.0%	49.8%	1.3%	72.8%	1.3%	29.8%	0.7%
Information and communication	18.1%	0.5%	51.0%	1.4%	18.4%	0.5%	14.4%	0.4%	23.9%	0.7%
Finance and insurance	23.8%	1.1%	45.0%	2.0%	20.3%	0.9%	10.1%	0.5%	23.5%	1.0%
Real estate	-4.1%	-0.5%	19.7%	2.2%	6.6%	0.6%	15.0%	1.4%	9.2%	0.9%
Professional, scientific and technical work	-0.1%	0.0%	24.8%	0.5%	9.4%	0.2%	6.3%	0.1%	9.8%	0.2%
Administrative and support services	-36.3%	-0.4%	7.4%	0.1%	40.8%	0.3%	27.9%	0.2%	5.6%	0.0%
Public administration and defense; compulsory social security	1.6%	0.1%	0.4%	0.0%	-3.9%	-0.2%	-1.5%	-0.1%	-0.9%	-0.1%
Education	-4.9%	-0.2%	-1.2%	-0.1%	-7.8%	-0.3%	4.4%	0.2%	-2.3%	-0.1%
Health and social services activities	12.2%	0.5%	43.7%	1.9%	23.8%	0.9%	34.4%	1.2%	28.7%	1.1%
Arts, entertainment and recreation	-24.1%	-0.9%	181.0%	3.6%	48.1%	1.2%	31.0%	0.8%	43.1%	1.1%
Other services	-39.7%	-0.3%	29.6%	0.2%	27.3%	0.2%	29.4%	0.2%	10.3%	0.1%
Activities of households as employers; undifferentiated goods and services producing activities of household for own use	-11.0%	0.0%	-0.7%	0.0%	-29.3%	0.0%	-36.1%	0.0%	-20.1%	0.0%
(+) Taxes on products	-12.6%	-1.6%	8.1%	1.0%	8.4%	1.1%	4.3%	0.6%	2.6%	0.3%
(-) Subsidies on products	1.0%	0.0%	5.0%	0.0%	0.9%	0.0%	-2.7%	0.0%	1.3%	0.0%
GDP		**-4.1%**		**28.9%**		**9.1%**		**8.8%**		**10.4%**

Source: NBG

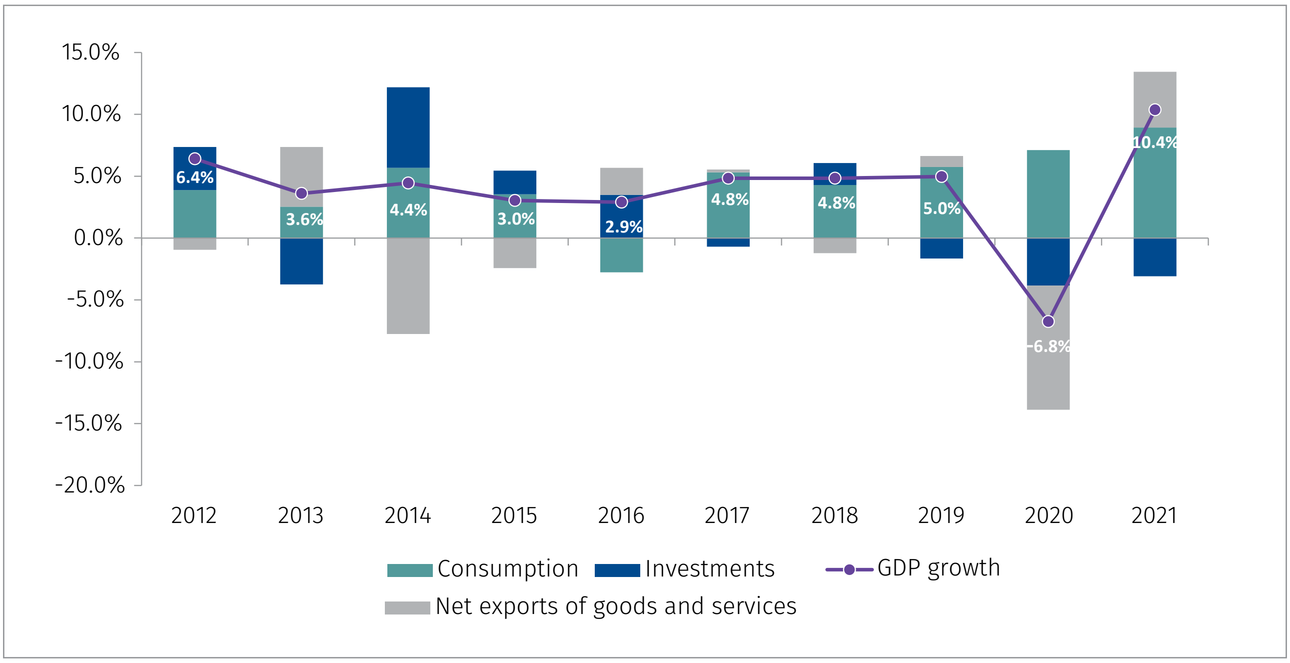


DEMAND

The revival of demand, following months of severe COVID-related restrictions, and the improvement of the foreign sector fueled the high economic growth seen in 2021. Therefore, 8.9 pp of the 10.4% growth was related to consumption, while the contribution of net exports equaled 4.5 pp. High growth in consumption was observed from both households and the public sector. Following the partial recovery of tourism, net exports saw a 57.1% YoY real growth in service exports.

The contribution of investments to GDP growth was a negative 3.1 pp (see Diagram N 1.17).

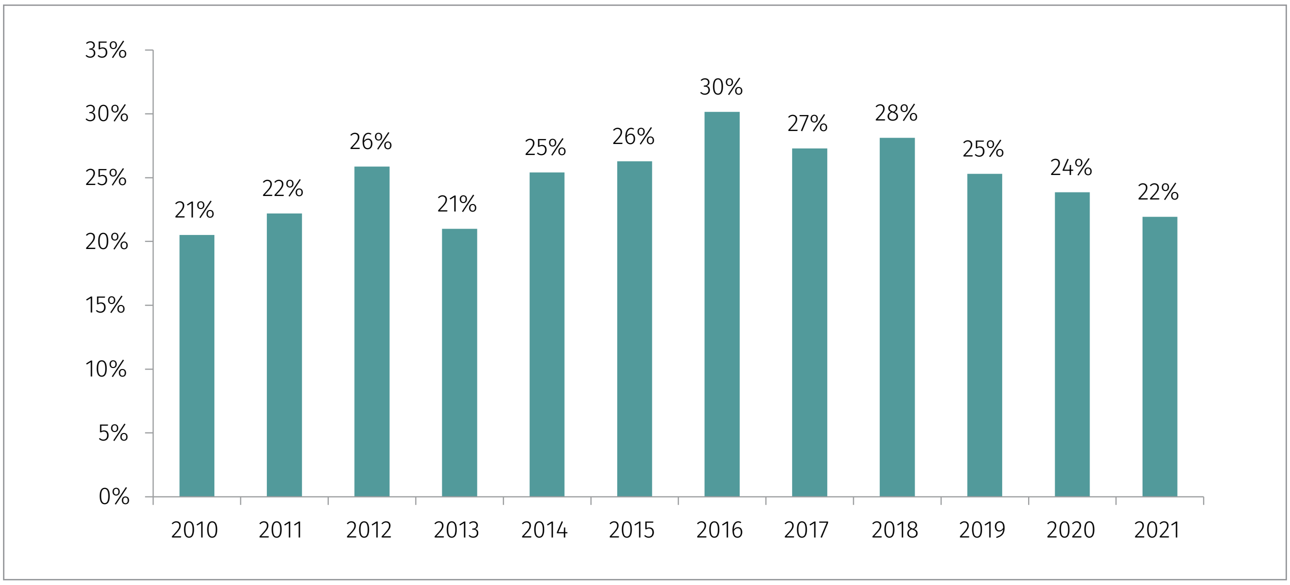
DIAGRAM N 1.17 GROWTH BY CATEGORY OF USE



Source: NBG

In 2021, the ratio of investments to GDP was 22%. Remaining stable in recent years, this indicator can be considered adequate for the development of the Georgian economy (see Diagram N 1.18).

DIAGRAM N 1.18 INVESTMENTS TO GDP



Source: GeoStat

1.4 INFLATION

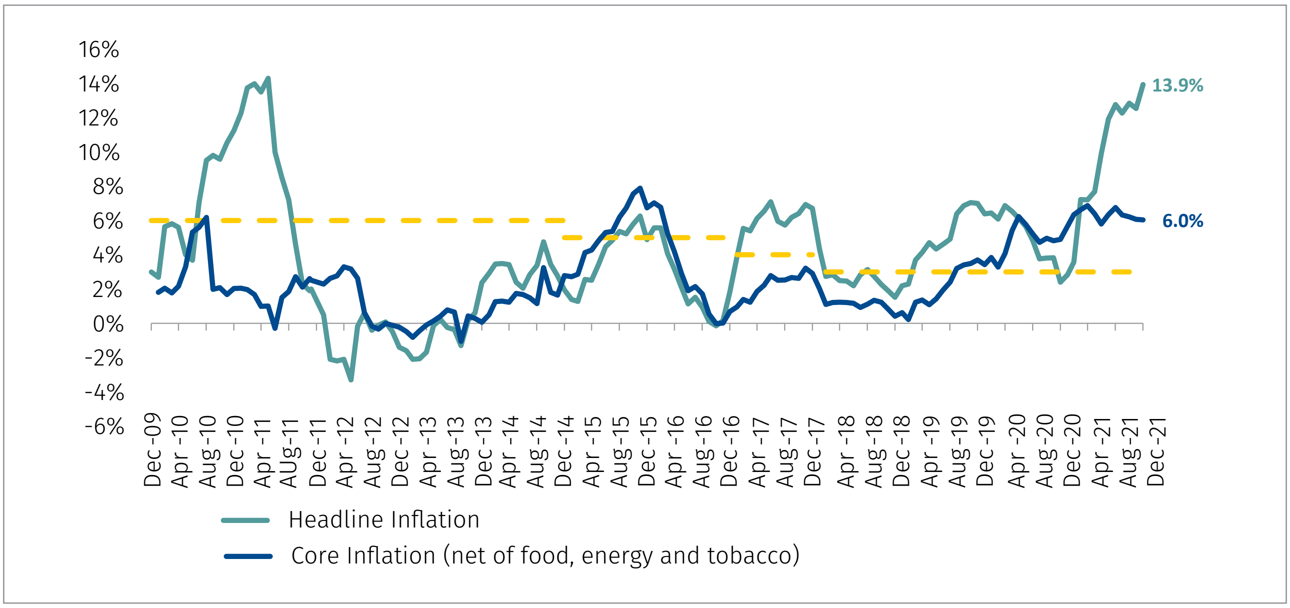
Inflationary pressures intensified in 2021 in both Georgia and globally. The reason for high inflation was the extraordinary situation caused by COVID-19, which led to several factors simultaneously affecting inflation in the direction of growth. The rise in inflation in Georgia was closely linked to rising prices of consumer goods around the world. Indeed, global inflation was a hot topic in the various reviews of the International Monetary Fund, the World Bank and other international institutions.[17]

In 2021, inflation had an upward trend. Although inflation was relatively low at 2.8% in January 2020, due to the subsidy on utility bills that was introduced as early as December 2020, it gradually increased in the following months, reaching a peak of 13.9% in December.

Inflation is a problem not only for developing but also for developed countries. Inflation in the US was 7.0% in December in 2021, while eurozone inflation was 5.0%. High inflation was also recorded in the Baltic states: in December, it was at 12.2% in Estonia, 10.6% in Lithuania and 7.9% in Latvia. The rate of price growth has accelerated further in early 2022. Inflation in the US reached 8.5% in March, the highest level in the last 40 years, while eurozone inflation was at a record 7.5%. Inflation in the Baltic states also rose: in March 2022, it was at 12.0% in Estonia, 15.7% in Lithuania and 11.5% in Latvia. Inflation in Georgia in 2021 averaged 9.6%. Core inflation, which excludes changes in highly volatile food, energy, and tobacco prices from the consumer basket, was lower relative to headline inflation, averaging 6.3% (see Diagram N 1.19). Monitoring core inflation is important in order to assess its long-term dynamics.

17. See, for instance, https://blogs.imf.org/2021/06/24/four-facts-about-soaring-consumer-food-prices/

DIAGRAM N 1.19 HEADLINE AND CORE (EXCLUDING FOOD, ENERGY AND TOBACCO) INFLATION



Source: GeoStat

As previously stated, the reason for high inflation was the rise in international prices of consumer goods, predominantly stemming from the rise in food prices. Due to pandemic-related delays, poor harvests, and increased transportation costs, world average food prices hit their highest level in ten years in 2021. The rise in food prices predominantly hit developing countries, where the weight of food in consumer baskets is higher than in developed countries. The weight of food in the consumer basket of Georgia is also high, at 28.9%. Therefore, changes in food prices have a significant impact on inflation.

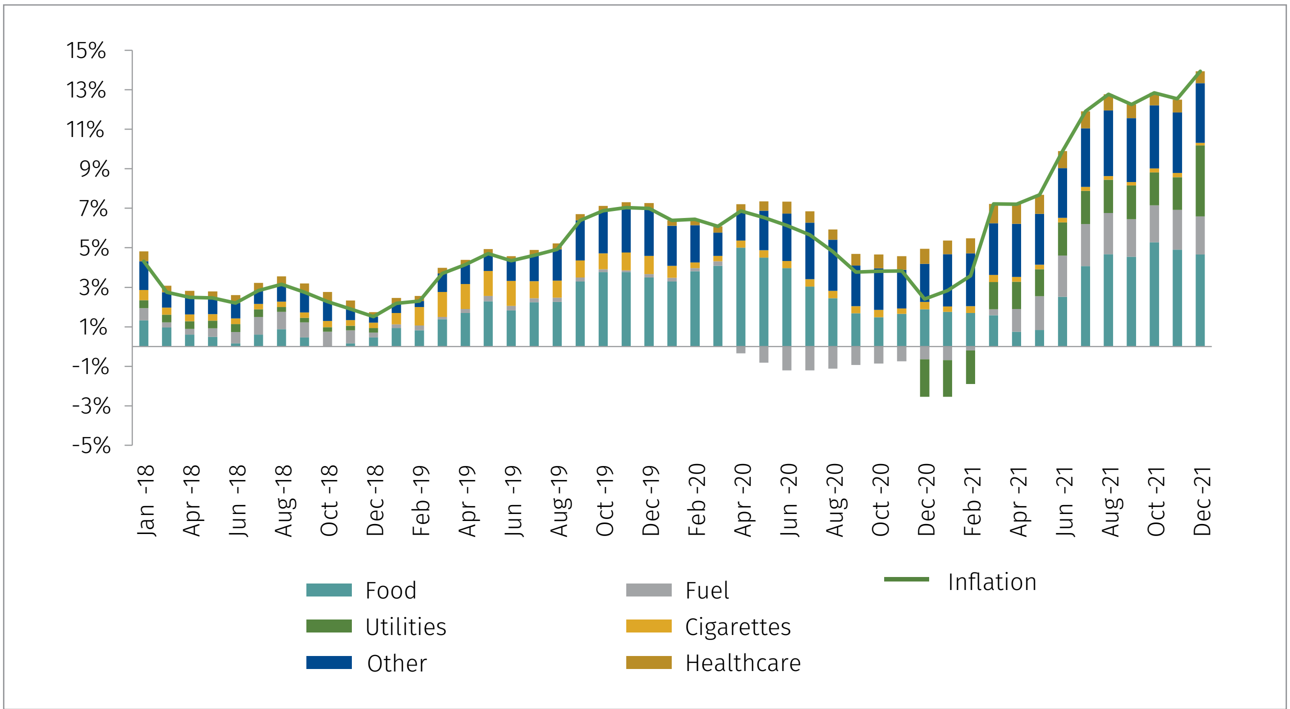
Of the previous year's 9.6% average inflation, 3.1 pp was related to food inflation, where the inflation of imported food and that dependent on imported raw materials was prevalent. This specifically concerned sunflower oil, bread, sugar, chocolate, and dairy.

As the pandemic-related restrictions were gradually lifted, the economy picked up and demand increased accordingly. This led to the overloading of transport channels, dramatically increasing the cost of transport and other operating costs around the world. For example, in December 2021, the 40 ft container freight index had almost tripled in comparison to the average price of the last five years. Such hikes in freight and other operating costs also affect the final price of almost all types of products.

With the restoration of mobility and increased demand, the price of oil on international markets has increased. World oil prices have been rising steadily over the years, which have been transmitted to fuel prices on the local market. The contribution of fuel prices to inflation was negative at the beginning of the year, but would reach 2.0 pp in the second half of the year. The overall contribution of fuel to inflation averaged 1.4 pp during the year.

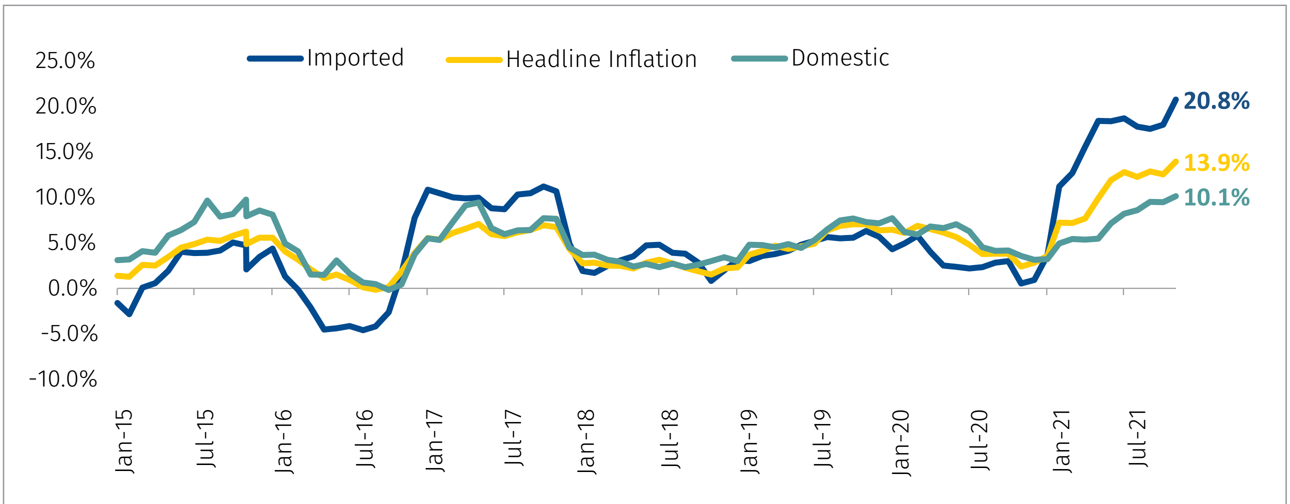
In 2021, the inflation rate was significantly affected by the prices of utility bills, which included both the expansion of utility bills and the statistical effect. Due to government subsidies, utility bills were lower in December 2020 than in November, increasing only slightly in March 2021 compared to November levels. However, in percentage terms, the increase turned out much more than the decrease. With the weight of utility bills unchanged, this difference increased the annual inflation rate by about 1.2 pp over the next year only as a result of the effect of the statistical methodology. Since June, this effect increased by an additional 0.1 pp, rising to 1.3 pp, with an increase in natural gas tariffs. Finally, in December, the annual contribution of utility bills increased by an additional 2.0 pp to total 3.6 pp due to the base effect (see Diagram N 1.20).

DIAGRAM N 1.20 CONTRIBUTION TO HEADLINE INFLATION BY CORE COMPONENTS



Source: GeoStat and NBG calculations

DIAGRAM N 1.21 INFLATION OF IMPORTED AND DOMESTIC GOODS[18]



Source: GeoStat

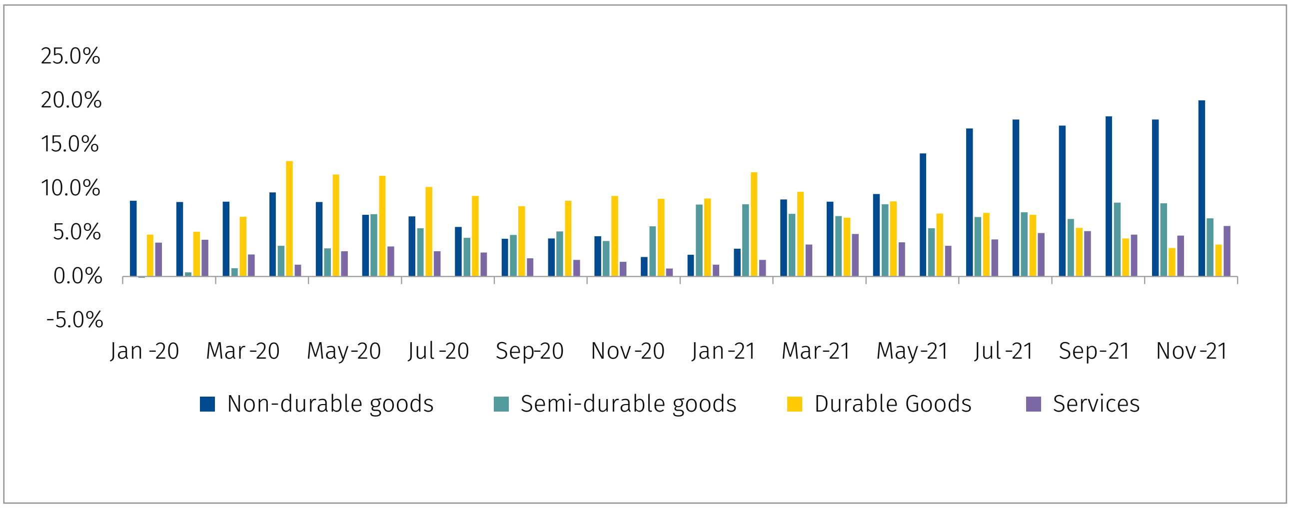
18. In addition to domestic and imported goods, the headline inflation rate also includes mixed types of goods, and so it may be outside the range of local and imported goods' inflation.

TABLE N 1.4 INFLATION INDICATORS ACCORDING TO INDIVIDUAL COMPONENTS (PERCENTAGE), THEIR SHARE IN THE CONSUMER BASKET (PERCENTAGE), AND CONTRIBUTION TO CPI (PERCENTAGE POINTS)

	2021 Year Weights	Dec. '21/Dec. '20		Jan. '21-Dec. '21/Jan. '20-Dec. '20	
		Inflation	Contribution	Inflation	Contribution
Total	100.0%	13.9%	13.9%	9.6%	9.6%
Food and Non-Alcoholic Beverages	32.2%	15.6%	5.0%	10.8%	3.4%
Food	28.9%	16.1%	4.7%	11.0%	3.1%
Bread and Bakery	5.6%	20.2%	1.1%	11.7%	0.6%
Meat and Meat Products	6.8%	10.2%	0.7%	6.5%	0.4%
Fish Products	0.5%	16.5%	0.1%	12.1%	0.1%
Milk, Cheese, and Eggs	6.3%	15.3%	1.0%	12.5%	0.7%
Oil and Fats	1.9%	24.5%	0.5%	36.8%	0.6%
Fruits, grapes	1.6%	10.5%	0.2%	-4.8%	-0.1%
Vegetables, Melons, Potatoes and other Tubers	3.3%	20.7%	0.7%	9.4%	0.3%
Sugar, Jams, Honey, Syrups, Chocolate, Pastry	2.3%	19.8%	0.5%	15.2%	0.3%
Other Food Products	0.6%	4.4%	0.0%	6.0%	0.0%
Non-alcoholic beverages	3.3%	11.2%	0.4%	9.0%	0.3%
Alcoholic Beverages, Tobacco	6.4%	5.2%	0.3%	7.1%	0.4%
Clothing and Footwear	3.8%	2.8%	0.1%	2.0%	0.1%
Housing, Water, Electricity, Gas and other Fuels	9.0%	43.5%	3.9%	6.9%	0.8%
Furnishings, Household Equipment and Maintenance	5.3%	11.8%	0.6%	11.5%	0.6%
Healthcare	7.8%	7.9%	0.6%	10.6%	0.8%
Transport	13.0%	17.3%	2.3%	14.9%	1.9%
Communication	3.6%	-0.7%	0.0%	-0.3%	0.0%
Recreation and Culture	3.7%	2.5%	0.1%	3.1%	0.1%
Education	4.6%	4.8%	0.2%	2.7%	0.1%
Hotels, Cafes and Restaurants	5.4%	14.0%	0.8%	10.0%	0.5%
Miscellaneous Goods and Services	5.3%	6.0%	0.3%	7.0%	0.4%

Source: GeoStat

DIAGRAM N 1.22 CHANGE OF ANNUAL INFLATION FOR SERVICES AND GOODS OF DIFFERENT DURABILITY



Source: GeoStat

02

MONETARY AND EXCHANGE RATE POLICY

2.1 MONETARY POLICY

The primary goal of the NBG is to ensure price stability.[19] Price stability implies a level of inflation over the medium term that is optimal for high and sustainable economic growth in the long term.

The monetary policy of the NBG follows an inflation-targeting framework. This regime, which is seen as the most efficient contemporary approach for maintaining price stability, relies on the announcement of an inflation target that is then used to guide policy for maintaining inflation at the target level in the medium term. The key monetary policy instrument of the NBG is the monetary policy rate, which changes according to inflation forecasts. If an inflation forecast exceeds the target rate, the NBG will tighten monetary policy; whereas if the inflation forecast is lower than the target level, the NBG will resort to loosening monetary policy. The inflation-targeting framework guarantees price stability and, compared to other policy frameworks, results in relatively lower long-term interest rates. In line with the development of monetary policy instruments and monetary policy transmission mechanisms, the social costs of achieving price stability will decline. The NBG is thus continuously working on increasing the efficiency of monetary policy instruments and monetary policy transmission mechanisms.

Monetary policy is guided by the Decree of the Parliament of Georgia on the Main Directions of Monetary and Exchange Rate Policy.[20] According to the policy, the target inflation rate has been set at 3% since 2018. It should be noted that developing countries tend to have higher inflation than advanced countries, resulting from the faster growth of productivity.[21]

In Georgia, as in other small open economies, exogenous shocks (independent from monetary policy) are always looming. Exogenous factors can cause actual inflation to deviate from the target level. Monetary policy is a tool to impact aggregate demand and is thus the central bank's response to demand shocks. Central banks do not usually react to supply-side exogenous shocks (e.g., higher excise tax, rising commodity prices in global markets and international freight costs), since doing so would lead to high economic costs, volatile economic growth and decreased employment in the long run.

For instance, research by Clinton et al. (2017) states that "Under the flexible IFT framework, strong exogenous macroeconomic shocks did lead to significant deviations of inflation from the target, and of economic activity from potential. But monetary policy instruments were systematically adjusted to bring inflation back to target over time."[22] It is also noteworthy that, as Bernanke and Blinder (1992) and Bernanke and Gertler (1995) demonstrated, monetary policy is transmitted to the real economy with a certain time lag.[23] Hence, in the short run, actual inflation can temporarily deviate from the target level. However, if a deviation is so significant that it affects inflation expectations and the inflation forecast, the NBG will adjust its policy response accordingly.

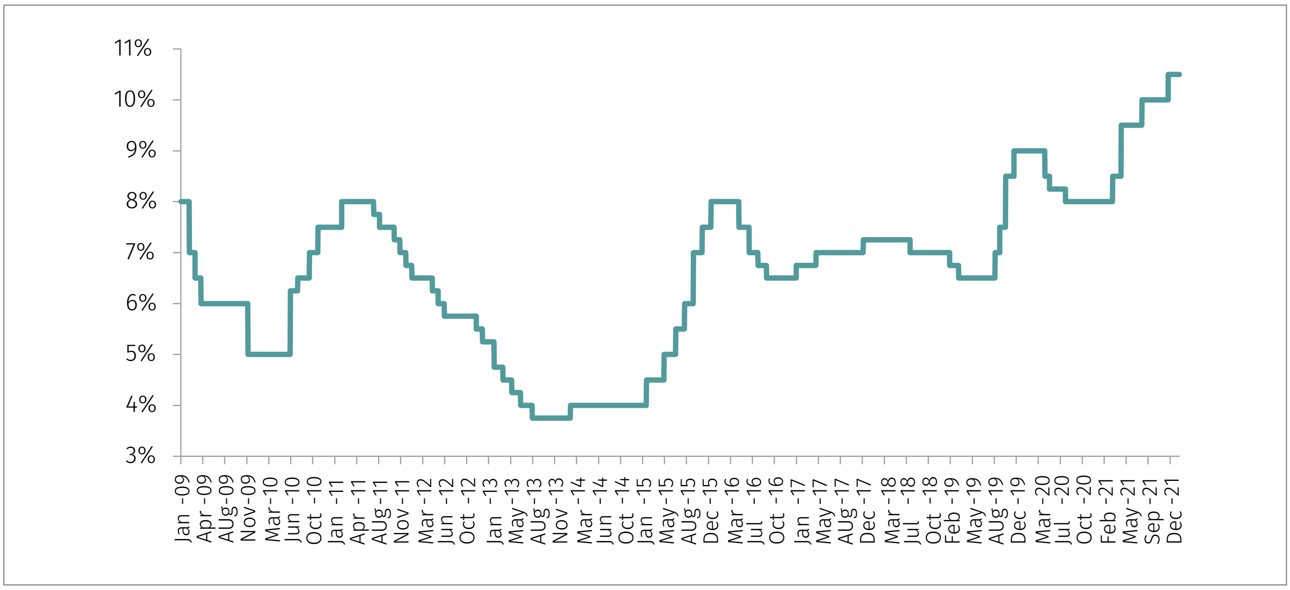
The year 2021 started with inflation below the target: it stood at 2.8% in January. The lower inflation was temporary in nature and was linked to the subsidy of utility bills. After the end of the subsidy period, inflation rose again, reaching 7.2% YoY in March. A trend of rising prices was also evident in the following periods. Since the beginning of 2021, prices on international commodity markets have shown sharp growth dynamics. For example, Brent crude oil prices on international markets rose by 66% annually on average in 2021. Also, according to the Food and Agriculture Organization (FAO), the

19. Paragraph 1, Article 3 of the Organic Law on the National Bank of Georgia.
20. Decree of the Parliament of Georgia, "On the Main Directions of the Monetary Policy of Georgia, 2020-2022", para. 1
21. Balassa, B. (1964), "The Purchasing Power Parity Doctrine: A Reappraisal", Journal of Political Economy, 72, pp. 584-96; Samuelson, P. (1964), "Theoretical Notes on Trade Problems", Review of Economics and Statistics, 23, pp. 1-60.
22. Clinton, Hlédik, Holub, Laxton, & Wang (2017) "Czech Magic: Implementing Inflation-Forecast Targeting at the CNB", IMF Working Paper, p. 30.
23. Bernanke & Blinder (1992) "The Federal Funds Rate and the Channels of Monetary Transmission", American Economic Review; Vol. 82, Issue 4, pp. 901-21; Bernanke & Gertler (1995) "Inside the Black Box: The Credit Channel of Monetary Policy Transmission", The Journal of Economic Perspectives, Vol. 9, No. 4 (Autumn, 1995), pp. 27-48.

growth of the food index averaged 28%. These rising food and oil prices have been transmitted to the local market under the influence of imported raw materials and products. At the same time, on a local scale, lockdowns and other logistical delays at international shipping ports drastically increased transportation costs, which were naturally echoed in product prices. Inflationary pressures were created by the depreciation of the GEL exchange rate amid a sharp decline in foreign inflows. However, the tighter pandemic restrictions, inflationary pressures stemming from supply chain disruptions, and rising staff costs per unit of output persisted.

A sharp improvement in economic activity began in the second quarter of 2021, driven by fiscal stimulus and credit growth. As a result, aggregate demand improved significantly in contrast to 2020, and real growth was observed compared to 2019. Among the factors affecting economic activity, the quicker-than-expected revival of pent-up demand, as accumulated after the end of lockdowns, is noteworthy. As a result, unlike in the previous year, aggregate demand did less to offset inflationary pressures, while supply-side factors were still strong. Maintaining a high inflation rate relative to the target risked stimulating inflation expectations. Considering these factors, over the course of the year the monetary policy rate was gradually increased from 8.0% to 10.5% (see Diagram N 2.1).

DIAGRAM N 2.1 MONETARY POLICY RATE



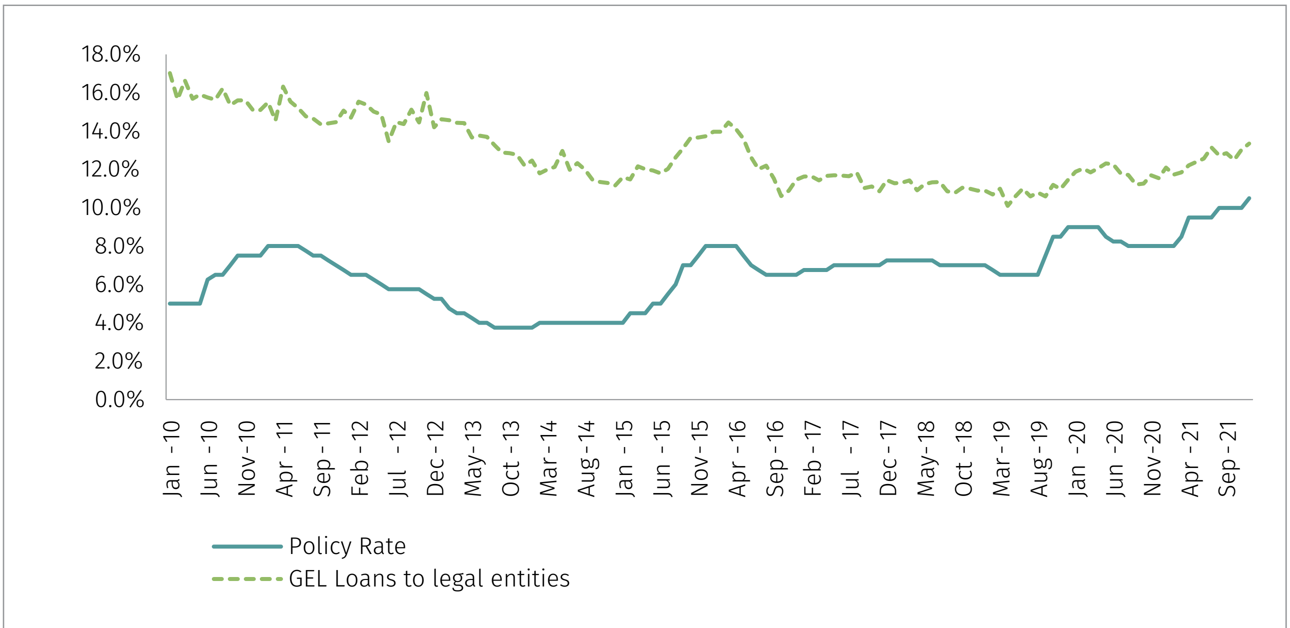
Source: NBG

Overall, inflation has been on an upward trend since March, rising to 13.9% in December 2021, which was mainly due to one-off shocks from the supply side, including sharply higher commodity prices on the international market and rising freight costs due to the difficulty of international shipping. The total impact of utility bills was higher in December (by 3.6 pp), which mirrored the arithmetic effect of the subsidy termination and the base effect of the previous year.[24] Core inflation, which excludes the high volatility of food, energy and tobacco prices, has been declining since the second half of 2021, reaching 6% at the end of the year. Headline inflation averaged 9.6% during the year.

24. Due to government subsidies, utility bills in December 2020 decreased compared to November, while in March 2021 these indices increased slightly compared to November levels. However, in percentage terms, the increase turned out to be much more than the decrease. The base effect was added to these factors from December: the effect of subsidized utility bills mirrored itself on inflation from December 2020 through to February 2021, causing inflation to decline during this period. In total, in December, the impact of utility bills contributed 3.6 pp to annual inflation.

Following the 6.8% decline in 2020, weak economic activity continued into the first quarter of 2021; however, as pandemic restrictions were gradually eased from the second quarter, the economic picture changed considerably. In the second quarter of 2021, real GDP increased by 29.9% compared to the same period of the previous year. One of the reasons for this high growth was the base effect, as the severe pandemic-related restrictions, which led to a major economic downturn, were initially imposed in the second quarter of 2020. However, growth continued in the following periods and, according to preliminary data, real GDP in 2021 increased by 10.4%. Notably, the volume of GDP in 2021 actually exceeded the level of 2019 by 2.9%. Another reason for the high growth, alongside fiscal stimulus and lending, was the revived demand that had been accumulated over months of restrictions. Notably, local demand was the main driver of economic growth. In terms of the foreign sector in 2021, international tourism was refreshed with the gradual opening of the country's borders; income from foreign visitors thus gradually increased, having a particularly positive impact on tourism-related areas. As mentioned above, lending activity was high during the year, despite the tight monetary policy. Interest rates on loans in the national currency to both households and legal entities rose due to the tightening of monetary policy. Overall, interest rates on mortgage loans increased by 1.6 pp YoY, while those on GEL loans to legal entities increased by 1.8 pp (see Diagram N 2.2).

DIAGRAM N 2.2 MONETARY POLICY RATE AND INTEREST RATE ON GEL LOANS



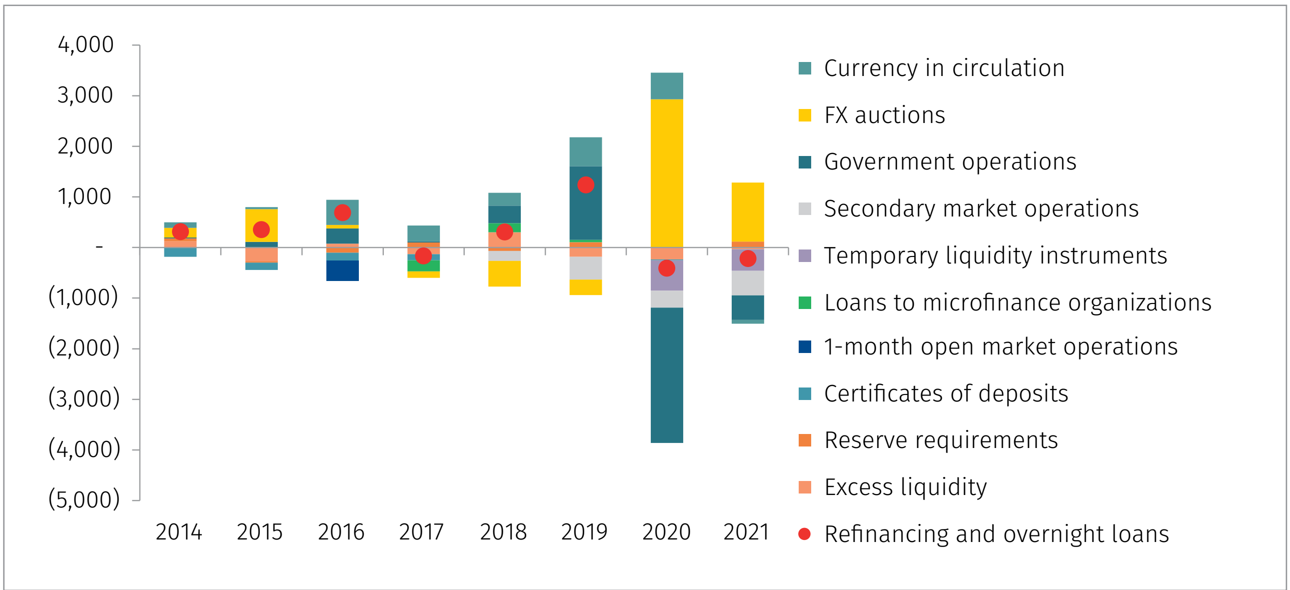
Source: NBG

As noted, under the inflation-targeting regime, the short-term interest rate is the key instrument of the NBG to ensure price stability. For monetary policy to be effective, it is important that policy changes reflect interbank interest rates and ultimately affect the real economy. Interest rates, in turn, are managed using a liquidity management framework.

The liquidity management framework of the NBG includes both liquidity delivery and liquidity absorption instruments. These include open market operations (refinancing loans and certificates of deposit), minimum reserve requirements, and standby instruments. In addition, temporary liquidity delivery tools that were developed after the start of the pandemic also continued to be available through 2021. These were the FX swap, the standby swap, and the SME liquidity support instruments. The NBG continued to issue 3-month certificates of deposit throughout the year, aiming to form the short-term portion of the yield curve. As a result, through these operations, the NBG kept the balance of certificates of deposit at a minimum level, in the range of GEL 60-80 million.

In 2021, banks vigorously used refinancing loans to manage liquidity and offset fluctuations from other sources of liquidity. However, the volume of refinancing loans decreased compared to 2020, which was influenced by several factors (see Diagram N 2.3). Government sector operations had a lessening effect on refinancing loans. Additional factors that reduced refinancing loans were reduced demand for cash, the NBG's purchase of government securities in the secondary market, and the use of temporary liquidity supply instruments. In contrast, the NBG's FX interventions acted to increase them.

DIAGRAM N 2.3 FACTORS AFFECTING ANNUAL CHANGES IN REFINANCING LOANS

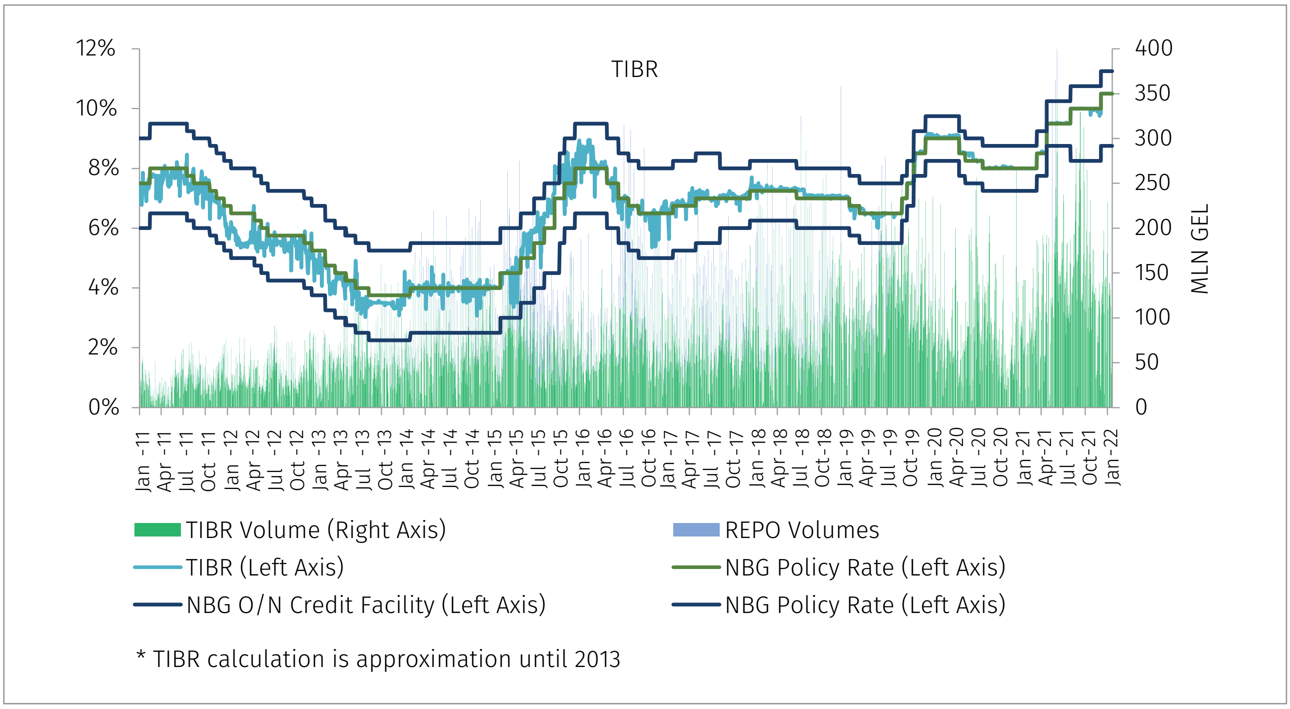


Source: NBG

Using the above instruments, the NBG provided short-term liquidity to the financial sector as needed. As a result, as shown in Diagram N 2.4, interest rates in the interbank money market remained close to the policy rate, which is the best indicator that the NBG provided the financial system with adequate liquidity.[25] If the system had been supplied with less than the required liquidity, then the interbank interest rate would have increased relative to the policy rate; and, conversely, it would have gone down in the case of excess liquidity. Either instance would have caused greater interest rate fluctuations and would have reduced the effectiveness of monetary policy. The availability of sufficient GEL resources for the banking system and effective management is important to encourage GEL lending and to promote de-dollarization, which in turn reduces risks to financial stability.

25. IMF Country Report No. 17/97 (April 2017) https://www.imf.org/en/Publications/CR/Issues/2017/04/13/Georgia-Request-for-Extended-Arrangement-Under-the-Extended-Fund-Facility-and-Cancellation-44834

DIAGRAM N 2.4 INTERBANK MONEY MARKET



Source: NBG

BOX 1 FACTORS AFFECTING LIQUIDITY

The amount of liquidity available to the financial sector is influenced by many different factors, including government operations, demand for cash and FX interventions. To manage the liquidity of the financial sector and to support the monetary policy transmission mechanism, the NBG has instruments for both liquidity supply and liquidity absorption. For almost the last ten years, the financial sector has had a structural liquidity deficit.[26] Accordingly, refinancing loans, as a liquidity supply instrument, is the key instrument of monetary policy.

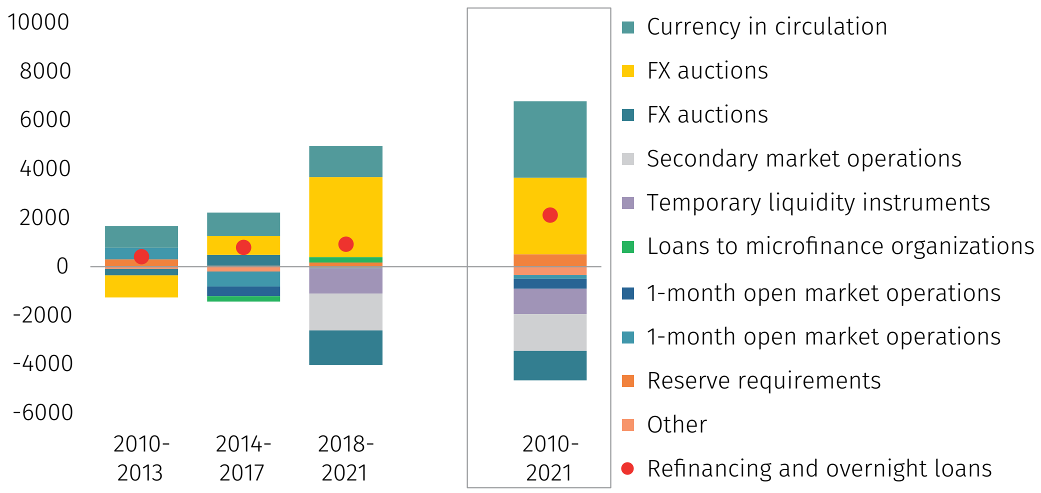
In general, bank liquidity tends to fluctuate widely in the short run. In order for these fluctuations not to be echoed in interest rate fluctuations, the supply of liquidity needs to be in line with its demand. The NBG supplies the market with as much liquidity as is required at current interest rates. It should be noted, however, that refinancing loans are issued in exchange for appropriate collateral (government securities, etc.). Until 2014, the financial system operated under structural surplus conditions. Thus, since the monetary policy rate is the refinancing rate, up until 2014 the NBG used certificates of deposit to absorb liquidity from the system, to increase the demand for the refinancing instrument and, consequently, to enhance the effectiveness of monetary policy. However, the structural liquidity surplus started reducing in 2013 and gradually

26. A structural liquidity deficit means that without the short-term market operations of the central bank (e.g., refinancing loans), the financial system would have less liquid balances than demanded. A structural liquidity deficit is a normal state of the financial system, and many countries are in this position of liquidity, except, for example, those countries with quantitative easing policies (the latter involve central banks purchasing long-term assets to supply local currency liquidity) or those where the active accumulation of foreign exchange reserves occurs (this also serves to supply local currency liquidity).

shifted to a structural deficit in 2014. Consequently, this increased demand for using refinancing loans as an instrument to meet the financial system's demand for liquidity naturally, without having to absorb liquidity from the system using certificates of deposit. The transition of the financial system to the state of structural deficit in 2014 and, consequently, the natural increase in demand for refinancing loans was due to two main factors: FX interventions by the NBG and the growing demand for cash.

1. When the NBG sells foreign currency at FX auctions in exchange for GEL, the GEL liquidity available in the financial system decreases and vice versa. For example, in 2006-2007, the NBG actively bought foreign currency through FX interventions, which was an important source of GEL liquidity supply. Consequently, liquidity absorption became more relevant at this time, which was achieved through the sale of certificates of deposit. Conversely, since 2014, as the exchange rate depreciated, the NBG sold a significant amount of foreign currency, which reduced GEL liquidity (i.e., increased the structural liquidity deficit). As a response, in order for the banking system to function smoothly, banks sought to replenish their liquidity shortfalls with refinancing loans (see Diagram N 2.5).
2. In addition, with an increase in income, the population consumes more and there is thus a relatively high demand for cash. This is a consequence of long-term economic growth. Demand for cash is also growing as the financial sector is enhanced and there is wider access to financial resources. Greater demand for GEL in cash is, in part, an indicator of entities transitioning from foreign currency to GEL (cash larization). The increase in demand for cash in circulation reduces the liquidity of commercial banks and, consequently, the demand for refinancing loans naturally increases.

DIAGRAM N 2.5 CHANGE AND DECOMPOSITION OF REFINANCING LOANS (BY CAUSES)



Source: NBG

In terms of liquidity demand, the impact of government operations needs to be considered, since these have increased the financial sector’s liquidity in some periods and decreased it in others. For example, in 2010-2013, the bulk of the budget deficit was financed by external debt, which increased the money supply. Whereas in following years, in line with the government’s strategy, the budget deficit was increasingly financed with domestic debt. In this case, the government was buying treasury bonds, thus reducing the liquidity of the lari. In 2014-2017, against the background of reduced GEL liquidity, the demand for refinancing loans increased.

To summarize, the intensified demand for liquidity and, consequently, for refinancing loans, especially since 2014, was mainly due to the NBG selling foreign currency through FX interventions and the increased demand for cash. As evidenced in Diagram N 2.5, the increased FX interventions and higher demand for cash over these years (which increases the demand for liquidity) has outpaced other instruments of liquidity supply, leading to a more intense use of the refinancing loan instrument (as indicated by the large red dots on the diagram). As a result, in 2014 the need for the NBG to absorb liquidity through certificates of deposit was replaced by the need to provide liquidity through refinancing loans, so that the amount of liquidity held by the financial system would remain equal to the demand for that liquidity. As noted at the outset, balancing liquidity demand and supply is an important condition for the stability of short-term market interest rates and, consequently, for the effectiveness of monetary policy.

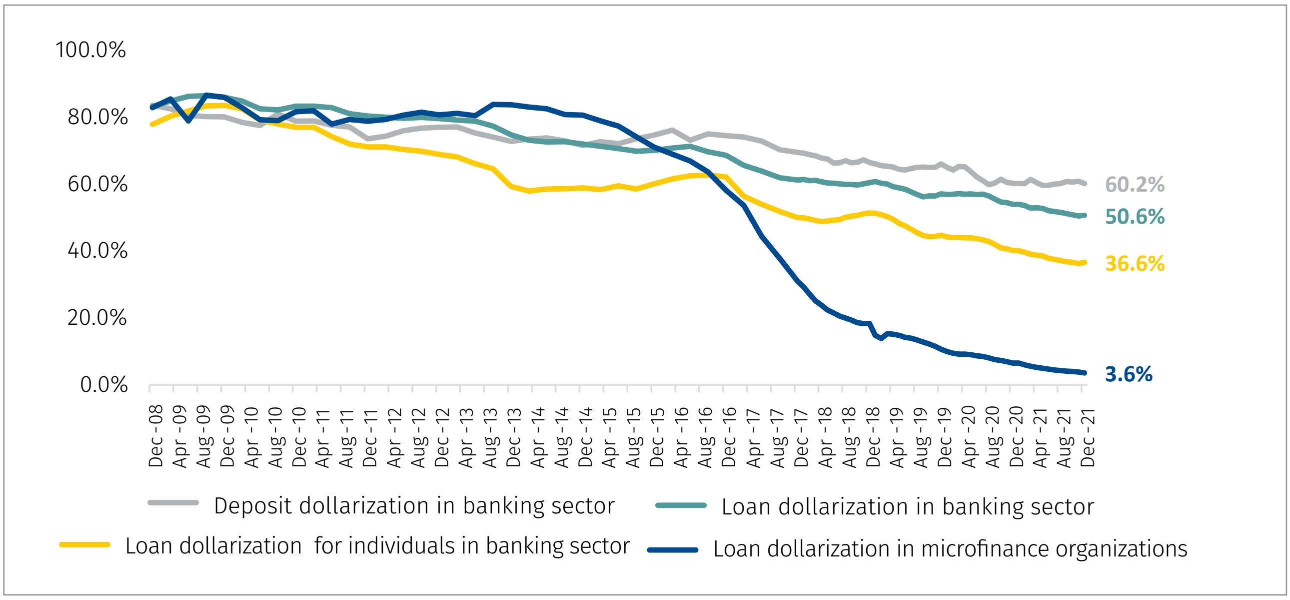
It is important to note that in April 2021, the International Monetary Fund (IMF) successfully completed the last review of the Extended Fund Facility (EFF), thus ending the program. The last two reviews of the facility were aimed at mitigating the adverse impacts of the COVID-19 pandemic, by helping to address the immediate needs of the balance of payments. It is noteworthy that the IMF Mission unequivocally gave a positive assessment regarding the NBG's fulfillment of all the criteria of the facility.

Promoting larization is a long-term task of the NBG. Encouraging larization is a prerequisite for reducing macro-financial risks and increasing resilience to external vulnerabilities in the country. Accordingly, increasing larization is one of the NBG's priorities and reforms to support this goal are being implemented in phases. Since the second half of 2021, following the tightening of monetary policy, the share of foreign currency loans in the loan portfolio has increased due to the growth in GEL resources, leading to an upsurge in the dollarization of loans. Despite significant declines recently, dollarization remains a significant challenge for the financial sector. Along with limiting the effectiveness of monetary policy, it carries risks to financial stability.

The NBG analyzes the dynamics of dollarization on an ongoing basis and takes appropriate measures as necessary. An amendment was enacted in July 2021 to encourage the de-dollarization of deposits. It states that the minimum reserve requirement for foreign currency funds is set differentially for individual commercial banks, based on the dollarization of their deposits. This constitutes a reduction in the minimum reserve requirement for commercial banks with a dollarization of deposits in the range of 40-70%. The reserve ratio for residual funds borrowed in foreign currency with a maturity of up to one year is set at 10-25% and depends on the dollarization ratio of deposits at each commercial bank.

Overall, the dollarization of total deposits during the year, excluding the exchange rate effect, remained virtually unchanged (reduced by 1.4 pp without excluding the exchange rate effect) and stood at 60.2%. The dollarization of loans, excluding the exchange rate effect, decreased by 3.3 pp (without excluding the exchange rate effect, this decreased by 4.7 pp) and amounted to 50.6% in December. The dollarization rate of loans to individuals decreased from 40.2% to 36.6% in 2021 excluding the exchange rate effect (and decreased by 4.9 pp without excluding the exchange rate effect).

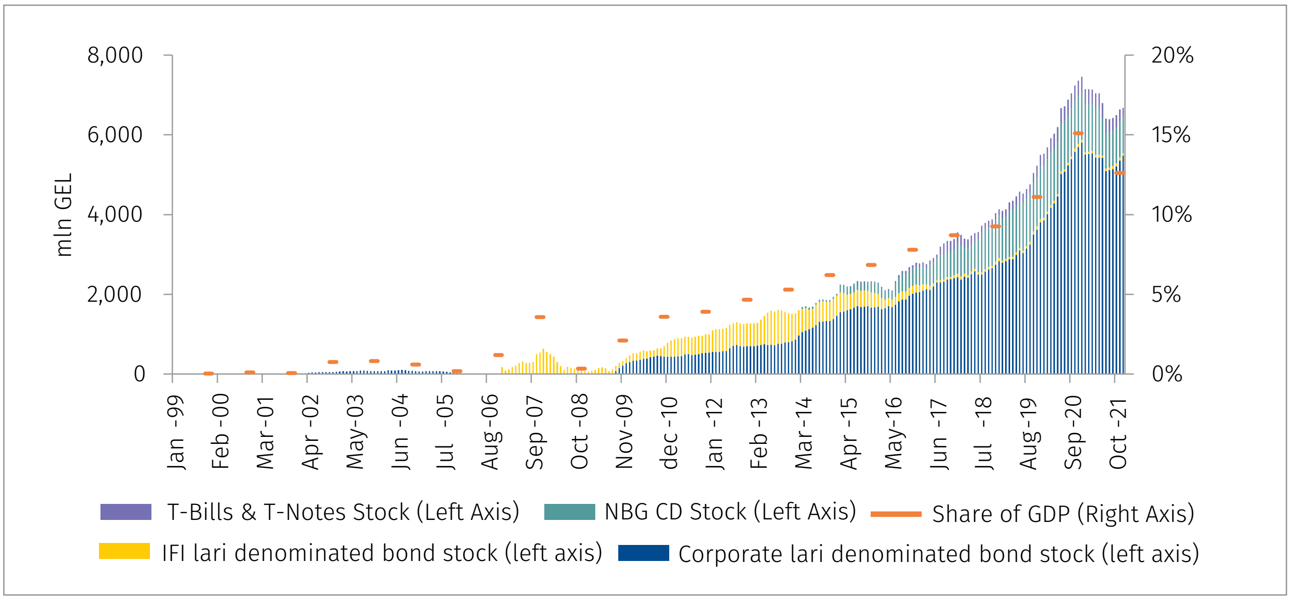
DIAGRAM N 2.6 DOLLARIZATION LEVEL IN THE BANKING SECTOR (EXCLUDING THE EXCHANGE RATE EFFECT)



Source: NBG

Promoting capital market development remains one of our top priorities. The development of the capital market will increase the availability of long-term GEL resources while facilitating larization. New GEL-denominated corporate securities emerged on the market in 2021, signaling a revival of the capital market (see Diagram N 2.7). Based on the amendments made to the collateral base in 2016, these securities will also be allowed in monetary transactions with the NBG. This, added to investment goals, creates an additional incentive to hold them for liquidity management. Demand from non-residents increased towards the end of the year, although a general decrease is evident for the year as a whole.

DIAGRAM N 2.7 DYNAMICS OF GEL-DENOMINATED SECURITIES



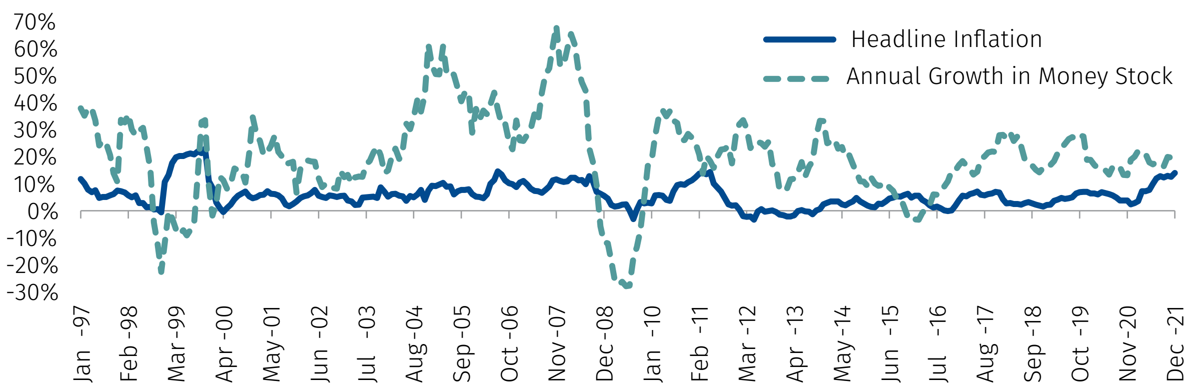
Source: National Bank of Georgia

BOX 2 CORRELATION BETWEEN M2 MONEY SUPPLY GROWTH AND INFLATION

With the growth of inflation fluctuations, discussions tend to intensify around its underlying causes. In such discussions, a change in the money supply is occasionally cited as the reason behind such fluctuations. It is often assumed that an increase in the money supply has an unequivocal effect on inflation, which is supported by the argument of a seemingly positive correlation found in the data at certain periods. Notwithstanding the fact that such links have no theoretical basis in the monetary framework of the NBG, the quantitative facts and the dynamics of the variables presented below show that these assumptions lack even an empirical basis (see Diagram N 2.8 and Table N 2.1).

As the data show, since 2010, when the NBG embarked on the inflation-targeting regime, changes in money supply and inflation have often been confused. This underscores the fact that when a central bank uses the interest rate as its operating benchmark, as is the case with inflation targeting, the direct correlation between money supply change and inflation is misleading.

DIAGRAM N 2.8 ANNUAL CHANGE IN M2 MONEY SUPPLY AND ANNUAL INFLATION



Source: GeoStat, calculations of the NBG

A few simple findings evident in Diagram N 2.8 are as follows: (i) The change in money supply is almost always higher than inflation, which reflects the strengthening of the function of money as a means of saving. This was especially evident in 2004-2008, when the money supply was growing rapidly, but at that time inflation was not really commensurate with this growth rate (moreover, the exchange rate was also appreciating during this period); (ii) The correlation between money supply change and inflation has virtually disappeared since 2010. Thus, under the current regime, it is wrong to only use the money supply to explain inflation; (iii) We can see periods when the money supply decreased but inflation increased (and the exchange rate also depreciated). For example, in 2015, impacted by severe external shocks and other factors, the demand for GEL decreased, leading to a lessening of GEL deposits and M2. Reducing demand for the GEL, in turn, further weakened the exchange rate and boosted inflation. This example underscores that a change in the money supply alone provides insufficient information, unless we are aware what factors are behind this change – whether it is a reflection of a change in demand or in supply. That is why we need the price of money – the interest rate. Thus, if the money supply increases but the price of money (short-term market interest rate) does not decrease, then this means that the demand for money has increased, which cannot be the cause of inflation. This is especially true from 2016 onwards, once the larization efforts intensified.

Finally, we can also look at whether the relationship between money supply change and inflation is hidden in the shift of time periods. For example, an increase in the money supply in the current period may not cause immediate inflation, but could do so in later periods (with a lag). However, no such lagged correlation is evident in the data (see Table N 2.1). Moreover, according to the data, an increase in the money supply is associated with a decrease in inflation. While the latter in itself does not denote a cause-and-effect relationship, it underscores the argument we make above: if an increase in the money supply, provided there is no change in rates, is a reflection of increased demand, then this cannot be a cause of rising inflation. Therefore, basing an analysis on mere, content-free correlations is most likely to be misleading.

TABLE N 2.1 CORRELATION OF THE ANNUAL CHANGE IN M2 MONEY SUPPLY AND ANNUAL INFLATION

	1997-2021	2000-2010	2011 -2021	2011-2016	2017-2021	2017-2021 (1-Month Lag)	2017-2021 (2-Month Lag)	2017-2021 (3-Month Lag)	2017-2021 (6-Month Lag)	2017-2021 (9-Month Lag)	2017-2021 (12-Month Lag)
Including December 2021	21.4%	67.1%	-0.1%	-12.2%	-9.4%	-6.9%	-5.3%	-4.1%	-6.7%	-16.7%	-27.5%

Source: GeoStat, calculations of the NBG

However, this does not generally suggest that the growth of the money supply is never linked to inflation. When the growth of money supply is backed by an excess growth in aggregate demand, then this can, naturally, lead to an increase in inflation. The two main reasons for the growth of aggregate demand are credit activity and the state budget deficit, both of which are sources creating demand for goods and services (which increases inflation), as well as the sources of money supply growth. The NBG permanently underscores the importance of aggregate demand for inflation. Neutralizing inflation from excess aggregate demand is a key function of central banks.

2.2 MONETARY POLICY INSTRUMENTS

The implementation of Monetary Policy Committee (MPC) decisions (tightening, easing, or keeping monetary policy unchanged) is done through monetary operations. The objective of monetary operations is to keep interbank interest rates stable and close to the policy rate determined by the Monetary Policy Committee of the NBG. The NBG's operational framework consists of the following monetary instruments: refinancing loans, the one-month open market instrument, open market operations with government securities, overnight loans, overnight deposits, certificates of deposit, and minimum reserve requirements.

The interbank deposit/loan market is the money market where banks trade short-term excess liquidity. The NBG has a vital interest in the market as it plays an important role in the efficiency of the monetary transmission mechanism. The NBG influences interest rates by declaring monetary policy decisions and by using monetary policy instruments.

The Tbilisi Interbank Interest Rate (TIBR) index of the money market is the overnight interest rate benchmark. As it is based on actual transactions on the interbank money market, the credibility of the index is increased. The reliability of the index is further enhanced by the involvement of the NBG in the process of collecting information and calculating the index. For the use of medium- and long-term instruments in the market as a benchmark (especially GEL variable rate instruments), on 14 March 2019 the NBG started publishing TIBR term rates that are based on the overnight TIBR index and represent a more effective way to manage interest rate risks. In a market economy, the interest rates on financial instruments (coupons, interest) are of different maturities (month, quarter, six months, year). The management of financial risks arising from exchange rate volatility requires appropriate maturity insurance mechanisms and appropriate maturity indices for pricing. Such indices, in turn, rely on a transparent methodology and market participants' trust in these as an independent source.

The methodology for calculating the TIBR index and TIBR term rates, which includes procedures for calculating and publishing the indices, was developed in close cooperation with participants of money markets and with the help of the EBRD. This methodology also provides procedures for data control and methodology review. The TIBR indices are published daily (at 9 a.m.) on the official website of the NBG.

The volume of transactions in local currency on the interbank market in 2021 was 154.9% of the previous year and amounted to GEL 31.1 billion. In the context of changes to the monetary policy rate of the NBG, 2021 saw interbank interest rates changing too, which were moving close to the monetary policy interest rate. The NBG determined weekly volumes for refinancing loans and monthly volumes for the one-month open market instrument within the framework of the decisions of the Monetary Policy Committee and based on the short-term liquidity forecast for the banking system. The National Bank managed these processes in such a way that the average interest rates observed at the auctions were maintained close to the monetary policy rate.

2.2.1 REFINANCING LOAN INSTRUMENT

The NBG used the refinancing loan instrument on a weekly basis throughout 2021 to ensure short-term liquidity in the banking system. The objective of the refinancing instrument is to provide adequate liquidity to the banking system. Refinancing loans represent a reliable and low-risk source of short-term liquidity and have positively affected the development of the money market and overall financial stability. GEL liquidity risks in the money market and fluctuations in market interest rates are declining, as is evident from the dynamics of the TIBR interest rates over the last decade (see Diagram N 2.4). As the NBG is the sole provider of short-term liquidity in lari on the market, the NBG has the capacity to achieve its desired interest rate on the interbank market with the help of the refinancing loan instrument. The interest rate for refinancing loans offered on auctions are based on the NBG's monetary policy rate.

In 2021, the collateral base of monetary operations encompassed the certificates of deposits of the NBG, Georgian government securities, lari-denominated securities issued by international financial intuitions, lari-denominated securities issued by legal entities, and the loan assets of commercial banks. To qualify for certain operations, the NBG defined appropriate criteria for each type of collateral (e.g., minimum level, residual maturity, currency). Commercial banks used all types of collateral in their operations with the NBG in 2021.

2.2.2 ONE-MONTH OPEN MARKET INSTRUMENT

Similar to other monetary instruments, the one-month instrument functions to manage short-term interest rates in the interbank market, which is in line with best international practice and the recommendations of the International Monetary Fund's Technical Assistance Mission. The liquidity forecasting group evaluates the short-term liquidity deficit in the banking system on a weekly and monthly basis, and auctions are then announced offering a specific volume of the one-month open market instrument. The minimum interest rate on this instrument at auction equals the monetary policy rate. The same assets as for refinancing loans are used as collateral.

2.2.3 OVERNIGHT LOANS AND OVERNIGHT DEPOSITS

In 2021, the NBG continued to use the interest rate corridor in the interbank market to support the development of the money market, reduce the volatility of interbank interest rates and increase the activity of the money market. The latter facilitated the interbank market to maintain a stable interest rate. The interest rate corridor was defined as an equal deviation from the monetary policy rate to form the upper and lower bounds of interest rates. The upper bound of the interest rate was used for overnight (O/N) loans of the NBG, and the lower interest rate bound was used for O/N deposits of the NBG. In 2021, the interest rate corridor was 1.5pp – the monetary policy rate plus/minus 0.75%. From August 2021, the interest rate on overnight deposits was defined as the monetary policy rate minus 1.75 pp so as to maintain the advantage of interbank deposits over overnight deposits of the NBG. The use of the interest rate corridor reduces the excessive volatility of interest rates in the interbank market and, in turn, helps bring the interbank interest rate closer to the monetary policy rate.

Overnight loans of the NBG represent the fastest source of liquidity for the banking sector, albeit being offered at a higher price in comparison with the market rate. The collateral base accepted for overnight loans was the same as that for refinancing loans.

Commercial banks can use the O/N deposit instrument to place excess GEL liquidity on correspondent accounts in the NBG's overnight deposits at the end of the day. Such deposits are returned to the commercial banks' correspondent accounts at the beginning of the next business day. This instrument plays an important role in stabilizing interest rates in the interbank market.

2.2.4 ADDITIONAL LIQUIDITY SUPPLY INSTRUMENTS

In the context of the pandemic, and to minimize potential liquidity risks to the financial sector, the National Bank launched a number of temporary liquidity instruments in 2020: currency swaps, standby swaps, and liquidity provision instruments for small and medium-sized businesses.

Swap Operations

The NBG used currency swap operations to provide additional liquidity for the banking sector in 2021. The need to apply this instrument was prompted by the problems and uncertainties that arose in the international and national economic environment as a result of the pandemic, which in turn could increase liquidity risks in the financial sector. Swaps were made available to microfinance institutions and commercial banks. In swap operations, the NBG bought foreign currency in the national currency for one month at the spot rate on the condition of selling it back at its forward rate. Currency swap transactions were conducted once a month, for a total of twelve times in 2021. As many as 11 commercial banks and two microfinance institutions (through banks) participated in these at different frequencies. The amount of currency swap operations varied each month and ranged from USD 12.9 million to USD 138.0 million, accounting for 3.23% to 34.5% of the resources allocated. As of 31 December 2021, USD 138.0 million was used in swap transactions, which is equivalent to GEL 427.8 million.

Standby Swap Instrument

The NBG introduced and launched a standby swap instrument as an additional liquidity support instrument for the banking sector in May 2020. This also helped insure against liquidity risks, allowing commercial banks to receive additional lari liquidity on any day at a penalty interest rate. Due to the higher interest rate offered, this instrument was only used in rare instances. Commercial banks used this instrument three times in 2021, amounting to GEL 345.8 million in total.

Liquidity Instrument to Support SMEs

In June 2020, the National Bank launched an additional liquidity instrument to reduce the negative impact of the pandemic on the economy and to support small- and medium-sized businesses. The one-month liquidity instrument offered the possibility of monthly renewals and was used by eight commercial banks over

2021. Based on the need for liquidity, the volume of the instrument changed over the months; its minimum number was GEL 473.7 million, while its maximum number was GEL 632.0 million at the end of the year.

2.2.5 SECURITIES

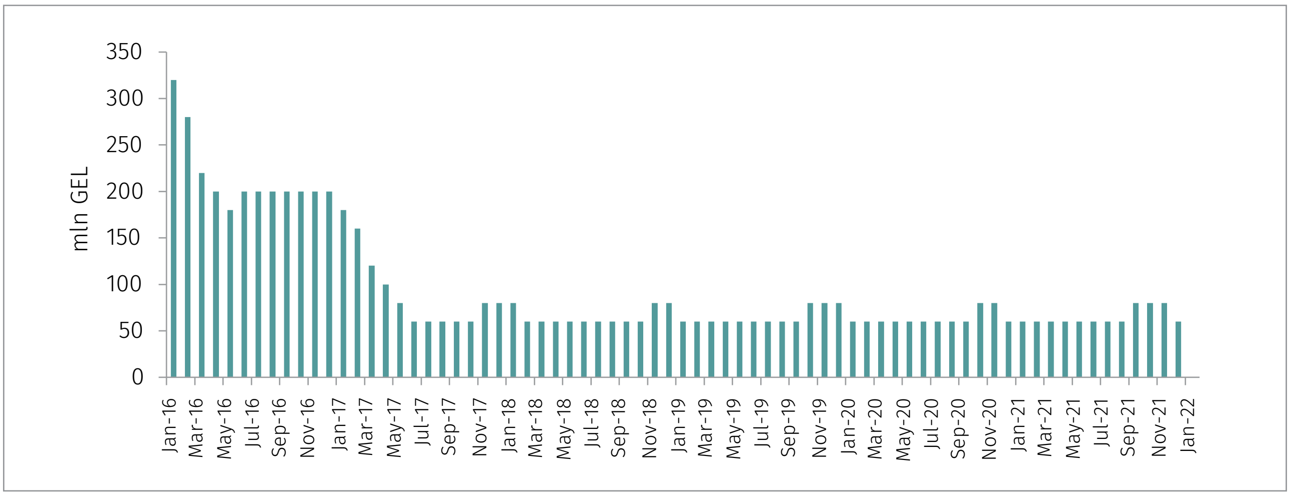
The NBG issued 3-month certificates of deposit, and the Government of Georgia issued 6-month, and 1-, 2-, 5- and 10-year treasury securities in 2021. These securities were in high demand by commercial banks and helped to establish a stable yield curve. This curve provides important information about interest rates at different maturities and the expectations of financial market participants.

Certificates of Deposit

The NBG issued 3-month certificates of deposit in 2021, which are used by the banking sector as an attractive and effective short-term liquidity management tool.

In all of the 13 auctions announced in 2021, commercial banks purchased the full amount of certificates of deposit on offer. In total, certificates of deposit with a nominal value of GEL 260 million were placed and those with a face value of GEL 260 million were repaid. As of 31 December 2021, GEL 60 million worth of certificates of deposit in circulation were held by three commercial banks.

DIAGRAM N 2.9 VOLUME OF THE CERTIFICATES OF DEPOSIT PORTFOLIO, 2016-2021



Source: NBG

Government Bonds

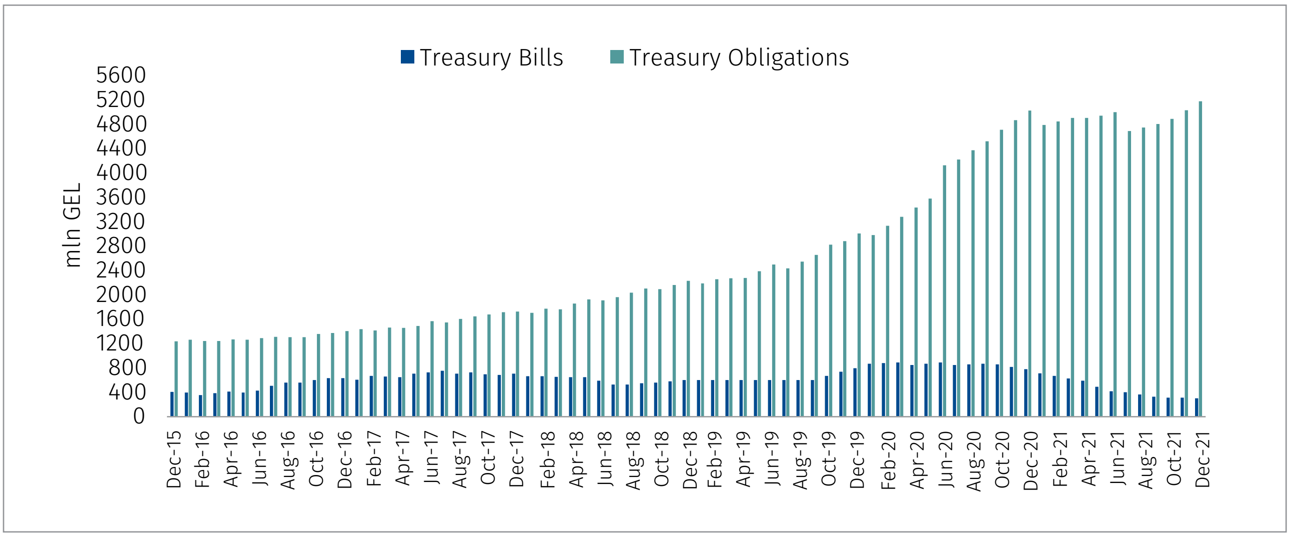
As of 31 December 2021, the NBG held government bonds with a nominal value of GEL 152 million, which were not used for open market operations during the year.

Treasury Bills and Treasury Bonds

To further develop the GEL money market, it was crucial that the Ministry of Finance of Georgia increased the emission of government securities. In 2021, the Ministry of Finance issued 6-month and 1-year discount securities (treasury bills), and 2-, 5-, and 10-year coupon securities (treasury bonds). These securities were denominated in the national currency in a dematerialized form. The nominal value of a security is GEL 1,000. The placement of treasury bills and bonds are executed through a multiple price auction conducted by the NBG via the Bloomberg trading platform. All commercial banks licensed by the NBG can participate directly in an auction and any legal entities or individuals may also participate using a commercial bank as an agent. In 2021, 46 auctions of treasury bills and notes were conducted, and GEL 1.35 billion worth of securities were offered. As of 31 December 2021, 14 commercial banks, the NBG and non-banking investors held GEL 5.5 billion worth of securities in circulation. Non-banking investors held treasury securities worth GEL 619.3 million.

The volume of government securities in circulation in the market is still small compared to the size of the economy. In order to increase market liquidity, the Georgian government has issued 2-, 5- and 10-year benchmark bonds since 2018. This has led to an increase in the issuance of treasury securities, which contributes to the reduction of foreign exchange risk.

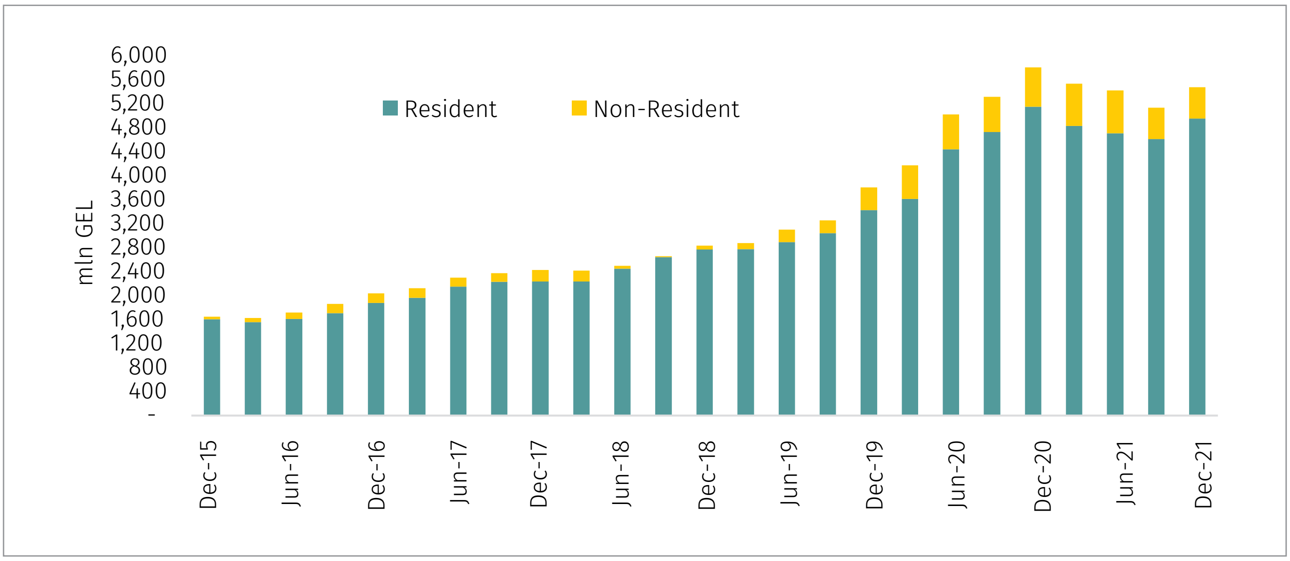
DIAGRAM N 2.10 DYNAMICS OF THE TREASURY BILLS AND TREASURY BONDS PORTFOLIO, 2017-2021



Source: NBG

The stable macroeconomic environment, attractive interest rates on GEL financial instruments, an acceptable level of financial market development and modern infrastructure have sparked the interest of non-resident investors in the treasury market. The increased activity of investors is evident in their involvement in both primary and secondary markets, hence the portfolio of treasury securities owned by them amounted to GEL 525.8 million in 2021.

DIAGRAM N 2.11 TREASURY BILLS AND TREASURY BONDS PORTFOLIO DYNAMICS, 2017-2021



Source: NBG

To promote the stimulation of the secondary securities market, by its own material and intellectual investments the NBG continued to foster the full functioning of the Georgian Securities Settlement System (GSSS) and various integrated systems in accordance with current requirements.

The interbank repo market, which is based on the repo master agreement, was established in line with best international practice and was initiated by the NBG in close cooperation with the Georgian banking community. A repo transaction is the sale of securities with a subsequent obligation to sell back the same or equivalent securities under pre-agreed terms. Banks used the Bloomberg trading platform and the GSSS to conduct repo transactions. Using these systems, in 2021 a total of 10 repo transactions were made between commercial banks worth GEL 616.9 million.

The infrastructure and experience in the securities market provide a good basis for the further activation of the secondary securities market, which should lead to an increase in the liquidity of the securities market.

Pilot Program for a Primary Dealer System for the Development of the Securities Market

The development of the treasury securities market is a strategic focus for the broader development of the Georgian financial market and government debt management. In recent years, the volume of the securities market has gradually been increasing. Benchmark bonds were first issued in 2018, with their volumes gradually increasing.

To take the development of the securities market to a new level, to expand the investor base and to activate the secondary market, the NBG and the Ministry of Finance of Georgia considered it expedient to establish a primary dealer institute, as tested in best international practice. Such an institute can act as an important mediator in the securities market, working between the Ministry of Finance of Georgia, as the issuer of treasury securities, and investors. A well-developed government securities market will, in turn, help the advancement of the capital market. Primary dealers will take care of the diversification of the investor base and increase the liquidity of the secondary market through regular price updates and the provision of appropriate trade and settlement infrastructure.

The NBG and the Ministry of Finance of Georgia, working with the technical assistance of the International Monetary Fund and the World Bank, have spent a great deal of time in recent years in preparing a pilot program for primary dealers. A jointly prepared memorandum of understanding was discussed with market participants and six commercial banks operating in Georgia expressed readiness to participate in the primary dealer pilot program, with memoranda of understanding subsequently signed with each of them. The pilot program was launched in November 2020 and its validity period was initially set at 1-1.5 years. After this period, the results of the pilot program will be summarized and plans for its future development will be outlined.

National Bank Operations in the Secondary Market

The NBG works on the improvement and development of monetary instruments and the liquidity management framework on an ongoing basis. Buying and selling securities through open market operations is one of the central banks' monetary policy instruments that serves the task of managing liquidity.

In 2021, the NBG continued purchasing securities under open market operations in the secondary market. The goal of these operations was to effectively manage the liquidity of the national currency, along with promoting the development of the securities market.

The NBG held 12 auctions during 2021, in which it purchased treasury securities with GEL 1.2 billion of nominal value. As of 31 December 2021, the securities portfolio held by the NBG amounted to GEL 1477.0 million, considering the balances of securities acquired in 2020 and repaid in 2021. At the end of 2020, the volume of this portfolio was GEL 984.96 million.

2.2.6 MINIMUM RESERVE REQUIREMENTS

By employing the minimum reserve requirements instrument, the NBG creates a precondition for the effective use of other monetary instruments. In the first half of 2021, the minimum reserve rate for funds raised with a residual maturity of up to one year was 5%; for foreign currency attracted funds it was 25%; and for foreign currency borrowings with a residual maturity of one to two years it was 15%. From the second half of 2021, the minimum reserve requirements changed for funds attracted in foreign currency. These are now 10-25% and depend on the level of dollarization at each commercial bank. In terms of residual maturities, funds borrowed in the national currency with a maturity of more than one year and those in foreign currency with a maturity of more than two years are exempt from reserve requirements.

Minimum reserves in the national currency placed by commercial banks at the NBG during 2021 were subject to the monetary policy rate (active at that period) accrued on them by the NBG.[27] US dollar minimum reserves were accrued at 50 basis points lower than the upper limit of the US Federal Reserve's policy, and euro minimum reserves were accrued at 20 basis points lower than the European Central Bank's deposit rate.

2.2.7 DEVELOPMENT OF THE SECURITIES SETTLEMENT SYSTEM IN GEORGIA

A Securities Settlement System has been operating at the NBG since 2010. This modern, high-tech, fast and secure electronic system ensures safe and transparent securities transactions for government- and NBG-issued securities.

Launched on 3 December 2018, and successfully operating throughout 2020, the Georgian Securities Settlement System (GSSS) provides both local and international financial market participants with high-quality services. This system can settle the whole spectrum of public and private securities. Via this system, transactions with securities have become faster, cheaper, more convenient, and fully protected. This project is a clear example of successful cooperation between the NBG and the private financial sector. The innovative GSSS system includes modern approaches, such as effective liquidity management mechanisms, partial settlement capacity, netting of reverse transactions, automatized pledging, and intraday liquidity provision mechanisms. All local commercial banks, as well as some brokerage companies, are connected to the GSSS. The system is integrated with the stock exchange and Bloomberg trading platforms and automates the entire trading and settlement cycle. Thus, it only takes a few minutes from the time of a transaction to its settlement. With the introduction of the new system, the available procedures and payment procedures, which are based on the principles recognized in international best practice, were renewed. Investors' security holdings will now be more securely protected, making it easier and more convenient to convert them into cash (through sales, pledge or repo operations) if needed. This will undoubtedly increase the attractiveness of the Georgian capital market for both local and foreign investors.

The updated GSSS allows the integration of the Georgian Central Securities Depository in the system, to provide services to all participants in the Georgian securities market, and to register and settle all types of securities in Georgia in this system (including bonds and shares issued by private companies). Private securities issuance, repayment, buying and selling, repo, coupon and dividend payment operations registered in this system are fully automated, as well as their pledging to the NBG or professional market participants.

The updated GSSS system is expected to make Georgian financial markets attractive for foreign financial institutions and investors, while helping the infrastructure of the local securities market to become more reliable and up to date.

27. For details, refer to the NBG official website: https://www.nbg.gov.ge/index.php?m=558

2.3 EXCHANGE RATE POLICY AND INTERNATIONAL RESERVES MANAGEMENT

Exchange Rate Policy

Similar to previous years, in 2021 the monetary policy of Georgia was based on a floating exchange rate regime, which involves maintaining market pricing principles for the national currency. A floating exchange rate mechanism is recognized as the optimal currency regime for countries with small open economies, like Georgia. The main advantage of this regime for the economy is the exchange rate functions as an automatic stabilizer and reduces the negative impact of external shocks.

During the reporting period, the continuation of the pandemic-driven crisis prompted an adapted monetary policy similar to that of the previous year.

Amid a protracted crisis, the private sector had to operate in the face of a negative external balance, while most of the foreign government inflows into the government sector were accumulated in government accounts with the NBG. To ensure macroeconomic stability, it was important to channel these resources to the foreign exchange market, in observance of market principles. The NBG thus maintained the policy of active foreign exchange interventions that was announced in 2020, implying foreign exchange sales.

Foreign exchange auctions continued to be used by the NBG as the main tool for intervention in the foreign exchange market during the reporting period. NBG interventions through such auctions took place at the beginning of the year and amounted to USD 242.9 million up until April. Over the rest of the year there were only two instances that prompted the necessity of market intervention using this instrument, which totaled USD 90 million. In total, the amount of foreign currency supplied through foreign exchange auctions in 2021 amounted to USD 332.9 million.

However, with the rapid recovery of the national economy, the revival of the tourism sector (albeit not yet at its complete potential), as well as a boost in remittances, the currency market imbalance was reduced and there was therefore no need for a larger supply of foreign exchange. It is important to note that during the reporting period, foreign exchange interventions by auctions accounted for about 38.1% of the foreign currency that had been supplied in 2020.

During 2021, the NBG also used the BMatch platform, which was first launched in 2020. This allows companies and commercial banks to trade. NBG interventions on the BMatch platform are rule-based and are performed under pre-defined amounts and terms. This allowed a reduction of excess volatility in the foreign exchange market through small-scale interventions, whereas exchange rate fluctuations were caused by low liquidity (low levels of activity) in the foreign exchange market. The net volume of foreign currency liquidity supplied to the foreign exchange market by the NBG through the BMatch platform amounted to USD 22.0 million. The NBG thus provided the foreign exchange market with a total net value of USD 354.9 million in the reporting year.

The GEL nominal exchange rate appreciated considerably from the middle of the reporting year and moved steadily, within a small range, over the following months. At the end of 2021, the nominal effective exchange rate of GEL had appreciated by an annual 18.1% compared to the previous year, while the real effective exchange rate appreciated by 20.5 % YoY.

BOX 3 FX MARKET REFORMS

BMatch platform

In 2021, interbank market participants were actively using the new BMatch platform for foreign exchange trading through the Bloomberg system. Launched in 2020, BMatch is a new foreign exchange trading system made available through Bloomberg's foreign exchange trading platform. It is based on the principle of the automatic matching of transactions. Market participants place foreign currency buying and selling bids on the BMatch platform, and when the exchange rates of the buyer and the seller match, then foreign exchange transactions are concluded automatically between these parties. Along with commercial banks, companies can also participate in the BMatch platform. The launch of the new system helps strengthen competition in the foreign exchange market and improve the transparency of the market operation process. An analysis of the past period shows that spreads were narrowed as a result of the competitive and transparent environment created on the BMatch that enables participants to trade fairly.

The launch of the BMatch platform has enabled the NBG to introduce an additional tool: rule-based interventions. These allow the NBG to intervene more effectively, as needed, in the foreign exchange market so as not to hinder the competitive pricing process in the market. NBG interventions on the BMatch platform are rule-based and are performed within a pre-defined amount. With small interventions, the NBG is able to reduce excess volatility in the foreign exchange market, whereas exchange rate fluctuations are caused by low liquidity (low levels of activity) in the same market.

FX Global Code

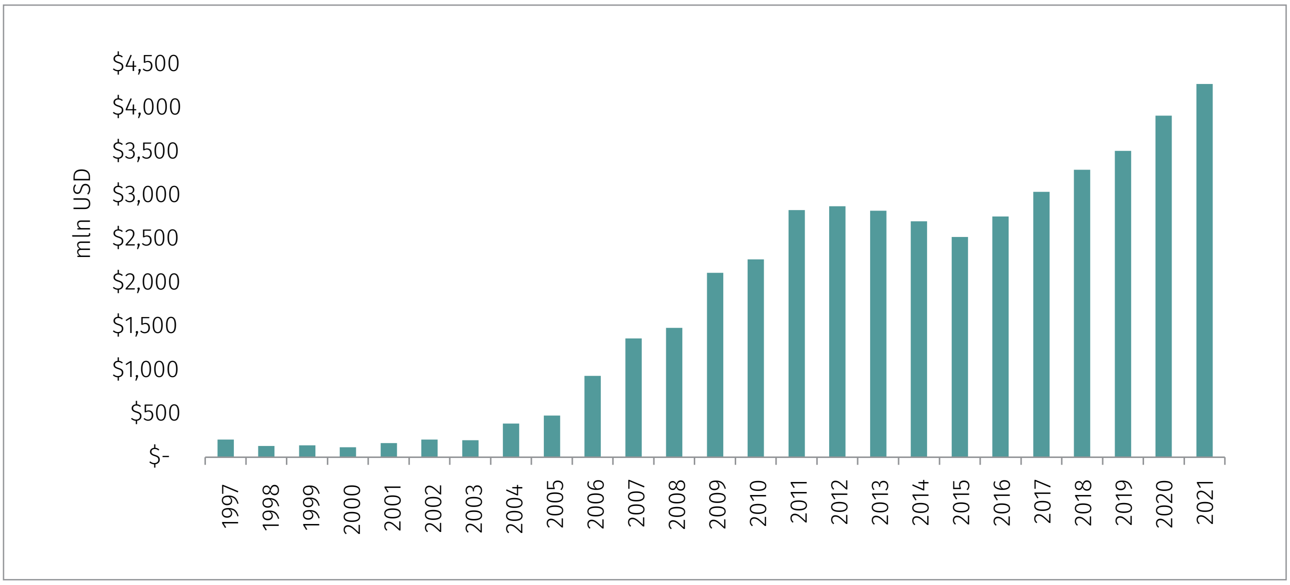
To facilitate the efficient functioning of the country's foreign exchange market, the NBG has started the process of harmonizing with the requirements of FX Global Code. The code was created in 2017 with the participation of the central banks of the world's leading countries. The Bank of International Settlements, the European Central Bank, the central banks of 48 countries, as well as more than 1,100 financial institutions and companies recognize the need to meet the conditions set by the FX Code.[28] These include the central banks and leading banking institutions of the USA, England, Europe, Japan, Canada and Australia. The NBG has initiated a new regulation on foreign exchange market participants that is based on the core requirements of this international code, while also considering the specifics of the local market. Both the FX Global Code and the regulations on foreign exchange market participants are designed to increase transparency and competition, establish fair and equitable conditions for market participants, and better protect the interests of their clients.

International Reserves Management

The volume of the international reserves of the NBG increased by USD 361 million in 2021, compared to the previous year, and amounted to USD 4.3 billion as of 31 December 2021 (see Diagram N 2.12). The funds raised by the government from international donors were vigorously provided by the NBG to the foreign exchange market through interventions. During the year, changes in compulsory reserve requirements reduced the international reserves by USD 142 million (by 3.6%).

28. For more information, see https://www.bis.org/about/factmktc/cbregister.htm

DIAGRAM N 2.12 OFFICIAL RESERVE ASSETS, 1997-2020 (MILLION USD, AS OF YEAR-END)



Source: NBG

03

FINANCIAL STABILITY

3.1 FINANCIAL STABILITY POLICY

Promoting financial stability as a precondition for sustainable economic growth is one of the fundamental goals of the NBG. As defined by the Organic Law on the National Bank of Georgia, the NBG is mandated to maintain financial stability in the country as long as that objective does not come into conflict with its main mandate of maintaining price stability. Financial stability is the state under which the financial system can provide crucial services to market participants in both good times and periods of stress.

The NBG conducts macroprudential policy with the goal of maintaining financial stability. The NBG identifies, evaluates and monitors systemic risks and implements corresponding policies to prevent or mitigate those risks, thereby enhancing the resilience of the financial system. The Financial Stability Committee (FSC) of the NBG, which is chaired by the bank's governor, coordinates macroprudential policy within the NBG's mandate. The FSC identifies and analyses systemic risks and ways to mitigate them, makes recommendations on the use of macroprudential measures and coordinates actions that promote financial stability.

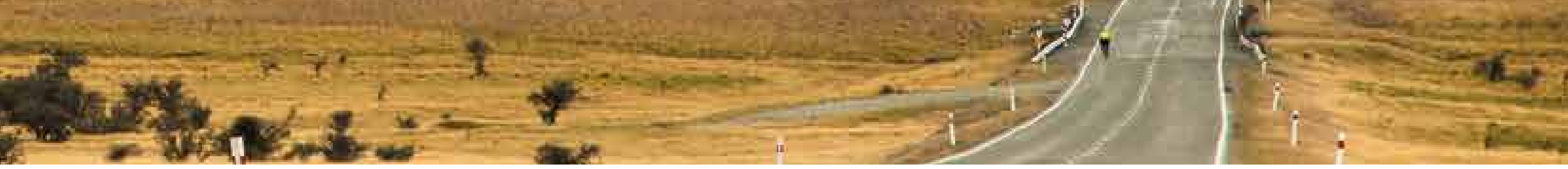
The countercyclical capital buffer is used as one of the main macroprudential policy instruments. Its goal is to limit excessive credit growth that leads to the build-up of systemic risks. The countercyclicality of the buffer serves the main purpose of macroprudential policy, which is to reduce systemic risks. In the event of negative shocks, the countercyclical buffer should help the financial system avoid a significant deterioration of lending to the economy and thus help prevent a further worsening of conditions in the financial sector and the economy as a whole. An analysis of a number of factors is incorporated in determining the countercyclical capital buffer, including the credit-to-GDP ratio and indicators describing its deviation from the long-run trend; trends in lending; other indicators of the financial sector's cyclical position; and the characteristics of the country's domestic and external macro-financial environment.

In addition to the countercyclical buffer, the NBG uses other capital buffers consistent with Basel III standards. These macroprudential instruments include the payment-to-income ratio and loan-to-value ratio, sectoral risk weights and other instruments.

As a result of the financial stability policy pursued by the National Bank of Georgia, the financial sector successfully passed a rather severe phase of the shock caused by the pandemic, continuing to lend to the economy smoothly. The capital requirements imposed by the NBG prior to the pandemic, the introduction of responsible lending regulations and a number of macroprudential measures aimed at reducing the dollarization of loans all contributed to robust asset quality and the accumulation of solid capital buffers. Meanwhile, the establishment of the Liquidity Coverage Ratio (LCR) and Net Stable Financing Ratio (NSFR) in recent years led to the stability of banks' funding sources and the improvement of the liquidity buffer. As a result, as of December 2021, banks maintained sound capital and liquidity ratios, while asset quality improved compared to the previous year.

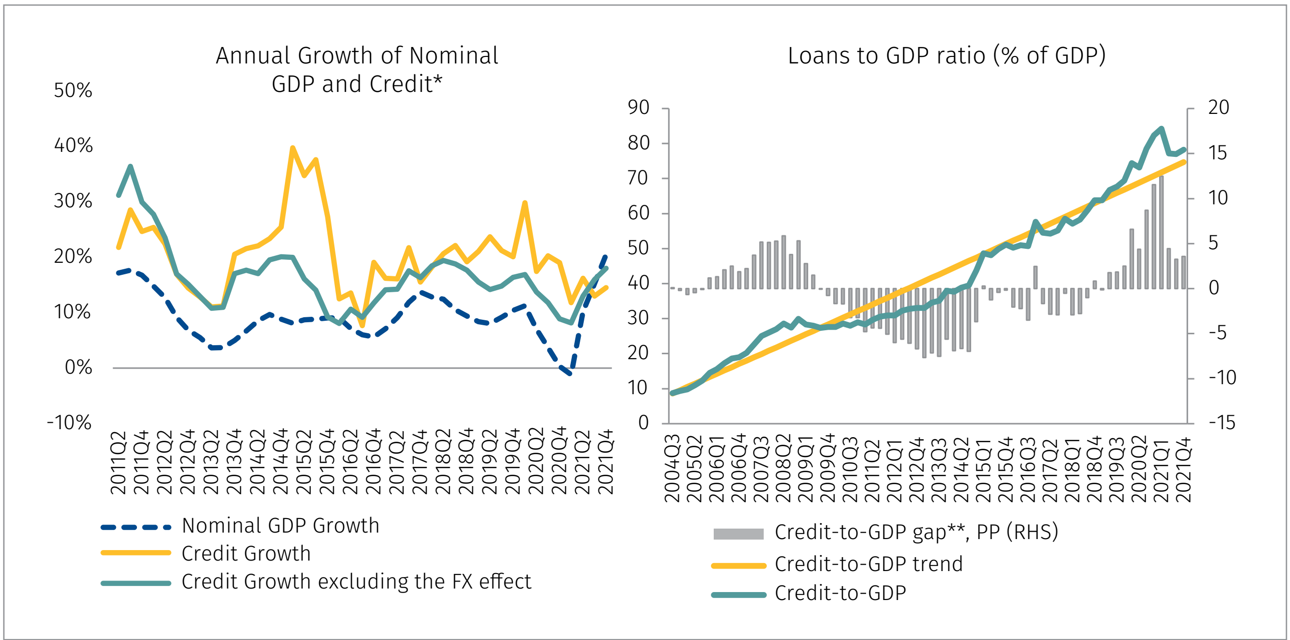
Banks ended 2021 with solid profits, fueled by high lending activity and declined credit losses, which in turn was caused by the loan loss reserves that had been created in advance in 2020. Better-than-expected economic growth, among other things, helped borrowers with their financial problems, and thus reduced the reserve that had been created after the outbreak of the pandemic. On the decision of the Financial Stability Committee, banks were given time until 1 January 2023 to restore the currency induced credit risk (CICR) buffer, and until 1 January 2024 to meet the capital conservation buffer requirement. However, as a result of improved financial performance, most of the banks have already restored the released capital buffers. According to the Financial Stability Committee, despite the subsequent deteriorating economic situation in the region following Russia's invasion of Ukraine, the banking sector remains resilient and continues to lend to the economy smoothly in 2022.

In December 2021, the annual growth rate of loans, excluding the exchange rate effect, amounted to 18.2%,



which was largely due to the growth of business loans and, in terms of currencies, was due to loans in the national currency. However, it is important to note the growing dynamics of foreign currency loans. The credit-to-GDP ratio continues to exceed its long-term trend, however, compared to the beginning of the year, the gap in the ratio has narrowed significantly, reflecting the effects of high economic growth and an appreciated exchange rate. Preliminary estimates suggest that real GDP growth in 2021 was high and exceeded 10%, which helps maintain a sustainable level of debt burden. Importantly, the process of restoring the capital buffers released at the beginning of the crisis and improving the level and quality of capital planned before the crisis (according to the Regulation on Capital Buffer Requirements for Commercial Banks within Pillar 2) will, to some extent, act as a countercyclical buffer in subsequent periods. Tightened monetary policy further reduces GEL credit activity and thus helps to reduce inflation.

DIAGRAM N 3.1 COMPARISON OF CREDIT AND NOMINAL GDP GROWTH RATES



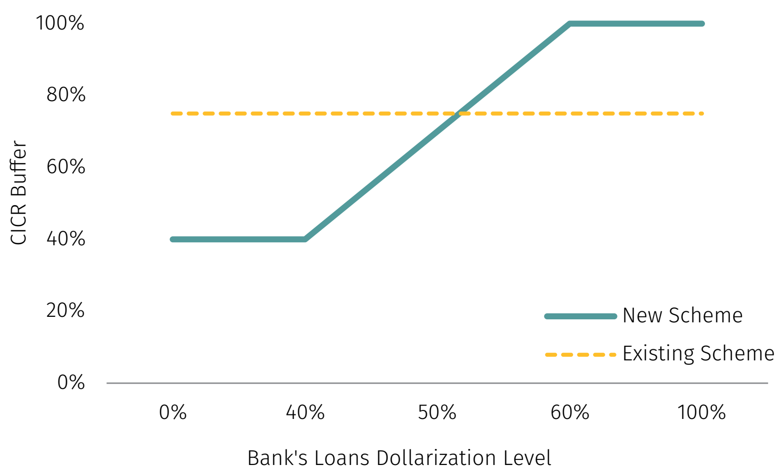
** Credit includes loans issued by banks and microfinance institutions, as well as bonds issued domestically by the non-financial sector.*
*** The credit-to-GDP gap is the deviation of the credit-to-GDP ratio from its long-run trend. The trend is estimated using an HP filter in line with the Basel recommendations.*
Source: NBG

According to the decision of the Financial Stability Committee, the method of calculating the currency induced credit risk buffer (CICR) has been recalibrated: it is now dependent on the level of dollarization of a commercial bank's loan portfolio. This is expected to motivate banks towards the larization of their loans. As noted in the previous year's annual report, dollarization remains a major challenge for the financial sector, despite a considerable reduction in recent years. In the pre-crisis period, the NBG took a number of macroprudential measures to reduce the dollarization of loans, hence contributing to a significant reduction of current vulnerabilities. However, given that the share of foreign currency loans in the loan portfolio is still high, dollarization remains a major risk for non-hedged borrowers and for the financial system as a whole. To support larization, the CICR buffer is now determined by the dollarization of loans, as opposed to the previous 75% risk weight requirement. If dollarization is 40% or less, the risk weight is 40%, and every 1 pp growth in dollarization increases the risk weight by 3 pp, up to a maximum of 100%. At the transition stage, this CICR

calculation scheme will not lead to a material change in system-wide capital requirements, although the buffer requirement will change for individual banks depending on their dollarization level. To ease the transition to the updated scheme, those banks that needed to replenish the buffer were given one year to meet the requirement, while the buffer reduction was implemented immediately for other banks. This tool is expected to encourage larization and, over time, as larization grows, the capital buffer requirement will be lessened, with the systemic risk stemming from the exchange rate also decreasing. In its nature, this change is similar to the initiative of June 2021 that implied that minimum reserve requirements were tied to the level of dollarization in banks.[29]

According to the FSC's decision, from 2022 the maximum term of foreign currency mortgage loans will be reduced from 15 to 10 years. From April 2021, in parallel with the recovery of the economy and the tightening of monetary policy, the growth of foreign currency mortgage loans has accelerated. If the current trend is maintained, the annual growth rate of such loans would reach 10% in 2022. As most borrowers are non-hedged, and hence highly vulnerable, the sizeable portfolio contributes to the accumulation of systemic risks in the financial sector. It also threatens the sustainability of the real estate market. Most mortgage loans have variable rates, so these carry both exchange rate risk and interest rate risk. This matter deserves attention, as the world markets currently have historically low

CICR Buffer Change Scheme

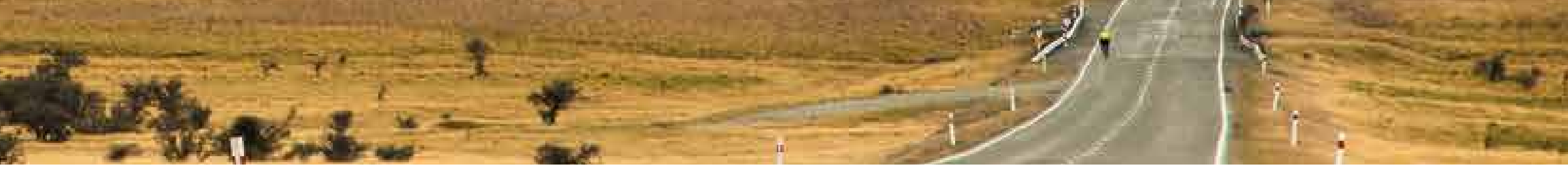


interest rates on USD and EUR and there is potential for interest rate hikes. Reducing the maximum maturity of foreign currency mortgages will alleviate these vulnerabilities and increase borrowers' abilities to absorb stress through the possibility of extending the maturity of their loans, a practice that was used effectively in 2014-2015 and again during the current pandemic. Reducing maturities will also accelerate loan amortization, which in turn will lessen credit risks and facilitate de-dollarization.

3.2 DEVELOPMENT OF THE FINANCIAL STABILITY FRAMEWORK

The development of the financial stability framework is part of the NBG's mandate to provide financial stability, which is one of the key factors in determining a country's economic development. The importance of financial stability and macroprudential policy has

29. For more information, see https://nbg.gov.ge/en/media/news/changes-in-the-minimum-reserve-requirement-for-commercial-banks-to-take-effect-on-july-6



increased all over the world in recent years. The pandemic that emerged in 2020 and the resulting global economic crisis have reaffirmed its importance. A sound and efficient framework for financial stability will ensure a smooth supply of financial resources, even during periods of economic downturn, and will make a significant contribution to the rapid recovery of the economy. According to best international practice, regular comprehensive and in-depth analyses of financial stability are required. Financial stability analysis not only encompasses an evaluation of risks in the banking system, but also focuses on external factors – the latter of which have been a source of significant risk in recent years. Financial stability also assesses the domestic macro-financial environment, including households, companies, and non-banking institutions.

The NBG continues to develop a financial stability policy framework in accordance with the best international practice of other central banks. As this requires the development of an adequate analytical capacity, the first step in this direction was focused on developing complex, Georgia-specific financial stability indicators. These indicators are used to make cyclical macroprudential policy decisions. As the next step, the NBG published the macroprudential policy strategy.[30] This strategy reflects the basic principles of the NBG's macroprudential policy and aims to improve the decision-making process, and communication and accountability to the public. In addition, the NBG is permanently working on the development of analytical instruments that are based on international experience as well as country-specific characteristics. In this regard, a research paper prepared by the Financial Stability Department in 2020 is noteworthy as it offers the analytical tools to ensure the timely detection of systemic risks and thereby establish a credible macroprudential policy guide.[31]

Macro-financial modeling is another important part of the financial stability analysis framework. The NBG is working on the development of a macro-financial model that aims to assess the risks to financial and macroeconomic stability, to construct and analyze macro-financial scenarios, and to conduct macroeconomic stress tests. These are the cornerstones of appropriate macroprudential policy design. Ongoing developments in the financial system and accompanying challenges are creating increased demand for the macro-financial model and are expanding the scope of its application. Thus, the development and advancement of the macro-financial model is an ongoing process, in which cooperation with international partner institutions is crucial.

Increasing transparency and improving communications is one of the most important aspects of the financial stability framework. The NBG is constantly updating the financial stability section of its website in order to increase public awareness about financial stability policy. The website outlines the main tasks of the Financial Stability Committee and describes the available macroprudential policy tools; it also provides a calendar of committee meetings, and offers reports on committee statements and decisions, issues related to IFRS 9[32] and information regarding the sustainable finance framework.

The NBG supports the efficient implementation of new financial accounting standards (IFRS 9) by financial institutions. The NBG regularly publishes macroeconomic and financial forecasts and risk scenarios along with quantitative assessments[33] of macroeconomic trends to aid the transparent, consistent and efficient implementation of IFRS 9, and to ensure comparability across the reports. The estimates provided within these scenarios can be used for calculating expected credit losses. The macroeconomic forecast scenarios for IFRS 9 are based on the macro-financial model and incorporate additional analysis and expert judgment. The scenarios provided are countercyclical by nature, which helps mitigate the potential impact of financial cycles. Given the high degree of uncertainty caused by the pandemic and the increased risks, in 2021 the NBG

30. Refer to https://www.nbg.gov.ge/index.php?m=738
31. Credit Gap Assessment as a Guide to Macroprudential Policy in Georgia, bit.ly/36me1EE
32. International Financial Reporting Standard (IFRS 9).
33. For more information, see https://www.nbg.gov.ge/index.php?m=694

released three updates to the forecast scenarios, allowing financial companies to reflect macroeconomic forecast information on their loan loss reserve estimates in a timely manner.

A sustainable financial system is essential for financial stability. This revolves around the management of social and environmental risks and is one of the main factors contributing to sustainable development. The NBG became a member of the Sustainable Banking and Finance Network (SBFN) in September 2017 and since then has been actively working on developing a framework for sustainable finance.

The National Bank of Georgia continues to implement the action plan outlined in the Roadmap for Sustainable Finance.[34] The roadmap summarizes all of the actions that the NBG plans to accomplish before the end of 2022. The ultimate goal of the roadmap is to provide a credible, predictable and stable regulatory framework and to prepare the market for a transition to sustainable finance. The action plan outlined in the roadmap consists of the following main pillars: increasing awareness and building market capacity for sustainable finance; embedding environmental, social and governance (ESG) issues into risk-assessment frameworks and decision-making processes; and ensuring greater transparency and market discipline, which will facilitate capital flow towards sustainable sectors.

Integration of ESG considerations into the Corporate Governance Code is one of the major objectives of the sustainable finance framework. Although these aspects were already covered for commercial banks in 2018, in the wake of sustainable finance development and the progress the National Bank has made in this direction, it became necessary to integrate ESG issues into the Corporate Governance Code in more comprehensive manner. In June 2021, the amendments made to the Corporate Governance Code of Commercial Banks brought greater clarity and accuracy on ESG issues and related requirements. More specifically, the supervisory boards' responsibility was defined for integrating ESG issues into banks' strategy and risk management frameworks, and for their effective implementation. The changes also specify the use of a ESG reporting form and refer to the ESG Reporting and Disclosure Principles developed by the NBG for guidance.[35] Furthermore, the ESG reporting form has been added to the Pillar 3 annual reporting.

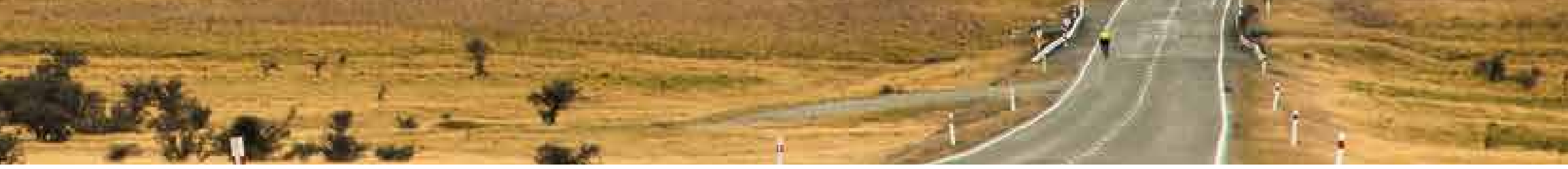
In 2021, for the first time, banks disclosed ESG information using the National Bank's form in accordance with the requirements of the Corporate Governance Code. The forms filled out by financial institutions were subsequently published on the NBG website.[36] Banks will conduct this reporting annually, which in turn will help provide information on ESG issues to investors and other stakeholders.

ESG issues were also integrated into the Corporate Governance Code for issuers of public securities, as adopted in December 2021.

From 2021, the NBG started publishing a Sustainable Finance Report. This is an annual publication issued by the NBG that presents an overview of current trends, policies, and plans regarding sustainable finance in Georgia. Within this scope, the report provides an analysis of the steps taken by the National Bank, a description of current and upcoming projects, and a summary of the information disclosed by commercial banks using the ESG forms. The report also highlights trends regarding the issuance of green and sustainable bonds and the related dynamics of the capital market in Georgia.

The development of a sustainable finance taxonomy[37] is one of the crucial phases for the development of sustainable finance and is a further step set out in the Sustainable Finance Roadmap. The lack of common definitions and classification systems in this regard is

34. See https://nbg.gov.ge/en/page/sustainable-finance-roadmap
35. See https://nbg.gov.ge/en/financial-stability/esg-reporting-and-disclosure
36. See https://nbg.gov.ge/en/financial-stability/esg-reporting-and-disclosure
37. The sustainable finance taxonomy is a document that identifies and classifies actions and economic activities that have a positive environmental and/or social impact.



recognized as one of the major challenges facing the development of sustainable finance and the NBG is thus actively working to develop the taxonomy.

The need to develop a taxonomy for Georgia stems from the need to consider the specifics of the Georgian financial system, the development stage of sustainable finance, and sustainability issues relevant to Georgia. The sustainable finance taxonomy document integrates Georgia's sustainable development priorities, incorporates international best practice, includes green and social taxonomies, and is developed with the involvement of various stakeholders. In particular, the development of the technical criteria of the taxonomy has been carried out with the involvement of industry experts from the Ministry of Environment Protection and Agriculture of Georgia and the Ministry of Economy and Sustainable Development of Georgia. Consultations with international experts and other relevant stakeholders and feedback from local financial institutions are also part of this process. In addition, the NBG will assist financial institutions in adopting the taxonomy through providing consultations, training and technical support. To this end, the NBG has launched a new project with the support of the Green for Growth Fund (GGF) Technical Support Program, as implemented by PwC Georgia and the Czech Republic. The main goal of this project is to develop screening and reporting tools for effective and consistent implementation of the taxonomy, to consult with financial institutions and to provide training for representatives of commercial banks.

In November 2021, the National Bank of Georgia hosted an online Sustainable Finance Forum within the scope of the Sustainable Finance Roadmap. The event was organized in cooperation with the International Finance Corporation (IFC, a member of the World Bank Group) and the IFC-facilitated Sustainable Banking and Finance Network (SBFN) with the support of the Swiss State Secretariat for Economic Affairs (SECO). The online forum was attended by European and Central Asian central banks and financial market regulators, representatives of SBFN member countries, IFC experts, and other stakeholders. This forum is the third event hosted by the NBG in partnership with the IFC/SBFN. The first meeting was held in 2018 and this has since become an annual event, a platform for fruitful discussions between various stakeholders on the development of sustainable finance in Georgia and other countries in the region.

The NBG membership of the Network for Greening the Financial System (NGFS), a voluntary association of central banks and supervisors, from February 2020 also serves to develop the Sustainable Finance Framework. As a member of the NGFS, the NBG has identified individual contributions under the 2021 United Nations Climate Change Conference (COP26) which is a part of the NGFS Glasgow Declaration. The individual pledge of contributions document[38] lists those actions planned by the NBG in order to follow the recommendations included in the NGFS's *Call for Action report*.

The National Bank of Georgia began its work on climate change risk analysis in 2021. This research will be carried out in several phases. First, the economic sectors that are most vulnerable to the physical and transition risks of climate change will be identified. Then the exposure of commercial banks to these sectors will be assessed. After that, the NBG will be guided by the NGFS's Climate Change Scenarios to conduct its own scenario analysis and will look at the climate change risks facing the Georgian financial sector. The first phase of this study is being carried out in collaboration with the German Sparkassenstiftung for International Cooperation.

Georgia's progress in these and other important steps in the development of a sustainable finance framework has received international recognition. During 2021, the National Bank of Georgia was invited to various sustainable finance conferences and workshops to share its success story. In November 2021, the UN Climate Change Conference was organized by the University of Glasgow's Adam Smith Business School and the

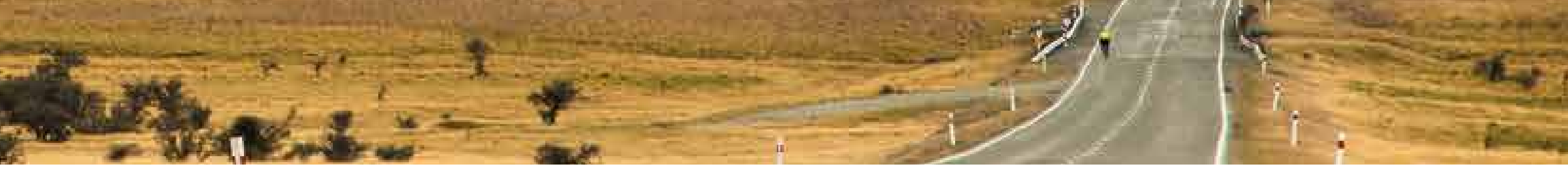
38. See https://nbg.gov.ge/en/page/nbg-pledge-for-cop26

Reinventing Bretton Woods Committee, where the NBG joined representatives from the University of Glasgow, the private sector, international organizations and other central banks to discuss climate change and sustainable finance. The Governor of the NBG was also invited to attend the UN Global Compact International Conference. Hosted by Georgia for the first time, this global conference was attended by representatives of the Georgian Government, Parliament, financial and business sectors, as well as representatives of the legislative and executive authorities, business sectors and international organizations of Ukraine, Poland, Turkey and Belarus. The NBG team was also represented at a webinar hosted by the SBFN, where the SBFN's third Global Progress Report, Accelerating Sustainable Finance Together, was presented. At this webinar, a representative of the NBG shared the NBG's experience regarding taxonomy, disclosure, climate risk management and sustainable finance instruments, and stressed the importance of cooperation and coordination both within the country and across countries. Following in the footsteps of the progress made and the experience gained, the NBG also co-chaired the SBFN Data and Disclosure Working Group. The NBG's success in the sustainable finance framework is echoed in the six-tier rating system of the SBFN's assessment of Georgia where it was upgraded to the advanced level (see Diagram N 3.2).[39]

DIAGRAM N 3.2 SBFN ASSESSMENT SYSTEM (JUNE 2021)

Source: SBFN[40]

39. See bit.ly/3uq6lcl
40. See https://sbfnetwork.org/wp-content/uploads/pdfs/2021_Global_Progress_Report_Downloads/SBFN_D003_GLOBAL_Progress_Report_02_Nov_2021.pdf



The National Bank of Georgia published the scheduled edition of its 2021 Financial Stability Report.[41] Updated versions of the Financial Stability Report, which are developed in close collaboration with the International Monetary Fund (IMF), have been published since 2019. The report is based on forward-looking macro-financial analysis and incorporates international best practices. The report presents the vulnerabilities and risks facing the financial system, focusing on the medium and long term. It reviews the structural characteristics of the financial sector and the aspects of the Georgian economy that are crucial for financial stability. The Financial Stability Report also includes an analysis of the sustainability of the local financial system. In addition, the report details the measures taken by the NBG to ensure financial stability. More specifically, both macroprudential measures, focused on the entire banking system, and microprudential measures, aimed at achieving greater resilience of individual financial institutions, are reviewed in detail. The 2021 edition of the report analyzes, in detail, the risks to financial stability posed by the COVID-19 pandemic and describes the response measures taken by the NBG to ensure the sustainability of the country's financial system.

Stress tests are another vital component of the financial stability framework. The NBG vigorously developed a stress-testing model with the support of an IMF technical mission in 2019-2020. Detailed information about the main characteristics of the stress tests is published on the NBG website.[42] The main objective of the stress tests is to assess the resilience of banks against sizable adverse shocks. This instrument allows central banks to identify shock mitigation measures and formulate policies that support the continuity of financial intermediation under stress. These measures and policies help decrease the duration of a shock and foster rapid economic recovery.

In 2021, the NBG launched an interactive stress test web platform to assess the financial resilience of commercial banks.[43] This platform allows interested parties to choose a hypothetical stress scenario for each macroeconomic variable and to observe the dynamics of a commercial bank's capital ratio. The results of the stress test show that all banks in the system maintain stability in the case of moderate and severe stress scenarios, while in the case of an extreme stress scenario, some banks need additional capital to meet the minimum requirements. It is important to note that the stress test does not consider an active response from banks to shocks or changes in their business models that may mitigate the impact of a shock. However, according to current estimates, given the existing ownership structure, banks have a good opportunity to replenish their capital. Consequently, hypothetical capital losses do not pose a threat to the stability and sustainability of the system. Consideration should also be given to the fact that in the extreme stress scenario, the capital ratio starts to recover from the second year, which, in addition to improved asset quality, is backed by stable operating profitability.

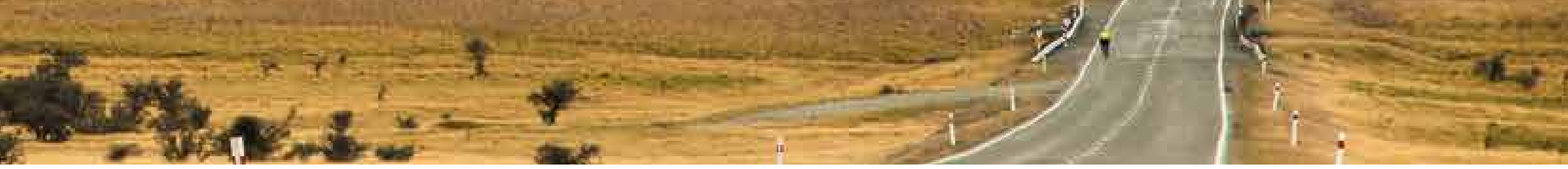
41. See https://nbg.gov.ge/en/publications/financial-stability-reports
42. See https://nbg.gov.ge/en/page/-top-down-stress-test
43. See https://nbg.gov.ge/en/page/interactive-stress-test

BOX 4 ASSESSMENT OF THE POTENTIAL IMPACT OF THE PANDEMIC ON FINANCIAL STABILITY WITHOUT IMPLEMENTING REGULATIONS

As a result of the financial stability policy pursued in recent years, the Georgian financial system faced the shock of the COVID-19 pandemic well prepared and has maintained its resilience. The COVID-19 pandemic has increased the vulnerability of households and companies and posed risks to financial stability worldwide. However, the introduction of additional capital requirements since 2017 has allowed banks to create a sufficient capital buffer to deal with stressful situations. Also, the macro-prudential measures taken by the National Bank of Georgia have helped reduce the vulnerability of the non-financial sector, including a decline in the dollarization of loans and a reduction of the over-indebtedness of households. The responsible lending practice has also been facilitated by a maximum effective interest rate cap set by the government and a restriction on foreign currency lending. As a result, the larization of the total portfolio, excluding the exchange rate effect, increased by 18 pp in December 2021, compared to the same period in 2016, and amounted to 49%. The larization of loans to individuals reached 64%. Also, the quality of pre-pandemic loans started to improve, facilitated by a restriction on the issuance of loans with a high credit burden. As a result, risky loans and the share of borrowers whose payment-to-income ratio exceeded 50% in GEL, or 30% in foreign currency, has significantly reduced. In December 2019, compared to the same period in 2016, the share of non-performing loans in total loans decreased by 2.9 pp and amounted to 4.4%. At the same time, the demand for capital increased during this period and the quality of capital improved. The requirement for the Tier 1 capital ratio increased by 1.5 pp, while the requirement for supervisory capital increased by 3.4 pp.

Without these regulations in place, more people would have had difficulty servicing their loan liabilities during the pandemic, and the banking sector would have slowed down lending amid rising credit losses, which in turn would have slowed the recovery of the economy. During the pandemic, financial difficulties were mainly faced by those borrowers with foreign currency loans and a high debt burden. If we assume that, without the enactment of the regulations mentioned in the previous paragraph, the quality and amount of capital, the distribution of borrowers' payment-to-income and loan-to-value ratios, and the dollarization of the portfolio would have remained the same as before the regulation came into force, then at the peak of the pandemic-driven shock, the share of non-performing loans in the total portfolio would have increased to 15% instead of 8.5%. Mostly individuals would have been affected, with their non-performing loan ratio exceeding 20% instead of the maximum of 8.5%. As a result, the capital adequacy of the banking sector would have been additionally reduced by approximately 2.5 pp. While the minimum requirements would still have been met, similar negative indicators could have eroded confidence in financial stability, deteriorating ratings and causing outflows of deposits, while rising mortgage defaults would have had a negative impact on the real estate market. Also, it would have been difficult for banks to have met the fully restored capital requirements. Consequently, due to the increased risk and the need to accumulate capital, banks would have slowed down their credit growth, which would have weakened the recovery of the economy.

The benefits of introducing a responsible lending standard and reducing dollarization are especially evident in the case of mortgage borrowers. During the pandemic, loan servicing was particularly difficult for borrowers with a payment-to-income ratio above 50% and for foreign currency borrowers. The share of restructured loans in foreign currency mortgages increased to 24%, while in GEL to 9%. At the end of 2016,



only 10% of the mortgage portfolio was denominated in the national currency, while at the end of 2021, 45% of the mortgage portfolio was denominated in GEL. Consequently, if the pre-regulation dollarization rate had been maintained, the difficulty of servicing the loan would have been evident for a significantly larger number of people, and the share of loans restructured due to the dollarization effect alone would have been about 5 pp higher. Before the introduction of the responsible lending standards, about 20% of mortgage borrowers had a payment-to-income ratio exceeding 50%. If these lending conditions had been maintained, the share of loans restructured as a result of the pandemic would have been 10 pp higher. Overall, without the enactment of the regulations, the share of restructuring in mortgages would have been about 15 pp higher.

To summarize, the implemented regulations curbed the excessive growth of the household debt burden and better protected borrowers from the risks of financial vulnerability. This helped the resilience of both the financial and non-financial sectors. As was noted when the regulations were first enacted, while the regulations may have a minor negative impact on economic growth in the short run, they are certain to contribute to the reduction of vulnerabilities in the medium term and, consequently, to the sustainable growth of the economy. The pandemic only served to demonstrate the correctness of this method. Despite the huge losses triggered by the pandemic, the financial sector was one of the main contributors to the rapid recovery of the economy.

04

BANKING SUPERVISION

4.1 DEVELOPMENT OF THE SUPERVISORY FRAMEWORK

Throughout 2021, the National Bank of Georgia continued to work intensively to improve the supervisory framework, bringing it closer to advanced international practice and enhancing a number of supervisory areas. The year 2021 was important in terms of the development of special legislation on competition issues and strengthening supervision in this regard. The powers of the NBG were specified by amendments made to the Law of Georgia on Competition and the Organic Law on the NBG in 2020. In line with the obligations set out in these amendments, in 2021 the NBG approved legal acts regulating competition policy for regulated entities. These regulations are based on the Law of Georgia on Competition, the secondary legislation of the Competition Agency and best international practice in this area, including the standards of the EU[44], Great Britain[45], Canada[46], and the Organization of Economic Cooperation and Development (OECD)[47]. The NBG was also provided with expert assistance from representatives of the World Bank in the process of drafting the regulations, along with intensive involvement and consultation with the Competition Agency and the financial sector.

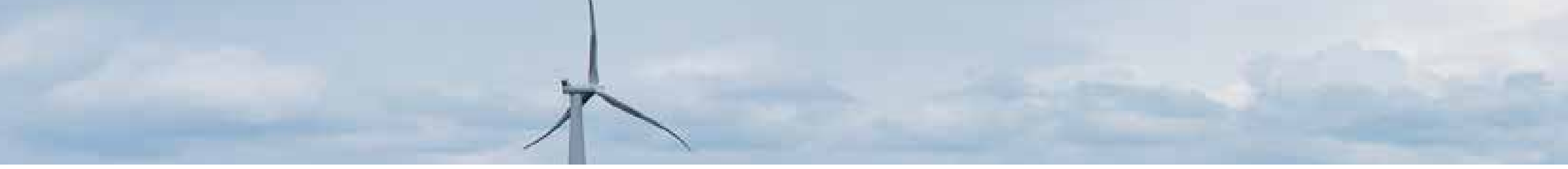
In addition to drafting special legislation, the NBG continued to work dynamically to develop incentives and facilitators for the emergence of sound entities in the market. The NBG remains committed to improving and developing competition policies and to enhancing and developing elements of the sustainable financial technology ecosystem. This includes the introduction and enforcement of a regulatory framework for bank-related ecosystems and platforms. See Box 5, below, for details on the special legislation governing competition policy and other factors promoting competition.

BOX 5 ENHANCING THE REGULATORY FRAMEWORK FOR COMPETITION AND OTHER MEASURES TO PROMOTE COMPETITION

Based on the amendments made to the Law of Georgia on Competition and the Organic Law on the National Bank of Georgia in 2020, the NBG began active work in the second half of 2020 on strengthening the regulatory framework for competition policy in the sectors regulated by it. As a result, in accordance with best international practice and the standards set by the Competition Agency, the following legal acts governing competition policy were approved in June 2021:

- **Regulation on submitting and reviewing market analysis and concentration notifications** – The goal of this regulation is to ensure the effective implementation of competition policy in NBG-regulated areas, and to enable the assessment and maintenance of a competitive environment in the market. It establishes the market analysis methods, criteria and parameters for competitive environment evaluation. It also sets out how to notify the NBG of a concentration (acquisition of control by one entity or the merger of two or more entities) and then allows assessment of the compatibility of the proposed transaction with the competitive environment.

44. Detailed information is available at https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A52004XC0205%2802%29
45. Detailed information is available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1051823/MAGs_for_publication_2021_--_.pdf
46. Detailed information is available at https://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03420.html
47. Detailed information is available at https://www.oecd.org/daf/competition/sectors/47836843.pdf



- **Regulation on investigating, filing, and reviewing a case related to a potential violation of competition** – This regulation establishes the procedure for investigating a case of abuse of a dominant position and other matters relating to the restriction of competition, including the review of complaints and appeals against potential violations. These include guarantees for the protection of the rights of the parties involved and the actions and decision-making required regarding the investigation of the case. The regulation also covers the contingent liabilities of the defendant economic agent, the principles of imposing fines, the details of involvement in the cooperation program, and inter-agency cooperation. Under the new competition regulation, the NBG will have greater transparency for its competition-related activities and decisions. More specifically, decisions on the compatibility of a concentration with the competitive environment, as well as decisions related to potential violations of competition, will be made public and published on the official website of the NBG, while ensuring the confidentiality of key parts of the information.

It is important to note that the NBG had the authority to implement competition policy in the regulated sector even before the legislative changes made in 2020, but the development of the special legislation has significantly improved the mechanisms for the effective enforcement of competition policy.

Status of the Improvement and Implementation of the Framework

The drafting of the above legal acts is the first step in strengthening the regulatory framework for competition policy. The NBG continues to work to improve these regulations (e.g., concerning cross-selling in banking groups, monitoring of transactions between group members, and the transparency of cooperation between banks and platforms) and enforce the framework in practice. In 2021, World Bank experts held one-week workshops on competition-related topics for both the financial sector and the NBG staff. The NBG will enjoy further support from the World Bank Technical Assistance Program in 2022.

The study of competition issues under the mandate of the National Bank of Georgia was conducted in the format of working groups in 2021. As working in this format is usually highly efficient, the NBG will continue to use the format to discuss various areas and issues in the future. Furthermore, in order to ensure the effective implementation of competition policy, establishing a designated business unit at the NBG is planned.

Other Actions to Promote Competition

In addition to working on secondary legislation on competition, the NBG has been intensively working on reforms encouraging and promoting competition to help the emergence of sound entities on the market and to facilitate their development. These areas include the following reforms:

- **Projects of the Regulatory Laboratory** – During 2021, 14 final projects under observation of the NBG passed the third and final real-environment testing phase at the Regulatory Laboratory. Most of the projects were related to remote identification/verification services and were implemented by banks as well as microfinance institutions and other regulated entities in cooperation with various Fintech companies. As a result, work on the remote identification process was completed and the applicable regulation was approved.
- **Progress of the Open Banking Project** – The NBG continued to work intensively on Open Banking throughout 2021. Following a successful completion of the first phase, the exchange of information between commercial banks became available through Open Banking from 31 March 2021. This means the

exchange of detailed information on account balances and account statements. From 1 December 2021, banks made the payment API available to individuals. The involvement of legal entities in the initiation of payments, and the introduction of the process of remote identification and exchange of information on standard products is planned for 2022. Non-banking institutions will also be able to use these services after the legislative changes come into force.

- **Fintech Forum** - In 2021, a forum dedicated to the development of the Fintech ecosystem in Georgia was hosted by the USAID Economic Security Program in partnership with the NBG and the Agency for Innovation and Technology. The event featured presentations and discussions on the program's findings, the plans of the NBG, development opportunities in the Fintech sector, and offers of potential cooperation platforms. The goal of the forum was to identify the capabilities of Fintech to promote the growth of the local market.

The NBG is committed to aligning its supervisory legislation with the EU legislation, as provided for in the Georgia-EU Association Agreement. The NBG teamed up with the State Insurance Supervision Service of Georgia to prepare an additional supervision framework for financial conglomerates. This regulatory framework imposes a number of requirements on capital adequacy, risk concentration, group internal transactions, internal control mechanisms and risk management processes, in addition to the prudential supervision of entities within a financial conglomerate. In 2021, the NBG hosted a joint mission of the International Monetary Fund and the World Bank under the Financial Sector Assessment Program (FSAP), for which the NBG had been preparing intensively since the second half of 2020. Financial sector stability and soundness, the NBG's reforms, development and growth prospects were all assessed under the FSAP. Importantly, the FSAP mission was unequivocally positive about the prudential policies and reforms pursued by the NBG.

As a result of the evaluation, the mission developed a number of recommendations for the development and improvement of the NBG's supervisory framework. The reports prepared by the mission are published on the IMF's website.[48] The FSAP recommendations define the NBG's current and future priorities and plans for supervision, and are followed scrupulously. Refer to Box 6, below, for details on the key recommendations of the FSAP mission.

BOX 6 KEY FINDINGS AND RECOMMENDATIONS OF THE FSAP

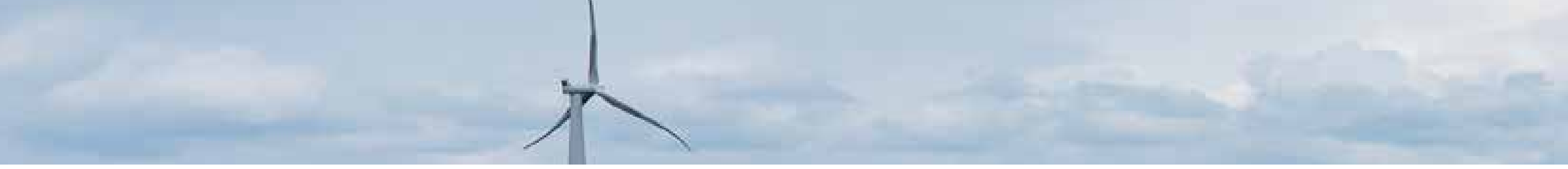
The FSAP mission that took place in January-February and May-June 2021 assessed all the important areas of the financial sector of Georgia. The mission developed the following key findings and recommendations:

Financial Stability

The mission noted that the pandemic has had a significant impact on the banking system, which has not yet been fully materialized. However, stress tests show that the banking system is prepared to offset the pandemic-driven credit losses under the baseline scenario without jeopardizing financial stability.

The mission stressed the importance of sticking to the no-dividends policy until the uncertainties and difficulties related to the pandemic are eliminated, credit losses are absorbed, and the capital buffers are fully

48. Refer to the IMF's website for further details: https://www.imf.org/en/Publications/fssa



restored. The mission also recommended the implementation of a Regulation on Risk Exposure Concentration and Large Risk, which is planned by the NBG.

Macroprudential Policy and Dollarization

The institutional framework for macroprudential policy was widely and comprehensively assessed, which includes sufficient measures to eliminate the underlying risk of high dollarization.

The mission's recommendation is the phased selection of de-dollarization measures and their periodic calibration based on impact assessments. According to the recommendation, it is also important to strengthen public communication on macroprudential policy decisions and the objectives of foreign exchange interventions.

Supervision of the Financial Sector

According to the mission, since the previous FSAP, the NBG has made significant efforts to improve the supervisory regime and has made progress in strengthening the risk-based supervisory framework that is being established.

The mission recommends

- Formalizing and strengthening the management of key internal processes related to supervision actions and decisions.
- Reviewing the internal GRAPE scoring and weighing methodology.
- Conducting regular in-depth assessments of bank governance and risk management practices.

Capital Market Supervision

The mission noted that the NBG has brought capital market supervision closer to international standards, although it recognized that there is still room for improvement in the supervision methods.
The mission recommended continuing to develop and implement risk-based oversight and ensuring that all market participants are adequately sanctioned for market manipulation.

Financial Safety Net

The mission commended the progress that has been made in updating the Bank Resolution Framework and the Crisis Management Framework.

The mission's recommendations are to do the following:

- Introduce a framework for early corrective action for banks.
- Develop appropriate mechanisms for the rapid and effective use of Temporary Bank Resolution Tools, as necessary.
- Continue preparing resolution plans for systemic banks, as well as discussing the issue of the prioritization of other banks.

Cybersecurity Supervision

The mission recognized that the NBG had taken some steps in recent years to strengthen cybersecurity regulations and the oversight of the financial sector, but thought that taking further steps in several areas would further strengthen the cybersecurity oversight framework.

The mission recommended that the role of the NBG should be clearly reflected in the amendments to the Law on Information Security in recognizing the bank and other members of the financial market infrastructure as critical information systems. It is also recommended to strengthen the cyber-risk remote monitoring framework and to automate the compliance monitoring process.

AML/CFT Supervision

The mission estimated that Georgia has made some progress in strengthening the AML/CFT framework since the last FSAP; however, it was recommended that regulation/oversight be strengthened for the gambling sector, virtual asset service providers, and real estate agents. It was also advised to set upper limits on the use of cash for certain transactions.

Financial Market Infrastructure

With regard to the development of financial market infrastructure, the mission's recommendation was to develop detailed procedures for the oversight of payment systems. It was also recommended that the self-assessment of the two central securities depositories (NBG and GCSD) be completed.

Competition in the Financial Sector:

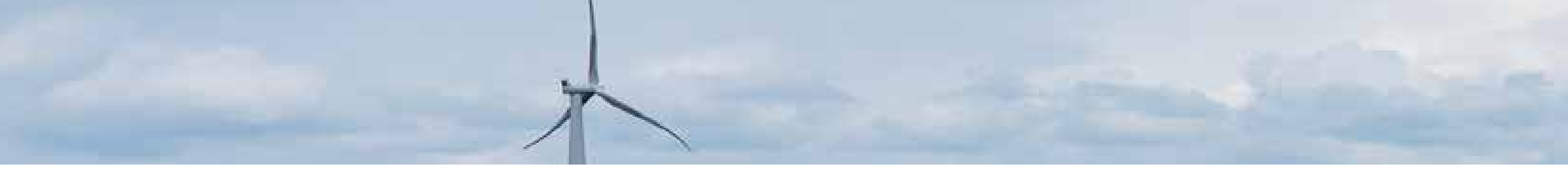
The mission particularly appreciated the development of secondary competition legislation and the work on reforms promoting competition. The recommendations in this direction were as follows:

- To develop institutional capacity for competition policy enforcement and advocacy as a separate function within the National Bank of Georgia.
- To assess the impact of legislative acts and regulations in the financial sector from a competition perspective, based on the recommendations of the International Monetary Fund and the World Bank Joint Mission (FSAP) and according to practical needs.

The NBG continues to work on the legal framework and other technical and procedural issues. Work on some priority recommendations has begun and will continue in future periods with the intensive involvement of international experts in providing technical assistance.

In 2021, the NBG resumed its work on those regulations and legislative changes that had been suspended under the temporary moratorium announced by the NBG in 2020 (that was due to the development and imposition of new supervisory requirements in response to the COVID-19 pandemic). These included improving the framework for the 'fit and proper' criteria for administrators and shareholders, as well as the framework for licensing and acquisition of significant shares to ensure full compliance with best international standards. At this stage, a draft of legislative changes on the criteria for the eligibility of administrators and shareholders has been developed, following consultations with representatives of the banking sector. The draft will be submitted to Parliament in the near future. Amendments to the NBG's Regulation on the Eligibility of Administrators and the Regulation on Commercial Bank Licensing, and a new regulation on the acquisition of significant shares have also been drafted. These are to be published upon the completion of legislative changes and following consultations with banking representatives.

Since the second half of 2021, the NBG has been vigorously working on the institutionalization of supervisory practices, which involved the development and



improvement of a number of internal policies and procedures. An internal procedure for the General Risk Assessment Program (GRAPE) has been developed that serves to detail the process, structural units and timelines involved, as well as the decision-making process. Also, in accordance with risk-based supervision and principle-based regulations, the guidelines regarding GRAPE will be updated to be in line with international best practices and to reflect the FSAP assessment's recommendations. This is expected to make risk assessment processes more efficient and transparent.

In 2021, the NBG published the 2021 edition of the Supervision Strategy for 2020-2022.[49] The NBG's supervisory priorities in the strategy remained unchanged. The annual strategy paper places particular emphasis on the key objectives and oversight priorities planned for the next 12-18 months. The NBG remains committed to the principle of maximum transparency. In this regard, it is important that the NBG presented the published strategy document to representatives of the financial sector, representatives of the Bankers' Association and experts in the field of economics, paying attention to their opinions and assessments.[50] In addition to the publication of the strategy document, the NBG decided to make the introduction of the strategy document an annual event and, in future, will seek to achieve greater involvement of financial sector and industry experts in the strategy development phase. This is meant to facilitate access to information on the NBG's supervisory priorities and plans, to increase the predictability of the NBG's future plans for the sector, and to encourage the sector's involvement. Notably, the NBG increased collaboration with various public institutions within the country in 2021. A memorandum of understanding was signed between the supervisory and regulatory agencies of Georgia, with the goal of cooperating on reporting issues.

4.2 CORPORATE GOVERNANCE AND GROUP STRUCTURE RISK

Decree N215/04 of the Governor of the National Bank of Georgia of 26 September 2018, approved the Corporate Governance Code of Commercial Banks. This code regulates issues such as the composition of supervisory boards and boards of directors, the responsibilities of the supervisory board committees, risk management, the effective operation of internal control functions and the principles of remuneration for senior management and material risk takers.

To improve the corporate governance of the banking sector and to align it with international best practice, considerable changes were made to the Corporate Governance Code in 2021. More specifically, it now includes more specific clauses on how to define a material risk taker. A list of functions and responsibilities assigned to a supervisory board was added in order to strengthen the board. In order to ensure the independence of the supervisory board and its members, the duration of the board's membership as an independent member was changed, and the appointment of an independent chairperson of the board was required in banks of systemic importance. The requirement to set up a nomination committee for systemically important banks was added and the requirements for the composition of supervisory board committees were made more specific. To ensure a sound remuneration system, the remuneration requirements were expanded and specified. To promote the long-term sustainability of the banking sector, the environmental, social and governance (ESG) commitments of banks were expanded by adding gender and climate change and related disclosure procedures. Banks were required to comply with these changes by 31 December 2021. For more details on these changes, see Box 7 below.

49. For more details, see Supervision Strategy 2021 Document.
50. Details of the event are available on the NBG website: (link)

Commercial Bank Corporate Governance and Group Structure Risk assessment is a part of the NBG's General Risk Assessment Program (GRAPE). The assessment of group structure risk includes assessment of the bank's ownership structure, investment-related risks, transactions with members of the banking group, and risks related to the banks' investments and investment activities. Within the framework of the evaluation, the NBG dynamically monitors developments in the parent countries of the international banking groups represented in Georgia and evaluates those investors holding significant shares.

In October 2021, JSC Credo Bank fully merged with JSC Finca Bank Georgia, thus successfully completing the process of purchasing a 100% stake in the latter in July of the same year. Accordingly, as of 31 December 2021, there are 14 commercial banks operating in the banking sector. As of the same period, the share of non-resident owners in the assets of banks (ultimate ownership) was 86.7% and was 86.2% in the share of capital. The NBG is dynamically working on a consolidated supervision framework, with its completion scheduled for the end of 2022. The NBG was granted a mandate to implement banking-group level supervision (so-called consolidated supervision) under the amendments made to the Organic Law of Georgia on the National Bank of Georgia that were made at the end of 2017.

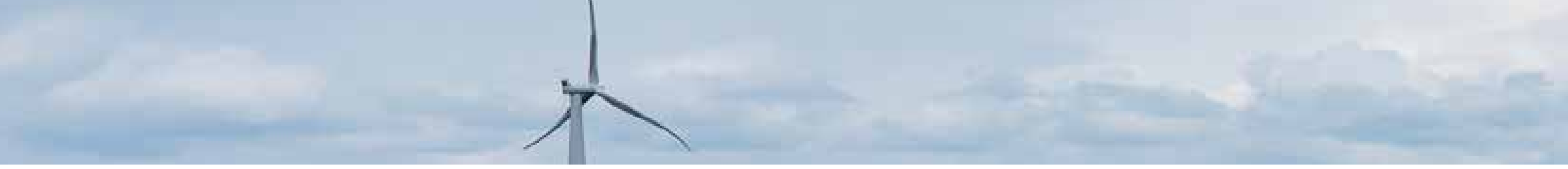
Following the global trend, banking groups in Georgia have vigorously started to develop e-commerce platforms and related ecosystems. To manage ecosystem risks, the NBG invited systemically important commercial banks to share the basic principles of ecosystem operation with them. These principles include platform openness, accessibility and operation according to the arm's length principle; the availability of adequate resources so that ecosystems can avoid using bank resources; and the avoidance of conflicts of interest in the decision-making process. The NBG intensively cooperates with the Competition Agency on issues related to the functioning of ecosystems. It is planned to improve the ecosystem regulatory framework as needed.

BOX 7 NEW REQUIREMENTS UNDER THE CORPORATE GOVERNANCE CODE

A draft amendment to the Corporate Governance Code of Commercial Banks was prepared in 2021 to ensure the improvement of corporate governance standards at commercial banks and to harmonize them with international best practices, the requirements of the Basel Committee on Banking Supervision's Guideline on the Principles of Corporate Governance of Commercial Banks, and the recommendations under the Directive on the Operation and Prudential Regulation of EU Credit Institutions (CRDIV - EU/2013/36/EU) and the European Banking Authority (EBA). The amendments covered the following areas:

Independence - It is important that the supervisory board performs its duties independently and impartially. To ensure this, the Corporate Governance Code sets out the criteria for considering members to be independent and the principles for staffing the board and its committees. Amendments to the code that were made in 2021 further strengthen the role and definition criteria of these independent members. More specifically, the duration for considering a member of the supervisory board an independent member was changed, being reduced to seven years. Moreover, systematically important commercial banks were required to appoint an independent board member as chairperson.

Remuneration Standards – The remuneration system should be in line with the bank's risk appetite and should not motivate the taking of extra risks. However, as risks may be realized over a longer period of time than the period of reimbursement, it is necessary that part of the variable reimbursement be deferred over time and be subject to adjustment based on risk (including cancellation). To ensure this, the code clarifies



the requirements for the remuneration system and specifies the criteria for determining fixed and variable remuneration, the duration of deferring variable remuneration, the basis for risk-based adjustments, and so on.

Material Risk Takers - It is important for banks to identify those individuals who have a significant impact on a bank's risk profile. Relevant qualitative and quantitative criteria were defined in the code to identify such persons. It was determined that banks should have higher standards of remuneration for material risk takers.

Environmental, Social and Governance Standards - To promote long-term sustainability, banks are required to include ESG issues in their strategies. ESG standards cover issues that may have a material impact on a bank's operations, including the gender diversity of its employees. ESG issues also include such issues as climate change risk, if these may have a material impact on a bank's investments, loans and the quality of other banking activities.

4.3 CAPITAL ADEQUACY

By the end of 2021, the Georgian banking system continued to maintain an adequate level of capital under the Basel III capital adequacy framework and in consideration of the supervisory measures related to the COVID-19 pandemic (see Box 8).

The systems buffer launched on 31 December 2018 was imposed on both supervisory and Tier 1 and CET1 capital. As no system buffer benefits were introduced under the COVID-19 supervisory plan, the buffer requirements for systemically important banks were increased according to a predetermined schedule in December 2021 (see Table N 4.1).

TABLE N 4.1 TIMEFRAME FOR SETTING SYSTEM BUFFERS

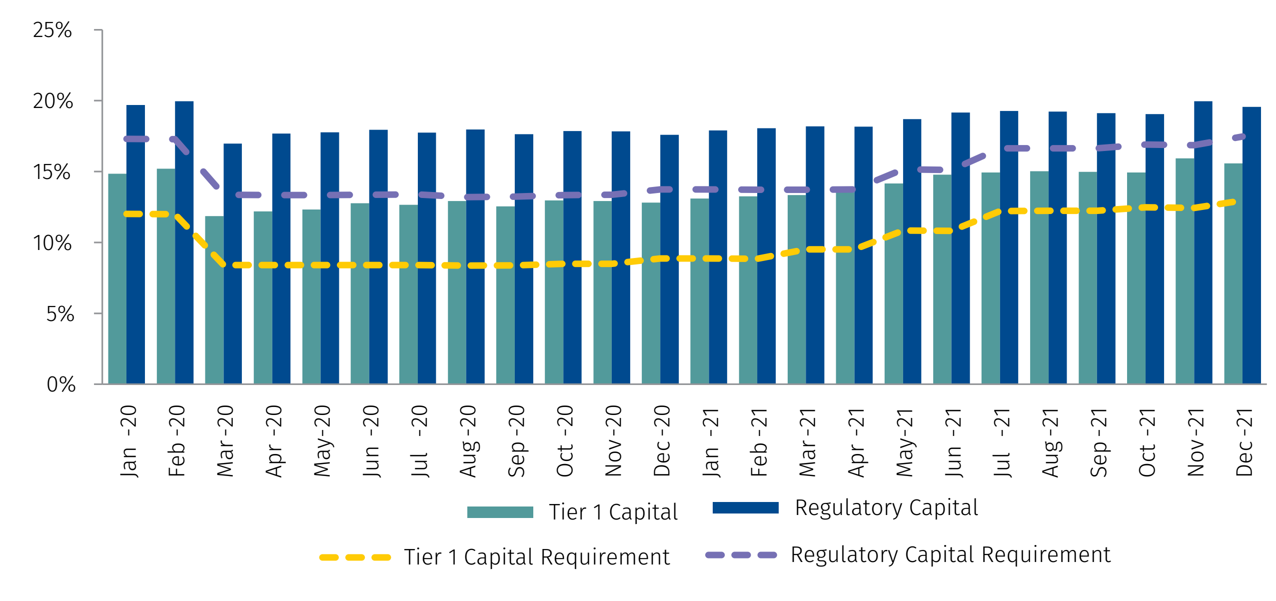
Bank	2017	2018	2019	2020	2021
TBC Bank JSC	0.0%	1.0%	1.5%	2.0%	2.5%
Bank of Georgia JSC	0.0%	1.0%	1.5%	2.0%	2.5%
Liberty Bank JSC	0.0%	0.6%	0.9%	1.2%	1.5%

As of 31 December 2021, the Tier 1 capital ratio calculated within the Capital Adequacy Framework was 15.58% and the regulatory capital ratio was 19.57%, which are higher than the total capital adequacy requirements (considering the actions taken under the COVID-19 supervision plan) by 2.62 and 2.09 percentage points, respectively. Excluding the easing of capital requirements as part of the actions taken under the COVID-19 supervision plan, the aggregate demand for Tier 1 capital and regulatory capital would be 13.33% and 17.87%, respectively.

The leverage ratio is also high[51], equaling 12.76% as of 31 December 2021 and exceeding the minimum leverage ratio requirement by 7.76 percentage points.

51. Capital-to-assets ratio.

DIAGRAM N 4.1 CAPITAL ADEQUACY RATIO ACCORDING TO BASEL III



Source: National Bank of Georgia

In parallel with the supervisory actions related to COVID-19, banks continued to calculate the capital buffers included in Pillar 2 during 2021. The Pillar 2 framework defines the capital buffer requirement for loan portfolio concentration risk (both nominal and sectoral concentration risks), the foreign currency induced credit risk buffer (CICR), the net stress test buffer calculated based on supervisory stress tests, and the procedure for determining the net GRAPE buffer as established by the NBG under the General Risk Assessment Program.

It is important that commercial banks are required to comply with the capital buffers imposed under Pillar 2 at the same proportion of regulatory capital elements as required by the minimum requirements (CET1 capital at 4.5%, Tier 1 capital at 6%, and total regulatory capital at 8%). Accordingly, 56% of the capital required under Pillar 2 must be observed by CET1 capital elements and 75% by Tier 1 capital elements. Commercial banks were given appropriate deadlines to comply with these requirements (see Table N 4.2)

TABLE N 4.2 CONCENTRATION AND NET GRAPE BUFFER PHASE-IN DATES BEFORE THE COVID-19 RELATED SUPERVISORY ACTIONS

Concentration (nominal and sectoral) and net GRAPE buffers	**From introduction to 30/12/2018**	**31/12/2018**	**31/03/2020**	**31/03/2021**	**31/03/2022 and further on**
CET1 Capital	0%	15%	30%	45%	56%
Tier 1 Capital	0%	20%	40%	60%	75%
Total Regulatory Capital	100%	100%	100%	100%	100%

As part of its COVID-19 supervisory actions, the NBG temporarily suspended the growth of its Pillar 2 CET1 and Tier 1 capital requirements. Accordingly, the concentration and net GRAPE buffers were set at 100% on regulatory capital, 40% on Tier 1 capital and 30% on CET1 capital as of 31 December 2021. As part of the COVID-19 supervisory actions, renewed deadlines for redistribution of the concentration (HHI) and net GRAPE buffers were determined in accordance with the schedule shown in Table N 4.3, which extends the deadlines for the redistribution of these basic buffers by one year.

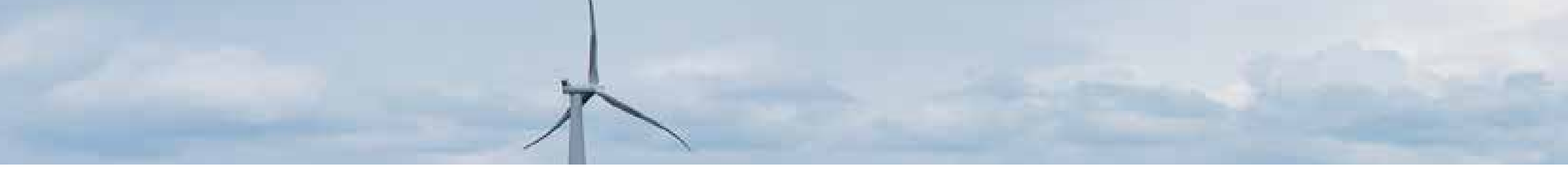


TABLE N 4.3 CONCENTRATION AND NET GRAPE BUFFER PHASE-IN DATES WITHIN THE COVID-19 RELATED SUPERVISORY ACTIONS

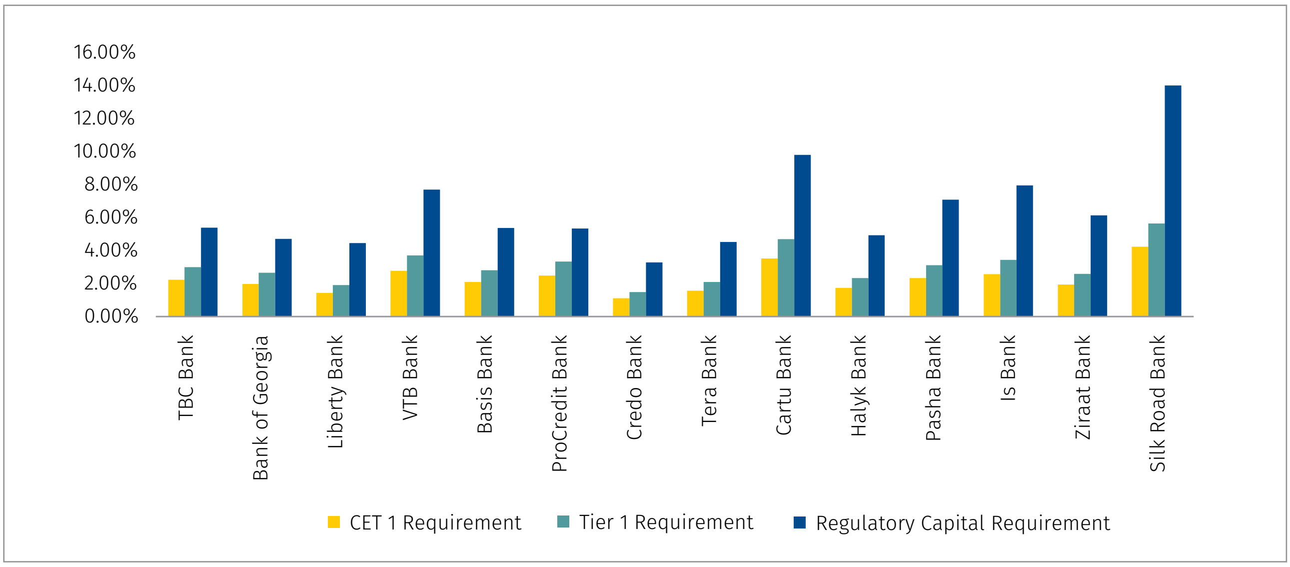
Concentration (nominal and sectoral) and net GRAPE buffers	31/03/2021	31/03/2022	31/03/2023 and further on
CET1 Capital	30%	45%	56%
Tier 1 Capital	40%	60%	75%
Total regulatory capital	100%	100%	100%

In 2021, the NBG worked on the calibration of the net stress test buffer. The NBG formalized the stress testing framework in cooperation with commercial banks in 2020. Enterprise-level stress tests help assess the effect of systemic and sectoral economic shocks and idiosyncratic events on banks and help determine the related capital requirements. With the integration of the net stress test buffer in the Pillar 2 requirements, it is important to avoid duplicate capital requirements. Accordingly, the stress test buffer requires capital in an amount that exceeds the sum of the conservation and countercyclical buffers. In addition, the NBG may, as necessity prompts, issue additional references to capital buffers that may be added to deductible items from the stress test buffer to avoid duplicate capital requirements for the same risk.

As a result of the stress tests conducted by banks in 2021, similar to 2020, the NBG did not impose a net stress-test buffer, as the NBG's approach to the capital adequacy framework involves the countercyclical distribution of requirements (i.e., the accumulation of capital buffers during economic growth and their release during times of stress). Due to the COVID-19 pandemic, the year remained somewhat stressful for the banking sector.

The net GRAPE Buffer, launched in 2018, is defined as part of a continuous cycle of risk-based supervision and aims to assess the risks of commercial banks. The risk profile of each commercial bank is assessed based on GRAPE. The 2020 net GRAPE buffers were not revised due to a change in supervisory priorities in the wake of the COVID-19 pandemic. The NBG reviewed the net GRAPE buffers in July 2021 and the volume of individual GRAPE buffers was set at 1.5-9.2% of risk-weighted assets.

DIAGRAM N 4.2 PILLAR 2 REQUIREMENTS FOR COMMERCIAL BANKS AS OF 31 DECEMBER 2021[52]



Source: NBG

52. The requirements of Pillar 2 are given under the COVID-19 regulatory measures, taking into account the reduction of the currency-induced credit risk (CICR) buffer requirement.

BOX 8 COVID-19-RELATED REGULATORY MEASURES AND THE CAPITAL RECOVERY PLAN

To mitigate the negative impact of the COVID-19 pandemic on the financial sector and to stimulate the national economy, the NBG took a number of significant supervisory measures in 2020. Under the oversight plan, commercial banks had their capital requirements eased, meaning that the capital conservation buffer (to the amount of 2.5% of risk-weighted assets) and a portion of the Pillar 2 buffer (two-thirds of the CICR buffer, in the amount of 1.6% of risk-weighted assets) were reduced temporarily.

Under the current capital adequacy framework, when the total capital imposed for a commercial bank is violated, the combined capital buffers of the Tier 1 capital are also violated. According to the Regulation on Capital Adequacy Requirements, a commercial bank is prohibited from distributing capital and the issuance of dividends whenever these buffers are violated. As part of the COVID-19 regulatory actions, the NBG instructed commercial banks not to use those buffers that were released as a result of easing capital requirements, for paying dividends, share repurchases, equity investments, management bonuses, or other payments that would reduce a bank's capital.[53]

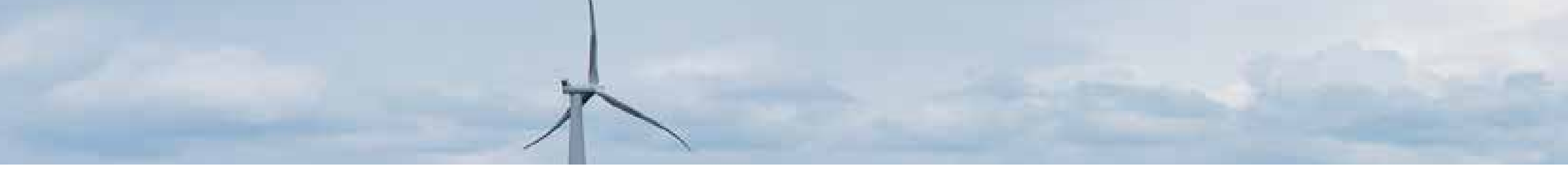
The NBG gave a positive evaluation to capital growth resources in 2021, both in terms of shareholder strength and profitability. In the context of maintaining the stability of the financial system and ensuring smooth lending to the economy, on 16 June 2021 the NBG announced a plan to restore the capital buffers and provided dates for their gradual replenishment, giving the banking sector sufficient time to replenish the buffers. As per the decision of the Financial Stability Committee, the recovery of the buffers released at the beginning of the COVID-19 crisis will begin on 1 January 2022 and will last for two years. Banks were given until 1 January 2023 to recover the CICR buffer, and until 1 January 2024 to meet the capital conservation buffer requirement. It is important to note that banks have the opportunity to opt out of the supervisory benefits offered by the NBG and, at their own discretion, re-establish those capital adequacy requirements that were eased under the COVID-19 regulatory actions. In such cases, such banks will no longer face restrictions on the distribution of capital. As of 31 December 2021, seven out of the 14 banks in the banking system had already recovered their capital requirements.

4.4 FINANCIAL REPORTING AND TRANSPARENCY

The Supervision Strategy of the NBG for 2020-2022 recognizes the alignment of supervisory reports with international standards as one of the most important priorities.

Supported by the World Bank, the project involves local and international experts with a diverse range of experience, who are consulting with the project working groups to discuss the best practices implemented by advanced economies. Box 9 provides detailed information about this project.

53. Detailed information is available in the following press release: "NBG Supervision Plan related to COVID-19" .



BOX 9 REFORM TO TRANSITION LOCAL ACCOUNTING STANDARDS TO THE INTERNATIONAL ACCOUNTING AND FINANCIAL REPORTING STANDARDS (IFRS)

The IFRS project aspires for the full adjustment of the NBG's regulatory statements to IFRS standards, the IFRS-based calculation of supervisory indicators under appropriate filters, and the development of an IFRS-9 provisioning approach for supervisory purposes.

For the purposes of the project, banks are required to maintain parallel reporting in 2022, which means submitting reporting forms with both local (current) and IFRS requirements. This process is temporary and aims to prepare solid ground for the full replacement of local accounting standards with IFRS. From 2023 onward, banks will only be required to submit IFRS-based reporting forms.

The introduction of an updated provisioning methodology is one of the most important parts of the IFRS transition project. The work is underway in close cooperation with the banking sector, auditors and World Bank consultants. To transition to IFRS 9, the NBG has developed a draft Regulation on Establishing the Risk Categories of Financial Instruments and the Expected Credit Loss. This regulation concerns the IFRS 9 standard and specifies some approaches to be used by banks when calculating reserves.

In 2022, commercial banks will submit to the NBG information on the effect of this regulation on the level of asset provisioning. This will allow work to continue on the change of capital-related tactics with regards to the transition to IFRS.

In 2021, work was completed on the update of the reporting forms to be submitted to the NBG in accordance with IFRS requirements, a draft IFRS-9 asset provisioning policy was developed, and an initial version of the capital-based method was prepared.

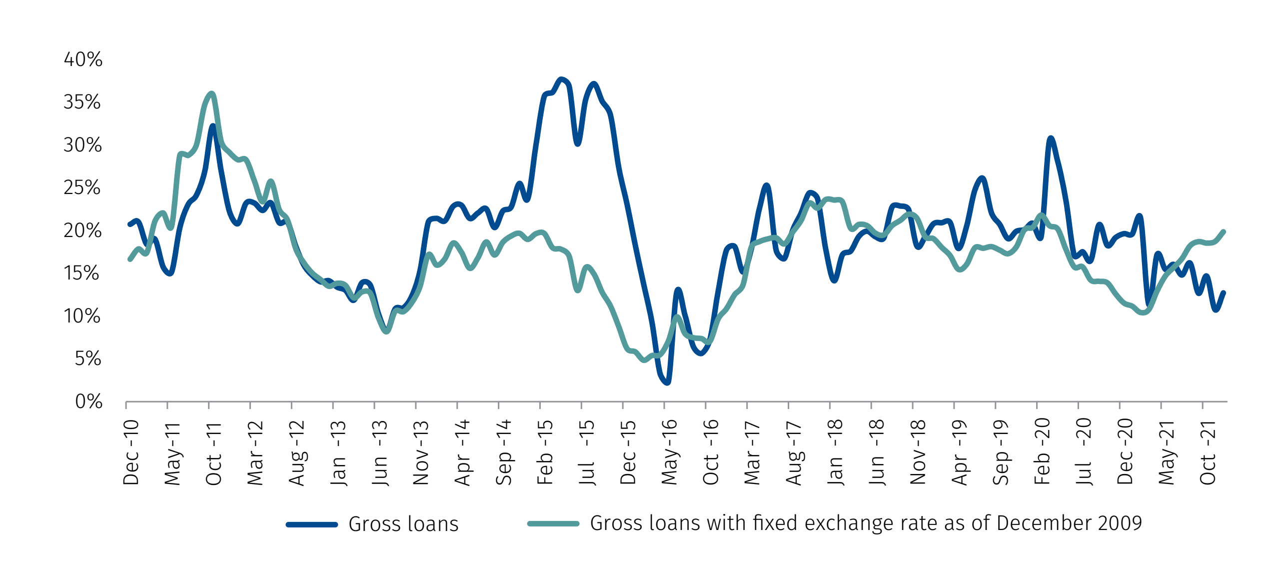
Introducing the FINREP reporting forms is one of the most important parts of the IFRS project. Work on this issue continued in 2021. Although commercial banks have been completing these forms in a test mode since 2018, with the full transition to IFRS the submission of the FINREP reporting forms will be required on a monthly basis.

A significant step was taken to improve effective communication with auditors in 2021. As indicated in the Guide to Effective Communication between Audit Firms and the NBG, which was published in 2020, meetings were organized between representatives of the NBG and audit firms to discuss complex matters related to audit reports and recommendation letters. Other meetings were organized to discuss important topics, as needed. The guide will gain more importance as the IFRS project is completed.

4.5 CREDIT RISK

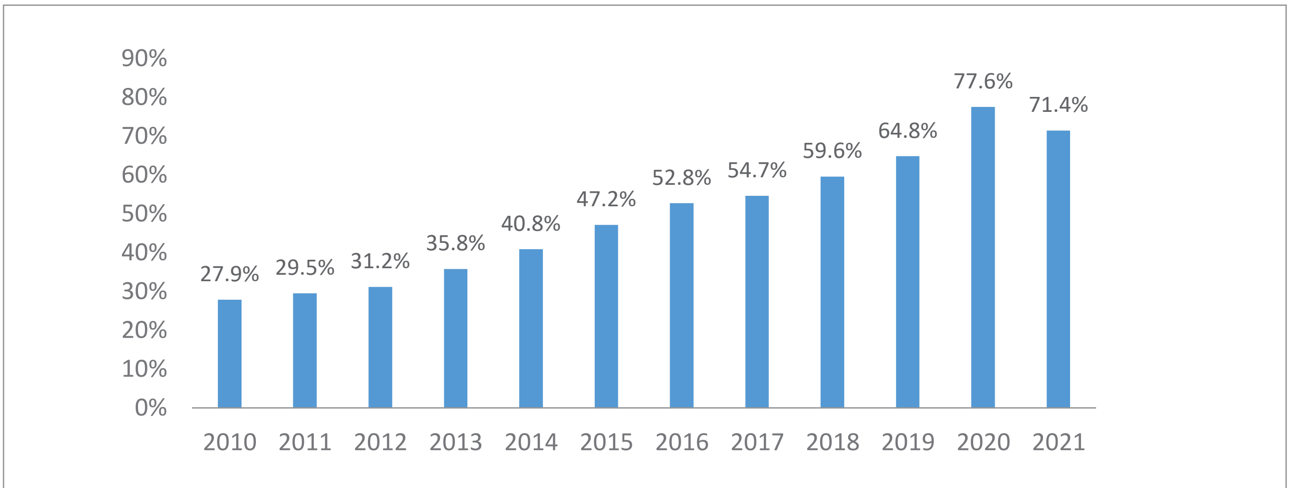
As of 31 December 2021, the total loan portfolio of the banking system reached GEL 43 billion and its annual growth, excluding the exchange rate effect, was 18.2%. The composition of the loan portfolio (excluding interbank loans) did not change significantly in terms of segments. In 2021, compared to 2020, the ratio of banking sector loans to GDP decreased, amounting to 71.4% at the end of the year.

DIAGRAM N 4.3 TOTAL LOAN PORTFOLIO CHANGE, YOY



Source: NBG

DIAGRAM N 4.4 RATIO OF BANKING SECTOR LOANS TO GDP

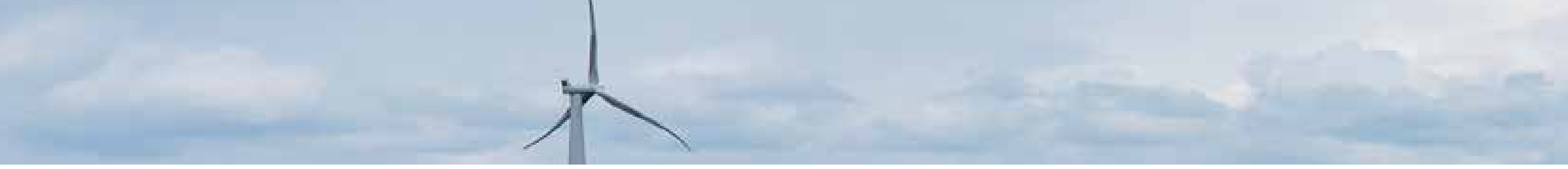


Source: NBG

TABLE N 4.4 COMPOSITION OF THE LOAN PORTFOLIO (EXCLUDING INTERBANK LOANS) BY SEGMENT (ADJUSTED FOR EXCHANGE RATE EFFECT, THE EXCHANGE RATE AS OF THE END OF 2020)

	Dec. '20		Dec. '21		Change %	Change without reclassification effect,%
	Million GEL	**share %**	**Million GEL**	**share %**		
Corporate loans	10,950	34%	11,728	34%	7.1%	15.8%
SME loans	8,121	25%	9,012	26%	11.0%	24.3%
Retail loans	12,844	40%	14,075	40%	9.6%	16.3%
Total:	31,915	100%	34,815	100%	9.1%	18.2%

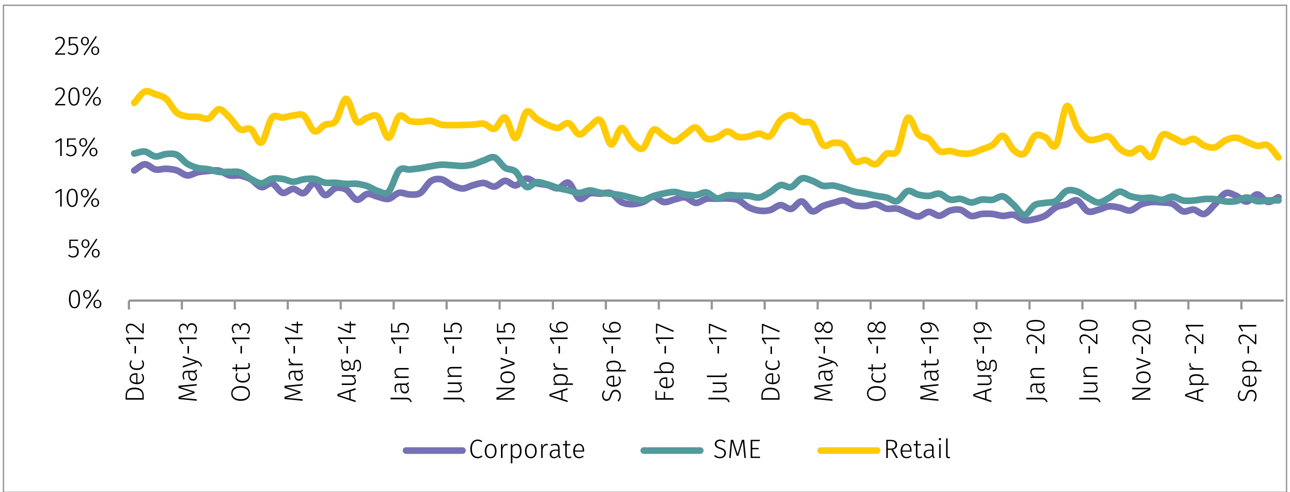
Source: NBG



During 2021, the volume of securities acquired by commercial banks from various corporate clients increased. Also, factoring transactions were funded. Given the effect of these acquisitions, the corporate segment portfolio growth was 16% and the growth of the total loan portfolio was 18.3%.

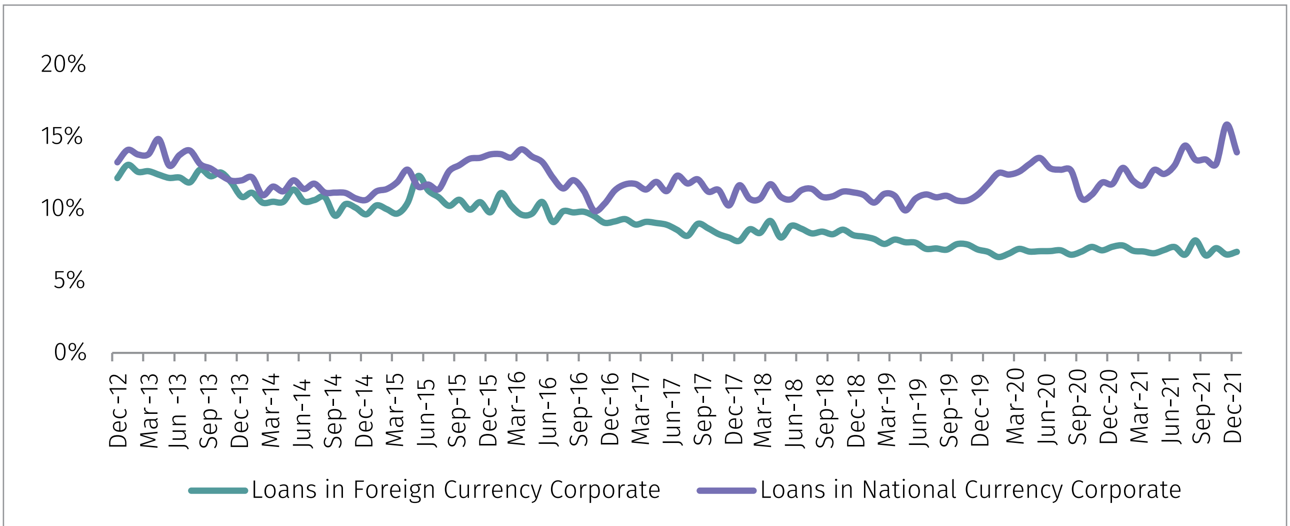
In 2021, as compared to 2020, there were no significant movements in interest rates on retail and small- and medium-sized loans, while corporate loans were disbursed at 1% higher interest on average in 2021, which was a consequence of increased interest rates on GEL loans.

DIAGRAM N 4.5 MONTHLY WEIGHTED AVERAGE INTEREST RATES ON LOANS PER SEGMENT



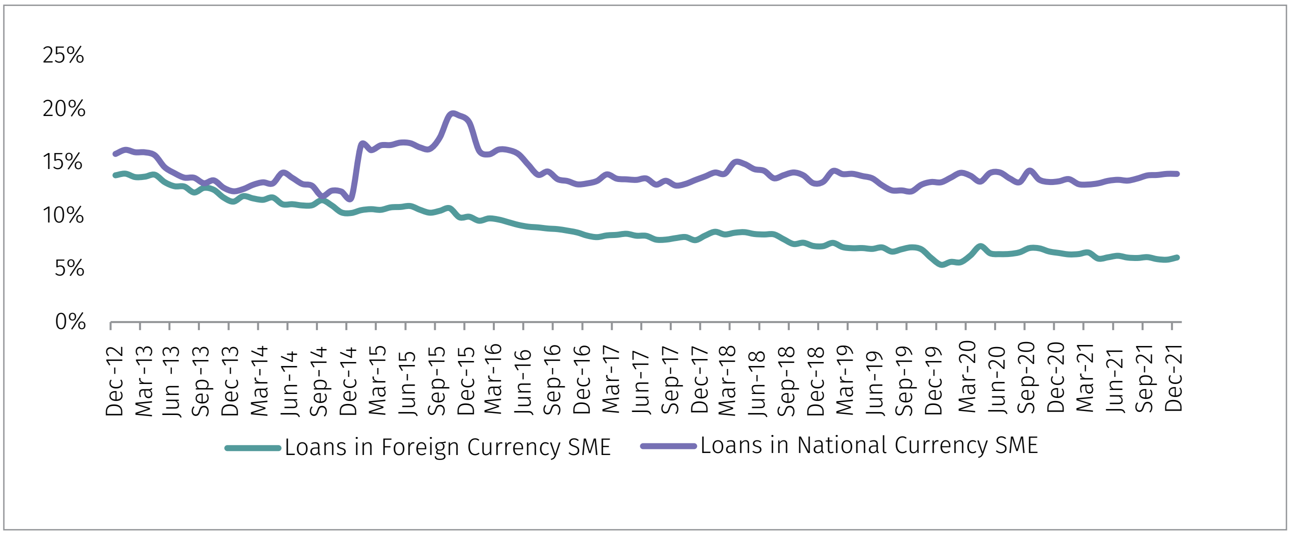
Source: NBG

DIAGRAM N 4.6 MONTHLY WEIGHTED AVERAGE INTEREST RATES ON LOANS FOR THE CORPORATE SEGMENT



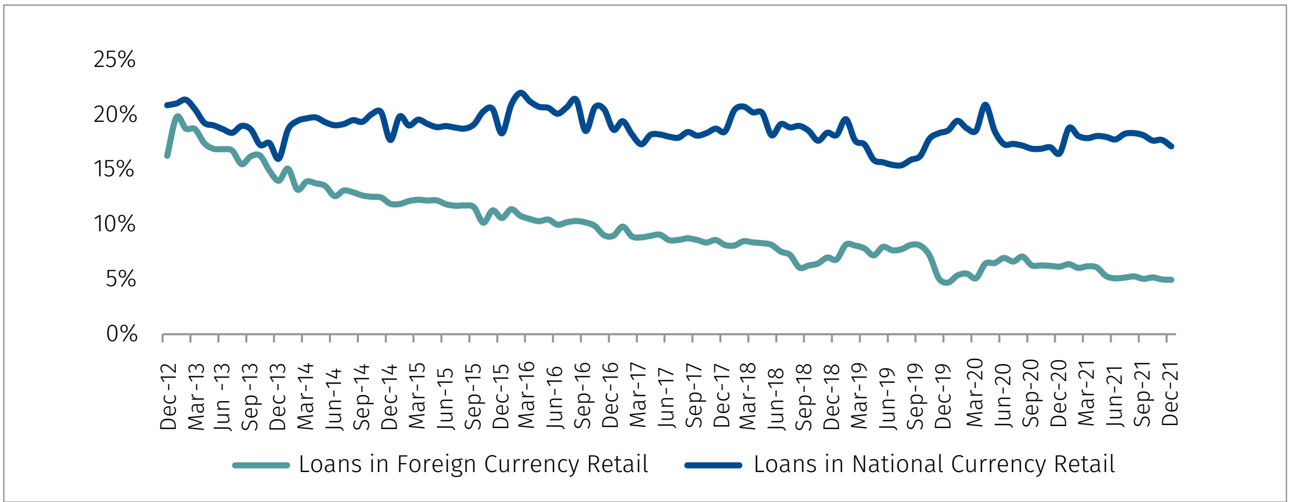
Source: NBG

DIAGRAM N 4.7 MONTHLY WEIGHTED AVERAGE INTEREST RATES ON LOANS FOR THE SME SEGMENT



Source: NBG

DIAGRAM N 4.8 MONTHLY WEIGHTED AVERAGE INTEREST RATES ON LOANS FOR THE RETAIL SEGMENT



Source: NBG

The loan portfolio is diversified across sectors. At the end of December 2021, the total share of economically vulnerable sectors (real estate development, real estate management, hotels and tourism, restaurants and catering, and car dealers) in the portfolio was at 18.1%, which is 11% less than in the same period in 2020. The high volume of possible loss reserves in some sectors is mainly due to the additional reserves created as a consequence of the pandemic.

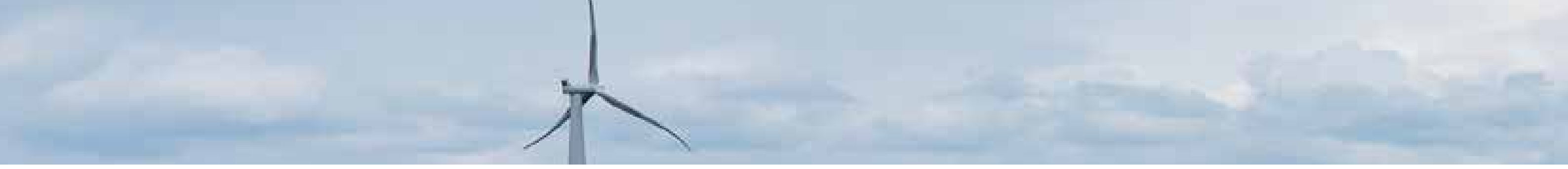
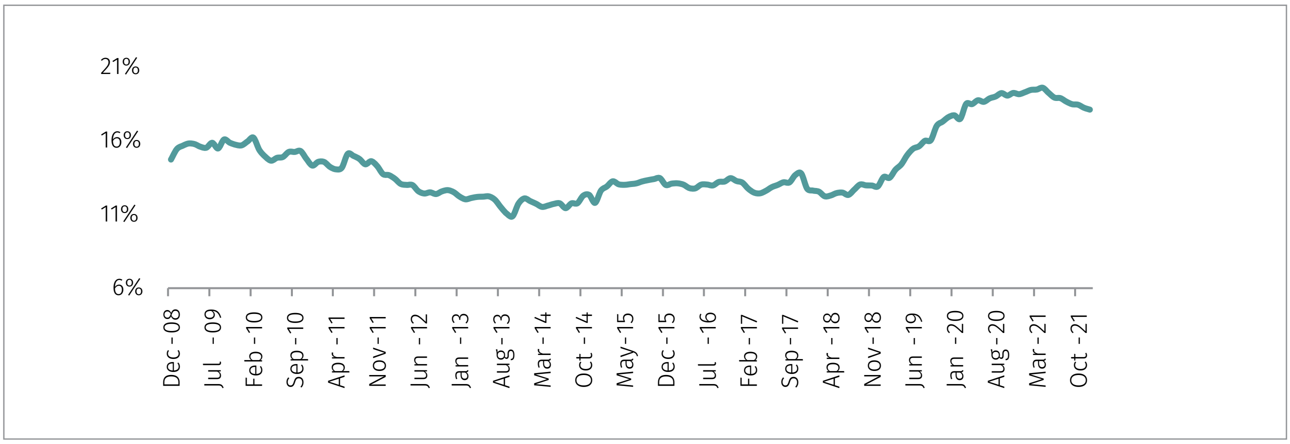


TABLE N 4.5 SECTORAL DISTRIBUTION OF THE LOAN PORTFOLIO

Sector (excluding interbank loans, million lari)	Share in total portfolio	Loan balance	Loan reserve	Loan reserve / portfolio
State Organizations	0.3%	133	3	2.2%
Financial Institutions	1.2%	524	14	2.7%
Pawn-shop Loans	1.0%	441	11	2.4%
Real Estate Development	3.5%	1,510	95	6.3%
Real Estate Management	5.9%	2,542	133	5.2%
Construction Companies (not developers)	1.9%	817	47	5.7%
Procurement, Production and Trade of Construction Materials	2.6%	1,125	40	3.6%
Trade in Consumer Goods	3.4%	1,486	71	4.8%
Production of Consumer Goods	3.7%	1,594	102	6.4%
Production and Trade of Durable Consumer Goods	0.7%	312	11	3.6%
Production and Trade of Clothes, Shoes and Textiles	0.5%	202	10	4.7%
Trade (other)	4.7%	2,004	85	4.3%
Production (other)	1.6%	709	24	3.3%
Hotels and Tourism	6.7%	2,905	183	6.3%
Restaurants, Bars, Cafes and Fast-food Outlets	1.3%	580	46	7.9%
Heavy Industry	1.9%	803	47	5.9%
Loans to Gas Stations and Gasoline Importers	0.8%	360	19	5.2%
Energy	3.8%	1,619	39	2.4%
Car Dealers	0.6%	270	21	7.9%
Healthcare	1.9%	804	27	3.4%
Pharmaceuticals	0.4%	154	5	3.3%
Telecommunications	0.7%	322	13	4.0%
Service	5.0%	2,135	97	4.5%
Agriculture Sector	5.4%	2,335	103	4.4%
Other (involving scrap metal business)	2.0%	855	30	3.5%
Retail products	**38.4%**	**16,540**	**718**	**4.3%**
Car Loans	0.3%	145	7	5.0%
Consumer Loans	14.5%	6,260	311	5.0%
Instant Installments	0.8%	359	24	6.6%
Overdrafts	0.1%	54	7	12.2%
Credit Cards	0.9%	380	22	5.7%
Loans for Apartment Renovation	1.8%	761	26	3.4%
Mortgages	19.9%	8,581	321	3.7%
Loan portfolio (net of interbank loans)	**100.0%**	**43,082**	2,003	**4.6%**

Source: NBG

DIAGRAM N 4.9 SHARE OF ECONOMICALLY VULNERABLE SECTORS IN THE TOTAL LOAN PORTFOLIO



Source: NBG

The year 2021 saw a higher growth of retail products compared to 2020. An increase was observed in all products except credit cards. However, given the fixed exchange rate, the main driver of growth in retail products was the increase in mortgage and consumer lending, although the latter grew more than the former.

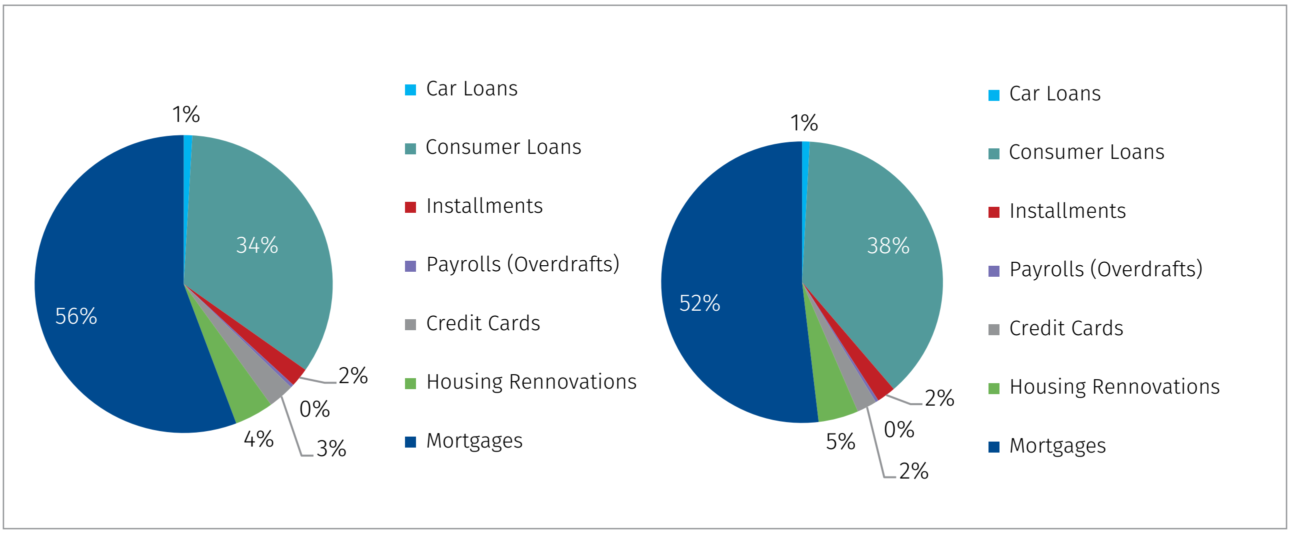
TABLE N 4.6 GROWTH OF RETAIL PRODUCTS (EXCLUDING THE EXCHANGE RATE EFFECT, AT THE EXCHANGE RATE ACTIVE AS OF THE END OF 2020)

Product	Dec. '20		Dec. '21		Change % at fixed rate	Change, million GEL	Change, % at fixed rate and reclassification
	Million GEL	share, %	Million GEL	share, %			
Retail products	**14,488**	**100%**	**17,073**	**100%**	**17.8%**	**2,585**	**17.1%**
Car loans	135	1%	150	1%	11.2%	15	11.2%
Consumer Loans	4,903	34%	6,321	37%	28.9%	1,417	26.6%
Instant Installments	300	2%	359	2%	19.6%	59	19.6%
Overdrafts	50	0%	55	0%	10.2%	5	10.2%
Credit Cards	412	3%	381	2%	-7.6%	-31	-7.6%
Loans for Apartment Renovation	620	4%	783	5%	26.2%	163	26.2%
Mortgages	8,067	56%	9,025	53%	11.9%	958	11.9%

Source: NBG

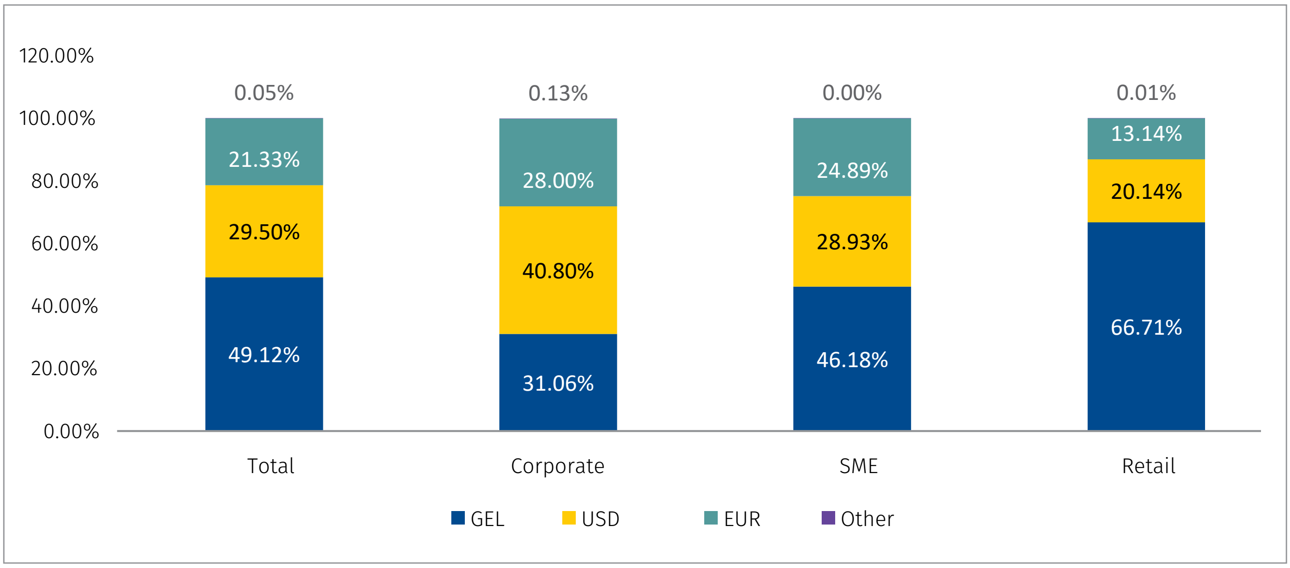
The structure of the retail product portfolio has changed slightly compared to the previous year, which has been echoed in the higher share of consumer loans and the lower share of mortgage loans. The decrease in the share of mortgage loans is mainly due to the higher growth rate of consumer loans and is also a consequence of the appreciation of the GEL exchange rate compared to December of the previous year, as the dollarization of mortgage loans is higher.

DIAGRAM N 4.10 DISTRIBUTION OF RETAIL PRODUCT BALANCES AS OF THE END OF 2020 AND 2021



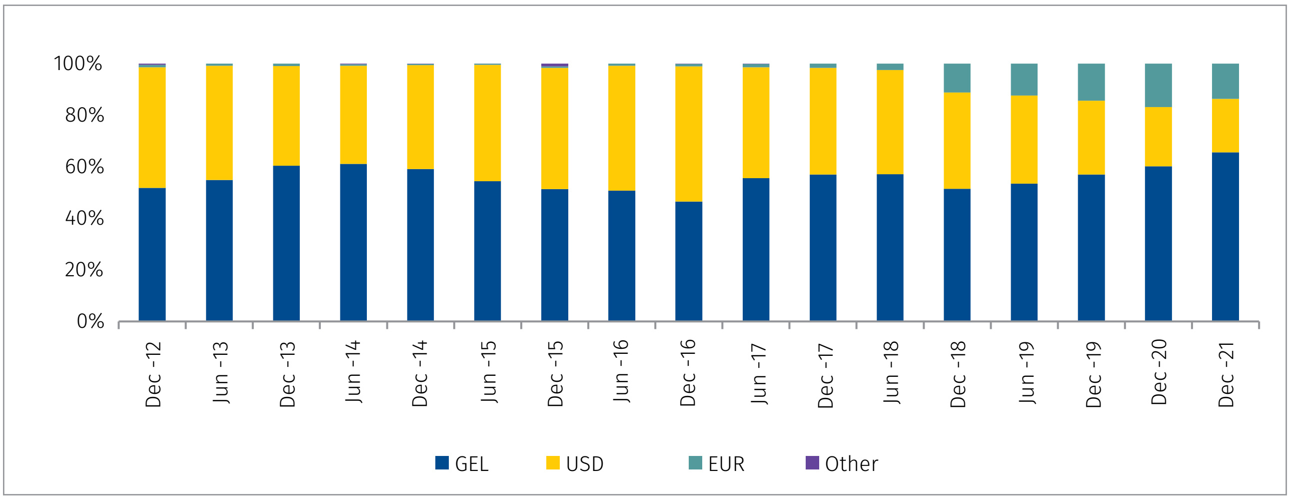
Source: NBG

DIAGRAM N 4.11 SEGMENT BALANCES BY CURRENCY AT THE END OF 2021 (EXCLUDING INTERBANK LOANS)



Source: NBG

DIAGRAM N 4.12 COMPOSITION OF THE RETAIL PORTFOLIO BY CURRENCY



Source: NBG

TABLE N 4.7 CLASSIFICATION OF THE LOAN PORTFOLIO BY QUALITY

Category (except interbank loans)	Amount in million GEL	Share	Reserve (provision?) N
Standard	38,358	89.0%	2%
Negative loans	4,725	11.0%	25%
Watch	2,470	5.7%	10%
Non-performing	2,255	5.2%	42%
Substandard	1,314	3.0%	30%
Suspicious	422	1.0%	47%
Non-performing	520	1.2%	68%
Total:	**43,083**	**100%**	**5%**

Source: NBG

TABLE N 4.8 PORTFOLIO QUALITY BY SEGMENT

Segment	Negative loans	Non-performing loans	Average reserve (provision)
Corporate	13.81%	5.58%	4.70%
SME	12.94%	6.51%	4.98%
Retail	7.17%	4.07%	4.33%

Source: NBG

Due to the COVID-19 pandemic, at the request of the NBG, banks assessed the expected credit losses during the crisis and fully reflected these losses at the very beginning of the pandemic. Consequently, the negative impact of COVID-19 had a significant impact on the quality of the loan portfolio in 2020. No additional losses were incurred in this regard in 2021. On the contrary, in some cases the loan portfolio recovered, which was primarily due to the faster-than-expected economic growth. Consequently, in 2021, as compared to 2020, the indicators of portfolio quality – the share of negative/non-performing loans and possible loan losses – significantly improved.

In terms of the quality of the retail loan portfolio, the percentage of both non-performing loans and reserves in the portfolio for all retail products decreased compared to the 2020.

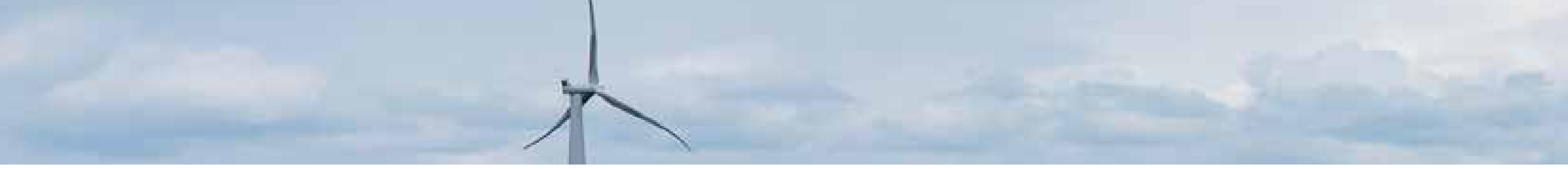
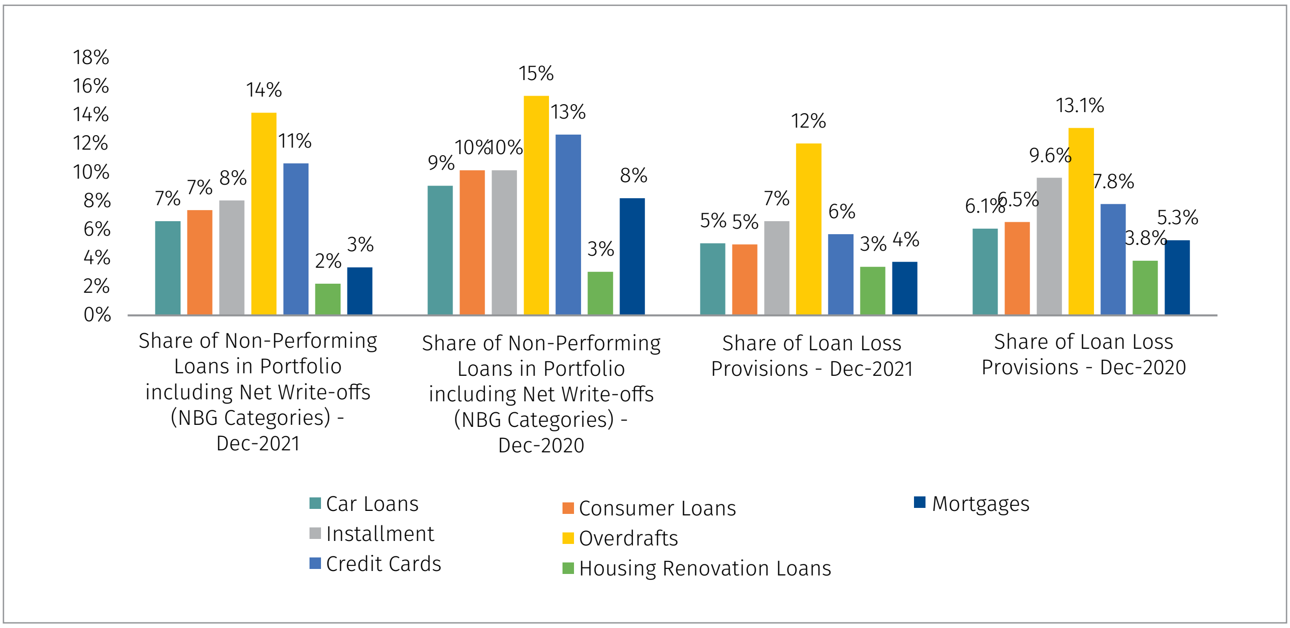


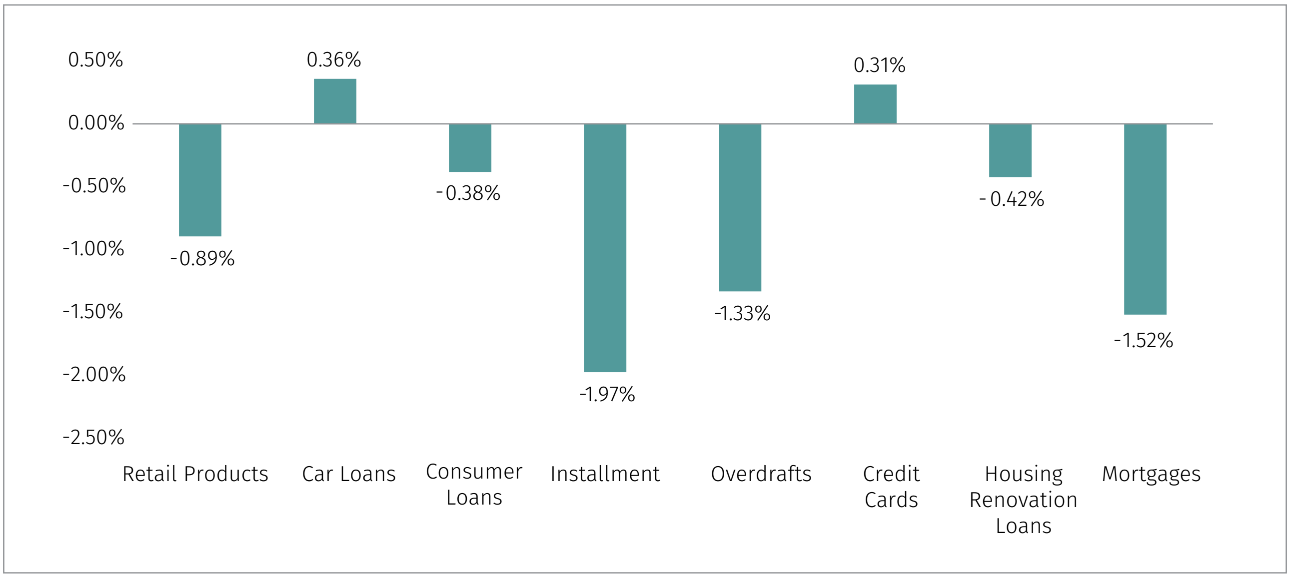
DIAGRAM N 4.13 QUALITY OF THE RETAIL PORTFOLIO AND COST OF RISK BY PRODUCT



Source: NBG

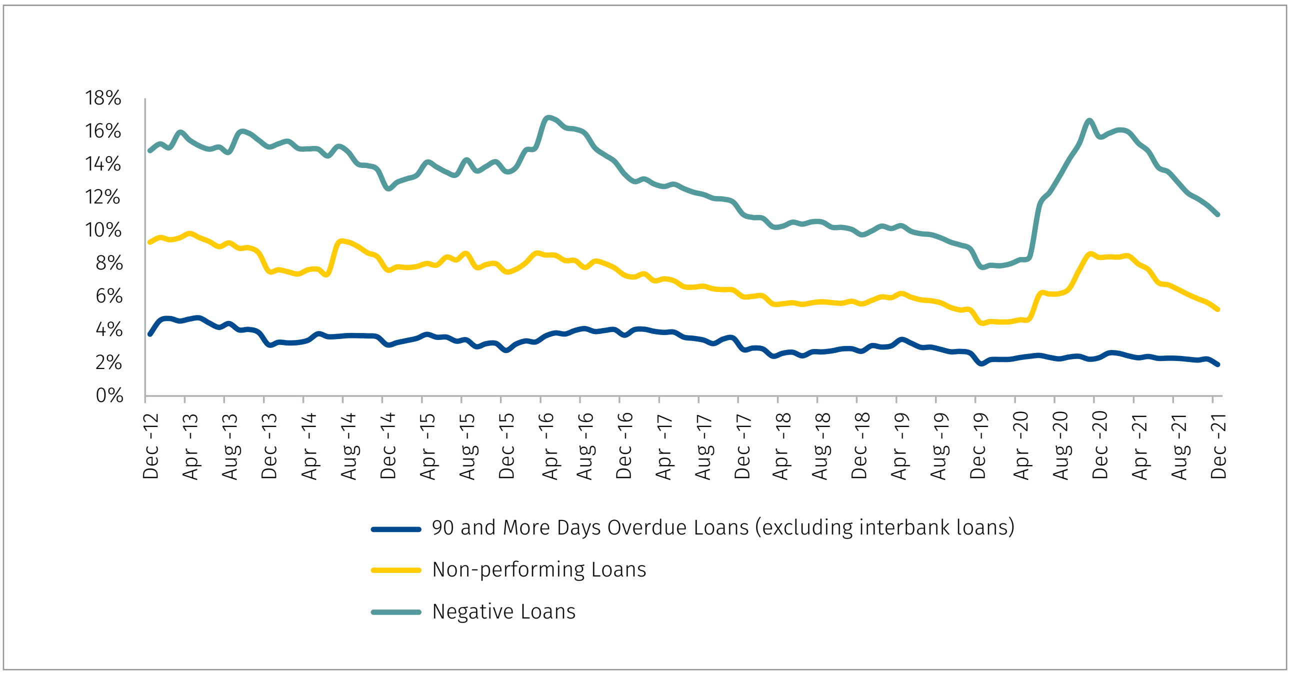
The cost of risk for the portfolio of major retail products also decreased in 2021. The increase in cost of risk for car loans and credit cards over the previous year was due to the slower growth of these products and shrinkage in the portfolio.

DIAGRAM N 4.14 CHANGE IN COST OF RISK (DEC. 2021 – DEC. 2020)



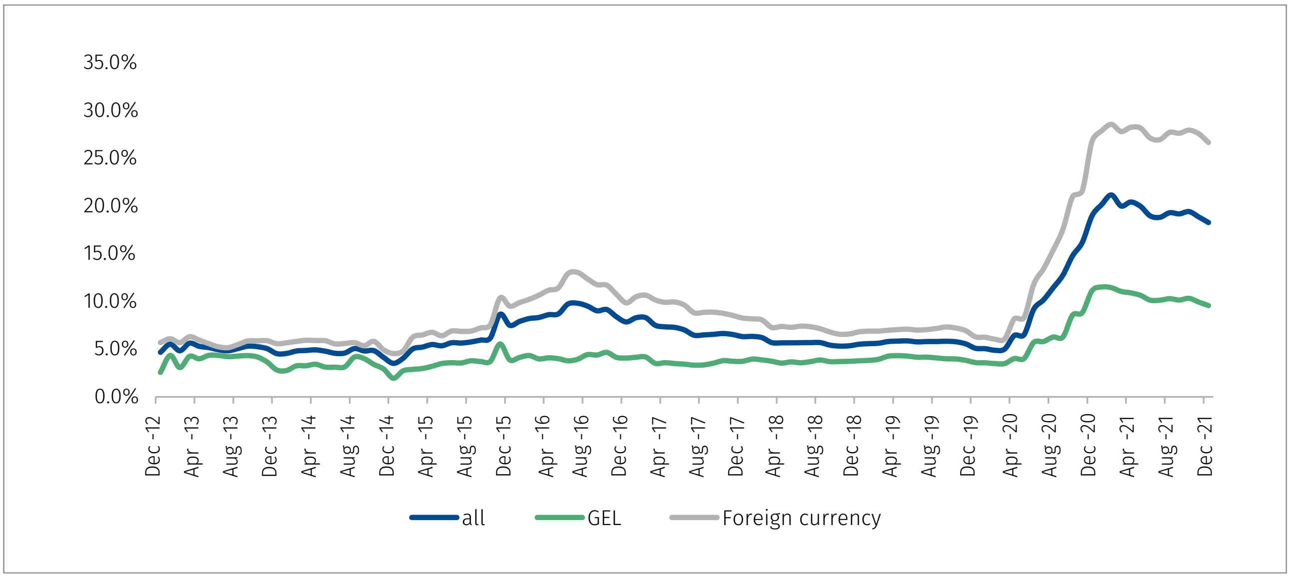
Source: NBG

DIAGRAM N 4.15 LOAN PORTFOLIO BY QUALITY INDICATORS (EXCEPT INTERBANK LOANS)



Source: NBG

DIAGRAM N 4.16 SHARE OF RESTRUCTURED LOANS BY CURRENCY IN THE TOTAL LOAN PORTFOLIO



Source: NBG

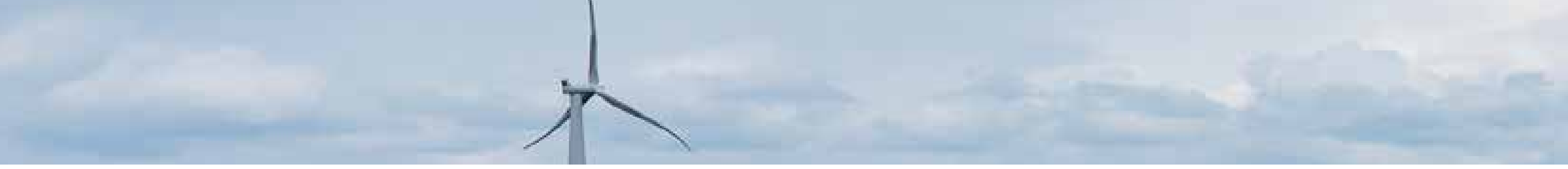
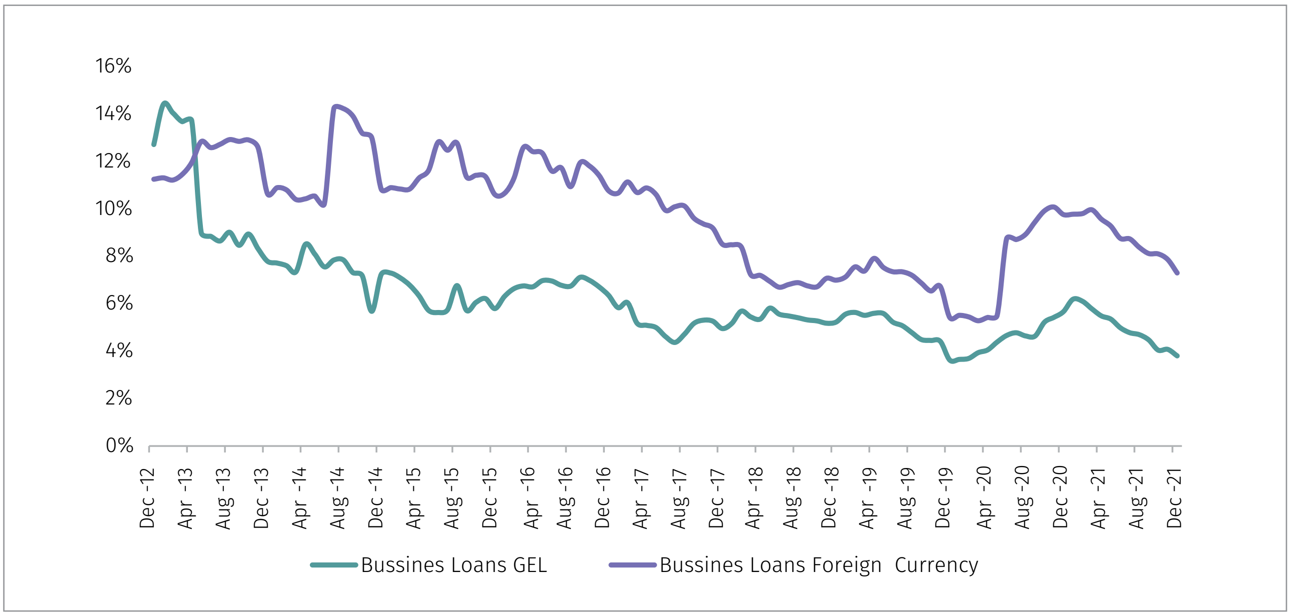
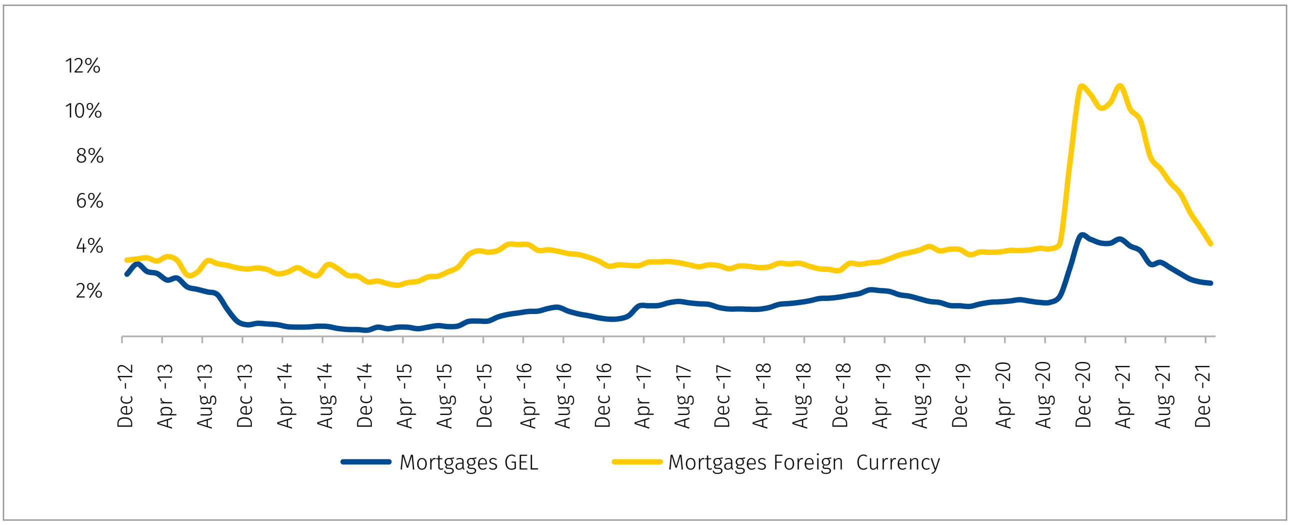


DIAGRAM N 4.17 SHARE OF NON-PERFORMING LOANS IN BUSINESS LOANS BY CURRENCY



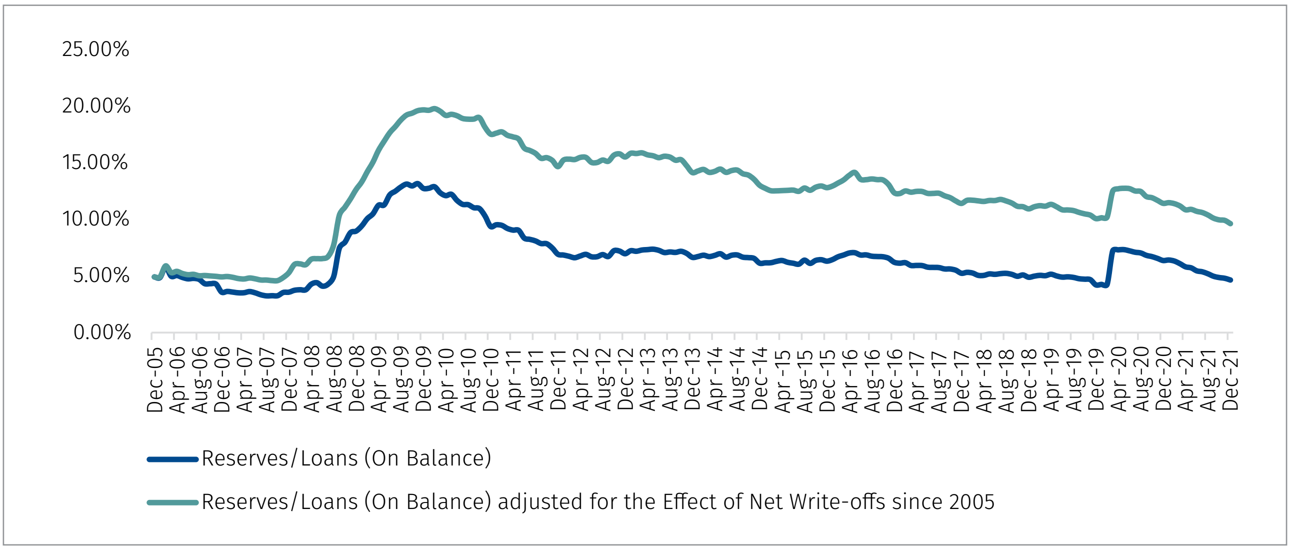
Source: NBG

DIAGRAM N 4.18 SHARE OF NON-PERFORMING MORTGAGE LOANS BY CURRENCY



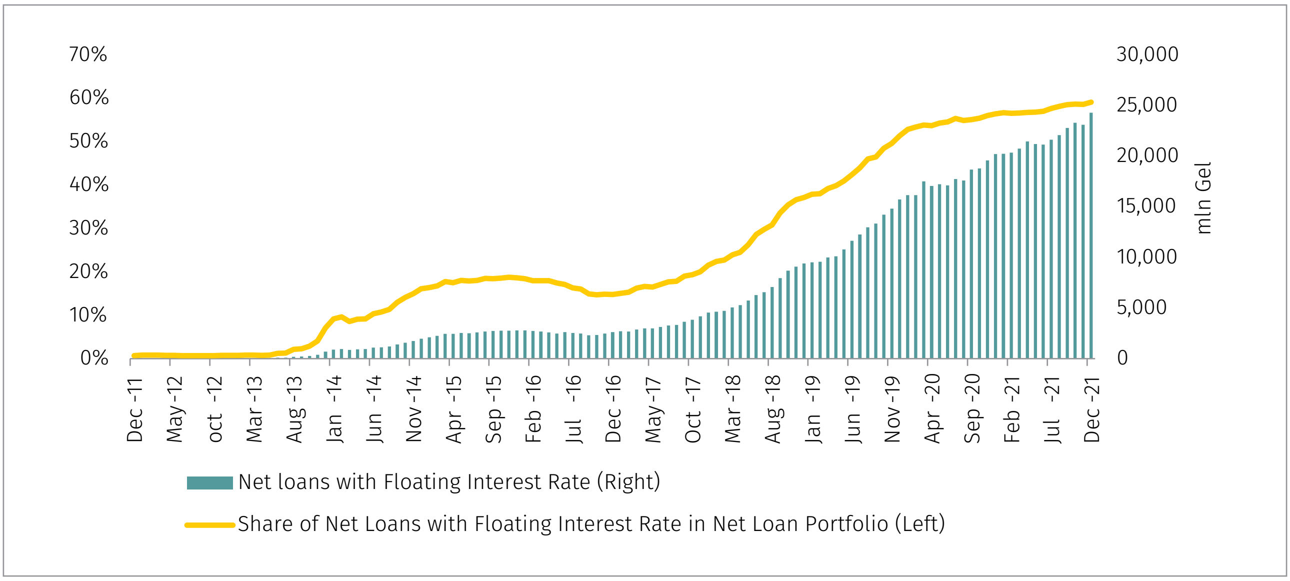
Source: NBG

DIAGRAM N 4.19 LOAN LOSS RESERVES TO THE TOTAL PORTFOLIO[54]



Source: NBG

DIAGRAM N 4.20 VOLUME AND SHARE OF NET FLOATING INTEREST RATE LOANS IN THE NET LOAN PORTFOLIO[55]



Source: NBG

The volume of net written-off loans in 2021 increased by 95.5% compared to the same period in 2020. A large share of net written-off loans came from the retail segment and were caused by the COVID-19 grace periods that were in place during 2020 and the first half of 2021. Accordingly, these loans were written off by commercial banks in 2021. An increase was recorded in both written-off assets and recoveries of written-off assets, although the latter shows slower growth.

54. This includes the general reserve.
55. Net loans – volume of loans after subtracting loan loss reserves.

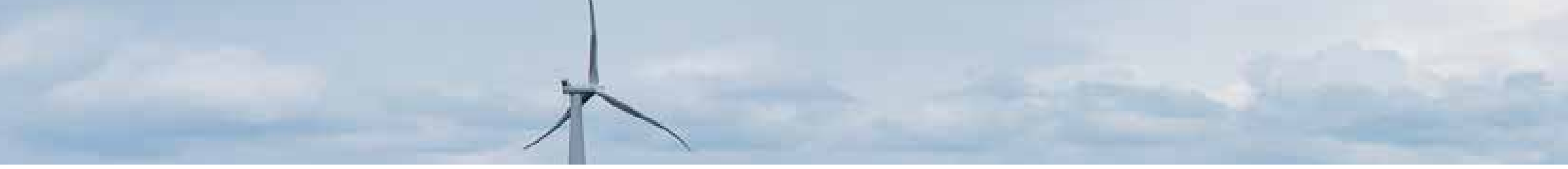
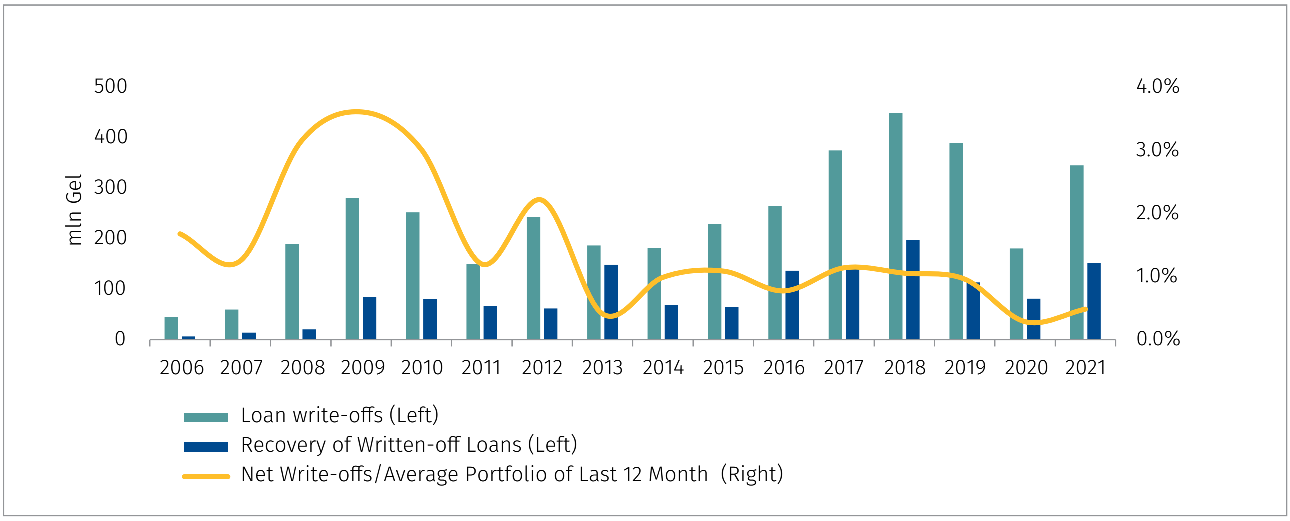
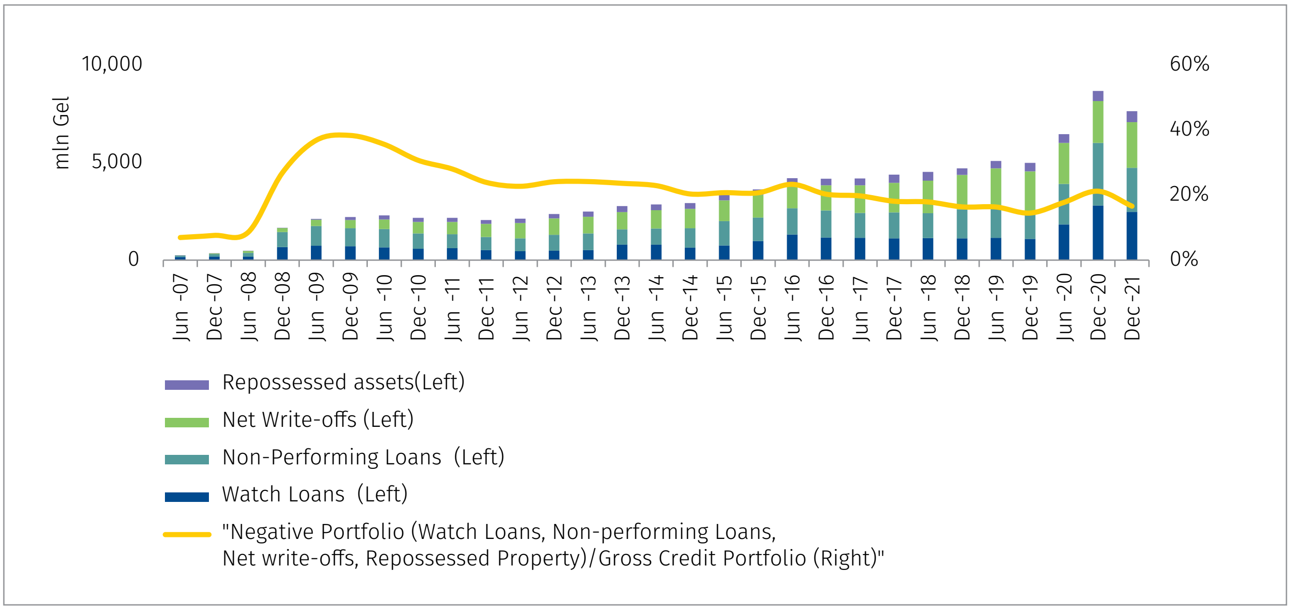


DIAGRAM N 4.21 LOAN WRITE-OFFS AND RECOVERIES



Source: NBG

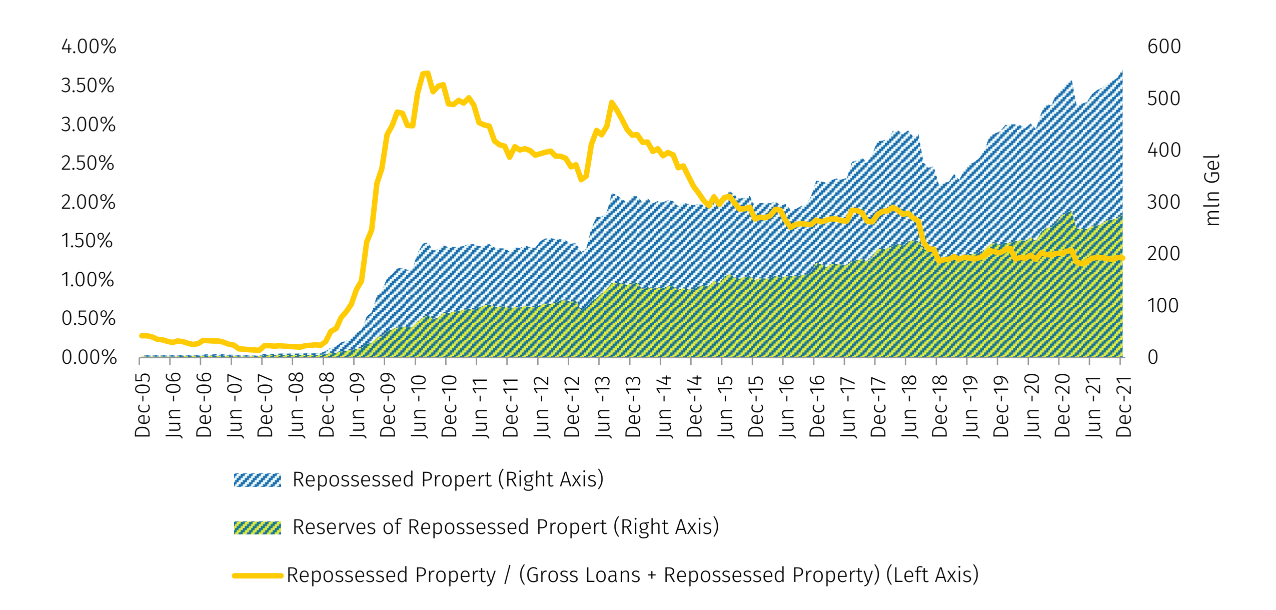
DIAGRAM N 4.22 PROBLEM ASSETS



Source: NBG

The share of repossessed property in total investments (loans plus repossessed property) largely remained unchanged in 2021 YoY.

DIAGRAM N 4.23 REPOSSESSED ASSETS



Source: NBG

Transitioning to IFRS 9 Provisioning

Alignment with international standards is one of the priorities defined under the NBG Supervision Strategy for 2020-2022. An important factor determining the difference between accounting and reporting principles for regulatory purposes and those under IFRS is the current practice of provisioning financial instruments. To address this gap, a preliminary version of the Regulation on Defining Financial Instrument Risk Categories and Expected Credit Loss was developed based on IFRS 9. The regulation outlines some of the methods that commercial banks should use to provision their financial instruments. The Regulation on the Classification of Assets and Establishment and Use of Reserves for Possible Losses by Commercial Banks will also remain in force, in parallel, until the end of 2022. The purpose of the IFRS project is to facilitate the comparability of the approaches used by commercial banks to calculate the expected losses of financial instruments and to improve financial reporting. However, under the new regulation, commercial banks will only have to prepare their financial reports under IFRS, and this is expected to allow the banking system to save resources. The updated provisioning approaches have been developed in close collaboration with stakeholders and the Regulation on Defining Financial Instrument Risk Categories and Expected Credit Loss was sent to the parties involved. The regulation was also published on the website of the NBG to allow for additional feedback, public consultations and increased stakeholder access.

The regulation defined the three stages of the credit risk category of financial instruments and the mandatory criteria for determining the pertinent category:

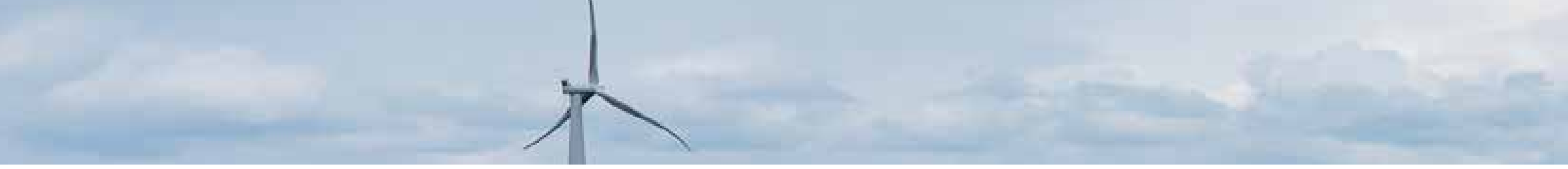
Stage 2 credit risk category:

- A significant increase in credit risk.
- Overdue for more than 30 days.
- Restructuring of the financial instrument.

Stage 3 credit risk category:

- The main sources of payment for a financial instrument, including capital, profits and/or the ability to generate cash, are insufficient to repay the debt. Accordingly, a commercial bank should use other sources of payment, such as selling collateral, mortgage or selling other assets of the borrower.
- Partial relief/write-off of principal and/or accrued interest.
- Overdue for over 90 days.

In addition to these mandatory criteria, for supervisory purposes, commercial banks should consider the following solvency ratios as mandatory criteria for determining the credit risk category of a financial instrument:



Financial instruments disbursed to business borrowers:

All Economic Sectors		
Risk Category	Debt/EBITDA	DSCR for 10 years
Stage 3 Credit Risk	> 6.00	< 1.0
* Hotels, energy, real estate management		
Risk Category	Debt/EBITDA	DSCR for 15 years
Stage 3 Credit Risk	> 7.50	< 1.0

Financial instruments distributed to individuals

Monthly net income (GEL or equivalent in foreign currency)	**Stage 3 Credit Risk**
< 1,000	> 55 %
≥ 1,000	> 70 %

The Regulation on Defining Financial Instrument Risk Categories and Expected Credit Loss provides qualitative and quantitative indicators it is recommended to consider when determining the credit risk category.

The credit risk category of a financial instrument can be upgraded if the following criteria are met:

	based on Financial Analysis	**Without Financial Analysis**
Stage 2 ➡ Stage 1	3 consecutive demonstrative payments	6 consecutive demonstrative payments
Stage 3 ➡ Stage 2		6 consecutive demonstrative payments
Stage 3 ➡ Stage 1	6 consecutive demonstrative payments	

When changing the credit risk category of financial instruments issued to individuals, if the PTI ratio exceeds the ratios required by the Regulation on Lending to Individuals, banks should consider a 10-percentage-point change in the ratio. When changing the credit risk category of financial instruments issued to business borrowers, if the debt/EBITDA ratio is greater than 4.5 or the debt-service coverage ratio (DSCR) is less than 1.2, banks should consider a 10% change in the ratio.

Commercial banks must ensure compliance with the contamination principle, which in the case of borrowers for retail and micro portfolios implies a significant increase/impairment of credit risk for a single instrument, leading to a significant increase/impairment of the credit risk for other financial instruments of the same borrower. For small- and medium-sized and corporate portfolios, it would take some additional assessment to determine whether other borrowers' financial instruments are impaired or whether their credit risk is significantly increased.

The Regulation on Defining Financial Instrument Risk Categories and Expected Credit Loss covers the factors to be considered in the collective assessment of expected credit loss. These include recommendation requirements for data quality, the incorporation of forward-looking information, the formation of homogeneous groups, a framework for construction of impairment models (PD, LGD, EAD), approaches recommended for building robust models, and a description of the credit risk rating process and related requirements for both internal and external ratings.

The evaluation of the model will incorporate the principles set out in the Regulation on Managing Risks Inherent to Statistical, Artificial Intelligence and Machine Learning Models. In addition, the NBG has developed a

results-testing guideline that outlines the basic principles, approaches, evaluation process, and ways to respond to the results. To determine compliance with the new methodology, NBG representatives scrutinized the current practices of the IFRS 9-provisioning financial instruments of commercial banks. Upon completion of the exercise, each commercial bank received individual feedback and recommendations. Following a review of the feedback received, and through the joint efforts of the NBG and the commercial banks, commercial banks began to modify their current approaches to align them with IFRS 9. Consultations with commercial banks and the involvement of the NBG in this process will continue until the end of 2022 (until the old regulation is abolished).

Whenever the omission of any of the requirements of the Regulation on Defining Financial Instrument Risk Categories and Expected Credit Loss does not result in a breach of the requirements of IFRS 9, a commercial bank may, for the purposes of audited financial statements, apply a different treatment for the expected credit loss. In this case, commercial banks are required to disclose the effect on capital adequacy of the difference between the provisioning approach offered by the said regulation and that done for financial reporting purposes. Banks also have the option of using approaches that are different from the Regulation on Defining Financial Instrument Risk Categories and Expected Credit Loss for regulatory purposes, provided that these approaches are substantiated and approved with the NBG. The difference between the provisions under the Regulation on Defining Financial Instrument Risk Categories and Expected Credit Loss and those under the NBG current approach is important, which is inconsistent with the key principle of the IFRS transition project – no significant impact on regulatory data and requirements must be observed. To settle the issue, the differences between the provisions are reflected in the Pillar 2 report. In addition to the requirements under the Regulation on Defining Financial Instrument Risk Categories and Expected Credit Loss, commercial banks will create, as required, a new Pillar 2 element – the Credit Risk Adjustment (CRA) buffer. This buffer is calculated for financial instruments categorized on all three stages of credit risk, with total reserves defined under the appropriate scenario and in consideration of the difference between the total reserves determined by the provisioning methodology used by the commercial bank for financial reporting purposes.

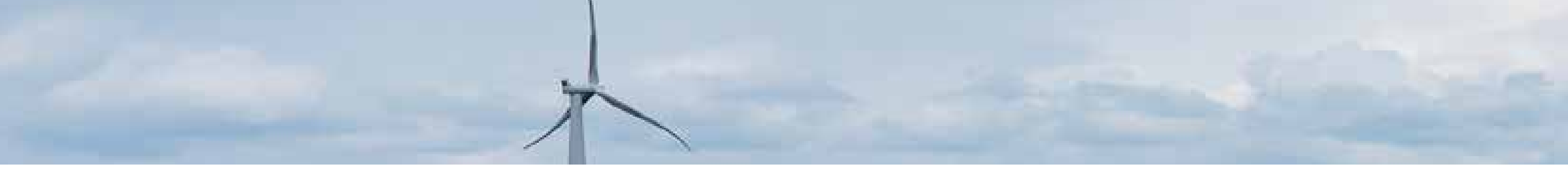
According to IFRS 9, in line with the change in asset provisioning approaches, the credit forms that commercial banks must submit to the NBG at appropriate intervals were updated.

BOX 10 CREDIT RISK ASSESSMENT FOR THE HOTELS AND TOURISM SECTOR

In 2019, the hotels and tourism sector contributed 8.4% to the total value added created in the country, and in 2016 the contribution was 6.2%.[56] Considering the high level of development and capital intensity compared to other sectors, the hotel and tourism sector is the largest in the credit portfolio of the Georgian banking system. Consequently, credit risks emerging in this sector can have a material impact on the quality of the entire portfolio. There has been increased interest in credit risk assessments during the COVID-19 pandemic as the mobility restrictions put in place had a direct adverse impact on tourism sector companies, including on borrower hotels.

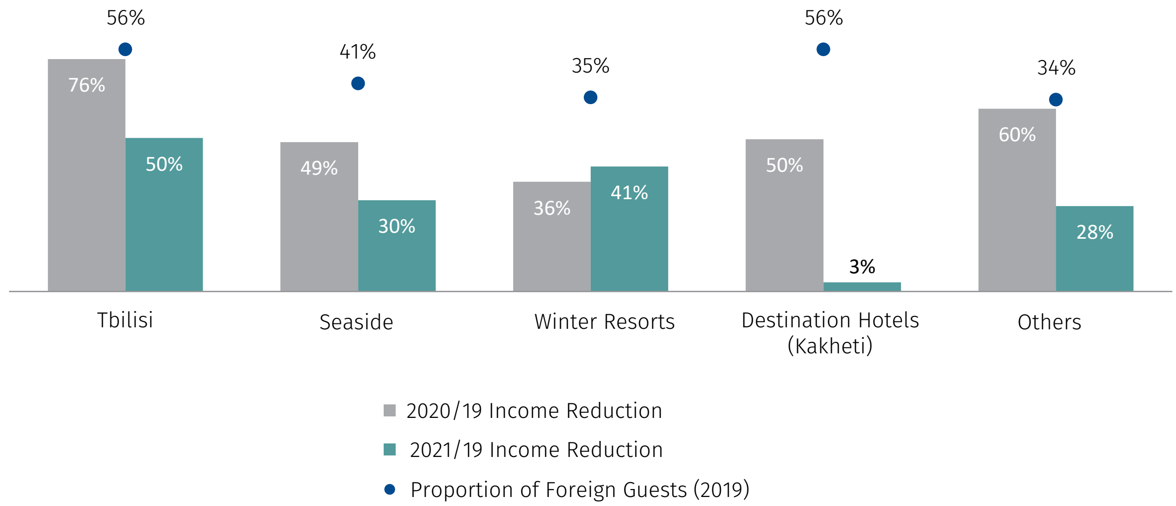
In view of these circumstances, the Specialized Risk Department of the NBG conducted a sectoral survey of the hotels and tourism sector by observing the relatively large borrowers in commercial banks and relatively small borrowers as selected on a random basis. The study found that the first year of the pandemic

56. See https://gnta.ge/wp-content/uploads/2021/12/2019_GEO_PRINT.pdf



was particularly difficult for the sector. Not just international travel, but mobility within the country was often restricted in 2020, preventing outbound tourism from being properly switched to domestic tourism, and causing a decline in the rates of domestic visits. Against the background of an easing of regulations, in 2021 domestic tourism options increased, even as compared to 2019, which played an important role in accelerating the recovery of the sector. A special increase in domestic visits was observed in the Mtskheta-Mtianeti, Kartli and Kakheti regions of the country[57], and expenditures on local accommodation by Georgian residents increased by 60% compared to 2019.[58] However, outbound tourism continued to decline in 2021.[59]

Based on the data of the borrower hotels selected for the study, we can say that the pandemic reduced hotel occupancy rates by more than the average daily rate (ADR) and that the recovery is proceeding similar to this trend. Hotels in Tbilisi suffered the biggest negative changes, which is explained by their relatively high dependence on foreign visitors and their being less loaded with domestic tourism; in contrast, the regions are recovering faster with a higher number and quality of domestic visits. For example, in 2021, for destination hotels in Kakheti some parameters (such as EBITDA margin and seasonal ADR) even improved over 2019 levels.[60]

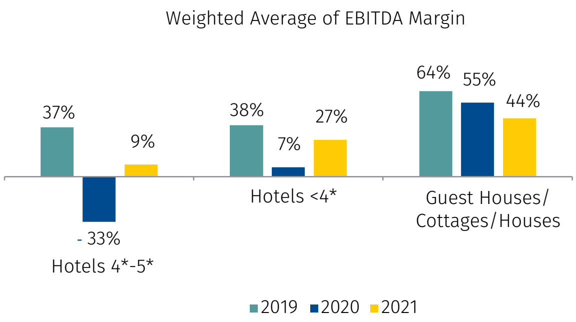


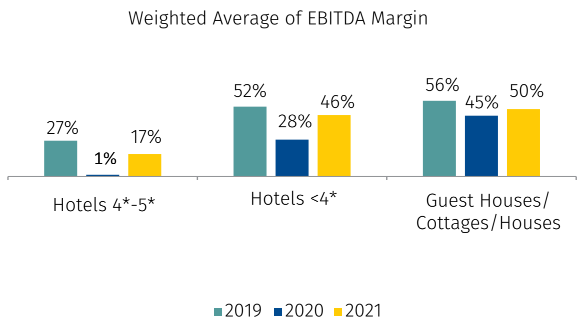
Hotels in the regions have more diversified revenues than those in Tbilisi. More specifically, the study suggests that, while the share of rental income in the total revenues of Tbilisi destination hotels averages 74%, Kakheti destination hotels record only half of that income, while the other half is obtained from additional services. The provision of additional services also requires additional infrastructure, which often takes material investment. That is why the construction of such destination hotels are some of the most expensive (in terms of total investment per room) as compared to other regions.[61]

Georgia's busiest tourism season is the third quarter of the year (peaking in August); however, from a global perspective, the country is not considered a so-called holiday destination and thus has relatively balanced tourism.[62] In general, high-end hotels tend to have lower seasonal incomes than midscale

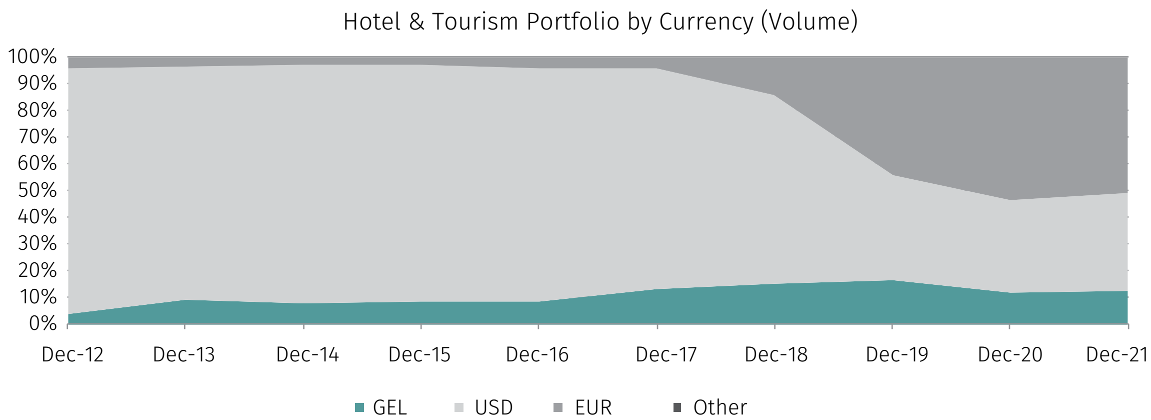
57. See https://geostat.ge/media/42152/vizitebi-monaxulebuli-regionebiT.XLSX
58. See https://geostat.ge/media/42156/xarjebi.xls
59. See https://geostat.ge/media/41811/vizitebis-raodenoba.xlsx
60. Based on NBG research.
61. Based on NBG research.
62. World Tourism Organization statistics.

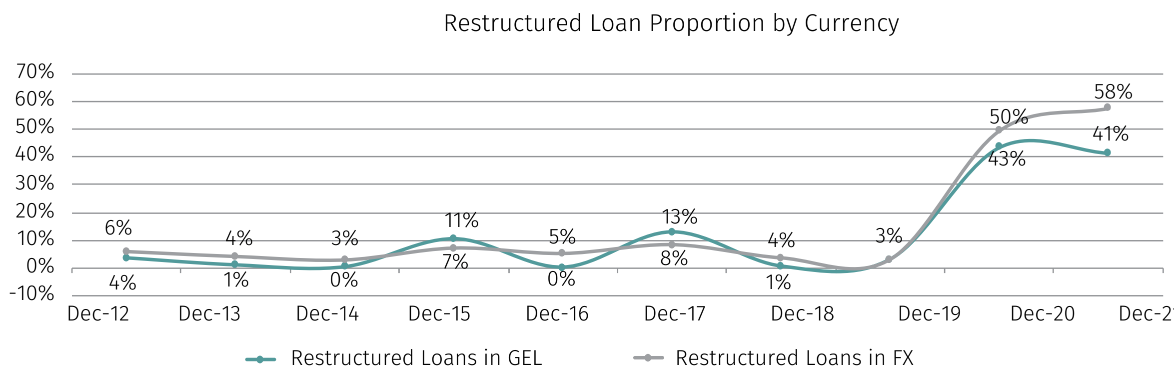
and economy hotels, and they have a high dependence on foreign visitors, which was a major risk factor in pandemic. Their workload thus heavily shrank in 2020, but showed faster recovery in 2021 in terms of both workload and ADR. However, their operating costs turned out to be less flexible, which greatly reduced their operating profit margins compared to hotels of other classes. This correlation can be seen in the cases of both Tbilisi and the seaside.

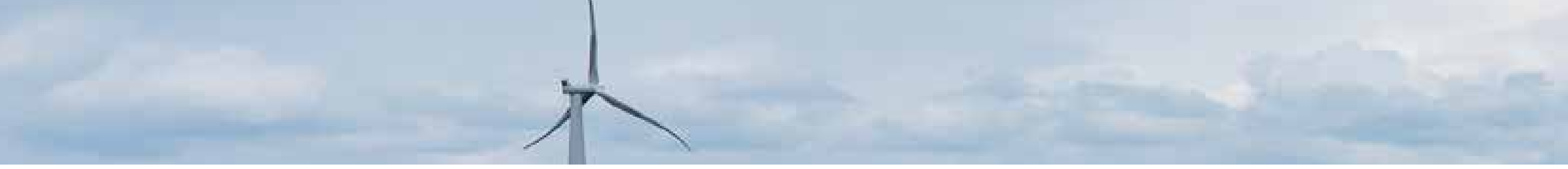




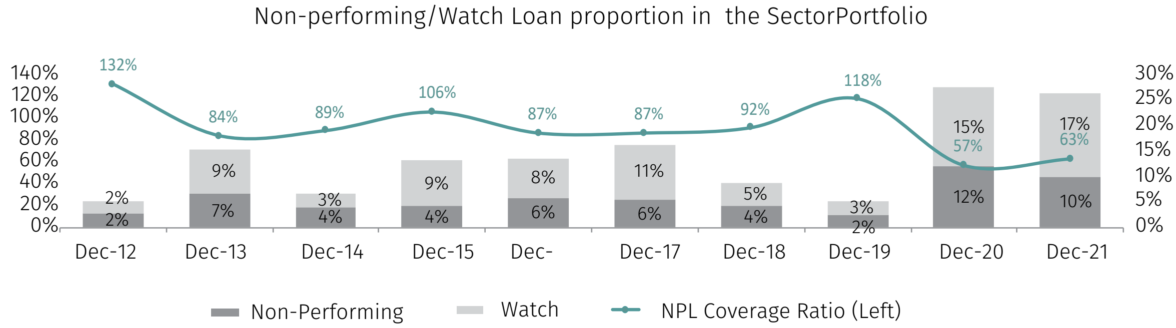
As the risks became realized, the quality of the loan portfolio deteriorated. This was also due to the fact that the majority of loans in the sector were disbursed in foreign currency. As much as 87% of the portfolio is denominated in foreign currency and statistics show that the restructuring of foreign currency loans during the pandemic was more extensive than those issued in GEL (see graphs).

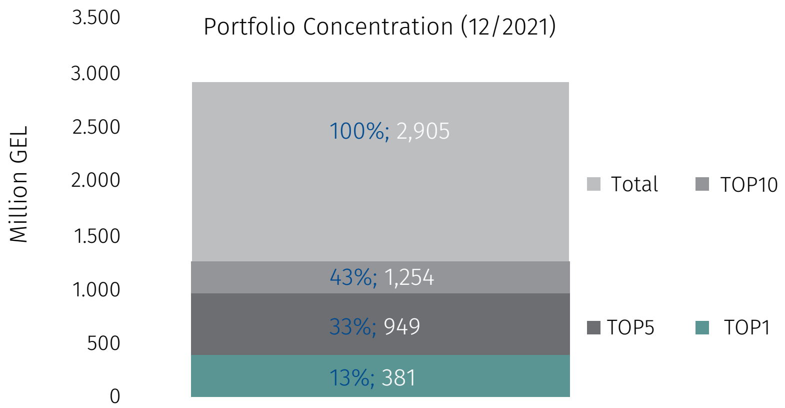






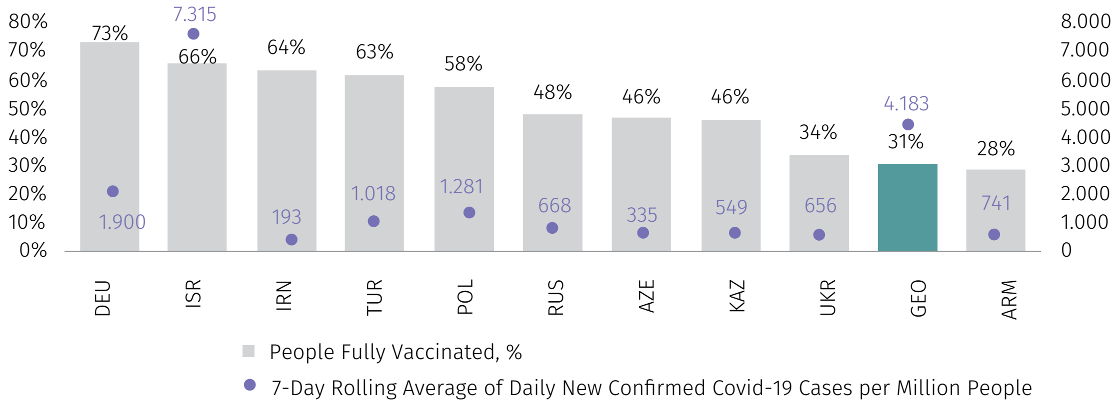
The portfolio also has a higher share of non-performing and watch loans, although loan loss reserves were initially created in the crisis-prone sectors of commercial banks, with grace periods and new loan repayment schedules being offered to hotels. They also received some state support and tax breaks, which eased the temporary pressure caused by the pandemic and laid the groundwork for the recovery figures seen in 2021. As a result of this contribution, the 2021 NPL Coverage Ratio increased, showing the adequacy of the loan loss reserve levels created in the sector for NPLs (substandard, suspicious, and bad loans). It is also interesting to note that the portfolio is quite concentrated and the top 10 borrowers take up some 43% of the total portfolio (see graphs).





As for the expected pace of the full recovery of tourism and, consequently, the hotel sector, this will be entirely dependent on the management of the pandemic worldwide. It is especially important for Georgia to monitor the current pandemic situation in our top visitor countries in order to get an idea of how fast it will be possible to get at least the same number of visitors from these countries as before the pandemic. The relevant data from the visitor countries should also be compared to those of Georgia, as safe guests will be interested in visiting safe host countries.

COVID-19 Pandemic Situation by Top Visitor Countries in Georgia (31/01/2022)



Source: ourworldindata.org

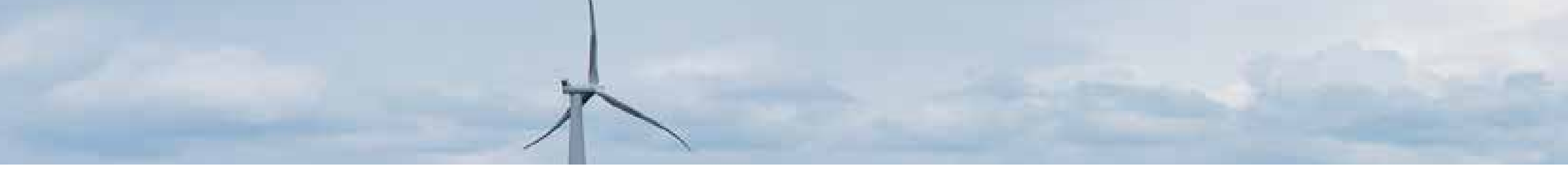
We can see from the graph that, as of 31 January 2022, Georgia lags behind the top visitor countries in terms of vaccination levels and, as the average infection rate in the country is also high, this does not create expectations of a speedy pickup of visitor numbers.

Developing a Policy for Connecting Borrower Groups

From 1 January 2022, an updated version of the Regulation on Concentration of Risk Exposures and Large Risks in Commercial Banks enters into force. The document is in line with the Basel Large Exposure Framework and regulates concentration challenges in the credit portfolios of commercial banks. According to the document, the NBG undertakes to develop instructions for defining groups of interconnected borrowers that will be in line with international best practice as well as incorporating country-specific aspects. This is important insofar as the direct regulation of large exposures provides certain limits and restrictions for commercial banks who lend to groups of interconnected borrowers.

Throughout 2021, the NBG team was dynamically working on researching and analyzing local and international practices, including the EBA's Guidelines on Connected Clients and the Basel Committee's Supervisory Framework for Measuring and Controlling Large Exposures. A series of discussions involving various stakeholders was held and an internal version of the instructions was prepared. The document is currently being discussed with commercial banks and will be finalized and approved in due course.

The document outlines the basic principles to guide commercial banks when deciding to register affiliated clients as a single group. The purpose of these instructions is to fully identify those clients that make up a single group for a particular commercial bank. It is important that each bank identify the potential spread of risk from a certain client, as doing so will help better manage concentration risk at the banking system level. To identify clients that form a group, it is necessary to assess two main issues: the type of control relationship between the clients and the existence of economic dependence. The document gives detailed explanations as to what each issue means and lists the factors (e.g., share ownership, ability to influence the company's management and operations, concentration of income/expenses, and mutual guarantees)



that should be given due consideration. As the process of registering a group of related clients is quite complex and because each case is individual, it is not recommended to record strictly defined rules to cover all potential cases. The document thus includes both rules and general principles, making it important for commercial banks to carefully assess the content while allowing them to consider special touches.

Updating Pillar 3 Spreadsheets and Increasing Transparency

As an important component of financial stability, the NBG aspires to improve the financial stances of commercial banks and enhance their asset transparency. The Regulation on Disclosure of Information by Commercial Banks under Pillar 3 sets an obligation for a commercial bank to disclose the required information within 30 calendar days of the end of a reporting quarter. To align with international best practice and meet growing public interest in the financial sector, changes were made to the disclosure procedures under Pillar 3 in 2021. These required commercial banks to disclose additional information on the following key issues from the second quarter of the year:

- Qualitative indicators of the loan portfolio, including the share of non-performing loans, loan loss reserves, overdue loans and write-offs.
- Other characteristics of the loan portfolio, such as residual loan maturity, collateral ratio, business sector and borrower type.
- Distribution of debt securities, off-balance sheet products and secured loans by qualitative classification and overdue status.

In addition, a new requirement was added to the regulation from the third quarter of 2021 related to the disclosure of general and quality information about retail products. Also, from the second quarter, banks started publishing the Net Stable Funding Ratio, which includes information on the availability and need for stable funding and the ratio calculated according to these data.

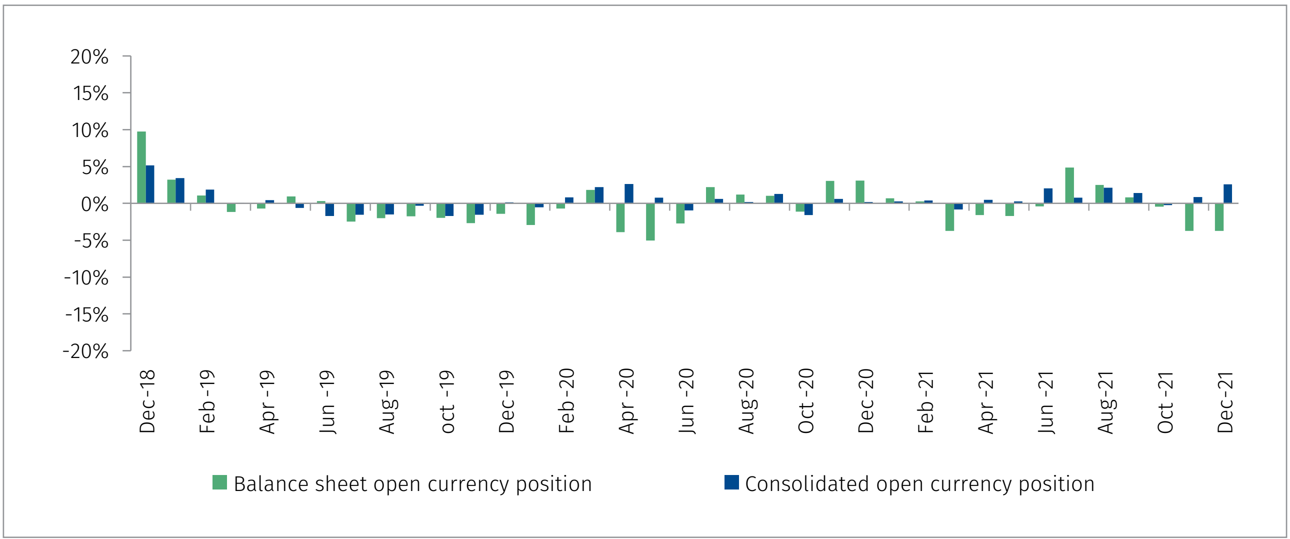
4.6 MARKET RISK

4.6.1 FOREIGN CURRENCY RISK

During 2021, the exchange rate was less volatile than in the previous year and had an appreciation trend; meanwhile, banks continued to operate in stable currency positions. At the end of the year, the aggregate currency position was within 2.6%. However, as total (and not fully net) loans are still partially incorporated in assets, when calculating this position in the current period the real position of banks is relatively short.[63] As a result, the depreciation of the GEL, taking into account the revaluation of reserves, causes a loss. Also, as share capital is denominated in GEL, the revaluation of risk-weighted assets during GEL depreciation significantly reduces the banks' capital adequacy ratios and makes them even more vulnerable to this risk. As the share of foreign currency assets and liabilities in the Georgian banking system is still high, the currency risk factor remains of considerable importance for Georgian banks. The NBG thus continues to oversee the improvement of current approaches to foreign exchange risk management, including how foreign currency asset reserves are reflected in the open currency position. The schedule set by the NBG in this regard is being observed. Considerable attention is also paid to the assessment of structural position risks and the development of banks' internal models of currency risk.

63. When the currency position is short, foreign currency liabilities exceed foreign currency assets.

DIAGRAM N 4.24 BALANCE SHEET AND CONSOLIDATED OPEN CURRENCY POSITIONS TO REGULATORY CAPITAL



Source: NBG

4.6.2 INTEREST RATE RISK

GEL interest rates rose with the increase in the refinancing rate in 2021. However, interest rates on foreign currency deposits decreased. Such fluctuations in interest rates underscore the importance of the monitoring and adequate assessment of interest rate risk for banks.

Banks operating in Georgia hold almost no securities for trading. However, banks that have a trading book[64] are required to develop appropriate procedures and to report to the NBG. If subsequent monitoring reveals the possibility of significant portfolio growth, trade book risk management regulations will apply.

At present, the regulations and approaches for interest rate risk for the banking book are applied to the aggregate balance. The Regulation on the Management of Interest Rate Risk for the Banking Book (IRRBB) is meant to identify, assess, and manage interest rate risk arising on the banking book, and, by imposing related requirements, to promote the stability and sound functioning of commercial banks and the financial sector. Interest rate risk reflects a bank's sensitivity to changes in interest rates. It refers to the current or future risk to the bank's capital and income that arises from changes in interest rates and affects banking book positions. Changes in interest rates change the net present value and residual maturities of future cash flows, changing respective assets, liabilities, off-balance sheet items and their economic value of equity (EVE). Changes in interest rates also affect a bank's net interest income (NII), being a result of changes in income and expenses that are sensitive to interest rate risk. This risk management has a significant impact on a bank's profitability and capital.

As of December 2021, based on the current interest rate risk approach, the ratio of changes in system economic value (EVE) and net interest income (NII) to equity was 5.2% and 3.4%, respectively. These figures remain far below the maximum regulatory limit.

64. The banking book includes the financial instruments held by a commercial bank for the following purposes:
a) To sell in the short run.
b) To expect profits resulting from revaluation due to expected price changes.
c) To receive proceeds from these through arbitrage.
d) To insure risk exposures of the instruments acquired for the purposes described in a) and c) above.

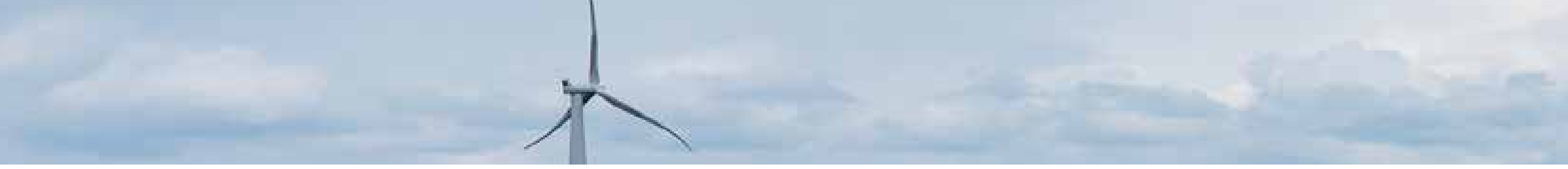
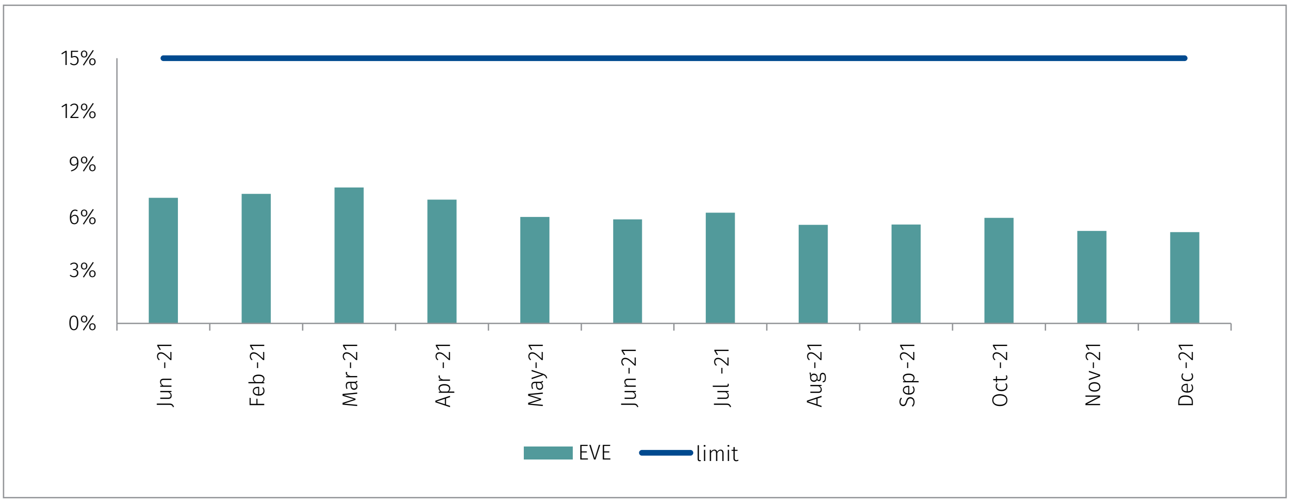


DIAGRAM N 4.25 ECONOMIC VALUE OF EQUITY TO TIER 1 CAPITAL

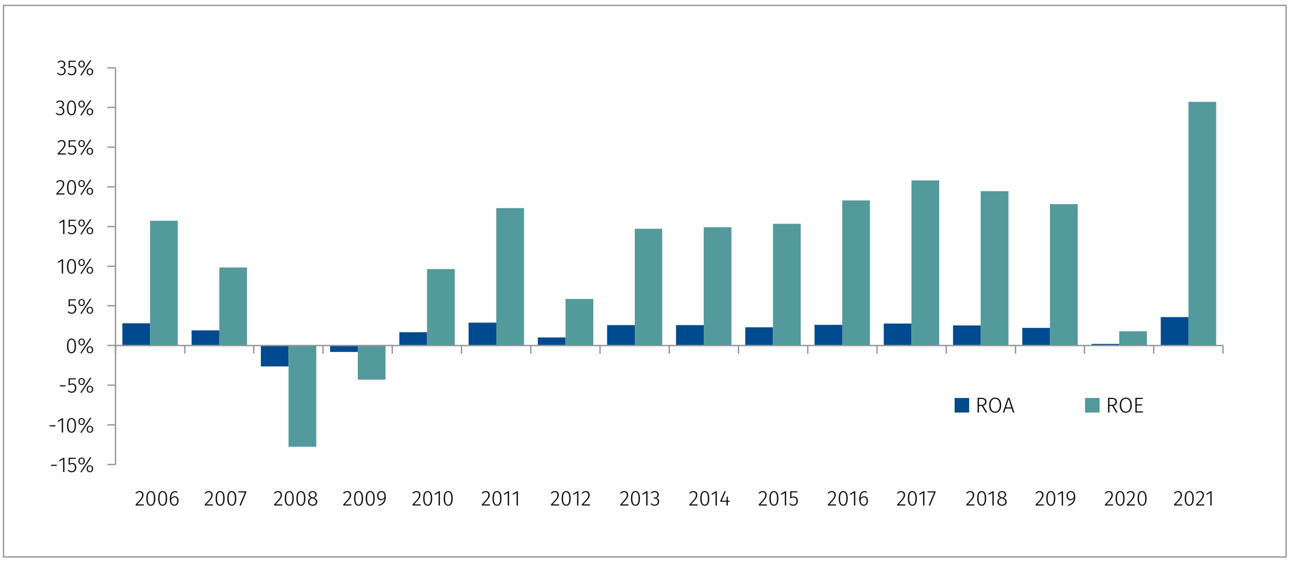


Source: NBG

4.7 PROFITABILITY RISK

In 2021, the return on assets and equity[65] amounted to 3.6% and 30.7% respectively. This was far above the previous year's figures of 0.2% and 1.8 % respectively. The increase was largely due to the improved quality of the portfolio. The total reserves of up to GEL 1.1 billion that were created at the onset of the pandemic in March 2020 adequately reflected the increased credit risks associated with the pandemic. Consequently, in 2021 the banking sector did not face additional reserve expenditures; on the contrary, due to the better-than-expected recovery of the economy, the loan portfolio recovered and the reserve for possible loan losses was reduced.

DIAGRAM N 4.26 RETURN ON EQUITY AND ASSETS

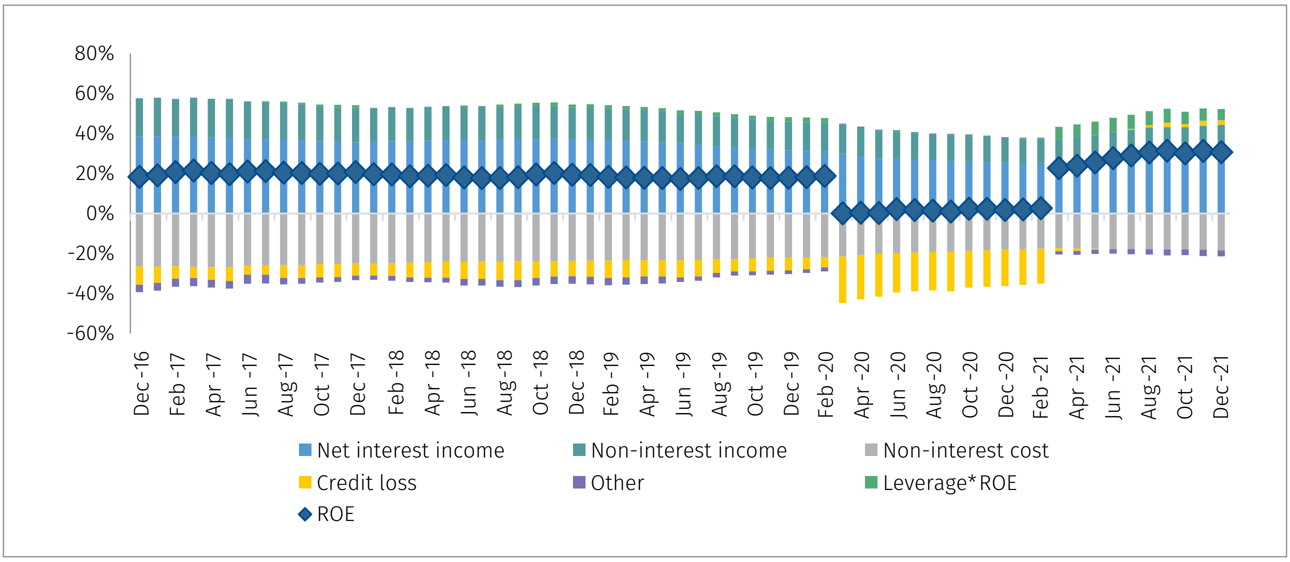


Source: NBG

65. ROE is the net profit to the average annual share capital and ROA is the net profit to the average annual assets. In these calculations, net profit is calculated as the sum of the net interest income and net non-interest income less provisions for potential losses on loans and other financial assets after unforeseen income and taxes.

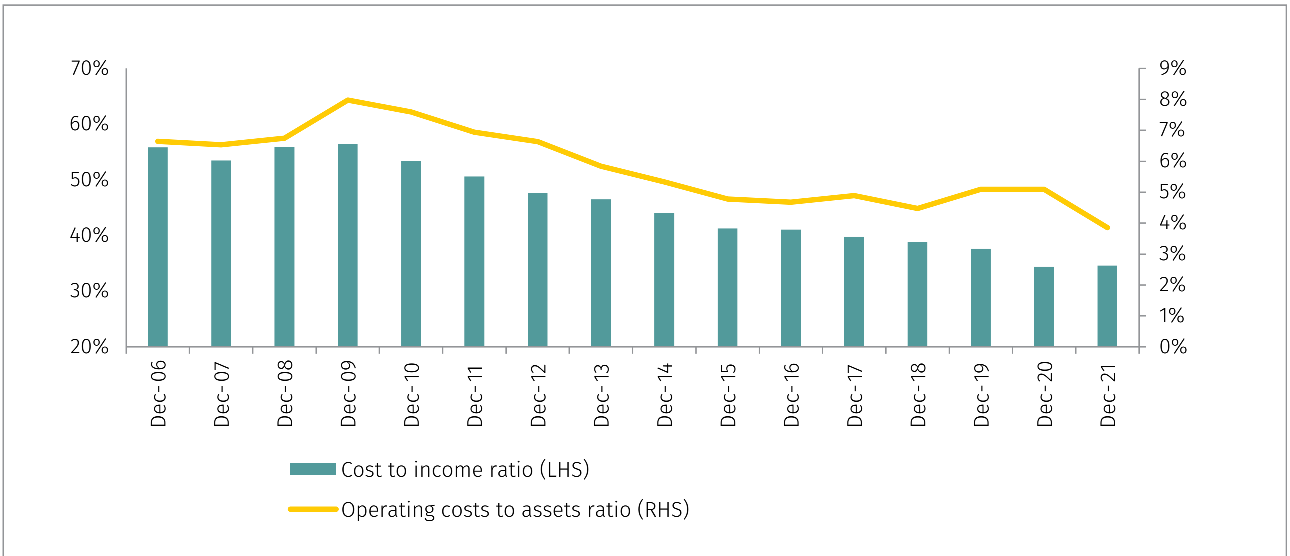
In terms of profit decomposition, several important factors affecting the profitability of the banking system are noteworthy. Net interest income and non-interest income increased by 34.4% and 36.6% respectively in 2021, which was mainly due to the revival of lending activity. As operating costs only rose by 15.8%, the cost-to-income ratio fell from 48.3% to 41.4%. The cost-to-assets ratio was stable at 2.6%.

DIAGRAM N 4.27 PROFIT DECOMPOSITION



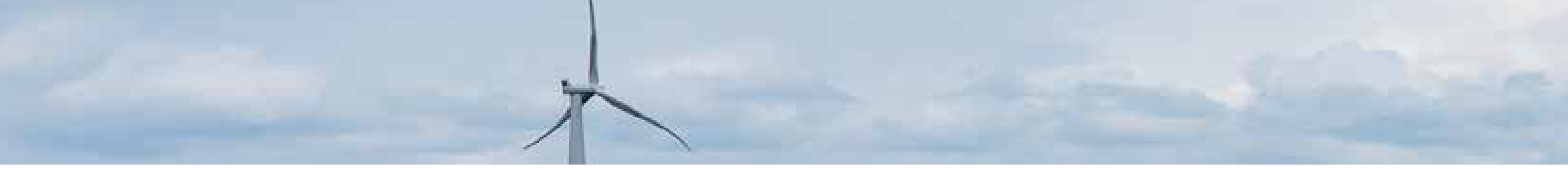
** Leverage is an indicator that has been indexed since December 2016.*
Source: NBG

DIAGRAM N 4.28 COST-TO-INCOME AND COST-TO-ASSETS RATIOS



Source: NBG

The NBG continues to review the profitability forecasts of banks, to analyze the business models and strategies of individual institutions, and to assess mitigating factors that are relevant to risks. Considerable attention is paid to the scale effect, market niche or other competitive advantage, and projected credit loss factors. The development and improvement of pricing models for bank products is also closely monitored.

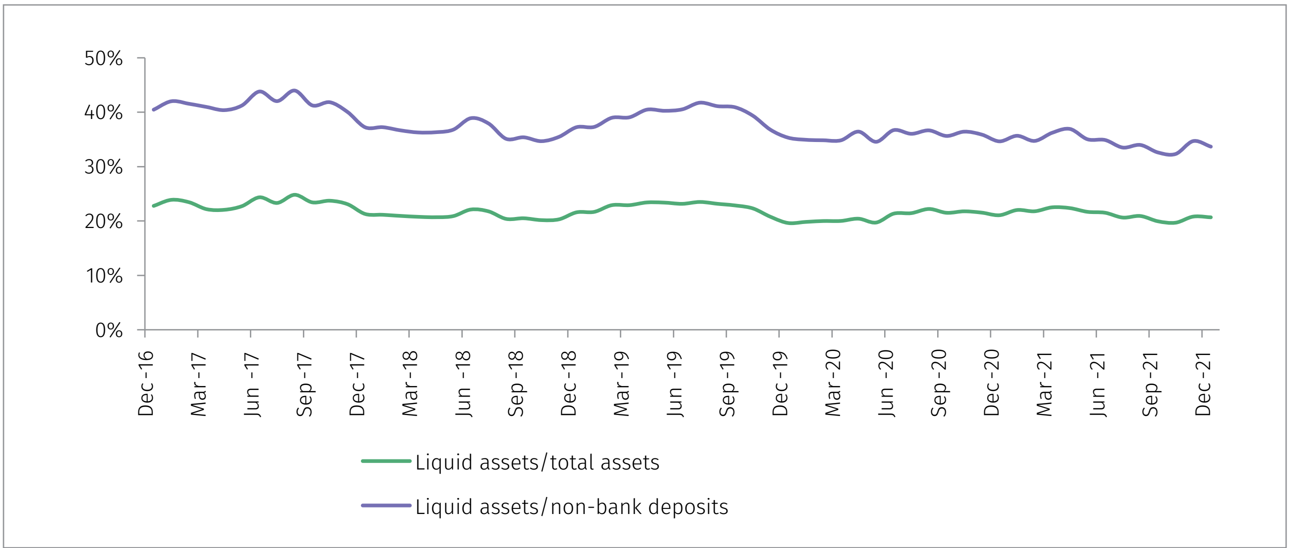


4.8 LIQUIDITY RISK

4.8.1 LIQUID ASSET STRUCTURE

The volume of liquid assets remained high in 2021, accounting for 21% of total assets, which are sufficient to cover up to 34% of non-bank deposits.

DIAGRAM N 4.29 LEVEL OF LIQUID ASSETS



Source: NBG

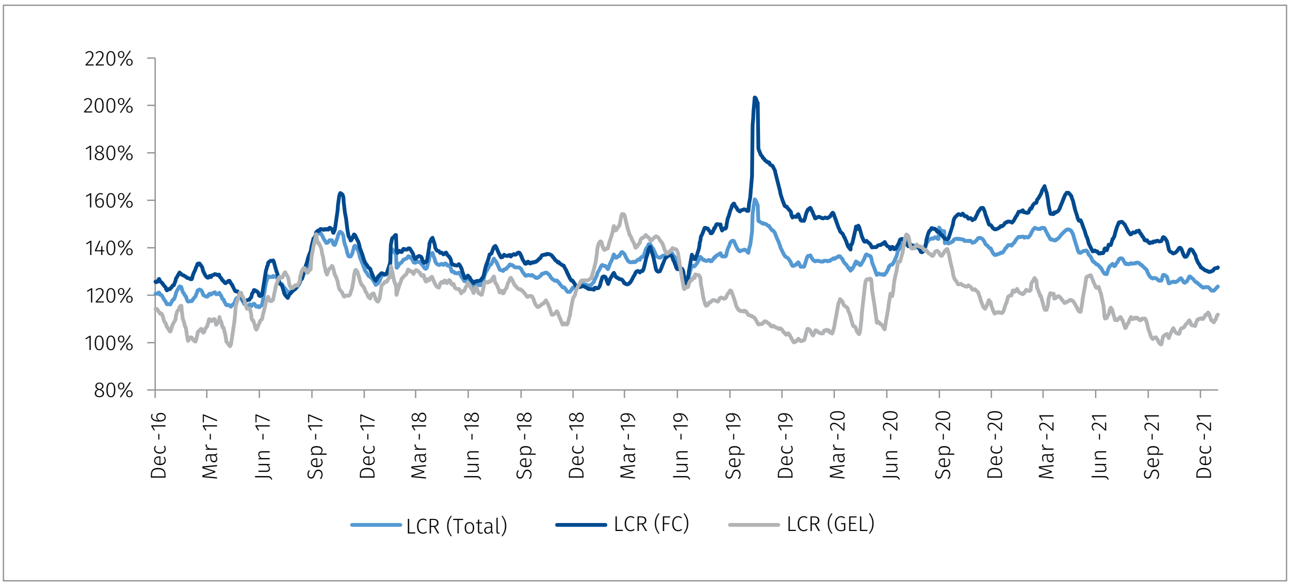
The liquidity coverage ratio (LCR) for 2021 was stable overall. Fluctuations between the GEL and foreign exchange rates were caused by transactions related to currency derivatives.

Following the risks related to the COVID-19 pandemic in 2020, the NBG immediately took significant actions to support and attract lari liquidity, and significantly reduce underlying risks. Some of these actions continued in 2021:

- The term of low-interest and affordable GEL/USD swap operations with the NBG that were offered to the financial sector was extended by one year to 15 April 2022; meanwhile the use of the standby swap operation instrument was extended.
- From 1 May 2021, the GEL LCR requirement was restored, from which banks were exempted for one year.
- The GEL collateral base remains expanded, allowing commercial banks to attract additional GEL resources from the NBG by securing them with loans extended to small- and medium-sized enterprises. Microfinance institutions can attract additional resources from commercial banks depending on the size of their own loan portfolios. From 2022, new loan assets will no longer be added to the collateral base and, as of 1 January 2022, the collateral base will be reduced by 25% of the volume once every six months.

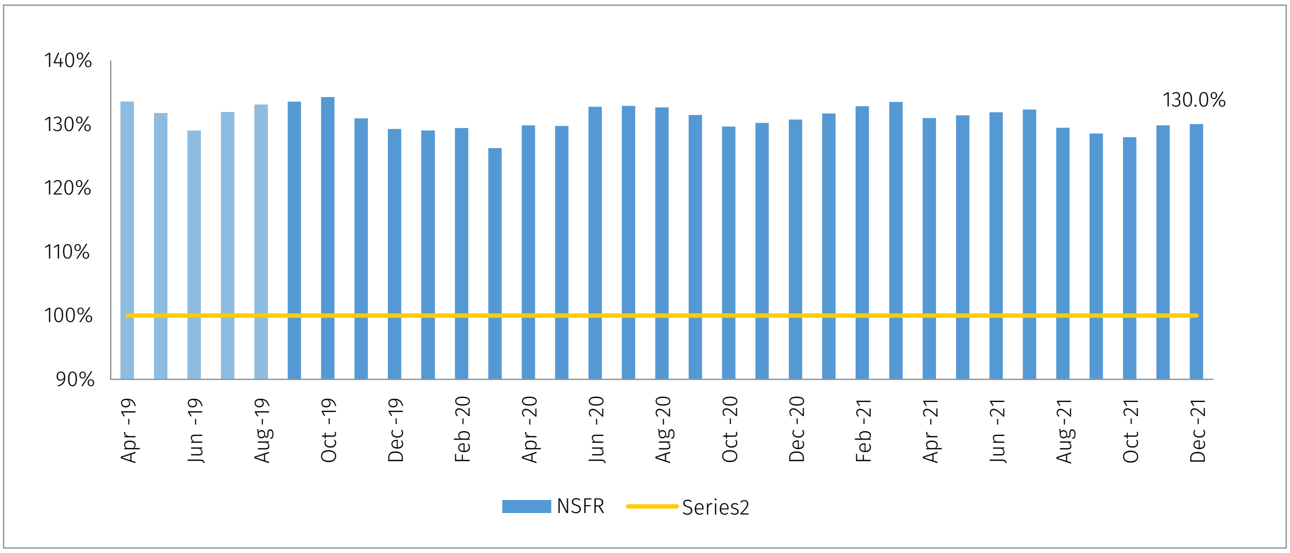
The decrease in the LCR in the last quarter was mainly due to the increased demand for loans, which contributed to the absorption of accumulated liquidity. The Net Stable Funding Ratio (NSFR) also remained high, at 130% during the year.

DIAGRAM N 4.30 LIQUIDITY COVERAGE RATIO DYNAMICS



Source: NBG

DIAGRAM N 4.31 NET STABLE FUNDING RATIO*



** Decree enacted in September 2019.*
Source: NBG

In 2021, the liquid asset gap structure remained stable for both the up-to-one-year and more-than-one-year time baskets.

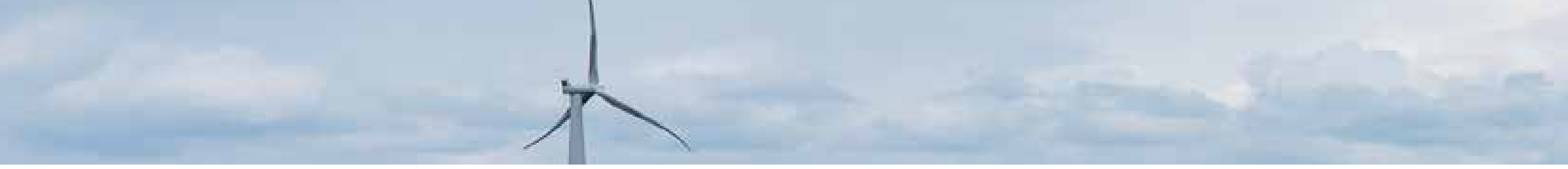
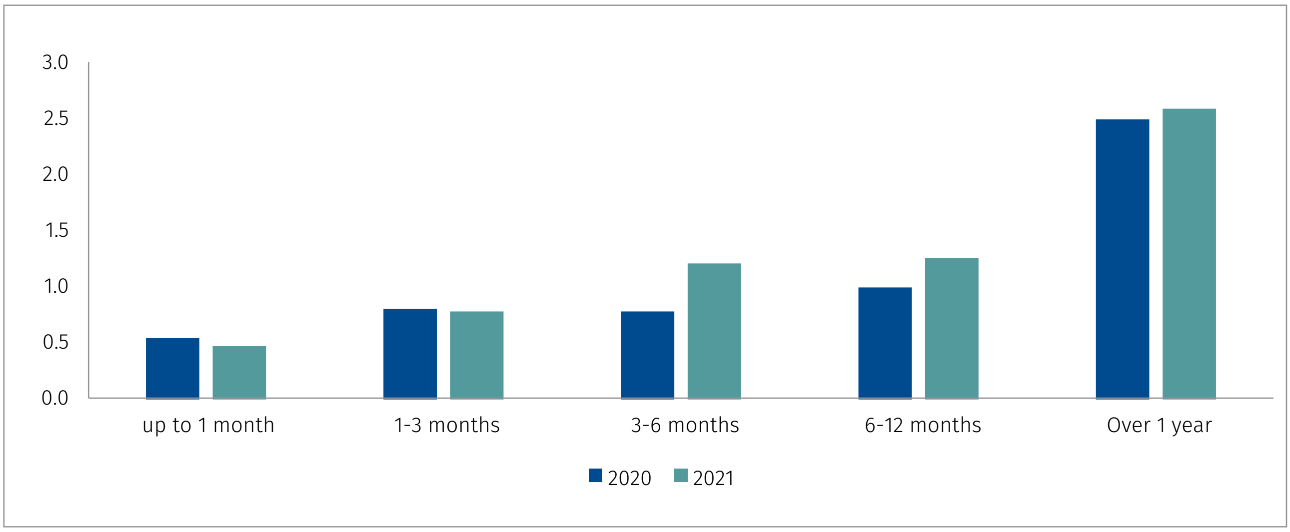
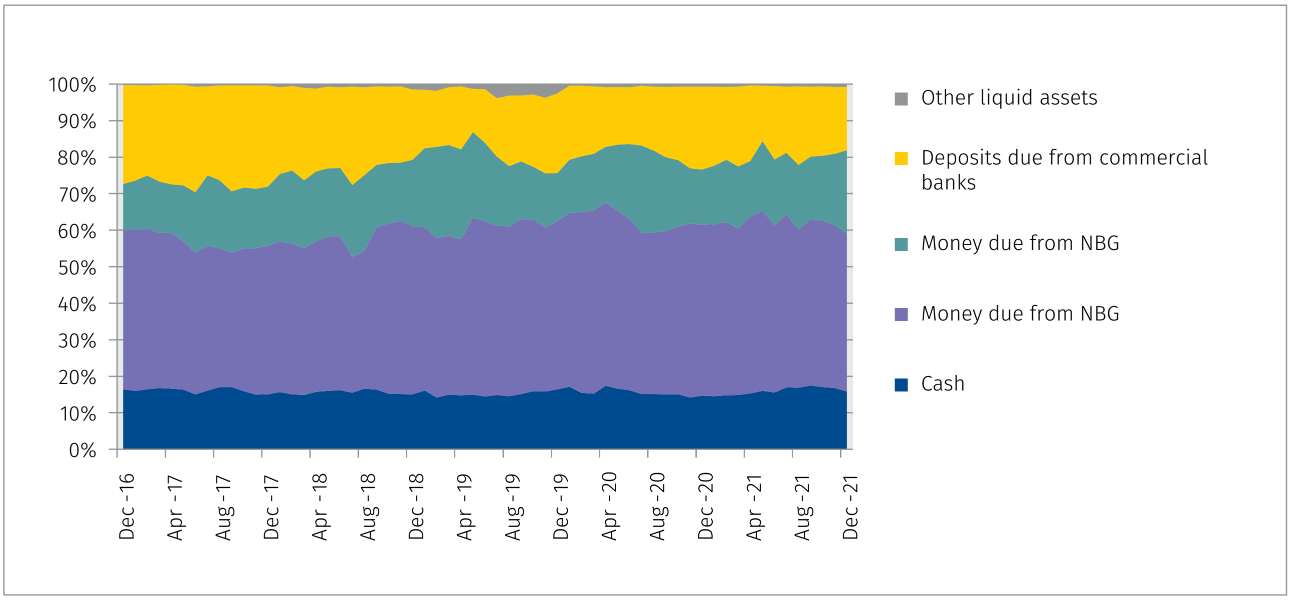


DIAGRAM N 4.32 LIQUIDITY GAP (ASSETS-TO-LIABILITIES RATIO)



Source: NBG

DIAGRAM N 4.33 VOLUME AND STRUCTURE OF LIQUID ASSETS



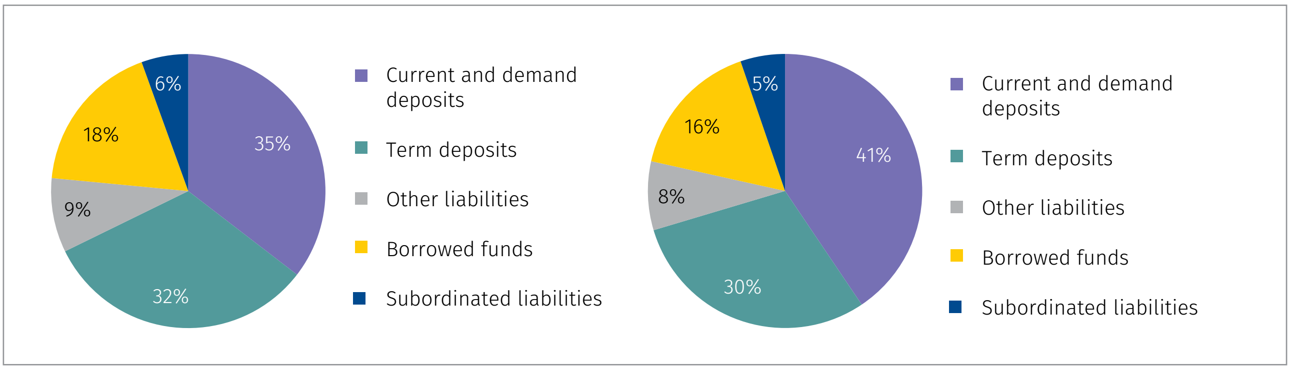
** Decree enacted in September 2019.*

Source: NBG

4.8.2 LIABILITY STRUCTURE

The share of current and demand accounts in the liability structure was higher than in 2021. The share of total term deposits as well as certificates of deposit remained stable, while the share of borrowings were slightly reduced. Nevertheless, banks maintained a fairly comfortable level of liquid assets relevant to the liability structure risks.

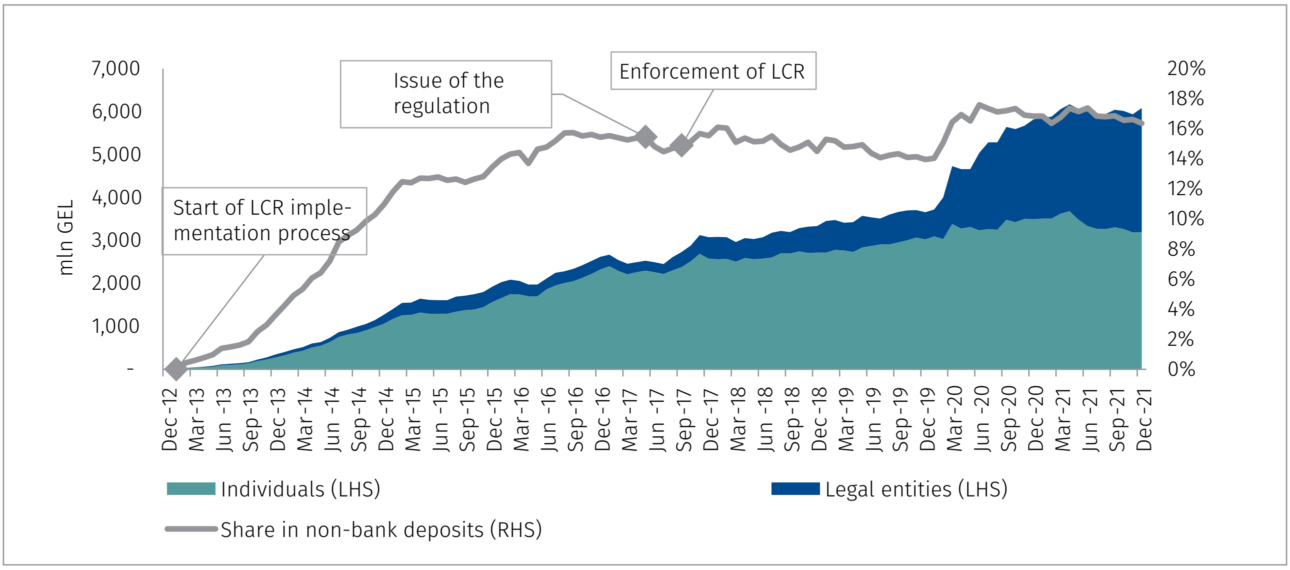
DIAGRAM N 4.34 LIABILITY STRUCTURE



Source: NBG

The development and growth of irrevocable certificates of deposit have a significant impact on the funding structure of the banking system. This stable funding product provides banks with a low-risk liquidity resource, allowing depositors to enjoy higher interest rates. The growth of certificates of deposit continued well in 2021 and exceeded GEL 6 billion at the end of the year, which is GEL 261 million more than the same figure at the end of 2020, and accounted for 16.4% of total non-bank deposits.

DIAGRAM N 4.35 CERTIFICATES OF DEPOSIT AND THE SHARE IN NON-BANK DEPOSITS



Source: NBG

4.8.3 RETAIL FUNDING

Deposits increased by GEL 2.6 billion (by 7.6%, or by 11.3% excluding the exchange rate effect) in 2021, reaching GEL 37.2 billion as of December (61.8% of GDP). In terms of the structure of depositors, the growth of deposits of individuals and legal entities was 9.7% and 5.2%, respectively (excluding the exchange rate effect, it grew by 14.4% and 7.8% respectively). The larization of deposits also increased during 2021 and stood at 39.9% by the end of December.

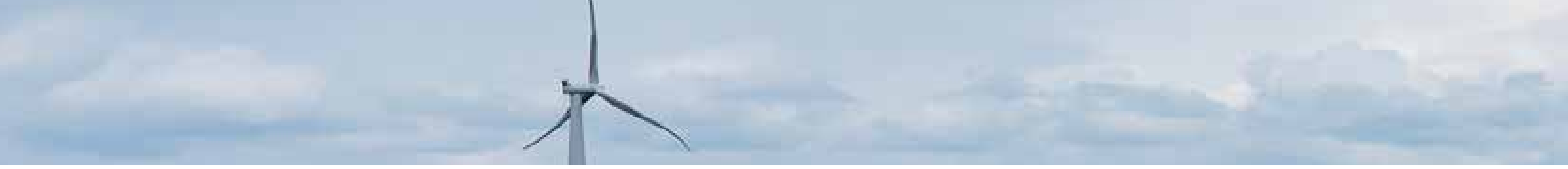
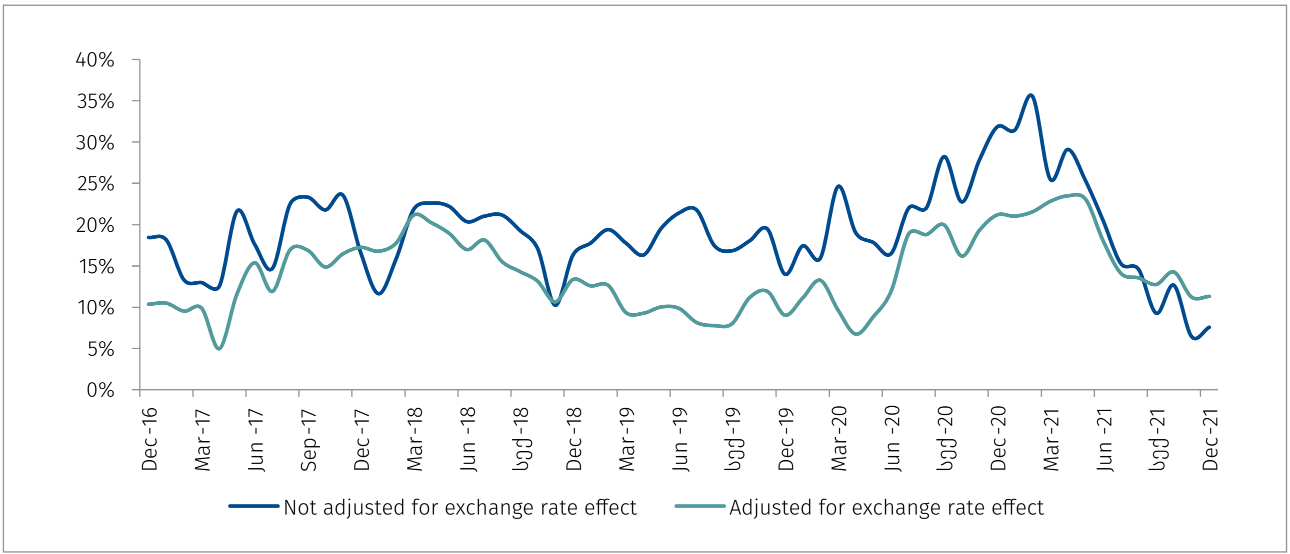
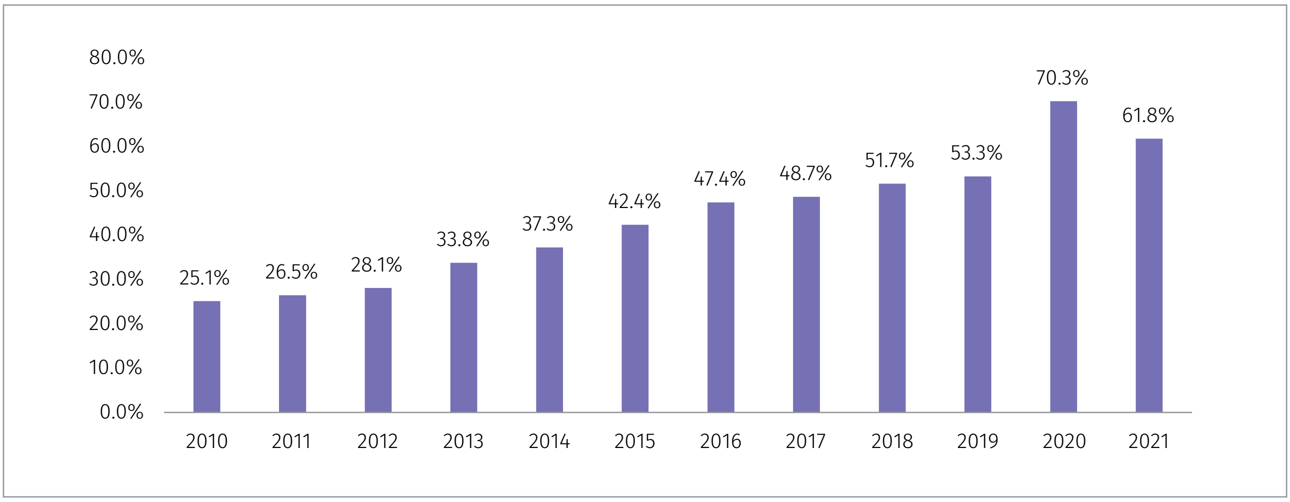


DIAGRAM N 4.36 ANNUAL GROWTH OF NON-BANKING DEPOSITS



Source: NBG

DIAGRAM N 4.37 BANKING SECTOR DEPOSITS TO GDP RATIO



Source: NBG

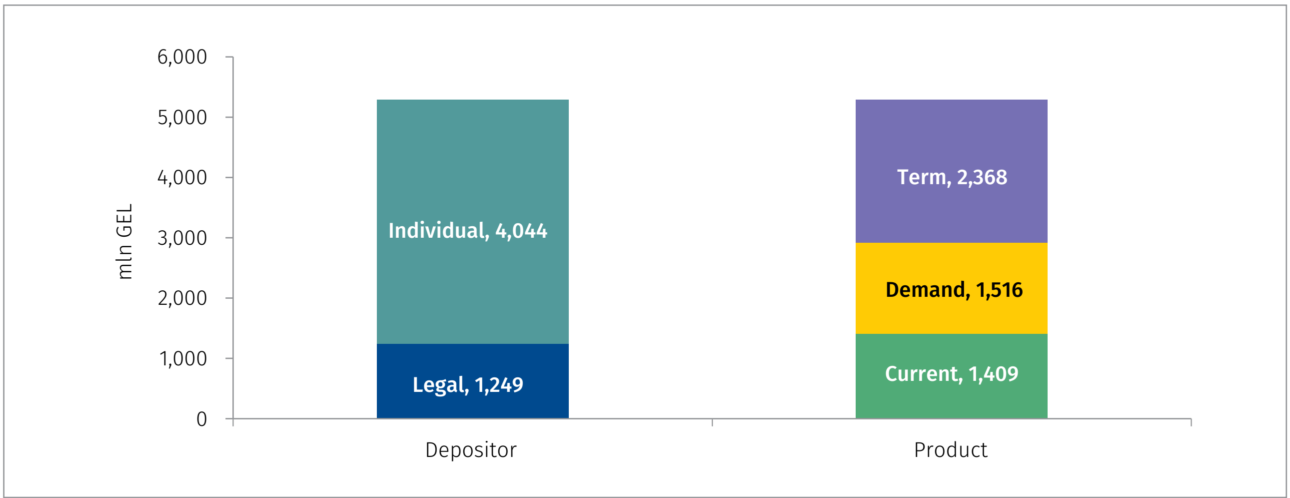
The share of non-resident customer deposits in total non-bank deposits slightly changed during 2021 and stood at 14.2% by the end of December. These deposits are still diversified by country of origin, which is a positive factor in terms of risk. Also, the share of term deposits is high, which significantly reduces the risk of outflow. To prevent overdependence on this type of funding, the NBG maintains an additional liquidity requirement for deposits of non-residents.[66] This requirement discourages banks with a high share of non-resident deposits from attracting this type of deposit portfolio. The enactment of this requirement was reflected in the stabilized shares of non-resident deposits in recent years.

66. For LCR calculation purposes, higher outflow rates will be applied to non-resident deposits than to resident deposits.

DIAGRAM N 4.38 SHARE OF NON-RESIDENT CLIENT DEPOSITS

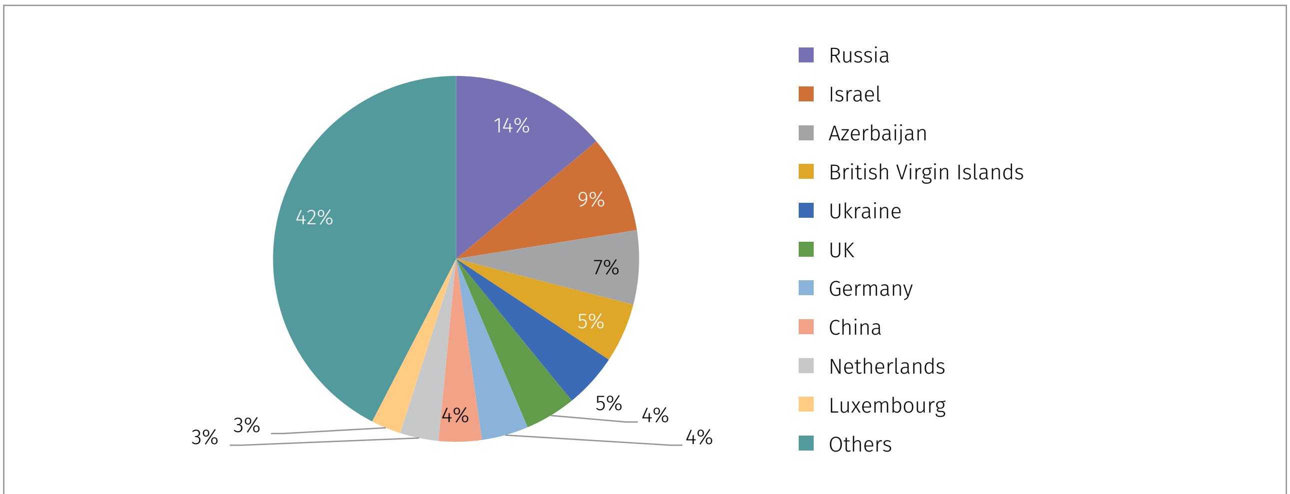
Source: NBG

DIAGRAM N 4.39 NON-RESIDENT DEPOSIT STRUCTURE (DEC. 2021)

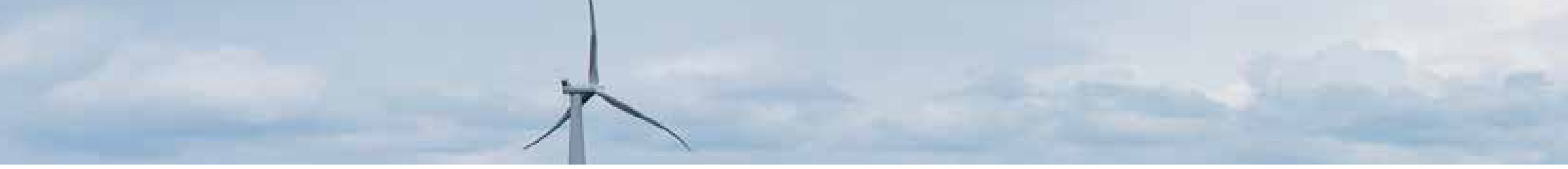


Source: NBG

DIAGRAM N 4.40 NON-RESIDENT DEPOSITS BY COUNTRY (DECEMBER 2021)



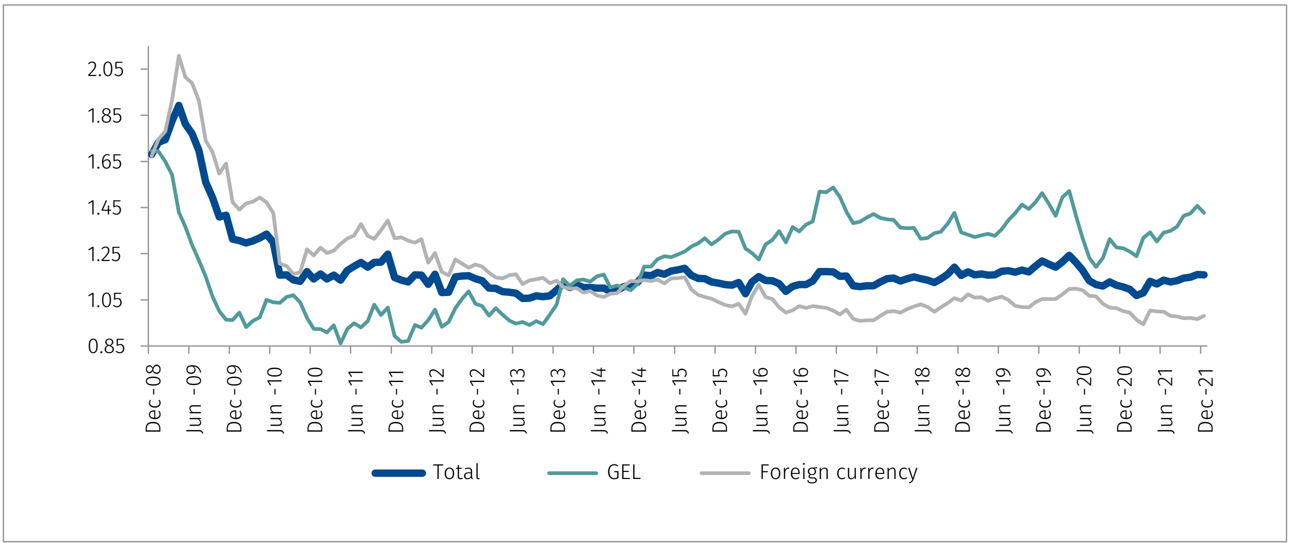
Source: NBG



4.8.4 WHOLESALE FUNDING

The loans-to-deposits ratio remained stable at a high rate during 2021. The same ratio calculated for GEL loans and deposits still exceeded that for foreign currency loans and deposits, which, to some extent, was due to the high growth rate of GEL loans as driven by currency risks and the NBG's larization measures.

DIAGRAM N 4.41 TOTAL LOANS TO NON-BANKING DEPOSITS RATIO BY CURRENCY



Source: NBG

The funds received from external sources of wholesale funding are quite diversified by both the type of creditors and their residual maturities. The residual maturity of up to 60% of the total share exceeds two years, which reduces risks to the funding of the system.

Some 56% of wholesale funding comes from international financial institutions, 10% from parent/affiliate companies, and 34% from other private institutions. Low risk can thus be assigned to the high share of international financial institutions and the long-term repayment schedules. A monitoring of covenants[67] is regularly performed by the NBG to manage funding risks.

TABLE N 4.9 EXTERNAL SOURCES OF WHOLESALE FUNDING AND THEIR REPAYMENT SCHEDULES AS OF 31 DECEMBER 2021

Month	<1	1–3	3–6	6–12	12–24	24–36	36–60	>60	Sum
Sum	5.5%	2.2%	4.0%	11.1%	17.5%	28.5%	15.2%	16.0%	100.0%
International Financial Institutions	2.1%	2.0%	2.1%	6.5%	11.2%	9.3%	12.9%	10.4%	56.2%
Parent/Affiliate Financial Institutions	0.5%	0.0%	0.2%	0.6%	3.7%	2.0%	0.9%	2.2%	10.0%
Other Private Funding	3.0%	0.2%	1.8%	4.1%	2.7%	17.2%	1.5%	3.3%	33.8%

Source: NBG

67. The limits set under loan agreements.

The NBG continues to monitor and assess the stability of the funding structure of commercial banks. In this process, it is important to analyze the concentration of funding sources in different contexts and to maintain a diversified structure. In 2021, a limit was set for raising unsecured funds from state and state-controlled organizations at an amount that is not to exceed 200% of a commercial bank's share capital. The goal of setting this limit was to prevent an excessive reliance on government deposits and to encourage highly diversified funding sources.

4.9 MACROPRUDENTIAL RISKS

The NBG continues to monitor systemic risk indicators that may have a material impact on the banking sector. Information about these risks is provided in the different chapters of this report. The main challenge in this regard in 2021 was to assess the risks to the stability of the financial sector arising from the COVID-19 pandemic and to develop and implement appropriate macroprudential and supervisory policies.

The NBG performs macroprudential supervision related to the following main areas: the increased debt burden for non-hedged borrowers due to foreign currency loans; the overindebtedness of the vulnerable part of the population; fierce competition in business and mortgage lending amid imperfect pricing models; cyber risks and scams across the system; the potential growth of non-regulated financial intermediation based on financial technologies; and regional threats.

During 2021, several important decisions were made in terms of setting a schedule for the recovery of the capital buffers released as an anti-COVID measure and for improving macroprudential policies:

- The recovery of the buffers released at the beginning of the crisis will begin on 1 January 2022 and will last for two years.
- Banks were given until 1 January 2023 to restore the CICR buffer, and until 1 January 2024 to meet the capital conservation buffer requirement.
- The method of calculating the CICR buffer will change and will depend on the level of dollarization of a commercial bank's loan portfolio; this adjustment will motivate banks to increase the larization of their loans.
- The maximum term of foreign currency mortgage loans will be reduced from 15 to 10 years.
- The countercyclical buffer remained unchanged at 0% during the year.

Dollarization of deposits remains a challenge for the financial sector, and, despite significant reductions in recent years, this remains high. This indicator varies by types of customers and the nature of their deposits. Dollarization is higher in the deposits of individuals and is relatively low in the accounts of legal entities, which is due to the need for GEL in company operating activities. Of particular note is the 73% dollarization of term deposits of individuals. This type of deposit is the largest item in the entire portfolio and, because its dollarization trend, this has a large impact on the dollarization of total deposits and is a good measure of the exchange rate expectations of individuals.

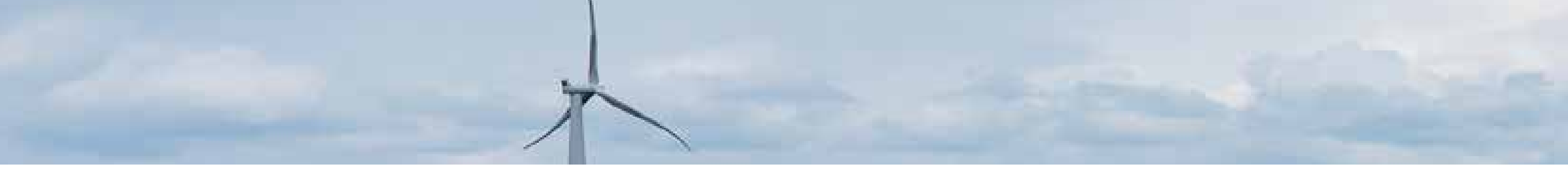
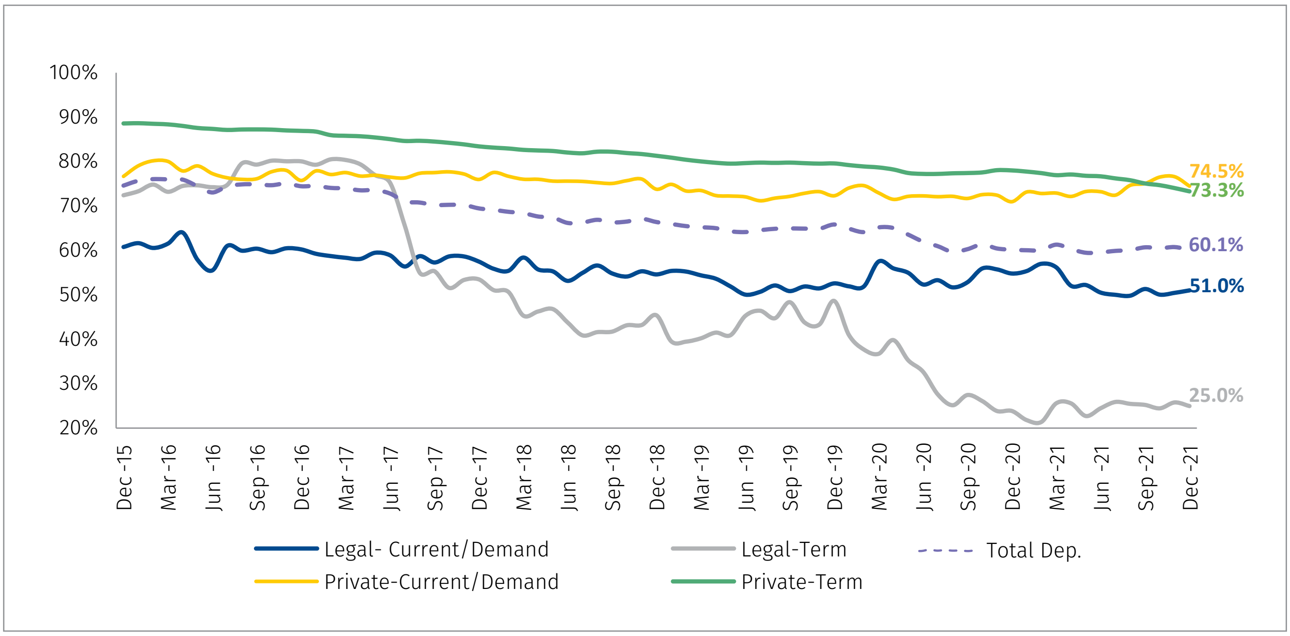


DIAGRAM N 4.42 DYNAMICS OF THE DOLLARIZATION OF DEPOSITS (FIXED EXCHANGE RATE)



Source: NBG

The NBG maintains a prudential approach to credit risk caused by currency mismatches. More specifically, the requirement for additional capital applies to foreign currency loans issued to non-hedged borrowers, while in the case of individuals, more conservative additional credit standards are imposed. To support the larization of liabilities, the NBG uses more preferential requirements for liquidity and minimum reserves on the national currency. In terms of mitigating the risks related to high dollarization with macroprudential instruments, it should be noted that there is only a limited ability to use banks' liquidity contingency plans, other mitigation measures or the NBG's support instruments in foreign currency. This fact, taken alongside global trends and regional risks, confirms the need for high requirements on minimum foreign exchange reserves and liquidity.

4.10 OPERATIONAL RISK

Operational risk is the risk of loss arising from deficient/inefficient internal processes, people, systems or external events. One such external factor is the COVID-19 pandemic, which has had a large-scale impact worldwide. This impact was also manifested on the financial sector, posing new challenges in terms of operational risk.

Operational risk is a crucial consideration for modern-day organizations, where reliance on electronic information systems is progressively increasing. Digitally transformed financial institutions tend to have a high level of dependence on information systems, since they employ new technologies and engage in

more complex operations and financial services. The pandemic has served to accelerate the digital transformation of financial institutions. With these trends in mind, cyber risk and challenges related to cybersecurity management are some of the main risks in terms of operational risk management.

The NBG pays close attention to raising awareness of operational risks in the financial sector of Georgia, expanding operational risk management and developing supervisory principles.

Instructions, guidelines and recommendations were developed during the year to facilitate the management of operational risks in the financial sector. In this regard, the following resources were made available: Operational Risks Loss Guideline; the Guideline on outsourcing; Recommendations on Protecting ATMs; and Recommendations on One-time passwords (OTPs) and Related Information Systems (Processes).

The NBG continued to work with with commercial banks to ensure that banks have proper and sound control mechanisms, and to develop and implement improved fraud monitoring tools and information systems. The NBG regards it as a priority to develop various detection and prevention processes related to payment card fraud.

Over the past year, the Operational and Cyber Risks Division were actively involved the study and assessment of operational and cyber risks related to open banking, digital banking, and remote identification in the banking sector.

The NBG continues to monitor the testing of commercial banks' business continuity plans. In this regard, under the situation created by the pandemic, a readiness to foster the continuity of employees and the smooth operation of critical processes is crucial.

The underlying pandemic and macroeconomic situation have made the expansion of operational risk forecasting tools more relevant. To this end, operational risk stress tests are being researched and studied, allowing determination of the expected impact of an event on a company's capital and the financial stance of the organization in the event of a negative scenario. In this regard, more importance is attached to the accuracy and completeness of historical data aggregation of historical data aggregation related to potential or actual operational risk losses, cause-and-effect analysis of operational risk events, and an assessment of systemic impact.

4.10.1 OPERATIONAL RISK IN THE GEORGIAN BANKING SECTOR

The banking sector of Georgia is the backbone of the country's economy. The local banking system is characterized by a relatively low complexity of banking products and services. Despite this, there is constant development and transformation in the banking sector: new banking products and services are being introduced at a fast pace and these are increasingly based on information systems. The pandemic has accelerated the development and introduction of remote banking products and the number of digital services increased in 2021, similar to the previous year. This was partly due to the pandemic and the rise of remote business services and processes. These developments all increase the inherent operational risk to the financial sector to some extent.

In 2021, total gross losses of Georgian commercial banks amounted to GEL 27.7 million, which was a 6.5% decrease compared to the previous year from 2020. Gross losses relate to the initial amount of the operational event prior to any reimbursement of operating losses.

During 2021, 18,269 operational loss events were recorded, which was a 0.4% increase over 2020. As part of the operational risk reporting procedure of the NBG, commercial banks are obliged to record all operational losses that equal or exceed GEL 10. The average loss for 2021 was GEL 1,626. Diagram N 4.43 shows the dynamics of total operational losses in 2021.

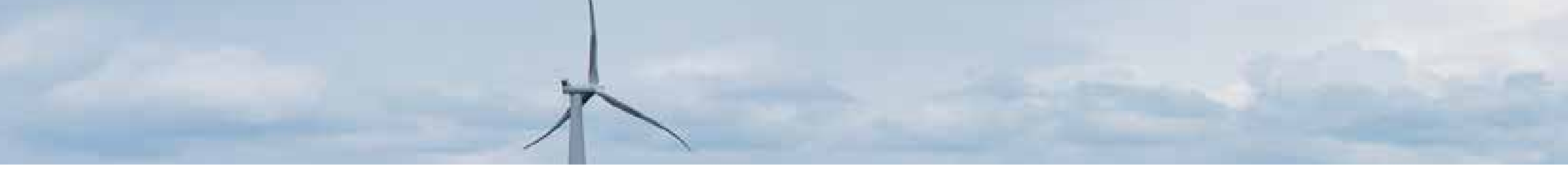
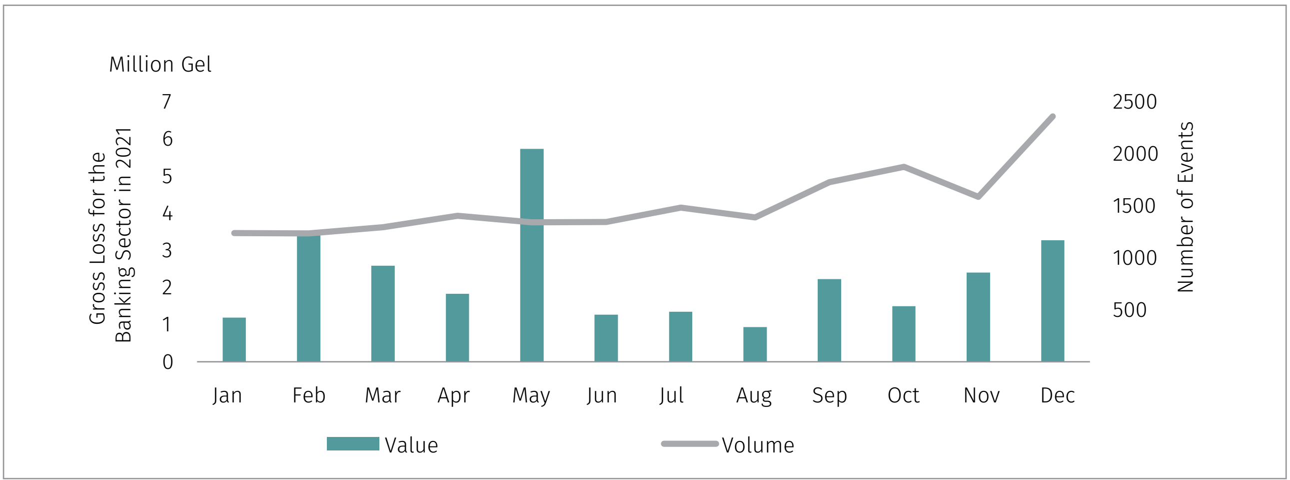


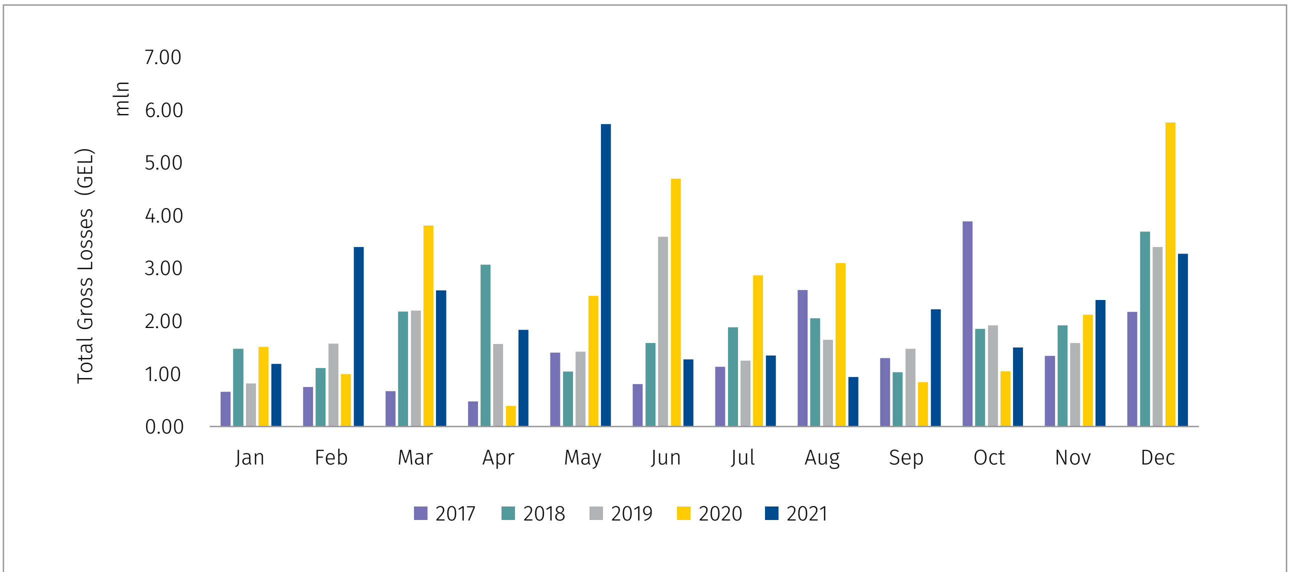
DIAGRAM N 4.43 TOTAL LOSSES FOR THE BANKING SECTOR IN 2021



Source: National Bank of Georgia

Diagram N 4.44, below, depicts the time series of total operational losses over the last five years (2017-2021). Over the past year, a major operational risk event was recorded in May, leading to an increase in the operational risk over the same period in 2020. It is also noteworthy that December historically records more operational eventscompared to other months, which is largely related to it being the end of the reporting year.

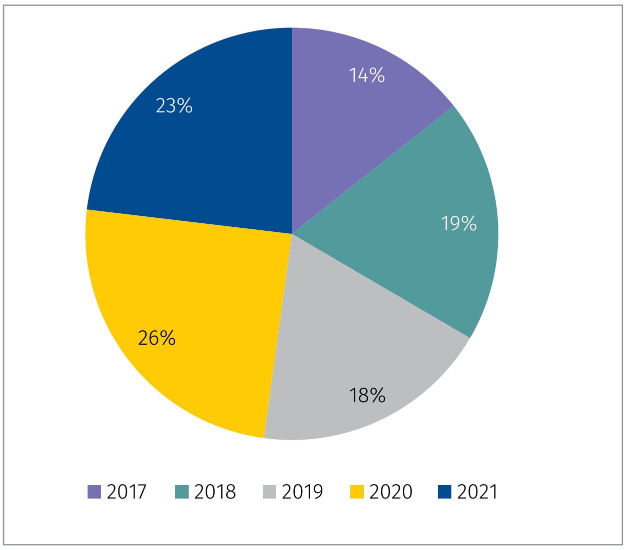
DIAGRAM N 4.44 TOTAL LOSSES FOR THE LAST FIVE YEARS (2017-2021)



Source: National Bank of Georgia

Diagram N 4.45 shows the proportional distribution of the total operational losses over the last five years (2017-2021). The gross operational risk loss for 2021 accounted to 23% out of the total losses recorded in 2017-2021. Proportionally, the largest operational loss over the last five years was recorded in 2020, and amounted to 25% oout of the total losses for the given period.

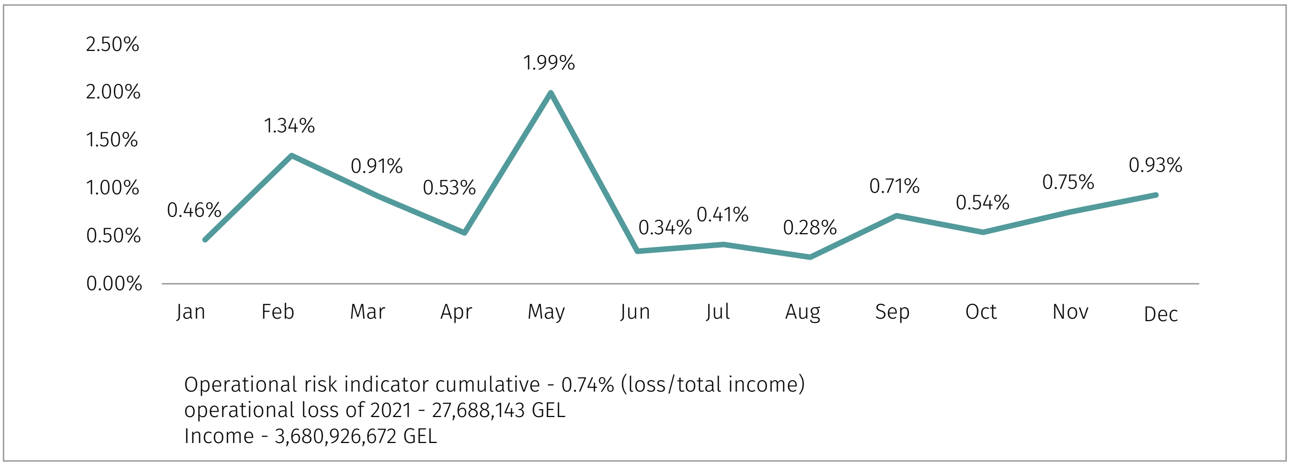
DIAGRAM N 4.45 PROPORTIONAL DISTRIBUTION OF TOTAL OPERATIONAL LOSS FOR THE LAST FIVE YEARS (2017-2021)



Source: National Bank of Georgia

The operational risk loss indicator is one of the best measures to determine the operational risk of a financial system. This figure is calculated as the ratio of the total operational losses of the financial system to total revenue. In 2021, the ratio of total annual loss to total revenue, as calculated under Basel II, was 0.74%. Diagram N 4.46 presents the monthly dynamics of the operational loss indicator for the Georgian banking sector.

DIAGRAM N 4.46 OPERATIONAL LOSS INDICATOR DYNAMICS FOR 2020 (TOTAL LOSS TO TOTAL REVENUE)



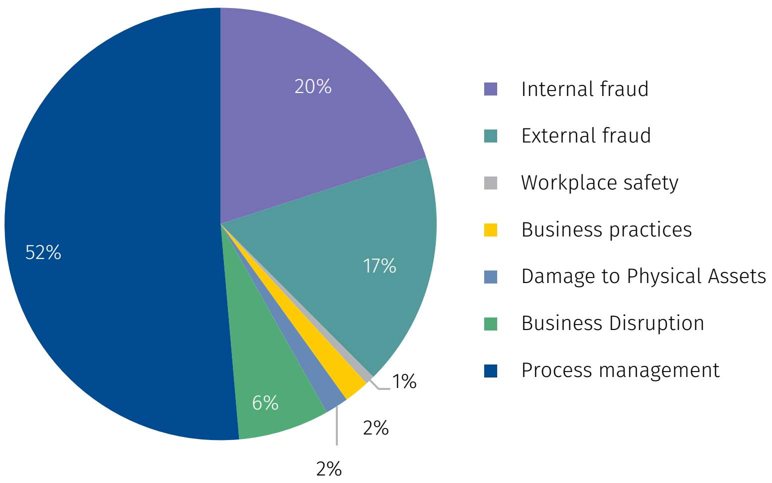
Source: National Bank of Georgia

In 2021, similarly to 2020, operational losses were mainly recorded in the business lines of retail banking services and, to some extent, in commercial banking services. The retail banking business line, in addition to retail banking services, also includes operational losses related to payment cards. The fact that operational losses in the Georgian banking sector are mostly found in the retail and commercial banking business lines is unsurprising as these two business lines are the most functional. The other six business lines as defined under the Basel principles are not well developed in Georgia.[68]

68. A detailed description of the Basel Business Lines is provided in Appendix 8 to the Basel II document on the Bank of International Settlements (link: http://www.bis.org/publ/bcbs128.pdf). According to the Basel classification, the following business lines are not actively developed in Georgia: corporate finance, financial instruments trading and sales, payments and settlements, custody/agency services, asset management, and retail brokerage services.

Looking at operational losses as a group of event categories, one can observe that process management had the largest share of total losses (51% of overall losses), while internal fraud was the second largest category (20%). External fraud was the third largest category, accounting for 17% of the total loss. It is important to note that the proportional increase in internal fraud over the previous year was due to one major event of internal fraud in the financial sector that took place in May, 2021. The structure of operational losses for 2021 is shown in Diagram N 4.47.

DIAGRAM N 4.47 DISTRIBUTION OF TOTAL LOSS OF THE BANKING SYSTEM FOR 2021 BY CATEGORY OF EVENT



Source: NBG

4.11 CYBERSECURITY

Cybersecurity is one of the most important challenges facing the financial sector. Remote service channels have undergone enhanced development and implementation amid increased geopolitical risks in the context of the pandemic.

The NBG provides continuously current developments in the banking sector in terms of cybersecurity and monitors cyber risks to identify cyber-attacks in a timely manner, to take prompt actions against them, to analyze such attacks and, if needed, rapidly report relevant information to the banking sector. The cybersecurity supervision requirements for the banking sector, which were introduced in 2019, allow the NBG to monitor and supervise the implementation, maintenance and continuous improvement of the cybersecurity management framework in the banking sector. In addition to complying with these requirements, commercial banks are required to perform information systems audits and penetration testing of their systems, which serve to eliminate potential vulnerabilities and reduce cyber risks. The NBG thus deems it highly important to conduct quality tests/audits, and to have in place effective business continuity and readiness plans in the event of a potentially large-scale cyber incident.

In 2021, the banking sector was a target of cyberattacks: these involve hackers stealing consumers' confidential and sensitive information and then using it for their own purposes (phishing) or otherwise interrupting the services of commercial banks (Distributed Denial-of-Service (DDoS) attacks). The NBG, together with commercial banks, has bee nactively working to improve appropriate control mechanisms to prevent similar incidents, to identify and eliminate such incidents in

a timely manner, and to effectively communicate with stakeholders. Given the pandemic, a large part of the financial sector continued to work remotely or in a hybrid mode in 2021. Hence, cyber risks and actions to reduce their impact remained particularly relevant. The NBG and commercial banks therefore worked intensively on the introduction of appropriate security measures and control mechanisms in banks, while also raising employee awareness, and fostering the security of internal corporate networks and personal computers.

The year also saw a number of cybersecurity awareness activities and projects being implemented, both for the financial sector and its clients. The financial sector joined the NBG's initiative to mark the first cybersecurity awareness month observed in Georgia. The campaign involved events organized by the NBG and commercial banks, including competitions, conferences, and educational videos. The effort helped to raise cybersecurity awareness among citizens.

In 2021, the Law of Georgia on Information Security was updated: entities with critical infrastructure were divided into three categories. The three banks deemed to be of systemic importance fell into the third category of this list. They will be subject to the Law of Information Security and other minimum security requirements as defined by the legal acts and regulations developed by the Digital Governance Agency. Within the context of the three systemically important banks, the NBG worked scrupulously to define boundaries and regulatory scope in terms of the new regulatory requirements for the financial sector as defined by the updated Law.

Considerable actions were also taken in 2021 to introduce and develop Open Banking with the involvement of the NBG, the Bankers' Association, and commercial banks. This would allow third-party financial service providers to access the banking and financial data of clients (upon their request and consent) through Application Programming Interfaces (API's). The involvement of payment service providers in Open Banking, who will own, process and share sensitive financial information, is accompanied by a number of risks related to data leaks, human error, weaknesses in third-party information systems, outsourcing services, and other cybersecurity threats. Open Banking theoretically allows cyber-attackers to gain access to sensitive information and perform fraudulent financial transactions. Thus, to minimize such cyber risks related to Open Banking and the expected negative consequences in the event that they materialize, the Cyber Risk Supervision Division of the NBG developed additional cybersecurity requirements for those payment service providers willing to engage in Open Banking.

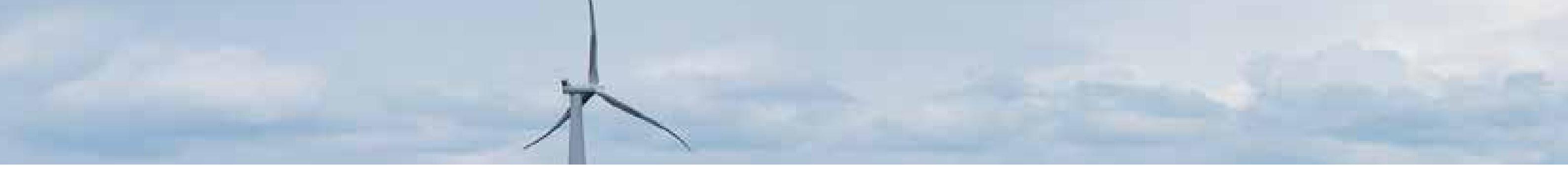
4.11.1 REGULATORY ACTIONS ADDRESSING CYBER RISKS

During the course of the year, the Cyber Risk Supervision Division of the NBG developed guidelines for the audit of information systems and cyber security management framework, as a complementary supervisory tool. This document sets out the requirements for the conduct, impartiality and operation of the information systems and cybersecurity management framework, the audit report and the audit team involved in the audit process. This will ultimately ensure the effectiveness and quality of the assessment of information systems and cybersecurity frameworks.

4.11.2 OUTSOURCING AND THIRD-PARTY RISK

Risks associated with the outsourcing of services are some of the most significant challenges in terms of operational risks. With the financial technologies being intensively introduced in the financial sector largely being undertaken through outsourcing services, the risk of dependence on third parties and their concentration increases. In terms of operational risk, it is important for financial institutions to have in place policies and procedures for outsourced services that address risk assessment, monitoring, exit planning, and business continuity management.

The NBG attaches great importance to the management and monitoring of outsourcing services. At present, work is underway to study the applicable regulatory acts and guidelines and to adjust them to the Georgian market as part of an effort to align these



with the recommendations of the European Banking Authority (EBA), and to minimize the risks related to outsourcing services to financial institutions.

4.11.3 DEPENDENCE OF THE BANKING SYSTEM ON OTHER SECTORS

Georgia's banking system, like many other banking systems in the world, is critically dependent on other sectors of the economy. Developing closer relationships with representatives of critical sectors is important in order to properly manage risks arising from dependence on such sectors. The financial sector is heavily dependent on the information technology and communications, energy, and, in part, transport sectors.

4.11.4 CENTER FOR INFORMATION SHARING AND ANALYSIS

In an effort to mitigate and prevent major operational events, including the systemic spread of cyber risk, and to promptly notify the banking sector of any realization of such events, the NBG has set up a pilot Information Sharing and Analysis Center, which operates as a closed communication platform for commercial banks. The goal of establishing the center is to ensure the timely and centralized exchange of information on both local and international operational risk events between the NBG and commercial banks.

The establishment of the Information Sharing and Analysis Center was recommended by leading international risk management practices and guidelines, including the EU Information Systems and Networks Security Directive, which obliges European member states to cooperate and ensure the exchange of information on cyber-incidents.

4.11.5 DATA QUALITY AND ACCURACY RISK

The NBG continuously assesses the accuracy, integrity and quality of financial data in the banking sector. Within data quality management, the focus is on streamlining business processes related to financial reporting, improving analytical tools, enhancing automated reporting, and reducing the complexity of related information systems. In an effort to improve data quality, work continues on the Basel Banking Supervision Committee’s document on effective aggregation of data on risk reporting principles (Basel Committee Standard, BCBS 239).

4.12 DEVELOPMENT OF FINANCIAL AND SUPERVISORY TECHNOLOGIES

4.12.1 PROMOTING FINANCIAL INNOVATIONS

The speed of innovation in the financial sector is increasing, which brings about new opportunities as well as new risks. The financial sector remains the most regulated economic sector in the world, and its regulation continues to grow. As a result, the modern supervisory framework can be quite technical and complex, especially for new financial startups. It is thus an important challenge for financial sector regulators to encourage innovators with Fintech ideas whilst at the same time supporting the transformation of those ideas into sustainable financial models. In response, the NBG is paving the way for the availability of basic Fintech infrastructure by developing various supervisory approaches.

Financial Innovations Office[69]

The Financial Innovations Office is an effective platform for the NBG to communicate with the financial innovator community. The mission of the office is to facilitate responsible innovation in the financial sector and to assist Fintech organizations and startups in learning about the NBG's regulatory approach.

During 2021, the office hosted a number of important meetings with about 200 individuals with innovative ideas and those interested in entering the financial

69. Visit the stability section of the NBG’s website for more information about the Financial Innovations Office: https://www.nbg.gov.ge/index.php?m=742

sector. Many of them subsequently started successful cooperation with the financial sector or are vigorously working on the introduction of new financial technologies in the sector.

One important event promoting the use of Open Banking technology was a project supported by USAID's Economic Security Program. Implemented in April 2021, this addressed the importance of Open Banking for Fintech companies. In May, a panel discussion on Open Banking was held in collaboration with the Bankers' Association that helped to inform and actively involve the sector in this initative.

The Financial Innovations Office has been in close contact with USAID, the German Economic Team (GET), BaFin, GFin and other organizations throughout the year to keep abreast of novelties and supervisory approaches to financial sector innovation.

Regulatory Laboratory

The Regulatory Laboratory is an important tool for promoting financial innovation. It allows for real-time testing of innovative products and services. Over the course of the year, the laboratory hosted over 40 entities whose work was related to remote identification.
In 2021, following the testing of biometric technologies at the Regulatory Laboratory, a change was made to the Regulation on Electronic Implementation of Preventive Measures by a Reporting Entity.

Digital GEL

Today, most central banks prioritize digital currency; however, the characteristics and technology applied to digital currencies vary by country depending on their intended use. The NBG publicly announced its interest in digital currency in April 2021 and invited Fintech companies to cooperate with it.

During the year, the NBG maintained ongoing communication with over 100 technology companies that had expressed willingness to be involved in the digital GEL project. Although the digital GEL project is still under consideration, the general characteristics that the digital GEL needs to meet have been identified: it should offer a cheap and fast alternative to payments that will allow for the emergence of new financial products, such as smart contracts.

A digital currency conference is planned to be held in Tbilisi on 4-5 May 2022 in partnership with USAID. Leading technology companies, including Ripley, Cardano, and Stellar, will take part in the event. As an outcome of the conference, specific technology requirements for the digital GEL technology will be developed.

Credit Registry

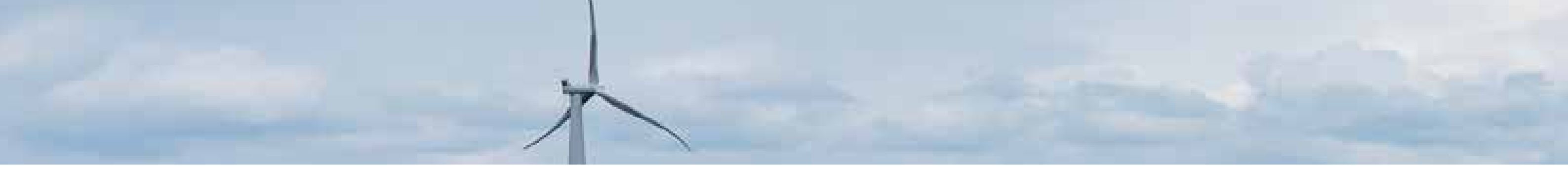
The NBG started collecting credit registry data in a test mode in 2021. Developed in consultation with the World Bank's Working Group, the Credit Registry is a database that allows for the collection of comprehensive information on credit risk. The data filed with the NBG on a monthly basis include the following:

- Loan liability details
- Loan liability collateral data
- Information on refinanced loans
- Information on investments
- Information on rejected loan applications
- Information on loan files closed during the reporting month.

It is planned to improve the information received and to start parallel reporting. We expect that shortcomings related to data accuracy will be eliminated by the end of 2022.

4.12.2 MODEL RISK

The use of different statistical models for business decision making has become common practice in the financial sector. Such models are widely used in lending, financial accounting, and risk management and there has been an especially large growth in the use of mathematical/statistical models in the area of retail lending. Recently, models based on machine learning and artificial intelligence algorithms have started to be used more frequently. Although the latter increase the efficiency of models, they can also complicate analysis and risk assessment.



In response to this challenge, over a year ago, the NBG developed a draft of the Regulation on Risk Management of Data-Driven Statistical, Artificial Intelligence and Machine Learning Models. An updated version of this statute will be published in 2022.

Three new areas were added to the regulation and comments and recommendations made by the financial sector were incorporated. The amendments to the regulation reflect current practices, challenges and international supervisory experience. This framework will facilitate the wider and more efficient use of models in the financial sector of Georgia.

Current trends in the sector prompted the necessity to develop a framework for the ethical use of models. To address this issue, the regulation sets out the ethical aspects of model development, implementation and application, and ways to mitigate the possible unethical use of models. This change is implemented for the benefit of customers as there is a risk that a model built without ethical principles may unfairly classify certain groups of consumers and restrict their rights. The second change concerns the expansion of the risk-based approach: the new amendment offers a methodology for ranking or grouping models by risk. It is important that the entities using a model ensure the transparency and interpretability of the model by employing the statistical method. This change will restrict model users from using 'black boxes' and shifting the responsibility for a model's results to the model's creators.

Following the introduction of the IFRS 9, models for accounting for expected credit losses in financial institutions are being introduced at the NBG. Based on their complexity and the potential impact on a bank's financial position, these models carry high risk. The NBG will use its resources to create an orientation model for their analysis. The orientation model will be one of the means for evaluating the models of financial institutions. The results of the orientation model and the software code will be shared with those financial institutions that are in the initial stages developing statistical models.

TechSprint Competition

The NBG continues implementing projects that involve young people in financial technologies. Initiated by the NBG, the TechSprint Competition was dedicated to supervision technologies and was open to anyone interested in data science. The competition turned out to be especially popular among students and concerned the machine reading of Georgian text. In identifying the winners, preference was given to the adequacy of the approach opted for solving the problem and the accuracy of forecasting.

The NBG will continue to organize other competitions in the future, striving to encourage talented people and to promote its role as a financial innovator.

BOX 11 GENERATING ARTIFICIAL MICRO DATA

The National Bank of Georgia collects a great deal of information from the financial sector. Alongside its regulatory importance, this information can also have great research value. However, as this information is confidential, only designated NBG staff have access to it. Nonetheless, it is important that this information be made available for research, and thus not be limited to NBG staff. There are researchers, students, and financial institutions that are all seeking to improve risk management by using models. Currently, the National Bank of Georgia enables researchers to obtain access to such data through a special computer on the NBG's premises. Such users can only process the data in an aggregated form and use the results for their research. However, this solution is not convenient. Because of limited resources, only a limited number of people can access the data in this form and one needs to enter into a legal relationship with the researcher, to determine responsibilities and control mechanisms.

To address this issue, in 2021 the NBG started considering a mechanism that would transform confidential data in such a way that it could be made accessible to all interested parties. The conversion has to modify identifying and sensitive information in such a way as not to deprive it of its research value, while also allowing recovery of the identifying data, even if additional databases were used. Currently, the National Bank of Georgia is considering two widely used methods for disguising the data. The first is Differential Privacy. This involves adding some noise to existing data, making it impossible to recover the original data, and thus obscuring sensitive information. In this way, we are considering use of the Laplace mechanism (Dwork, McSherry, Nissim, & Smith, 2006), in which data are added to the noise from the Laplace distribution.

The second approach, piloted in 2021, is to generate artificial micro-data, which involves an artificial intelligence model (GAN) learning to distribute data, and then it is possible to generate artificial data from that learned distribution that will approximate to the original data.

4.12.3 CREDIT INFORMATION BUREAU

The NBG has been regulating and supervising the work of the Credit Information Bureau since 2018. Over the years, the functioning of the bureau, as well as the entities with which it has a contractual relationship, have been supervised in accordance with the procedures approved by the Decree of the Governor of the NBG.
As of December 2021, 224 lending entities and 29 organizations enrolled on a non-mandatory basis are cooperating with the bureau. Naturally, this figure varies year by year, as the registration and liquidation of lending entities also affects their use of the bureau's database.

The regulations related to the supervision of the bureau have changed at certain intervals with the purpose of improving the functioning of the industry and to reflect the experience of the sector in practice. In the second half of 2021, a new package of amendments were prepared that covered the following areas: the market entry of entities whose functions are similar but not the same as those of the bureau; the adherence to a strong authentication rule when remotely obtaining consent from a data subject; preparation of reports on income from remittances, etc. The changes also affected existing records on consumer protection. Approval of the final draft of these changes is scheduled for the first half of 2022.

The NBG pays considerable attention to the study of and response to customer claims related to the proper presentation of data. The number of monthly claims recorded in 2021 is presented in Diagram N 4.48 below.

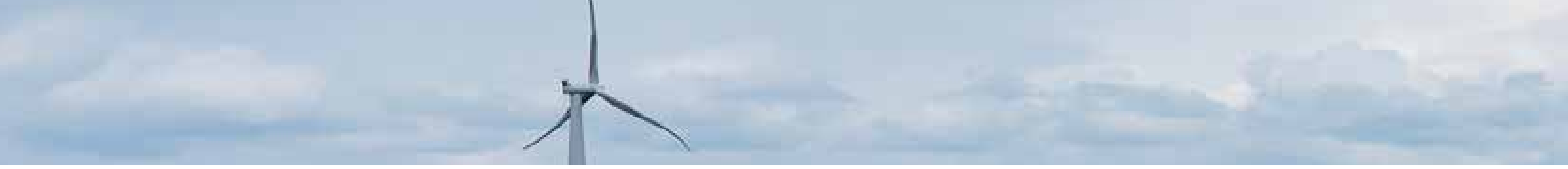
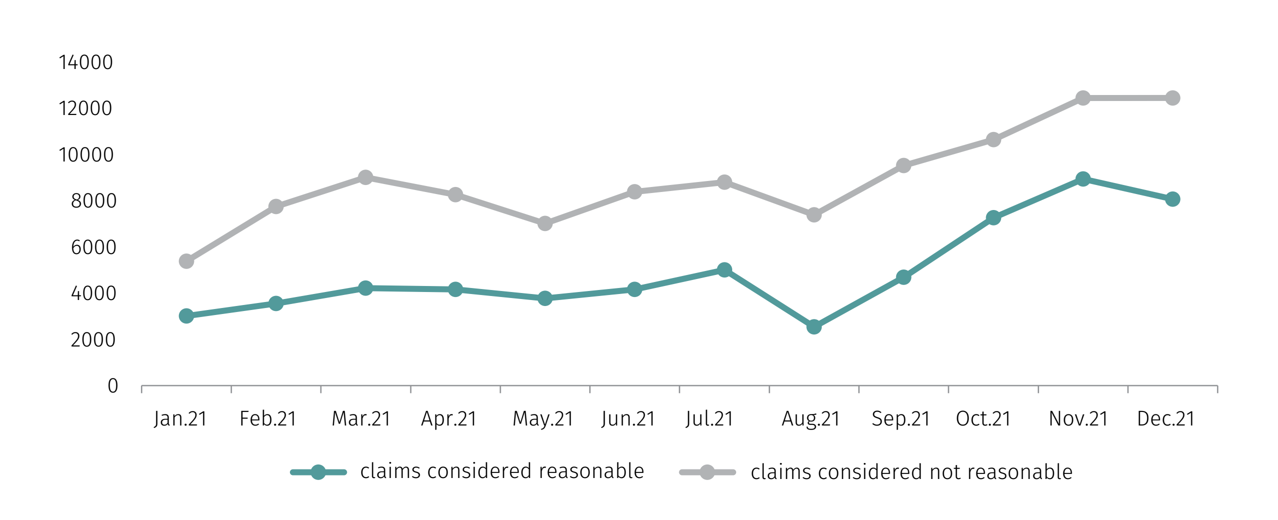


DIAGRAM N 4.48 NUMBER OF CUSTOMER CLAIMS (2021)



Source: NBG

4.12.4 OPEN BANKING

Open Banking services have been available in Georgia since 2021. Open Banking involves the immediate exchange of information between different financial institutions using electronic technologies, in the presence of a customer's wish and consent. The NBG first started working on the Open Banking project in 2019 and an Open Banking Committee was set up at the Bankers' Association in early 2020 with the task of developing a common standard for the introduction of Open Banking in Georgia and to facilitate the further development of the project.

Starting from 31 March 2021, subject to client consent and request, it is possible to exchange data between commercial banks, such as that related to bank account balances and transaction information. The exchange of these data must be done online using application programming interfaces (APIs).

From 30 November 2021, commercial banks can also initiate payments for individuals. The next step for Open Banking is the inclusion of other members of the financial sector, in addition to commercial banks and licensed Fintech companies. This should help increase access to banking services for consumers and achieve a greater diversity of banking services.

In 2022, Open Banking services will be made fully available for legal entities. Also, due to the peculiarities of the local market, Open Banking will be supplemented with remote identification functions and the exchange of information on standard products.

The development of Open Banking is not limited to these services. The next phase will be a transition to Open Finance, which involves the exchange of much more extensive information.

4.13 DATA PROCESSING AND SUPERVISORY TECHNOLOGIES

In efforts to improve the exchange of supervisory reports and data quality, the NBG, in cooperation with a top British company, "Corefiling", introduced the International Standard XBRL (Extensible Business Reporting Language) information system. This has two important components: a reporting portal and a Taxonomy Management System (TMS).

Through the reporting portal, banks can submit the required supervisory reports, including in XBRL format. The validity of the reports submitted in XBRL format is checked by the appropriate taxonomy. With the help of

the portal, banks can view the validation results before sending the data to the NBG. After the data are validated, the information provided is recorded in a database and is made available for the analysis as required for banking supervision.

The Taxonomy Management System (TMS) allows the NBG to create a taxonomy – a set of information where the metadata on reporting are presented. The information presented in the taxonomy includes definitions, connections between elements, hierarchies and other rules that define how information should be presented in order to meet the NBG's reporting requirements. A well-written taxonomy also provides a significant improvement in data quality.

The staff of the Information Processing and Supervision Technologies Division of the NBG underwent intensive training on the introduction of the XBRL information system. That training was necessary to create the taxonomy, in addition to the TMS software. To move things further, work began in 2021 on the NBG's Supervisory Taxonomy, which was developed using the EBA-developed Data Point Model (DPM) methodology. We are committed to continuing work on the NBG taxonomy in the coming years. Our ultimate goal is to replace spreadsheet-based reporting with XBRL-based reporting.

In addition to the XBRL information system, the NBG uses the world-renowned Tableau business intelligence system for its data processing activities. In 2021 we continued using this to visualize different reports and create dashboards for regulatory purposes.

In 2021, the NBG continued to work on the full transitioning to IFRS reporting, as part of its commercial bank supervision efforts. In support of this project, we started accepting individual FINREP financial statements, as established in the EU under the EBA 2.8 Reporting Framework, in the XBRL standard. In the coming years, we will continue receiving FINREP reports from banks with appropriate updates, and we have the XBRL information system capable of doing so automatically. Moving ahead with the development of surveillance technologies, we plan to further refine the analytical information software related to surveillance. Through this tool, banking sector supervisors process the information needed for the functions as defined by their mandate. These changes are expected to increase the accuracy of oversight information, simplify the reporting process, and facilitate effective supervision analytics.

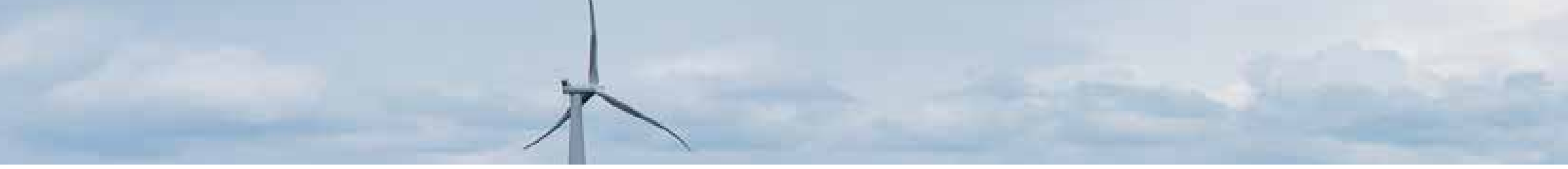
In 2021, we were keen to share knowledge both within the NBG and with our partners. The National Bank of Poland is cooperating intensively with the NBG within the framework of the EU Twinning Mission with the common goal of the successful implementation of ongoing projects. Work is also underway with the Central Bank of the Netherlands to develop a data strategy that covers, among other areas, granular data processing, bulk data processing, and the development of a structure fitted for the DPM data view architecture.

Knowledge sharing across the NBG was also intensive during the year. Training on information processing and data visualization were conducted for the staff of the NBG's Information Processing and Supervision Technologies Division, with the purpose of sharing the knowledge accumulated in the field of information processing. The practice of knowledge sharing will continue in the coming years.

4.14 RESOLUTION AND LIQUIDATION

The Recovery and Resolution Framework

In 2021, the NBG started working on the implementation of the Commercial Bank Recovery and Resolution Framework (hereafter referred to as the resolution framework). The planning component of this is in continuous operation, serving as a kind of pre-crisis preparation exercise enabling better organization and management of processes when the need arises. The first recovery plans for 2021 were drawn up by all participants in the banking sector. These included measures to be taken by commercial banks to improve their financial positions, and to restore and maintain their critical functions in the event of significant financial difficulties or delays to those critical functions. This



process involved intensive communication with the regulator. The NBG examined the documents in the context of each bank and provided valued feedback in accordance with the regulatory procedures and international good practice.

An important element of the recovery plans developed by commercial banks is the self-assessment of critical economic (banking) functions and sub-functions. The plans also assess the potential for substitutability over time by other market participants in the event of the interruption of these functions, taking into account the impact this would have on both counterparties and the real economy.

Key economic functions/critical functions	Impact of the termination of function	Substitutability of function
Deposit Taking	**Assessment of criticality**	
Lending		
Payment Services, Cash Services, Clearing, Settlement Services, Custody Services		
Activities in the Capital Market		
Wholesale Funding		

The requirements for the above plan are regulated by the relevant procedure of the resolution framework. The document focuses on marking indicators for recovery purposes and calibrating their thresholds; determining recovery measures; testing the extent of financial damage and the effectiveness of recovery measure(s) by using stress scenarios that are relevant for the bank; and doing preparatory work. The document also focuses on the management of governance issues, with the aim of the early detection of deteriorating financial conditions and further organizational management.

Mandatory categories of recovery plan indicators			
Capital	Liquidity	Profitability	Asset quality

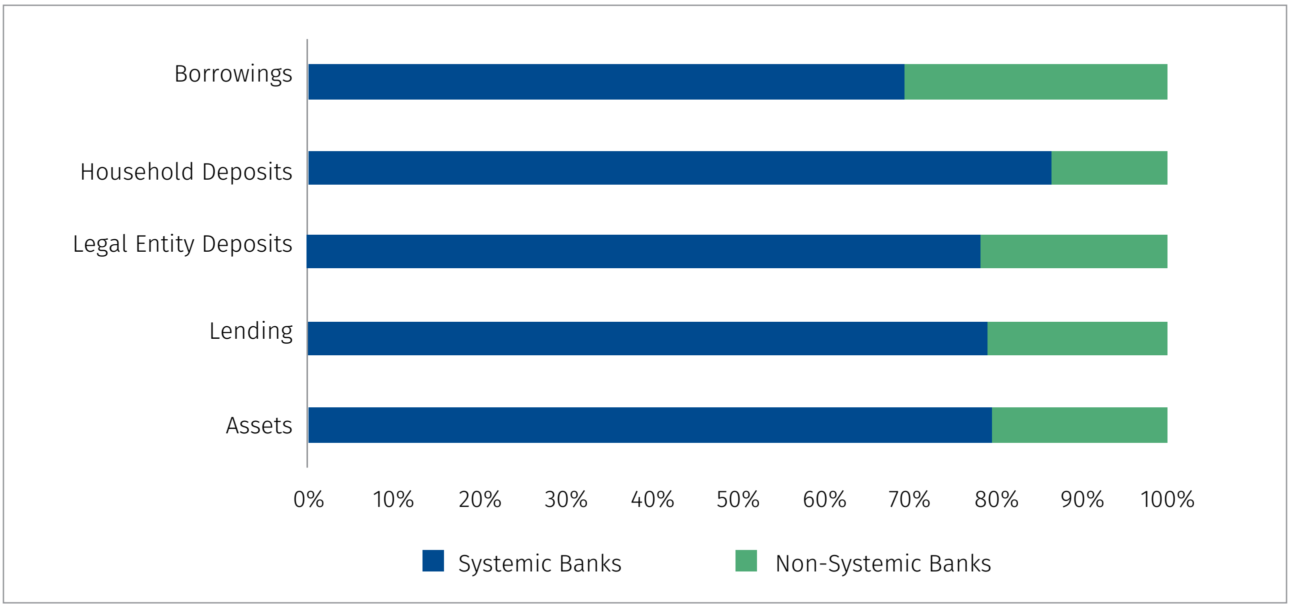
Commercial banks will take care of updating their recovery plans and the NBG will evaluate these on an annual basis. The assessment document will be integrated into the overall risk management framework of the banks.

The resolution mechanism, presented with appropriate resolution tools, is an opportunity to recover a bank in the event of a severe financial crisis. It is used when recovery measures are unlikely to be implemented within a reasonable time and, to avoid a significant negative impact on the stability of the financial sector, it is advisable to maintain the functioning (critical functions) of the financial institution while restricting the use of taxpayers' funds.

The resolution authority of the NBG includes the individual or combined use of the following resolution instruments without consent or giving prior notice to shareholders and/or creditors:

- Merger of a bank in resolution with another commercial bank.
- Disposal of the shares, assets and/or liabilities of a commercial bank.
- Transfer of the shares, assets and/or liabilities of a commercial bank to a temporary bank.
- Recapitalization of a commercial bank by issuing new shares.
- Recapitalization of a commercial bank by a write-off or bail-in.

DIAGRAM N 4.49 CONCENTRATION OF SYSTEMIC BANKS IN THE BANKING MARKET (31 DECEMBER 2021)



Source: NBG

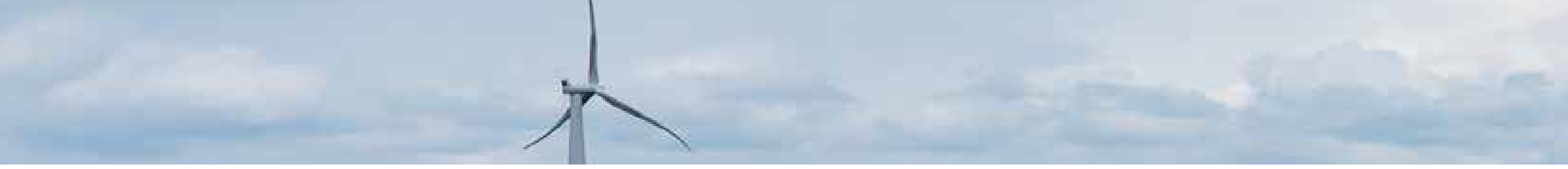
The peculiarities of the banking sector and the high concentration of systemically important banks indicate the criticality of their economic functions and the need for resolution plans. The NBG has prepared initial versions of resolution plans for systemically important banks (for internal use). Their key elements include assessing resolvability and determining the preferred resolution strategy, which would include the following aspects: resolution triggers, qualitative and quantitative analyses of resolution instruments, key phases of the resolution, and core processes. International practice suggests that the expansion of the resolvability and operational organization of the instruments continues to be under development and remains a topical issue even in advanced countries. The NBG will continue to work on the operational implementation of the resolution framework in the future.

In 2021, a resolution committee meeting was convened to discuss the current schedule and issues. During the year, no need was identified in the banking sector for a resolution, no early warning signs were detected, nor were any grounds for enacting recovery measures observed.

An annual meeting of the Interagency Financial Stability Board (IFSB) was held in 2021. The board was chaired by the Minister of Finance and this was attended by the leaders of the NBG, the Deposit Insurance Agency and the State Insurance Supervision Service. The IFSB discussed key elements and aspects of the resolution framework, the implementation of the planning component, interaction with the banking sector, and the need to intensify inter-agency cooperation. In addition, members of the board were informed about the dynamics of financial stability indicators in the banking sector, the current assessment of the lending cycle and the results of the stress test.

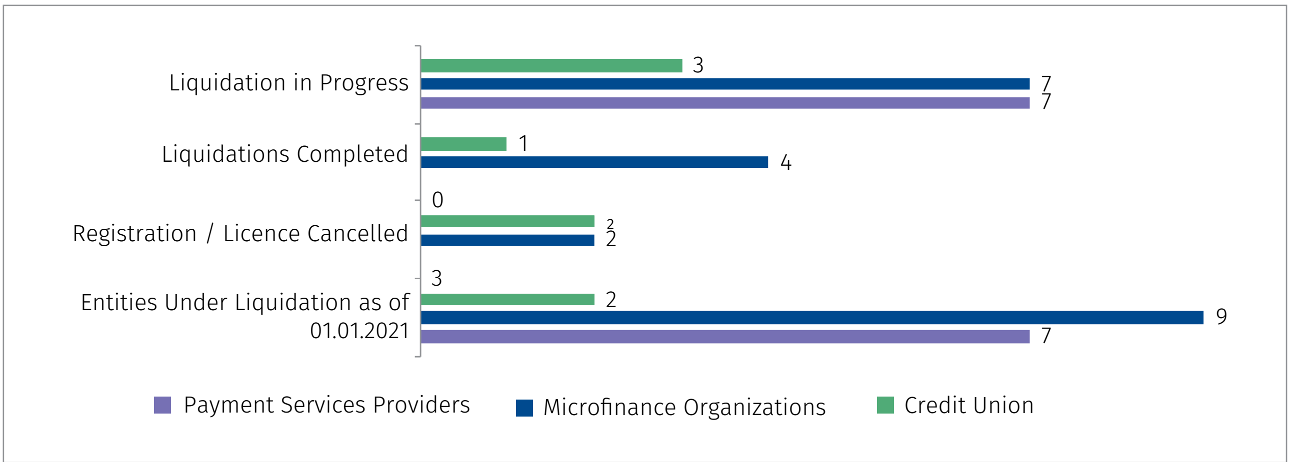
Liquidation of Financial Institutions

There are 14 commercial banks currently operating in Georgia. There were no cases of bank liquidation initiated in 2021, with the last liquidation in the banking sector having been completed in 2019. During and after the liquidation of the supervised entities, the National Bank registers the funds unclaimed from the creditors in a special account, administers them and, upon disclosure of the holder, ensures the return of these funds. In 2021, based on the required documentation being submitted by the NBG, four requests for the transfer of funds from the account of unclaimed funds were granted. These included applications of three creditors of a liquidated commercial bank and one creditor of a liquidated microfinance institution.



The NBG also manages the assets discovered after the liquidation of a commercial bank (there have been such occurrences in the years following the completion of liquidation). The proceeds discovered in such a way are normally distributed among the remaining creditors of the liquidated bank, in the appropriate order. In 2021, four newly discovered assets of liquidated commercial banks were disposed of. In one of these, the funds were partially recovered and distributed to creditors that had been paid in previous years. Disposal of two such assets was completed without cash recovery during 2021, while the proceedings for the other two assets will continue into 2022. In carrying out its liquidation functions, the NBG is guided by the applicable laws and decrees in relation to the supervisory entities below. In addition to existing legal acts, the NBG develops procedures and other technical internal control documents that help improve governance during liquidations and make the processes more organized and standardized.

DIAGRAM N 4.50 PROGRESS OF LIQUIDATION OF FINANCIAL INSTITUTIONS IN 2021



Source: NBG

The National Bank partnered to initiate a package of legislative changes in 2020, submitting these to Parliament for approval. The proposed legislative changes encompass the following laws: the Organic Law of Georgia on the NBG and the Law of Georgia on Microfinance Institutions. The purpose of the legislative changes is for the NBG to have greater authority granted by law in terms of the liquidation, insolvency and bankruptcy of microfinance institutions, as well as related to their temporary administration. These amendments give the NBG sole authority to declare a microfinance institution insolvent and/or bankrupt. This, in turn, will make sure that the claims of the creditors of the microfinance institutions are satisfied in a timely and effective manner. The NBG will appoint a temporary administrator and liquidator of the microfinance institution concerned and they will be accountable to the NBG. The supervisory framework of the NBG for the regulation and supervision of microfinance institutions will be strengthened as these legislative amendments are approved. This is also expected to fill the legislative gap previously discovered by judicial practice that referred to the lack of legal norms related to the insolvency and bankruptcy of microfinance institutions and hindered progress on such cases.

05

CONSUMER RIGHTS PROTECTION AND FINANCIAL EDUCATION

5.1 CONSUMER RIGHTS PROTECTION

REFINING THE LEGISLATIVE FRAMEWORK

Regulation on protecting consumer rights

The NBG developed an updated version of the Regulation on the Protection of Consumers' Rights as Financial Institutions Provide Services, which came into force on 1 April 2017, in accordance with Decree N32/04 of the Governor of the NBG of 9 March 2021. The purpose of the new regulation and the expansion of consumer protection requirements for the financial sector was to bring Georgia closer to relevant the EU legislation in accordance with the Association Agreement between Georgia, EU and the European Atomic Energy Community and their member states and better to respond to market challenges.

Our goal for the new consumer protection requirements is to promote competition in the financial sector and introduce more equitable practices. The changes include the following important issues:

- When financial institutions unilaterally change significant terms of loan or deposit agreements, they now have longer deadlines for the prior notification of customers.
- Obligations to inform the guarantors and the owners of items used as collateral were established in cases when loans are issued as part of a general agreement or when the terms of an already issued loan are being changed.
- Amounts of early repayment fees were determined according to the types of loan interest rate and the remaining term of the loan.
- To promote competition and give consumers more choices, requirements were set for offering insurance products related to a specific financial product. More specifically, in the event of financial institutions requiring the acquisition of a loan-related insurance, lenders must offer their clients three possible alternative insurance products from three different insurance companies. In addition, customers must be informed that they can independently find and submit an alternative policy of their choice. Financial institutions are obliged to inform their customers about the minimum conditions that such policies must meet. Relevant information related to insurance should also be made available to the customer.
- Additional requirements were set for the provision of information to the customer. For instance, when a unilateral change of a contract occurs or when a loan is issued as part of a so-called general agreement, information about this must be provided to the guarantor and the owner of the collateral, in addition to the client concerned. Also, when issuing a loan, the borrower/guarantor and the owner of the collateral must be informed about the legal risks associated with the loan. The text of the relevant notice should also be included in warranty and pledge agreements.
- According to the changes, current account, deposit and credit product statements should be free of charge for a certain period of time. The changes also determine the list of information that these statements should include. The purpose of this change was to raise awareness and transparency. Also, the list of information to be indicated in texts of advertisements and offers was expanded and specified.
- The concept of fixed and variable interest rates was defined and the early repayment terms for different interest rate loans were specified.

In addition to the above, in late 2021, we commenced working on further amendments to this regulation that will be enacted in phases during 2022.

Code of ethics for loan recoveries

In 2021, work continued on the draft Code of Ethics for Financial Institutions for Loan Recoveries. This is based on the requirements of advanced economies and international best practice and is expected to be approved in early 2022. The relevant parties in the sector were intensively involved in the work on this code. The enactment of the code will help strengthen the reputation of financial institutions as trusted partners in the eyes of consumers. It will serve to protect consumer rights and interests during the process of loan recovery. The relationship between the financial institution and customers should be based on generally accepted principles and on the norms of reliability, transparency, mutual respect, the provision of accurate and truthful information, and the responsibility of the parties.

The draft code addresses the following important issues:

In the process of recovering a loan, financial institutions are obliged to follow a business-like and polite form of communication with their clients, contact persons and third parties, including mortgage/pledge holders and guarantors. The financial institutions should not provide such persons with misleading or incorrect information, so as not to push them to make a decision that they would not have made if they had had dependable, complete and accurate information.
Financial institutions are prohibited from providing incorrect information to the clients or their representatives, including that related to the amount, term and status of the liability, or the statute of limitation. Further, financial institutions are prohibited from misrepresenting themselves, ostensibly introducing themselves as a representative of the LEPL National Bureau of Enforcement or another authority. Nor may they provide information to their clients that failure to meet their financial liabilities would result in a deprivation of their liberty, etc.

The code prohibits the verbal or physical abuse of clients and persons related to them. Use of degrading, obscene, inhuman, or discriminatory terms is not permitted. Also, harassing, pressuring or intimidating these individuals, taking actions that would damage their reputation, and engaging in illegal actions against them are prohibited.

Financial institutions are also prohibited from visiting the family homes of clients and their family members' residences to undertake an inventory and/or sale of the property they own, unless the financial institution is legally authorized to do so.

Financial institutions are obliged to maintain records reflecting and confirming communication with customers and other persons through any channel other than on-site visits and to keep records for at least two months after receipt. These records will significantly help to proper investigation, study and evaluation of the case should a legal dispute arise. However, customers and third parties have the right to refuse to produce the said record. The requirement for the storage of communication information must be met by financial institutions no later than 1 June 2022.

Financial institutions must contact customers and related persons using only the details provided to them by these persons or obtained from public sources. However, contact with customers and other persons or on-site visits should be made only in the period from 09:00 to 20:00.

There are frequent cases when financial institutions are unable to communicate directly with customers. In such instances, according to the current legislation, they are authorized to contact third parties related to the customer; however, according to the code, the purpose of such contact should only be to determine the location of the client or to contact them. In addition, the contact person or third party related to the client is entitled to request termination of any such communication. In such cases, within the scope of the code, the financial institution has no right to contact the said person.

The code makes it possible, with certain exceptions, to sell a loan portfolio or a separate loan only to an entity under the supervision of the NBG. These entities may also be given a portfolio or a separate loan for management purposes. In such cases, the responsibility for any violation of the requirements of the code rests with the latter (i.e., the financial organization that has acquired or is in charge of managing the loan portfolio or a separate loan). Whereas if the portfolio or a certain loan is transferred (for management purposes) to a third party, and that entity is not under the supervision of the NBG, the responsibility for any violation of the requirements of this code shall be borne directly by the lender.

In a case where financial institutions fail to comply with the requirements established by this code, the NBG will be authorized to apply supervisory measures and/or sanctions as provided by the legislation of Georgia.

Credit Information Bureau

Consumers have provided feedback to the Credit Information Bureau since 2019, and relevant reports are filed with the NBG on a monthly basis. Based on the reports received and the direct consumer feedback provided to the NBG, matters are studied and analyzed in detail, which allows the finding of solutions and elimination of shortcomings identified at the system level. In 2021, the NBG started working on changes in the Regulation on Providing Information to the Credit Information Bureau on the Territory of Georgia, and the Registration and Accessibility of Information in the Credit Information Bureau Database. These amendments are due to be approved in 2022. The regulation refers the obligation of the Credit Information Bureau to develop an ethics code regarding customer relations. The amendments also cover additional requirements for responding to customer claims. To ensure the maximum involvement of the relevant parties in the sector, the draft amendments were made publicly available.

Consultations on legislative changes related to consumer protection

In 2021, similar to previous years, the NBG continued to provide advice and recommendations to representatives of the financial sector and other stakeholders on issues related to legal requirements in the field of the protection of consumers' rights. Simultaneously, draft amendments to the legislative framework were being developed remotely.

At the initiative of the NBG, and with the involvement of the State Insurance Supervision Service of Georgia, online training was conducted for practicing judges and their assistants. The project was implemented in cooperation with the High School of Justice and concerned the introduction of the legislative acts and principles adopted by financial sector regulators, including in the field of consumer protection. The two-day online meeting was chaired by the staff of the NBG and the State Insurance Supervision Service. The training module, designed specifically for the judiciary, focused on consumer protection, as well as payment system legislation and consumer solvency assessment. The project is intended to help raise the awareness of judges about the legal acts in force in the field of consumer protection, and will help them to better understand the specifics of consumer protection mechanisms in the financial sector.

Remote and on-site inspection of consumer protection standards in the financial sector

The audit of financial institutions, which is intended to monitor compliance with supervisory requirements, was conducted remotely in 2021 due to the COVID-19 pandemic. In response to the identified violations of the requirements of the legislative framework, the NBG undertook a number of supervisory measures. Written instructions were sent to four commercial banks, two microfinance institutions and 78 lending entities, and two commercial banks were fined GEL 12,000 and nine lending entities were fined GEL 9,000 for violations.

Consumer referrals

In 2021, a total of 6,644 consumer referrals were registered in the Consumer Rights Protection Division of the NBG, a decrease of about 32% compared to the previous year.

The majority, 5,160 (77.66%), of such contacts were made by telephone, 693 (10.43%) were via e-mail, 404 (6.08%) in writing, 384 (5.78%) through social media, and three personal visits were made (0.4%) – the lowest figure as a result of the pandemic.

The decrease in the number of applications to the NBG compared to the previous year was mainly due to the completion of the loan deferral program, which entailed a reduction of questions and requests from consumers in this regard.

In terms of content, most customer feedback concerned administrative matters/service, there were also claims related to restructuring and interest rates, along with general information requests.

In terms of products, the most frequent feedback concerned consumer, mortgage and problem loans.

Claims filed to financial institutions

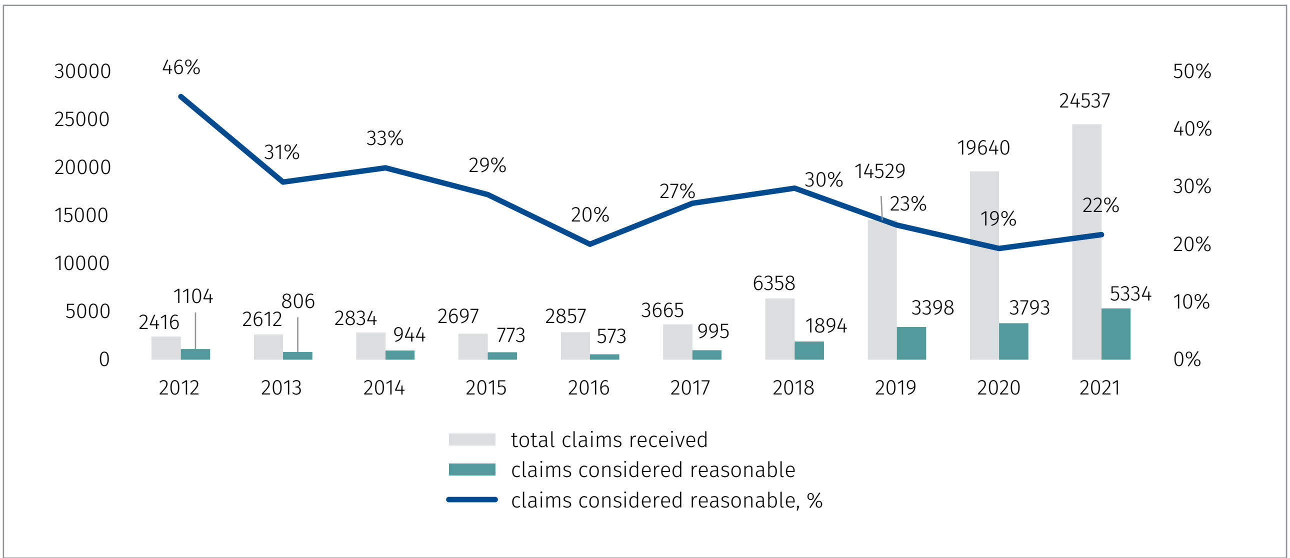
Consumers also applied to financial institutions (commercial banks, microfinance institutions and lending entities) and the Credit Information Bureau to file complaints. These entities are required to record such information and provide it to the NBG on a monthly basis.

Complaints recorded at commercial banks

Judging by the reports submitted to the NBG by financial institutions, 24,537 claims were registered in commercial banks in 2021, which is 25% higher than the previous year. It is important to note that since 2012, the dynamics of appeals made in commercial banks has been steadily increasing. This is an indication of increased consumer awareness of consumer protection mechanisms. The complaints received related to transactions, administration/services and terms of contracts.

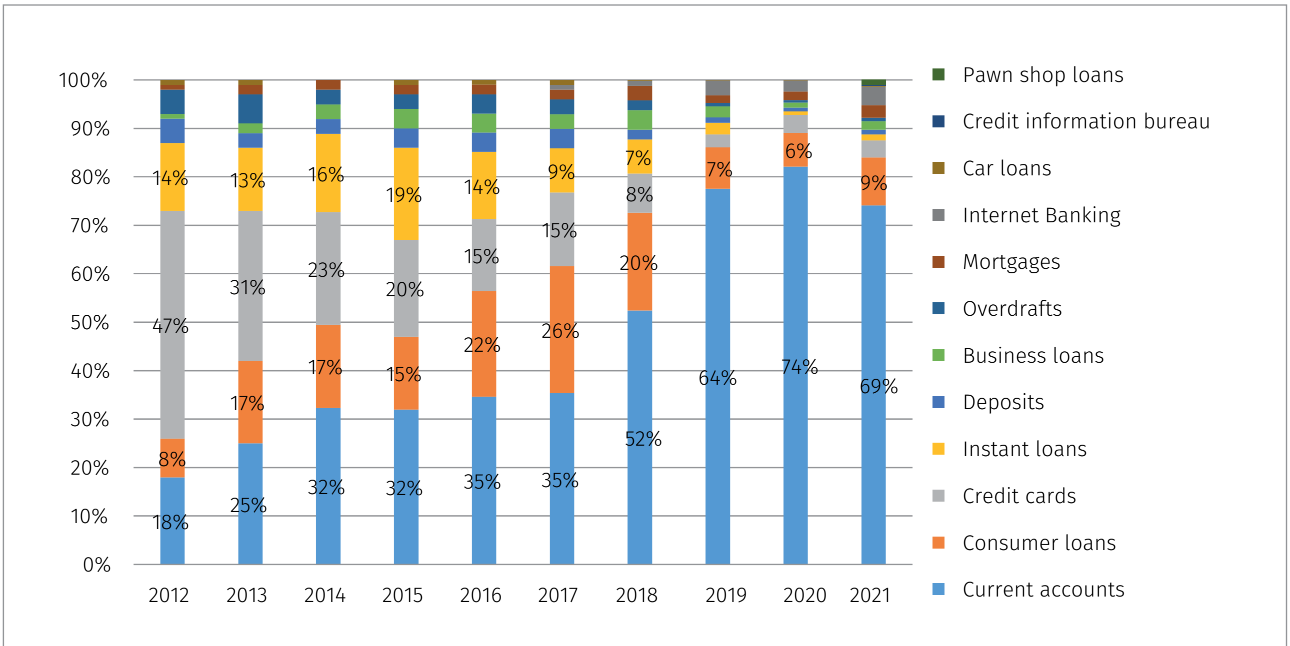
The most common claims were made about the following products: (i) current accounts/debit cards; (ii) consumer loans; (iii) other types of claims, and (iv) credit cards. Disagreement regarding transactions were mainly related to current accounts/debit cards, while complaints about terms of contracts related to consumer loans and credit cards.

DIAGRAM N 5.1 DISTRIBUTION OF CLAIMS AT COMMERCIAL BANKS BY STATUS



Source: NBG

DIAGRAM N 5.2 DISTRIBUTION OF CLAIMS AT COMMERCIAL BANKS BY PRODUCT



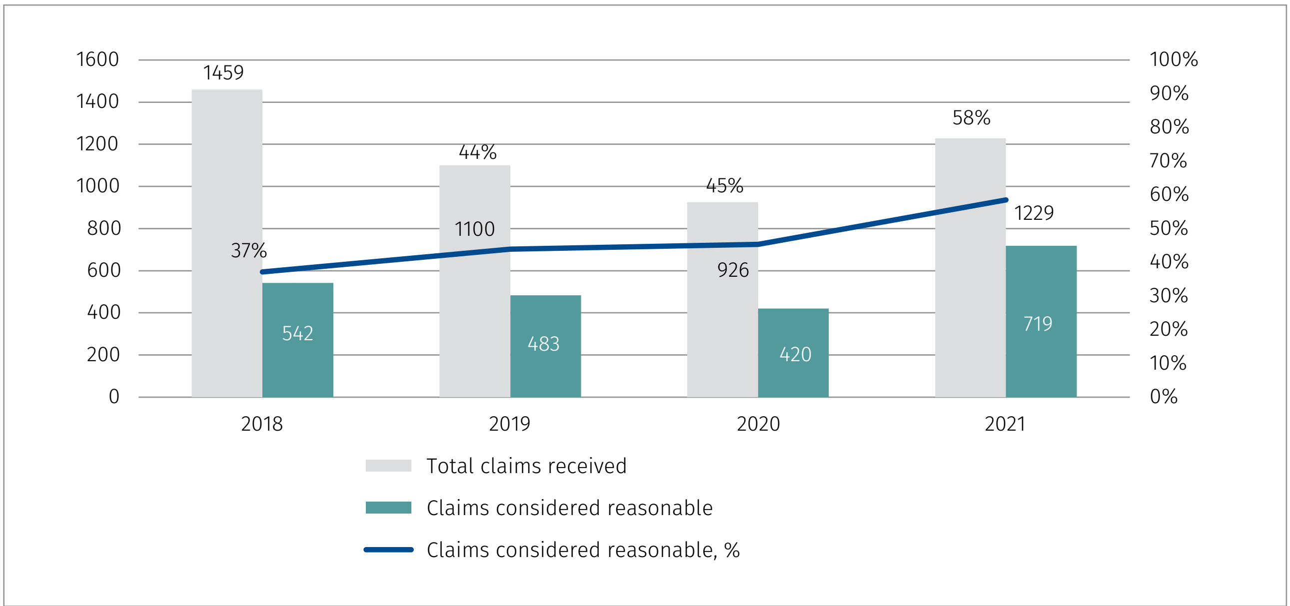
Source: NBG

Complaints recorded at microfinance institutions

During 2021, 1,229 claims were registered in microfinance institutions, an increase of about 33% over the previous year. The increased number of complaints is due to increased consumer awareness and the improved recording of claims by microfinance institutions.

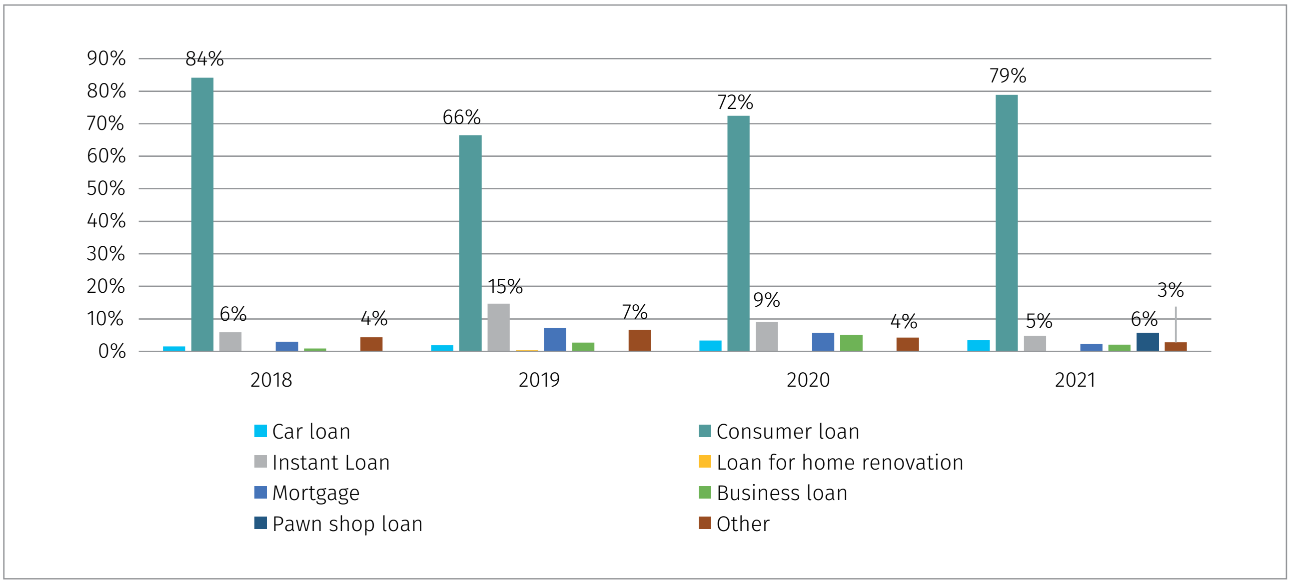
About 78% of claims in 2021 related to consumer loans, which is to be expected as these are the key product of microfinance institutions. Since April 2021, the methodology of recording claims changed slightly and three additional products were singled out in the reports: debit cards, the credit information bureau and pawn loans. Despite the change in methodology, the share of consumer loans within the number of claims recorded continued to grow. In terms of the nature of the claims, the largest share was taken by fines and overdue claims and administration/service issues.

DIAGRAM N 5.3 DISTRIBUTION OF CLAIMS AT MICROFINANCE INSTITUTIONS BY STATUS



Source: NBG

DIAGRAM N 5.4 DISTRIBUTION OF CLAIMS AT MICROFINANCE INSTITUTIONS BY PRODUCT



Source: NBG

5.2 FINANCIAL EDUCATION

The NBG continued running its financial education projects and programs in 2021. Created in 2020, FinEdu (www.finedu.gov.ge) is a financial education portal that has been used for ongoing communication with the public. Through this, consumers were provided with reliable, impartial and unambiguous information needed to make financial decisions. A number of projects were implemented in this direction, including webinars, online meetings and competitions held for a variety of target groups, including children, youngsters, teachers, entrepreneurs and adults. Animated videos on key issues related to financial education were developed. In addition, as has become a tradition, various annual awareness-raising events were celebrated with the involvement of our partner organizations. These included Global Money Week, Innovations Camp and World Savings Day. In addition, two new dates – Consumer Rights Day and International Youth Day – were added to our events calendar. Cooperation continued with the International Network on Financial Education of the Organization for Economic Cooperation and Development (OECD/INFE) and, in this regard, a study on the financial education of micro, small and medium entrepreneurs was conducted for the first time in Georgia.

Financial Education Portal (www.finedu.gov.ge)

FinEdu, the financial education portal launched by the NBG in September 2020, alongside its social media channels (on Facebook, Instagram, LinkedIn and YouTube), represented one of the key channels for the dissemination of financial education considering the pandemic environment during 2021.

The FinEdu website provides essential information on financial education, including helpful tips, calculators, tests, publications, brochures, thematic textbooks, videos, and a blog. FinEdu provides users with objective, impartial information in simple language that is compliant with applicable legislation and best practices. The material published on the website (except for copyrighted blogs) is made readily available to be used by any interested party. The FinEdu portal was enriched with new thematic materials in 2021. More specifically, the subcategory “cybersecurity tips”, blogs, tests and publications were added to the website. It also features updated information in line with legislative changes; for instance, regarding the updated information on consumer protection. The page features all the events and news of 2021 with text and video materials, as well as the training materials used in the webinars. The materials available on the website, including information about the events, competitions and information campaigns on financial education, as well as events organized specially on the Facebook page, were widely covered on the FinEdu social media channels during 2021. Through these, it became possible to make financial education activities and materials available for citizens living in any region of Georgia.

As FinEdu marked its first anniversary in September 2021, a special information campaign was launched: videos were developed with the involvement of the NBG and its partner organizations that provided the public with information about the availability of the financial education portal and its work.

As of the end of 2021, the financial education portal was visited by over 95,000 users. During 2021, the website attracted more than 81,000 new unique users, with a total of 277,000 page views in more than 130,000 sessions. The FinEdu Facebook page enjoyed visits of 800,000 unique users in 2021 and gained 9,800 subscribers. The Instagram and LinkedIn pages were launched relatively late in 2021, so the number of their subscribers was a relatively modest 1,100.

FINANCIAL EDUCATION PROJECTS

Online Course on Personal Finance Management

The NBG has developed an online course on personal finance management to enhance the financial education of adult citizens. The goal of the course was to provide trainees with information that would help them make informed financial decisions and interact with financial organizations. Our online meetings were open for anyone interested in attending.

The meetings were held in five sessions, where participants were provided with important information about budgeting, savings, loans, financial security and the rights of the clients of financial organizations. This information was shared through interactive exercises and group activities. At the end of the course, participants were given electronic certificates.

The online course records, along with the presentation materials used, are available on our financial education portal[70] and its corresponding YouTube channel[71] for anyone interested.

Educational Videos

With the support of the German Sparkassenstiftung (DSIK), we filmed nine animated videos on financial education.[72]

The videos use simple language to explain the key issues of financial education, which are intended to help citizens to make wise decisions when it comes to money. These include information on the basic terms of loans, solvency, effective and nominal interest rates, insurance, the accumulative pension scheme, currency risks, and phishing as one of the forms of cyber fraud.

Facebook live series - “Fin-osophical Diaries”

The NBG launched a new project, Fin-osophical Diaries, on the Facebook page of its financial education portal FinEdu (www.facebook.com/finedu.gov.ge). These offer a series of conversations in the Facebook live format. The goal of the project is to present financial matters and concepts from a different angle, to offer engaging content and to promote the formation of reasonable attitudes from the general public towards finance.

During 2021, eight sessions of the Fin-osophical Diaries were held, hosting guest speakers who discussed financial matters in a non-standard, original and interesting way. Any interested person was encouraged to join and listen to the conversations without the need for preliminary registration. Listeners had the opportunity to write their own questions in the comments section during the meeting and hear the speaker's answers.

70. See https://finedu.gov.ge/ge/ghonisdziebebi-2/piradi-finansebis-martvis-onlain-kursi-tsarmatebit-chatarda-1
71. See https://www.youtube.com/watch?v=khVRMGGmzUA&list=PLhi_8_nnsD1OyMl23Q8VMYzWMFSFoa_Cr
72. See https://www.youtube.com/watch?v=eWvqJvTxCRw&list=PLhi_8_nnsD1OLJZYwLvS7czDNtmRYer9U

Interested parties are invited to listen to the recordings of these events on the Facebook page, as well as on our financial education portal[73], and the YouTube[74] channel.

Competitions

We announced a number of competitions through the Facebook page of our FinEdu financial education portal to spark the interest of citizens in financial education. A competition dedicated to International Book Day and the "11 puzzles" competition lasted for 11 weeks. Different types of puzzles were published in both competitions related to financial education and the financial education portal. Anyone interested was encouraged to take part. The winners were awarded educational materials and FinEdu-branded prizes.

Educational webinars and Facebook live sessions for different target segments

We conducted webinars and Facebook live broadcasts for various target segments during 2021. A live lecture on financial education and personal finance management was held for the Facebook group – W4W (Education and Career Development).[75] The webinar echoed the group's goal of empowering young women and providing them with information on education and career development. As part of the Civic Education Week organized by the Eastern Partnership Network for Civic Education, a webinar for teachers was held to share the NBG's experience in integrating financial education issues into civic education. The NBG was also pleased to conduct a webinar for entrepreneurs and those interested in entrepreneurial activities.[76] The webinar's participants had the opportunity to become familiar with real-world, practical examples and to explore the key aspects needed to analyze the financial position of a business, including information requested by financial institutions for loan disbursement, financial statements and ratios.

In 2021, another series of live broadcasts, called "Expert Hour" was launched on the Facebook page of the financial education portal. In these broadcasts, experts in their respective fields discussed various topics related to financial education that are relevant to society. One of the live broadcasts was devoted to the discussion of the property tax issues facing individuals: a representative of the Revenue Service of the Ministry of Finance spoke about property tax, the nuances and deadlines for filling out the declaration, and answered the questions of the audience.

Awareness-Raising Projects

We were pleased to continue to mark our traditional annual awareness-raising events in the year, including Global Money Week, Innovations Camp, and World Savings Day, as well as launch our new initiatives – International Consumer Rights Day, International Youth Day and cybersecurity awareness month.

Global Money Week

On 22-28 March 2021, Global Money Week was celebrated for the seventh time in Georgia and was organized by the NBG and finedu.gov.ge, our financial education portal. The event was attended by commercial banks, microfinance institutions, the Georgian Bankers' Association, the Youth National Palace of Georgia, the Junior Achievement Georgia NGO, Ilia State University, and the Georgian Institute of Public Affairs (GIPA).

Global Money Week is held annually in over 170 countries around the world and its main task is to promote financial, economic and entrepreneurial awareness among children and young people. Georgia gladly shared the 2021 international motto of the 2021 *"Take care of yourself, take care of your money! ".*[77] *We organized a competition for video questions called "Money and the World of Money".* Contestants had the opportunity to expand their knowledge of the history of money and the banking system. Based on their correct answers, a total of 15 winners were announced who were awarded branded gifts from the NBG, an album of *"Money in Georgia"* and certificates. Posts, blogs, and articles on the history of money, savings, and budgeting were additionally posted on the FinEdu website and the corresponding Facebook page.

73. See https://finedu.gov.ge/ge/video-galerea-2/finosofiuri-dghiurebi-1
74. See https://www.youtube.com/watch?v=ySAglFW6yI4&list=PLhi_8_nnsD1NHDtf_DKNkdp6M5D-wHkbp
75. See https://finedu.gov.ge/ge/ghonisdziebebi-2/vebinari-finansuri-ganatleba-da-piradi-finansebis-martva-1
76. See https://www.youtube.com/watch?v=pUbdeTcCGl8&t=167s
77. See https://www.youtube.com/watch?v=Xw0gMIQsS08&list=PLhi_8_nnsD1Ml5OqoglUPK-ujrUeWhuI9

Representatives of the financial sector held a number of educational events during the Global Money Week. Educational videos on consumer protection were developed by the Crystal Foundation and the Financial Inclusion Organization Crystal. Microfinance institution Crystal, Liberty Bank and microfinance institution Micro Business Capital conducted webinars for young people on personal budgeting, savings, loans, insurance and financial security. In addition, a webinar on the key issues of financial education was organized by the Georgian Bankers' Association, which was attended by representatives of the NBG, TBC Bank, FINCA Bank Georgia and Liberty Bank. Bank of Georgia and TBC Bank were both eager to post a great deal of educational materials on saving, spending and money on their social networks, including videos, blogs, posts and quizzes. FINCA Bank, Credo Bank, Terabank and Basisbank were also pleased to share information about the week and pinpoint its significance.

The Youth National Palace of Georgia traditionally celebrated International Aflatoun Day to honor Money Week with the goal of raising public awareness about social and financial education. Webinars on history of money and financial security were held for young people during the week.

Webinars and training for young people were also conducted by Ilia State University's School of Business, Technology and Education, the Georgian Institute of Public Affairs and Junior Achievement Georgia. These meetings focused on a variety of topics, including money transformation, banking, savings, lending, and investments.

In total, more than 40 different types of projects were implemented during the week with the involvement of various organizations. Information about the week reached more than 1,230,000 customers across the country.[78]

Innovations Camp for Financial Education

We were happy to get involved in the Innovations Camp project together with Junior Achievement Georgia, for the fourth time. The event was co-sponsored and funded by five commercial banks – TBC Bank, Bank of Georgia, Liberty Bank, Basisbank and Credo Bank – and the microfinance institution Micro Business Capital, as part of the United States Agency for International Development's (USAID) project *"Supporting Entrepreneurial Education in Europe and Eurasia".*

The Innovations Camp is an intensive idea-generation event in which students work as a team on a specific business challenge and try to solve it using effective and innovative methods.

The 2021 event was titled *"Innovations Camp: Innovation in Financial Education"* and was dedicated to the challenges of financial education. The two-day event was held online and enjoyed attendance of over 100 young people aged 15 to 18 from the regions of Georgia. At the beginning of the event, participants listened to a lecture on financial education from the NBG. Next, they were given a situational task, which they worked on in teams during the day. During the work process, the teams had access to all necessary information and resources. In addition, they received necessary advice and consultations from invited experts from the banking and financial sector.

At the end of the event, the participating teams made presentations summarizing their ideas, and then a competent jury announced the winning team. Both the winners and other participants of the event were given symbolic gifts and certificates.

International Youth Day

The NBG, with the involvement of representatives of the financial sector, was happy to mark International Youth Day for the first time in 2021.

The United Nations General Assembly declared 12 August International Youth Day in 1999. Around the world this day is dedicated to discussing the problems facing young people, and dedicated to encouraging their ideas and initiatives.

An idea competition was announced as part of the event, where participants were asked to submit inno-

78. See https://globalmoneyweek.org/countries/142-georgia.html

vative projects to raise awareness about financial education among young people.

The final of the competition was held online on 12 August, International Youth Day, where the six finalists presented their ideas to a jury and answered their questions. The jury evaluated the contestants using the criteria set out in the terms of the competition and announced three winners.[79]

The winners were each awarded a GEL 1,000 voucher from partner organizations – including microfinance institution Swiss Capital, Credo Bank and the microfinance institution Eurocredit – and a *School of Young Entrepreneurs - YES Georgia* voucher from the Financial Inclusion Organization Crystal. The finalists were hosted by Koba Gvenetadze, Governor of the NBG, who handed over the prizes and certificates.

World Savings Day

The NBG celebrated World Savings Day for the tenth time in 2021. The event was supported by Basisbank, TBC Bank, Credo Bank, Liberty Bank and Bank of Georgia.

The goal of the World Savings Day is to raise awareness and encourage saving in children and young people. To celebrate the event in 2021, a competition was planned with the slogan *"Get Involved, Teach, Win!"* Anyone interested in disseminating financial education, including schoolteachers, had the opportunity to participate in the project. They attended a special webinar organized by the NBG, where they were given instructions for conducting a lesson on saving for students and were provided with teaching materials. Later on, educational meetings were held by the mentors and teachers for young people aged 12-15. They subsequently participated in the competition as well. The students discussed the challenges of saving and ways to solve them with the mentors, and presented their ideas to the jury. Based on the ideas presented, the jury announced 10 finalist teams that then competed against each other in an online quiz on 31 October, World Savings Day. Based on their correct answers, the five winning teams were announced live during a meeting on the Financial Education Facebook page.[80] Each member of the winning teams was awarded a deposit of GEL 300 by the supporting commercial banks, while the mentors were awarded a GEL 500 deposit.

In total, about 100 mentors and up to 2,000 young people were involved in the educational activities conducted within the framework of the event.

LOCAL AND INTERNATIONAL COOPERATION

Collaboration with members of the Steering Committee for the National Strategy for Financial Education

In 2021, the NBG held its sixth extended meeting of the National Financial Education Strategy Steering Committee, chaired by Koba Gvenetadze, Governor of the NBG. The meeting was held online and was attended by members of the committee, as well as representatives of the financial sector and other partner organizations.

The participants were provided with summary information on the financial education activities initiated and implemented by the NBG within five years after the approval of the National Strategy for Financial Education. At the end of the meeting, the members of the committee and the representatives of financial, public and international donor organizations discussed accomplishments and underlying challenges and agreed on the future format of cooperation.

Integrating financial education issues into the national curriculum: Cooperation with the Ministry of Education and Science, the German Sparkassenstiftung (DSIK) and the Civic Education Teachers' Forum

Supported by the German Sparkassenstiftung (DSIK) and the Civic Education Teachers' Forum, the NBG continued to implement the Civic Education Teacher Training Project in 2021, in connection with financial and economic literacy topics' integration into the national curriculum.

79. See https://www.facebook.com/finedu.gov.ge/videos/990574931767972
80. See https://www.facebook.com/finedu.gov.ge/videos/252643680164271

The goal of the project was to promote the professional development of teachers in economic and financial education, allowing teachers to plan and implement interactive lessons in consideration of the age characteristics of their pupils.

Up to 200 additional civic education teachers from different regions of Georgia were trained in 2021 using the training module and supporting training materials developed in 2020 as part of the project, which included the introduction of economic and financial issues in the 7th grade Citizenship curriculum.

Support materials for teachers were developed with the involvement of the Civic Education Teachers' Forum. These included integrating additional economic and financial issues into the 9th grade curriculum, including topics on financial organizations and services, insurance, international trade and economic integration, currency and exchange rates, investment, the economy and the state, the budget and taxes, consumer rights and responsibilities. These materials will be administered and published in 2022.

Representatives of the NBG and the Ministry of Education and Science of Georgia met in 2021 to discuss the National Curriculum on Financial Education, the approved 7th and 9th grade plans and the 10th-11th grade standard. The NBG is ready to continue providing advice and support materials on issues that will help schoolteachers to gain the necessary knowledge and information to educate their pupils on financial and economic issues.

Cooperation with the International Network on Financial Education of the Organization for Economic Cooperation and Development (OECD/INFE) and the Ministry of Finance of the Kingdom of the Netherlands

Work continued in 2021 on a five-year technical support project of the International Network on Financial Education of the Organization for Economic Co-operation and Development (OECD/INFE) and the Ministry of Finance of the Kingdom of the Netherlands. The project brings together seven Eastern European countries: Georgia, Bulgaria, North Macedonia, Moldova, Montenegro, Romania, and Croatia, aiming to support their central banks and other stakeholders in raising the level of financial education.

The project also includes an annual meeting of the states involved and the sharing of experiences. The first international conference conducted within the framework of this initiative was held in 2019 and was hosted by the NBG. The 2021 meeting was hosted by the Ministry of Finance of Bulgaria. The conference was attended by representatives of the participating countries, high-ranking Bulgarian public figures, as well as invited specialists and experts from different countries.

A two-day international conference titled “Consumer Finance and Financial Education in the Digital Age” was held online. Participants discussed access to and use of digital financial products by consumers.

The representative of the NBG shared the Georgian experience of the financial education, consumer protection and cybersecurity awareness-raising efforts that have been achieved through the FinEdu financial education portal (www.finedu.gov.ge).

Survey on financial education for micro, small and medium entrepreneurs

In cooperation with the International Network on Financial Education of the Organization for Economic Cooperation and Development (OECD/INFE), Georgia participated in the 2021 International Survey on Financial Education for Micro, Small and Medium Entrepreneurs. The survey was conducted based on the OECD/INFE methodology and involved 14 countries.

Research in Georgia was organized by the NBG, with the financial support of the European Foundation for Southeast Europe Development Facility (EFSE DF), and conducted by ACT research and consulting company. The survey covered 1,000 micro-, small- and medium-sized business owners across the country. Individuals who were directly involved in their company's financial decision-making process were interviewed. Organizations with an annual turnover of up to GEL 1.5 million and up to 50 employees were selected for the study.

The study assessed the level of financial education of micro, small and medium entrepreneurs by three components: knowledge, behavior and attitudes. The study looked at issues such as holding bank accounts by businesses, the level of digitization of transactions and the impact of the COVID-19 pandemic.

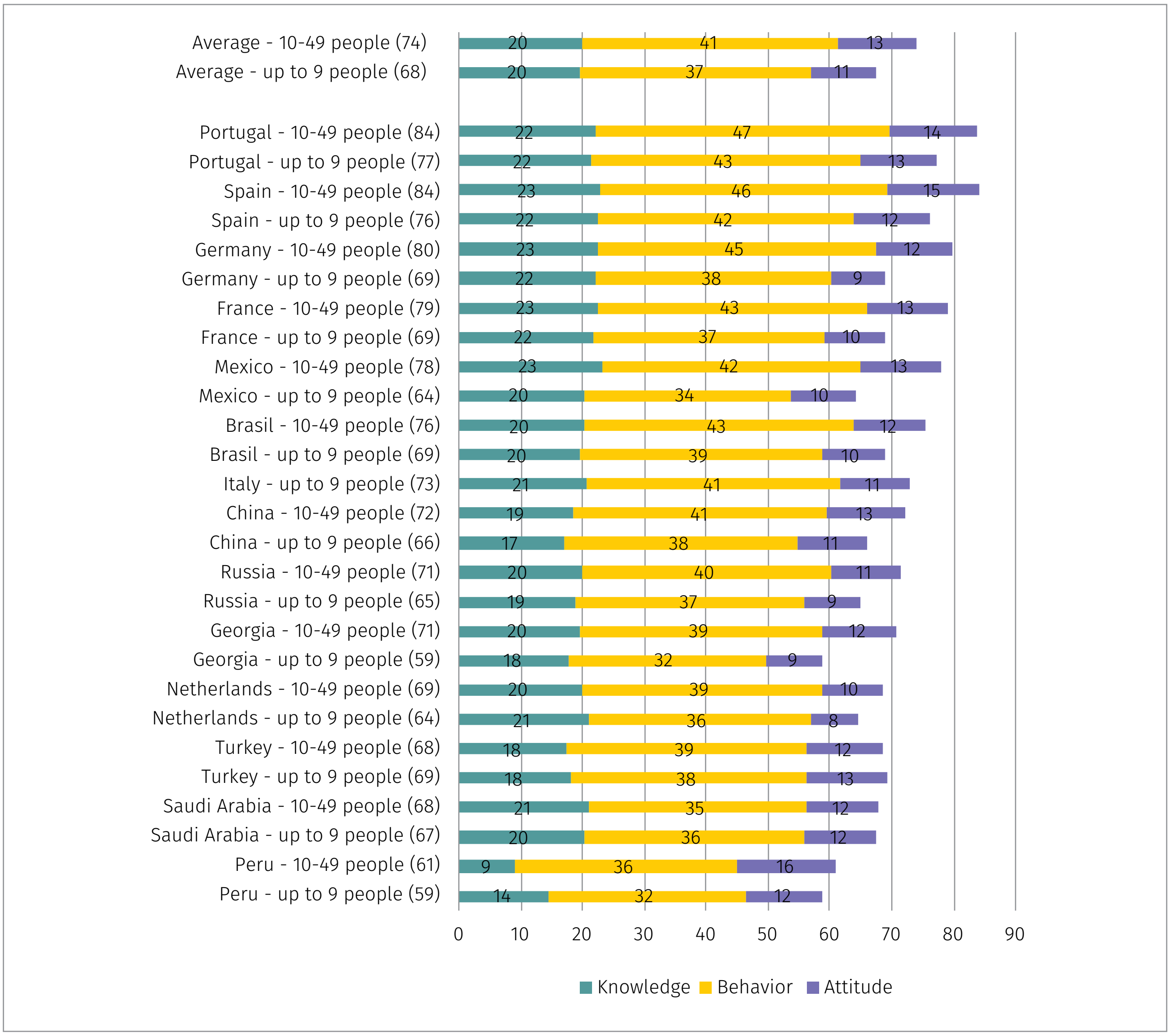
Level of Financial Education

According to the results of the survey, Georgia's financial education score on a 17-point scale was 10.3 points (60 %), which was lower than the average of the countries surveyed.

By individual components, Georgia's results were as follows: the financial literacy rate was 3.1 points (out of a maximum of 5), the financial behavior rate was 5.6 points (out of 9), the financial attitude rate was 1.6 points (out of 3). Businesses located in the capital showed higher results compared to the regions in all three components, and for the overall score of financial education.

The final results of the study were presented in a published report in terms of the number of staff employed by businesses.

DIAGRAM N 5.5 SURVEY ON FINANCIAL EDUCATION FOR MICRO, SMALL AND MEDIUM ENTREPRENEURS (FINANCIAL EDUCATION SCORE)



Source: OECD/INFE

** In Italy no data were collected on companies with 10-49 employees.*

The knowledge component was mainly based on knowledge of basic financial issues. It turned out that the majority of entrepreneurs in Georgia have a correct understanding of the notion of inflation, interest on loans, risk and return, and investing, although 41% misunderstand the content of dividends.

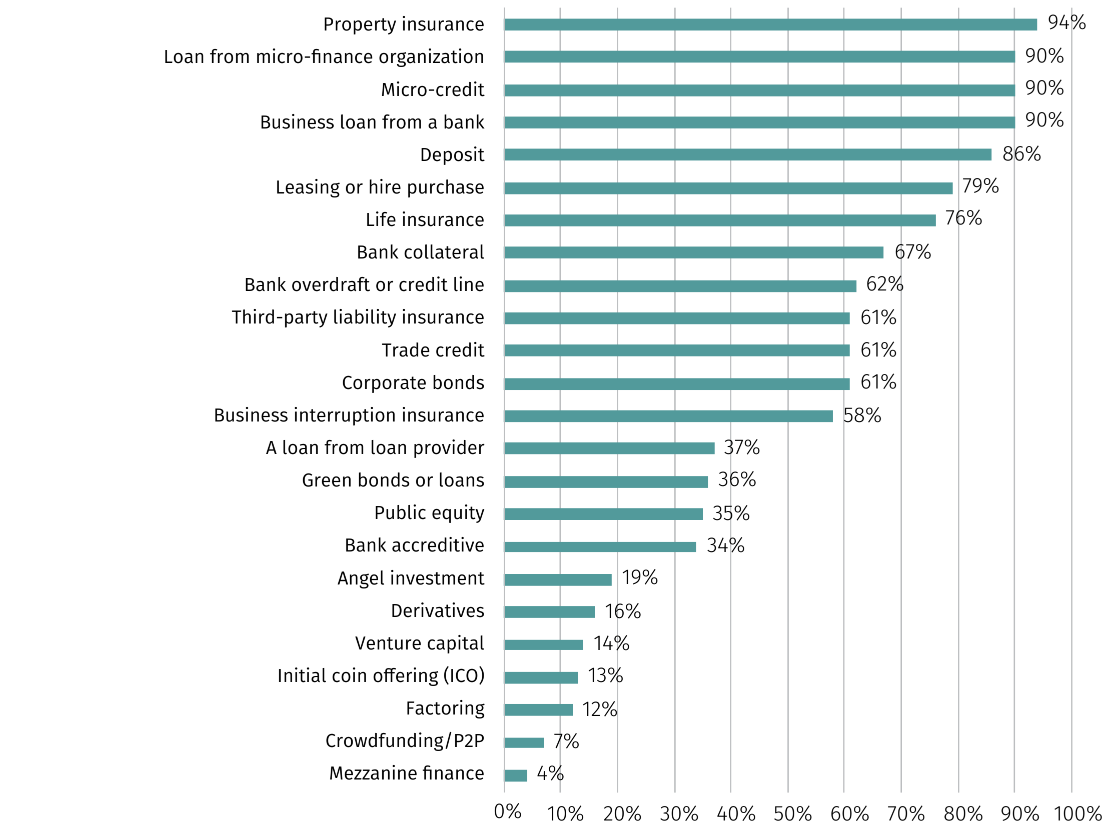
The behavioral component was based on business competencies in payments, accounting, finance, risk and insurance, financial security, business financing, and financial planning. It turned out that almost half of entrepreneurs have strictly separated business accounts and funds from their personal accounts and funds, some 23% have a separate account for business, but admit it is difficult to separate business funds and family funds, while some 28% use the same account for business and personal needs. When selecting a financial product for a business, more than half considered the offers of several suppliers. Half of the respondents thought about how they would support themselves financially after retiring. As for business management behaviors, 80% agree that their company's data and information security is fostered, 75% compare the cost of different sources of business financing before making a decision, and 79% undertake a business profitability forecast on a regular basis.

The component of financial attitudes was based on reasonable financial attitudes related to running a business. Some 71% found that they set long-term financial goals for their company and were striving to achieve them; however, 67% said that they preferred to follow their own instinct when running a company rather than developing detailed financial plans. Some 59% of entrepreneurs have faith and self-confidence in being able to attract finance for their business from banks or external investors.

Awareness and Use of Financial Products

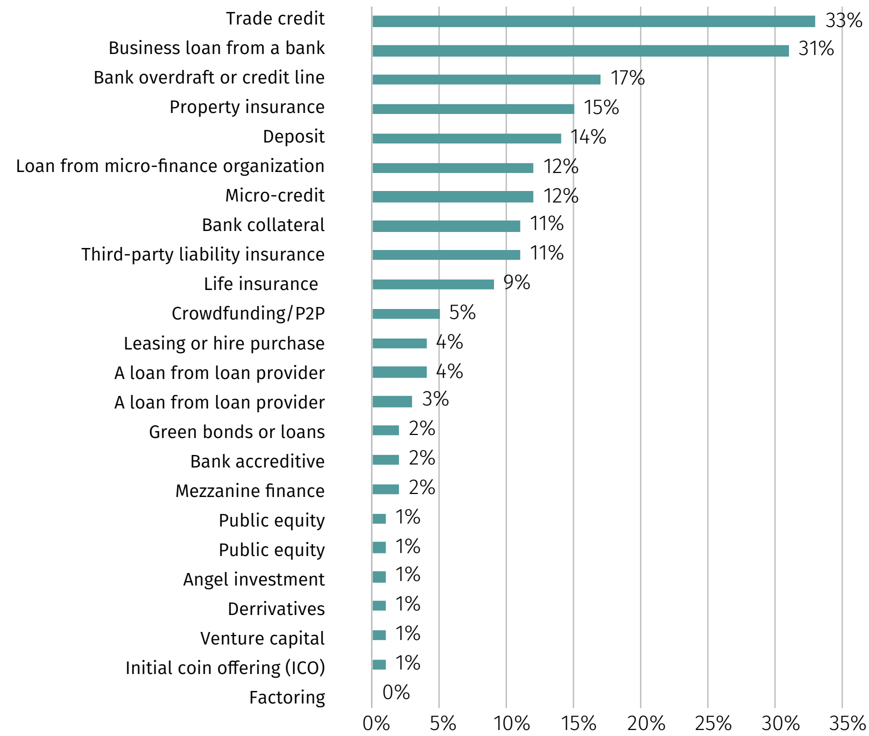
According to the survey, 75% of businesses surveyed have a bank account for their company's needs. As for their awareness of other financial products, rather high awareness was observed for the following financial products: property insurance (94%), micro-credit (90%), loans from microfinance institutions (90%), and business loans from a bank (90%). The most commonly used products were commodity loans (33%) and bank business loans (31%).

DIAGRAM N 5.6 AWARENESS OF FINANCIAL PRODUCTS



Source: ACT

DIAGRAM N 5.7 USE OF FINANCIAL PRODUCTS



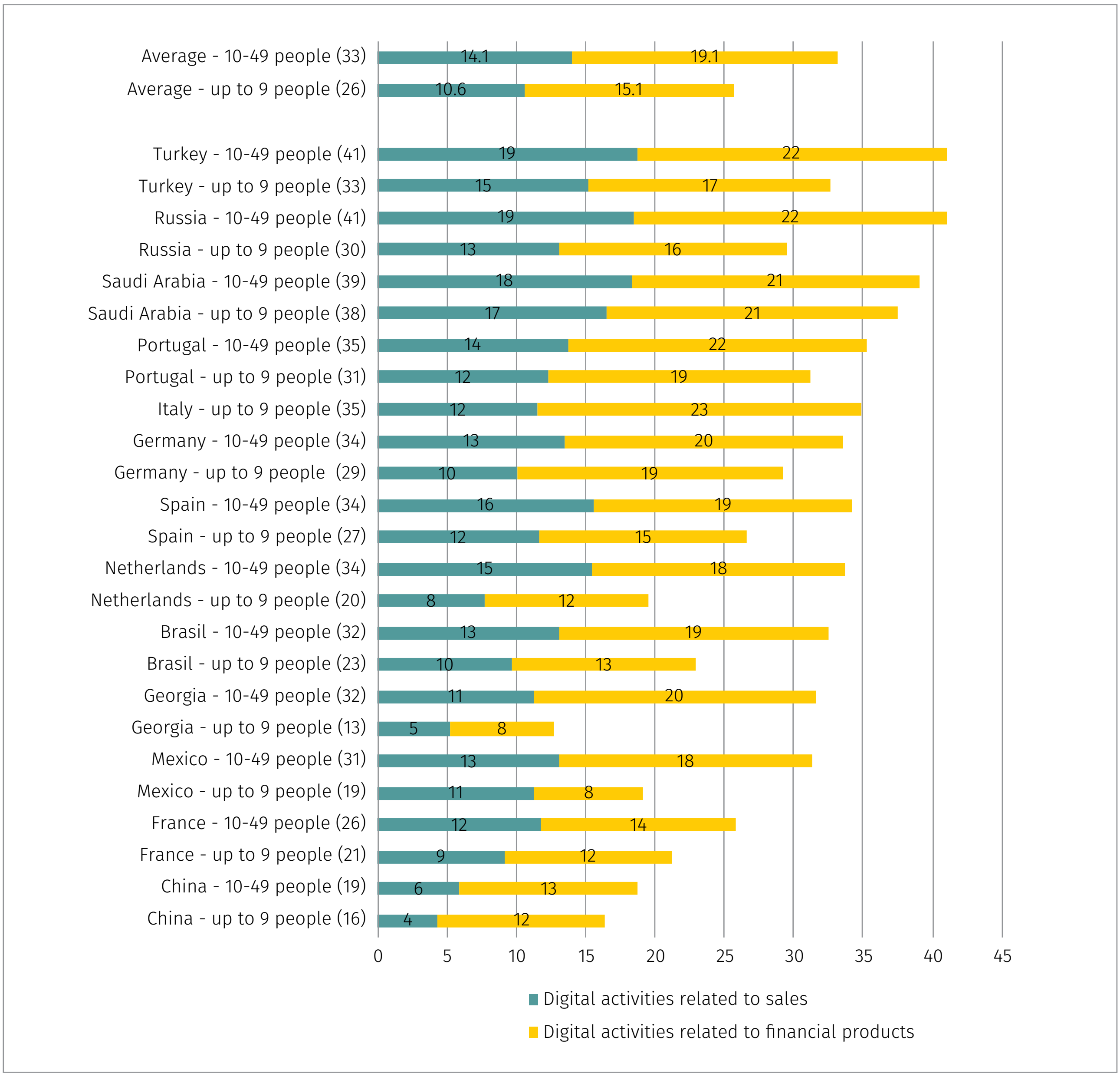
Source: ACT

Digitalization of Business

The study also describes the level of digitization of business-related transactions in the periods both prior to and after the pandemic. It turned out that before the pandemic (i.e., by the end of 2019), only 25% of businesses in Georgia had a special website describing their company's products or services. After the pandemic, this rate had increased by only 5 percentage points. In general, there have been no significant changes in online activities since the onset of the pandemic. This may also indicate that the use of online channels by small companies seeking to sell their products only happens on a small scale.

The digitalization score is based on indicators such as: a) online activities related to a business's financial products (e.g., opening a bank account remotely, signing a contract remotely, etc.); and b) online activities related to sales and operations (having a web presence, selling products through a webpage, etc.). Georgia has 13 points (out of 100 max) for digitalization for companies with up to nine employees and 32 points for companies with 10 to 50 employees. In the first case, the digitalization score is significantly lower than the average (of 26 points) of all countries, while in the case of companies with 10 to 50 employees it is almost equal to the average of other countries (of 33 points).

DIAGRAM N 5.8 SURVEY ON FINANCIAL EDUCATION FOR MICRO, SMALL AND MEDIUM ENTREPRENEURS (LEVEL OF DIGITALIZATION IN BUSINESS)



Source: OECD/INFE

** In Italy, no data were collected for companies with 10-49 employees.*

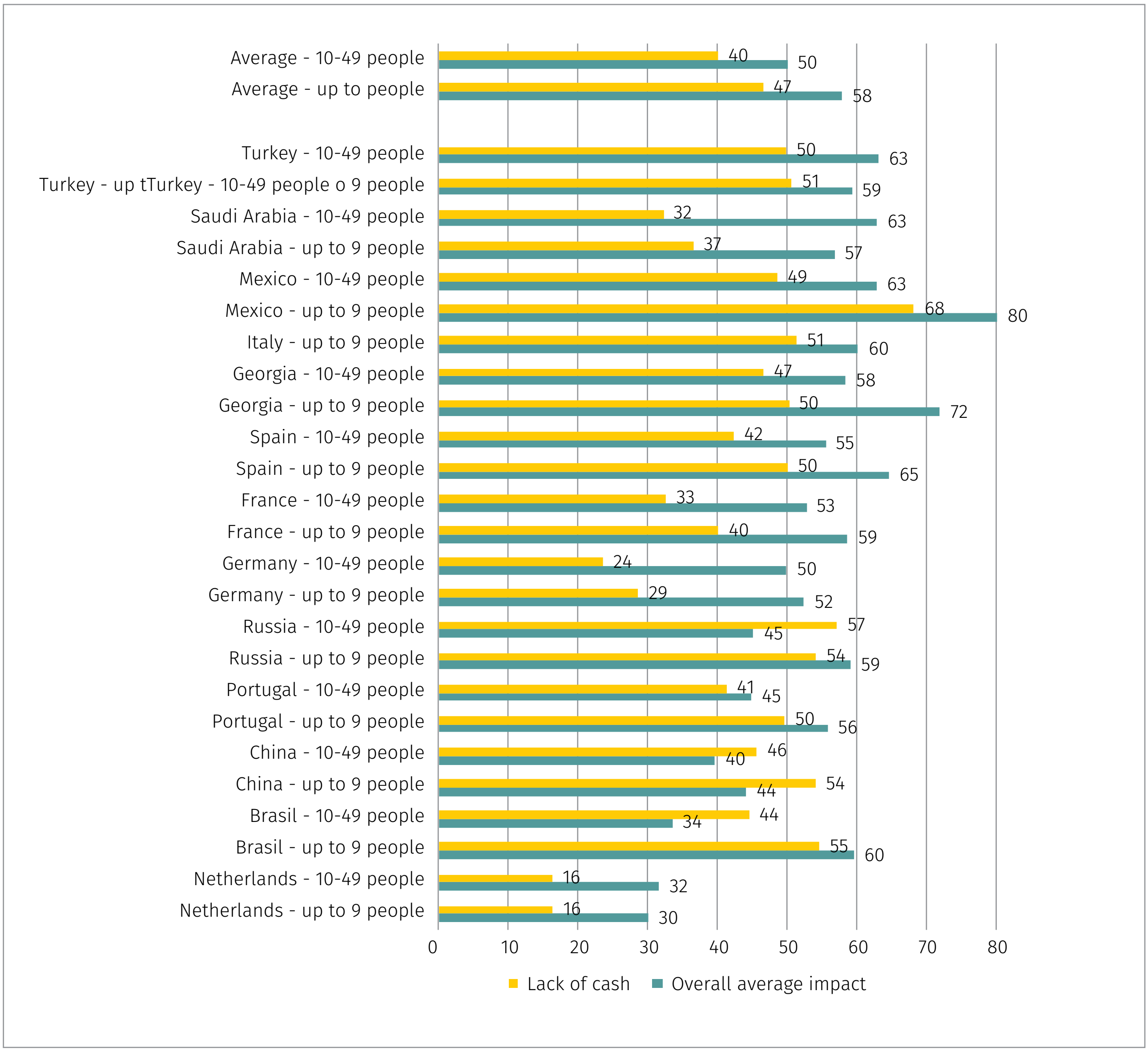
The impact of the COVID-19 Pandemic on Business

The study also examined the impact of the COVID-19 pandemic on various business indicators. It was found that COVID-19 had the greatest impact on business turnover and profitability. More specifically, 79% of entrepreneurs noted a significant decline in turnover and 81% stated that there was significant or generally declining profitability. The least effect of the pandemic was observed on a company's liabilities and number of employees. Fifty-two percent of entrepreneurs reported that their liabilities had not changed as a result of the pandemic, while 72% indicated that their number of employees had remained unchanged. Importantly, 38% of the surveyed businesses are self-employed (i.e., they do not have hired employees).

Nearly half of the entrepreneurs reported that after the onset of the pandemic, their business found itself in a situation where monetary income was not sufficient to cover their monetary liabilities or the expected costs of their business. To solve this problem, 46% reduced their operating costs, 38% used the owner's personal/family funds or credit, and 38% temporarily suspended their business.

As for the need for business loans, one-fifth of companies applied for a loan after the start of the pandemic, of which 66% received the full amount requested. Of those who did not apply for a loan, 64% said they did not need it.

DIAGRAM N 5.9 SURVEY ON FINANCIAL EDUCATION FOR MICRO, SMALL AND MEDIUM ENTREPRENEURS (IMPACT OF THE COVID-19 PANDEMIC ON BUSINESS)



Source: OECD/INFE
** In Italy, no data were collected on companies with 10-49 employees.*

CURRENT PROJECTS

Financial Game

In 2021, the NBG initiated a financial game project under the auspices of the European Fund for Southeast Europe Development Facility (EFSE DF). After the idea was developed and market research was undertaken, a software development company was selected and work commenced at the end of the year.

The project entailed the creation of a business simulation game to be made available on the web platform, as well as in the form of mobile phone applications (iOS, Android). The game would allow players to draw parallels with their own reality and to make informed financial decisions that would affect their wellbeing.

The aim of the project is to raise the awareness of financial education among the citizens and to let them learn through playing the game, so that they can better plan and manage their personal finance in real life. The game is targeted at a wide audience and will be interesting for users of any age.

The project is scheduled to be completed and presented to the public by 2022.

Facebook Live Series – Business Talks

In 2021, the NBG came up with an idea of a series of live engagement projects on the FinEdu Facebook page to raise financial education for micro-, small- and medium-sized businesses. The sequence of the topics discussed during the live sessions follow the logic of the general business cycle (business idea, starting a business, running a business, etc.). The selected topics are related to the decisions made by entrepreneurs at different times that directly or indirectly affect the financial stance of their businesses. The meetings are meant to focus on issues that need to be improved according to the 2021 survey on financial education for micro, small and medium entrepreneurs.

Experts in respective industries will be invited to act as speakers at the meetings. At the end of the session, the speakers will answer the questions of the audience.

The mission of the project is to show start-up entrepreneurs, micro and small business owners, as well as other stakeholders, that there are financial consequences for any business activity and decision, be it starting a business, expanding it, borrowing, or opening a deposit; to emphasize that any activity may entail benefits or losses. The project aims to deliver seemingly difficult matters to stakeholders in a light and accessible way, to promote the formation of reasonable attitudes towards finance in the target segment and to stimulate interest. Financial issues are an integral part of life and business, and it is thus beneficial and necessary to reflect on them, find reasoning and discuss them.

The project is scheduled to launch in the second quarter of 2022.

06

NON-BANKING SUPERVISIO

6.1 REGULATION OF THE NON-BANKING SECTOR AND THE REGULATORY FRAMEWORK

The microfinance sector faced the negative consequences of the COVID-19 pandemic well prepared. The experience gained in 2020 proved to be effective in 2021. Despite the underlying risks and challenges, the growth of the sector did not slow down. The share of the non-bank financial sector in the total financial sector was 3.3% in 2020 and remained at almost the same level in 2021 (3.4%).

Importantly, there is increased trust and interest in the non-banking sector, which has been further evidenced by the increased funding from non-resident institutional lenders. In such a capacity, the microfinance sector was provided with high level capital and liquidity.

To provide enhanced access of the microfinance sector to GEL resources, the liquidity support instruments developed by the NBG in 2020 were maintained during 2021: a USD 200 million swap instrument and commercial bank loans offered within the scope of the set loan portfolio criteria. Importantly, these instruments contributed to the stability of the value of funds, which was positively assessed by the sector.

The launch of the NBG's Remote Supervision Portal for Non-Banking Institutions provided instant remote communication with non-banking entities during the pandemic and made it more flexible and reliable to obtain information from them.

In 2021, amendments were also made to the Regulation on the Registration, Cancellation of Registration, and the Regulation of Lending Entities by the NBG, with the purpose of defining standards and requirements for the operational risks of lending entities. More specifically, requirements were defined in terms of operating software and accounting practice. The standards for the treatment and storage of collateral (jewelry, equipment, etc.) were defined for secured loans. The establishment of these standards will contribute to the sound, continuous functioning of the sector and will enhance its reputation in the market.

Notwithstanding the pandemic, non-banking institutions were intensively inspected during 2021 in order to ascertain compliance with the current legislation and to determine the accuracy of the reporting data submitted to the NBG.

In view of the pandemic, intensive meetings were held online during the year with representatives of the sector, both to share news and to exchange information about the challenges facing the sector.

6.2 NON-BANK FINANCIAL INSTITUTIONS

As of 31 December 2021, the non-bank financial sector was represented by 38 microfinance institutions (385 branches), 183 lending entities (345 branches), 561 currency exchange bureaus (732 branches) and one credit union.

The total assets of the non-bank financial sector amounted to GEL 2 billion, of which the largest share – GEL 1.6 billion – is taken by the microfinance sector.

6.2.1 MICROFINANCE INSTITUTIONS

Two microfinance institutions were liquidated in 2021, however, due to their insignificant market share, this did not have a considerable impact on the sector's performance.

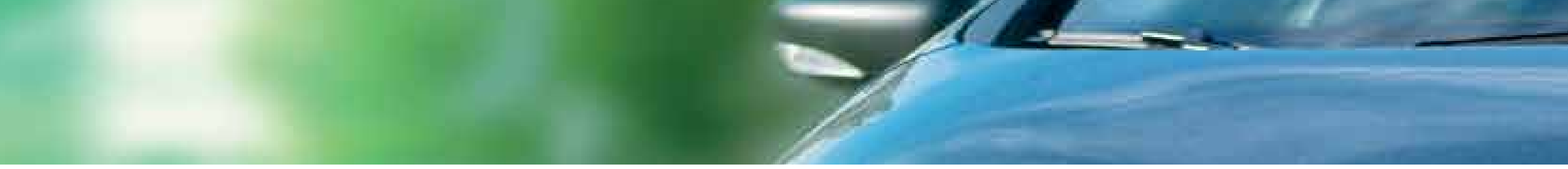
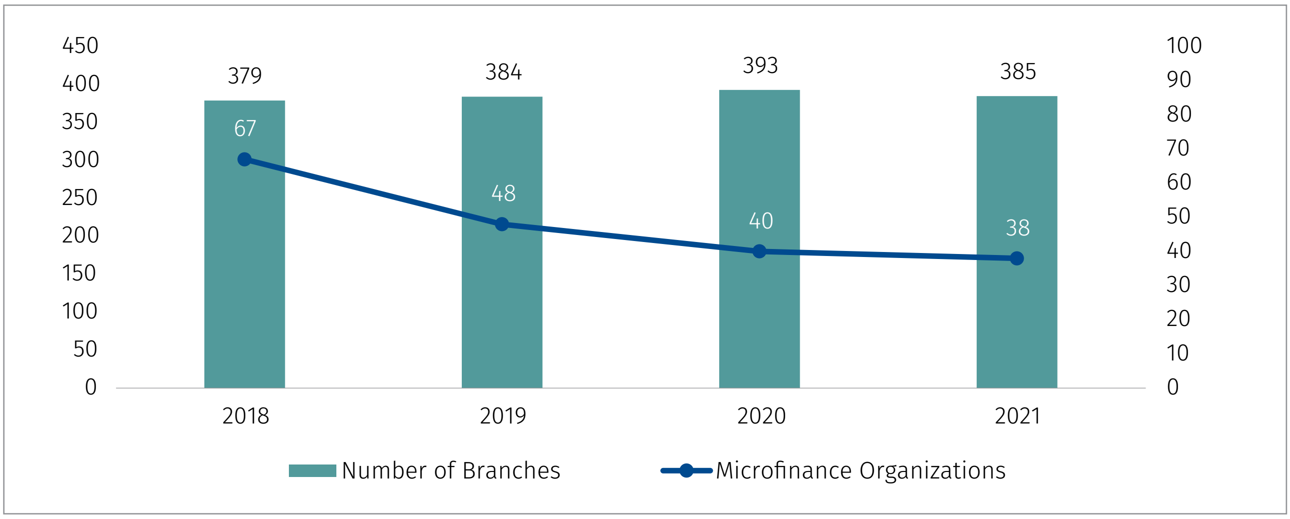


DIAGRAM N 6.1 NUMBER OF MICROFINANCE INSTITUTIONS AND BRANCHES

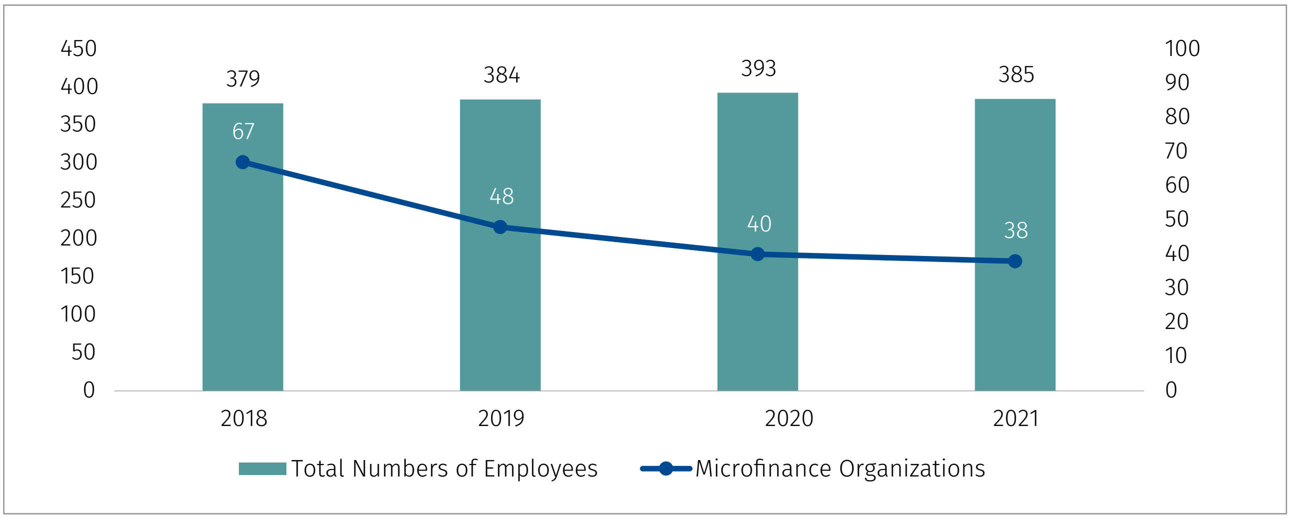


Source: NBG

Due to the pandemic, some institutions reduced their number of branches in order to optimize costs; however, the overall effect of this was not material as certain microfinance institutions opened new branches.

It is important to note that, despite the reduction of branches, the total number of employees has not been reduced.

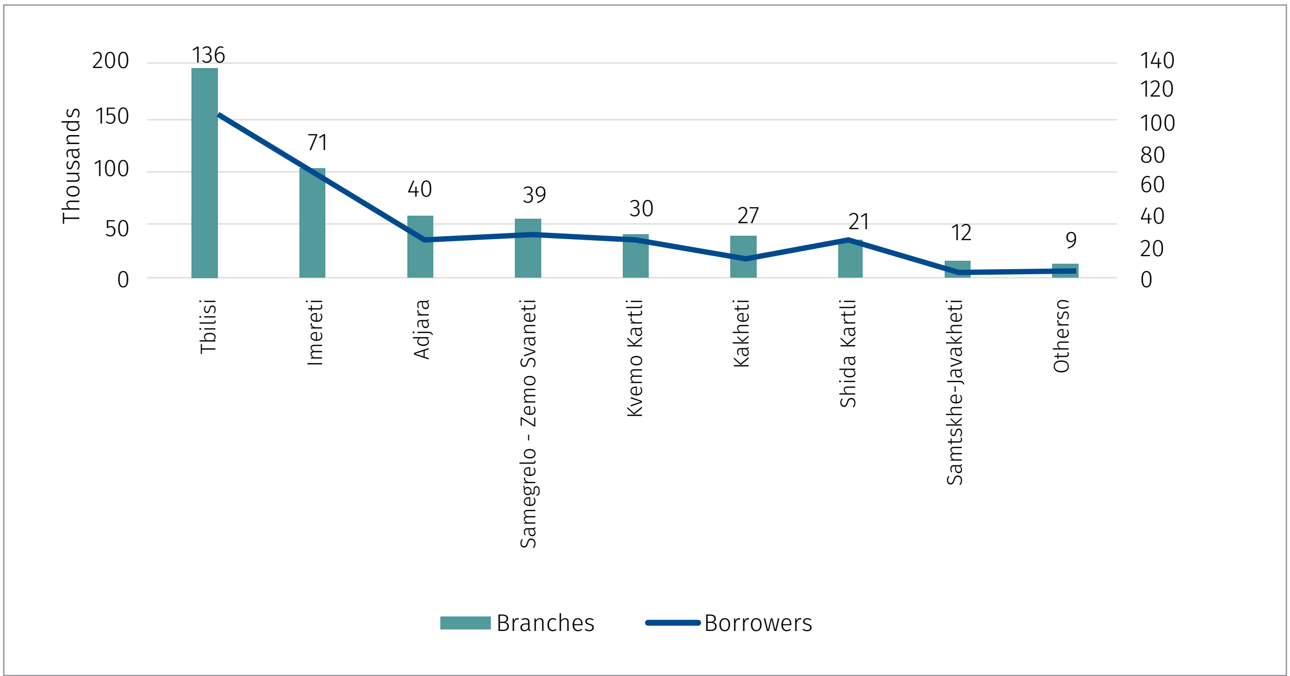
DIAGRAM N 6.2 NUMBER OF STAFF AT MICROFINANCE INSTITUTIONS



Source: NBG

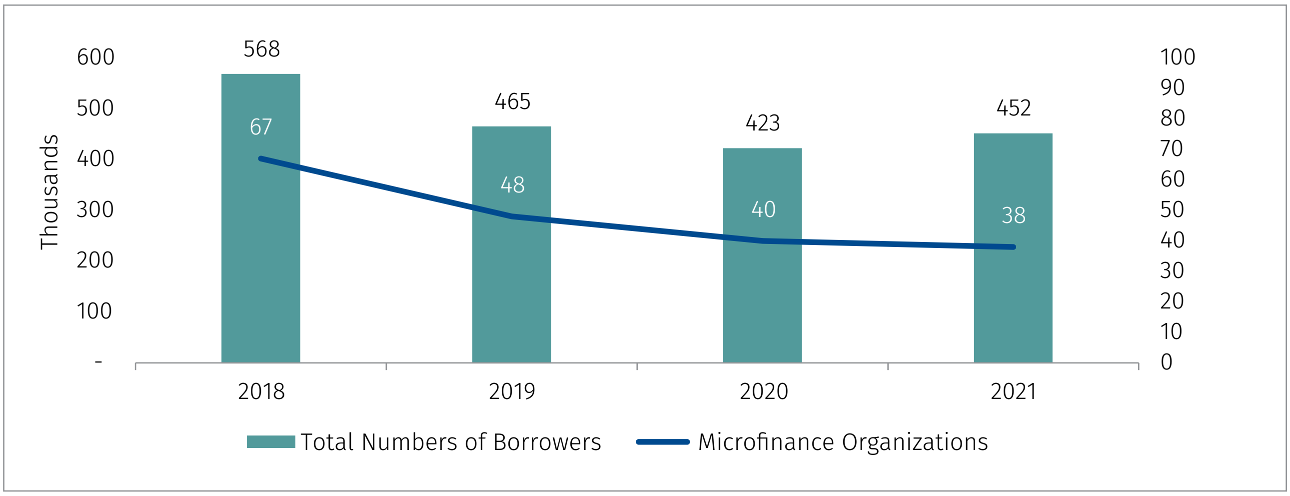
The share of the microfinance sector in the overall financial system is small (2.6%), but its role in access to finance is important. Regional coverage is high, both in terms of the number of branches and number of borrowers (30% and 20% of the system, respectively).

DIAGRAM N 6.3 REGIONAL DISTRIBUTION OF THE BRANCHES AND BORROWERS OF MICROFINANCE INSTITUTIONS



Source: NBG

DIAGRAM N 6.4 NUMBER OF MICROFINANCE INSTITUTIONS AND BORROWERS



Source: NBG

Despite the onset of the COVID-19 pandemic and the liquidation of two microfinance institutions, the loan portfolio maintained its growth trend (annual growth rate of 15%), rising to GEL 1.36 billion.

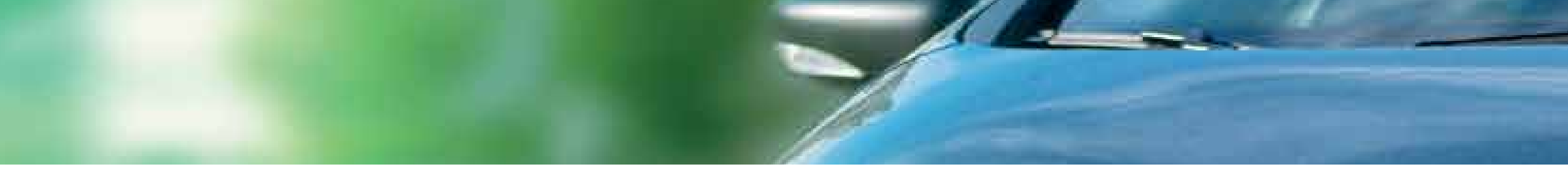
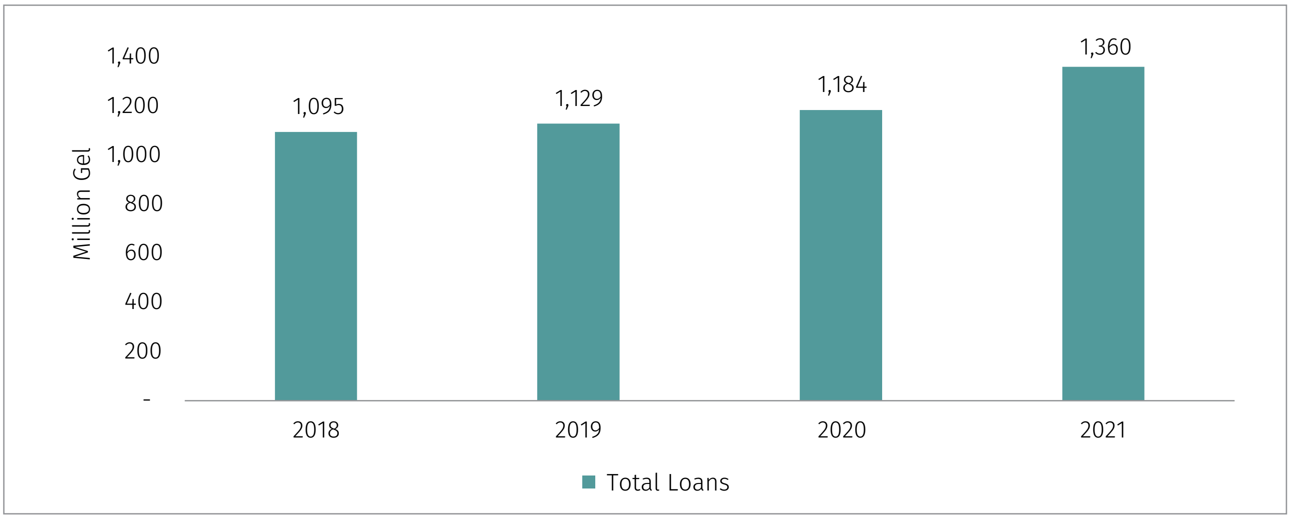


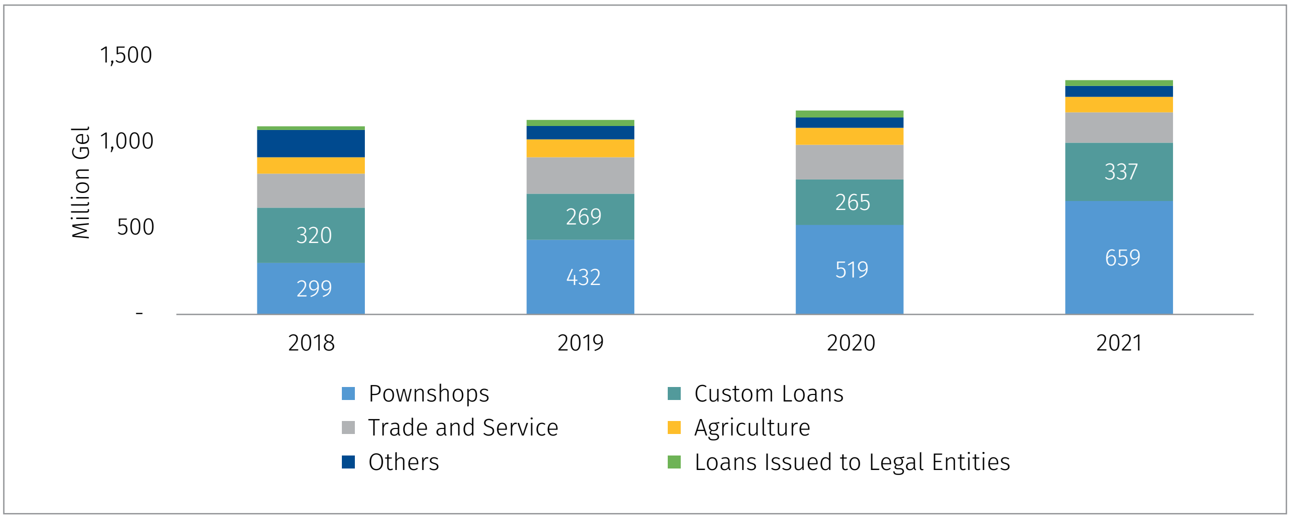
DIAGRAM N 6.5 VOLUME OF THE LOAN PORTFOLIO OF MICROFINANCE INSTITUTIONS



Source: NBG

Consumer loans to individuals is the main focus of lending in the microfinance sector, accounting for 78% of the sector's total loan portfolio, amounting to GEL 1.06 billion. The remaining 22% comes from loans issued to the business and agriculture sectors, amounting to GEL 300 million.

DIAGRAM N 6.6 STRUCTURE OF THE LOAN PORTFOLIO

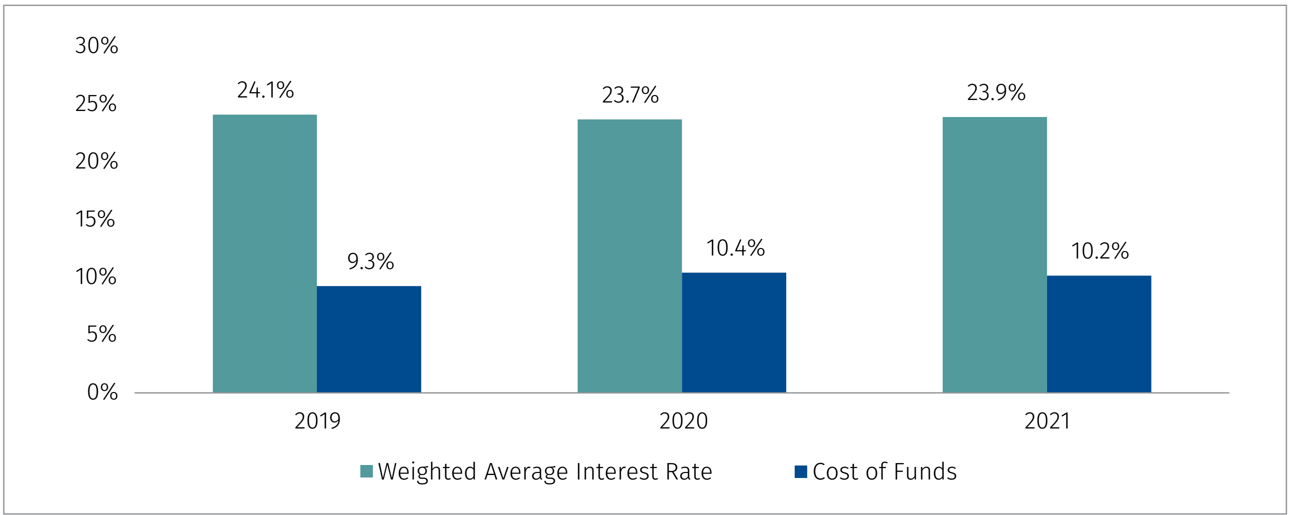


Source: NBG

Significantly, material growth in the sector was driven by a 26% increase in the consumer portfolio, totaling GEL 216 million. Meanwhile, the business and agriculture sectors declined by 11.8%, amounting to GEL 40 million.

With the launch of the NBG's liquidity support instruments, microfinance institutions managed to keep their cost of funds at pre-pandemic levels, leading to stable weighted average interest rates on loans.

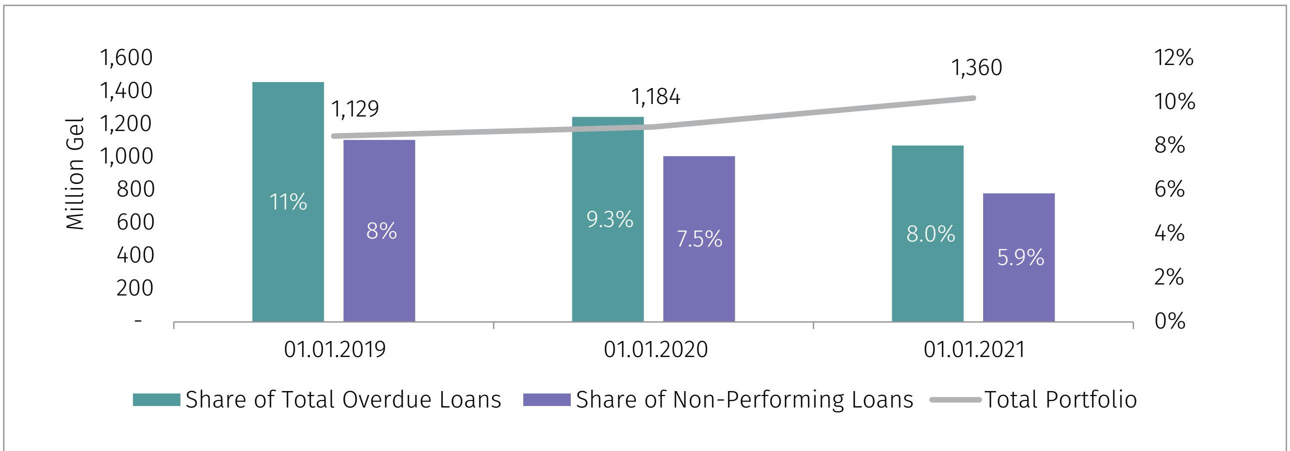
DIAGRAM N 6.7 COST OF WEIGHTED AVERAGE INTEREST RATES AND FUNDS IN THE PORTFOLIO



Source: NBG

Despite the COVID-19 pandemic, the quality of the loan portfolio improved compared to last year: the share of non-performing loans in the total portfolio decreased from 7.5% to 5.9%, while the share of overdue portfolios shrank from 9.3% to 8%. This was affected by the reduction of non-performing loans as well as by new disbursements. The total portfolio reserve remained within a moderate 6%.

DIAGRAM N 6.8 QUALITY OF THE LOAN PORTFOLIO



Source: NBG

The structure of the portfolio remained unchanged in terms of collateral: unsecured loans and those disbursed with a warranty had a 25% share in the total portfolio.

After the prohibition of issuing loans to individuals in foreign currency up to the equivalent of GEL 200,000, as under the amendments to Article 625 of the Civil Code of Georgia, the share of foreign currency-denominated loans in the total portfolio considerably declined.

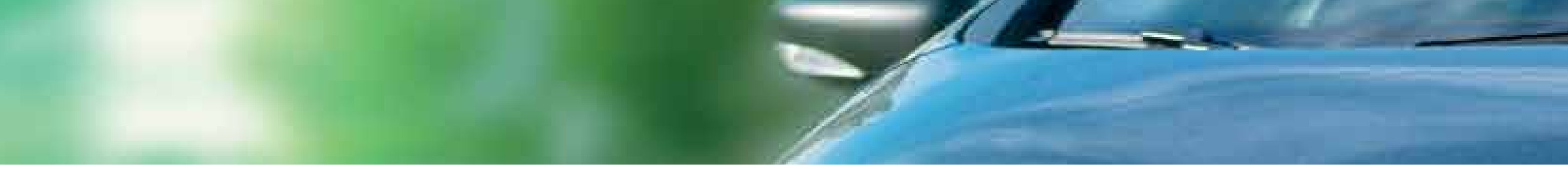
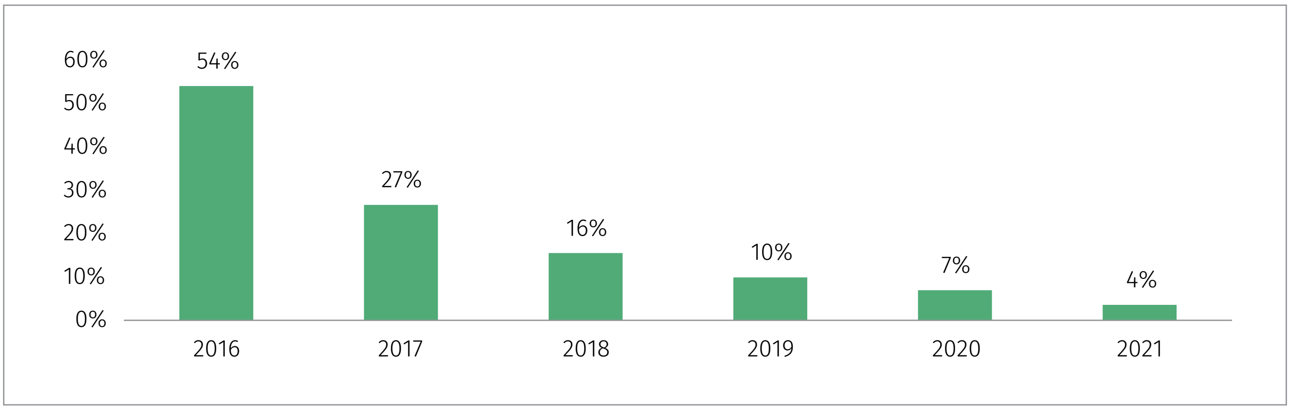


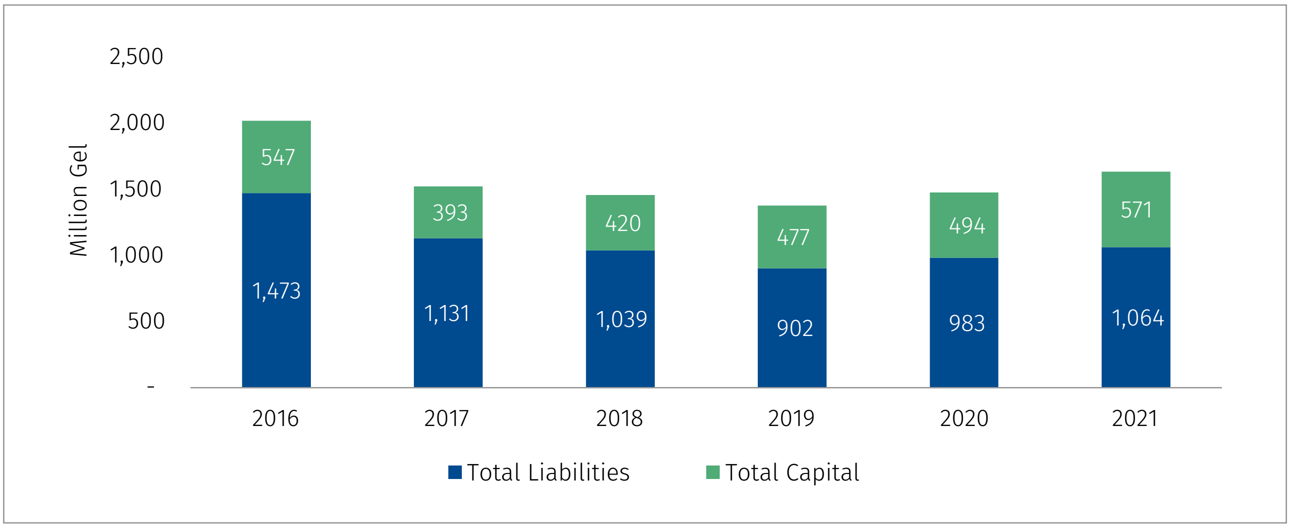
DIAGRAM N 6.9 DOLLARIZATION OF THE LOAN PORTFOLIO



Source: NBG

Changes to the structure of funding were insignificant. Due to the increase in capital, the share of liabilities in total funding has been reduced by 2 percentage points to 65%.

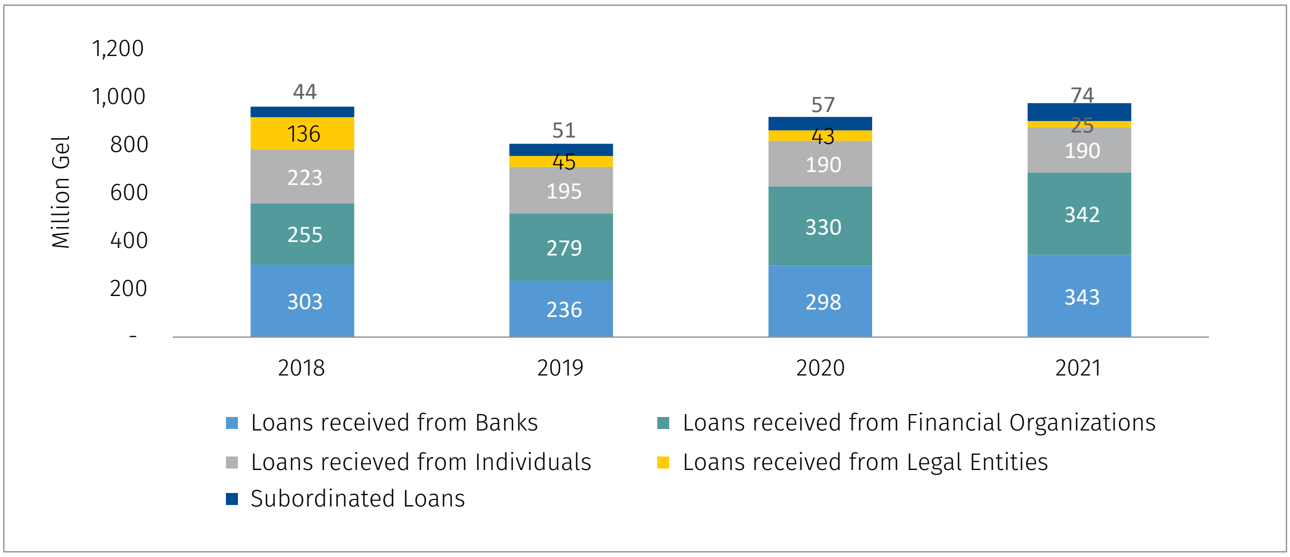
DIAGRAM N 6.10 SOURCE OF FUNDING



Source: NBG

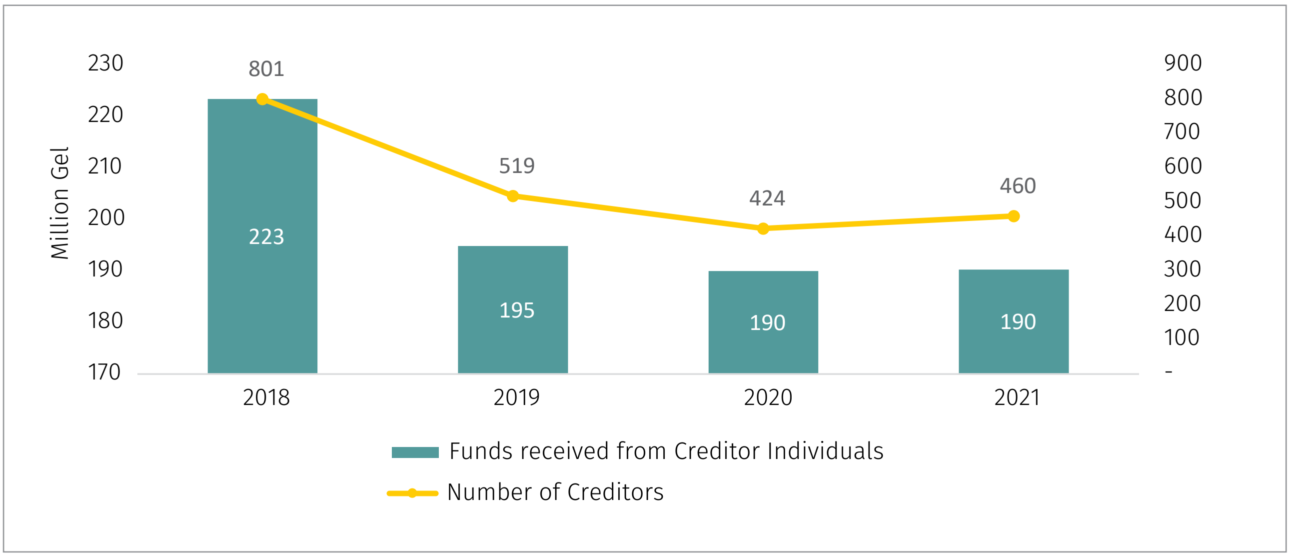
Borrowings increased by GEL 57 million to GEL 975 million in 2021. Significantly, borrowings from individuals did not increase in 2021, which was similar to previous years, while resources from banks and financial institutions grew.

DIAGRAM N 6.11 STRUCTURE OF BORROWINGS



Source: NBG

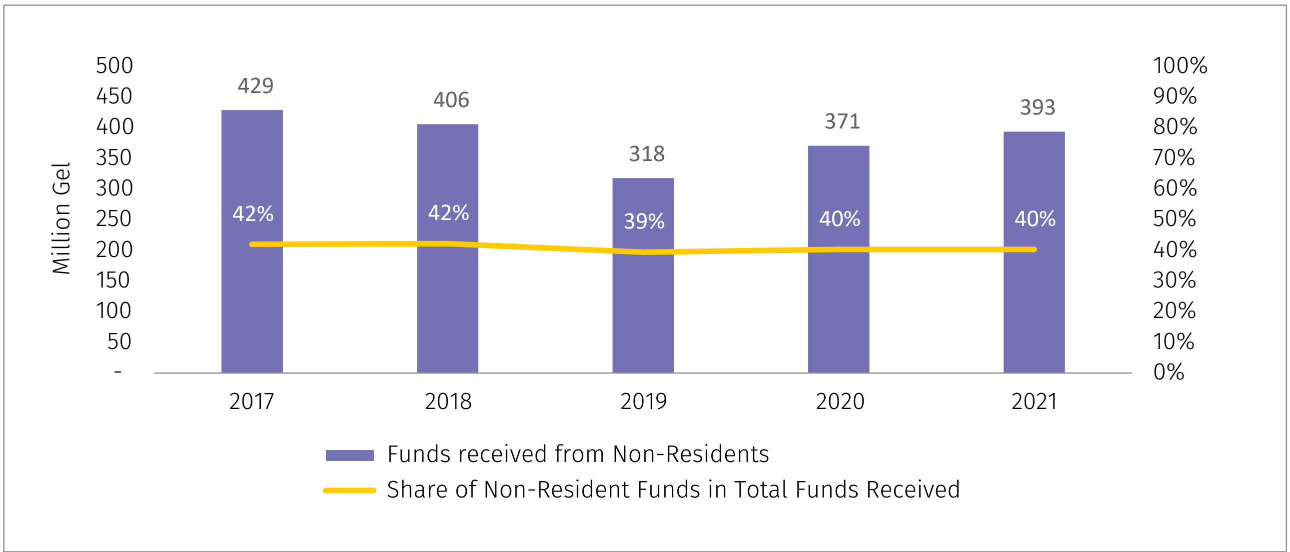
DIAGRAM N 6.12 BORROWINGS FROM INDIVIDUALS AND THE NUMBER OF INDIVIDUAL CREDITORS



Source: NBG

Borrowings from non-resident entities increased by GEL 22 million, although the ratio of borrowings from resident and non-resident entities remained the same as in the previous year.

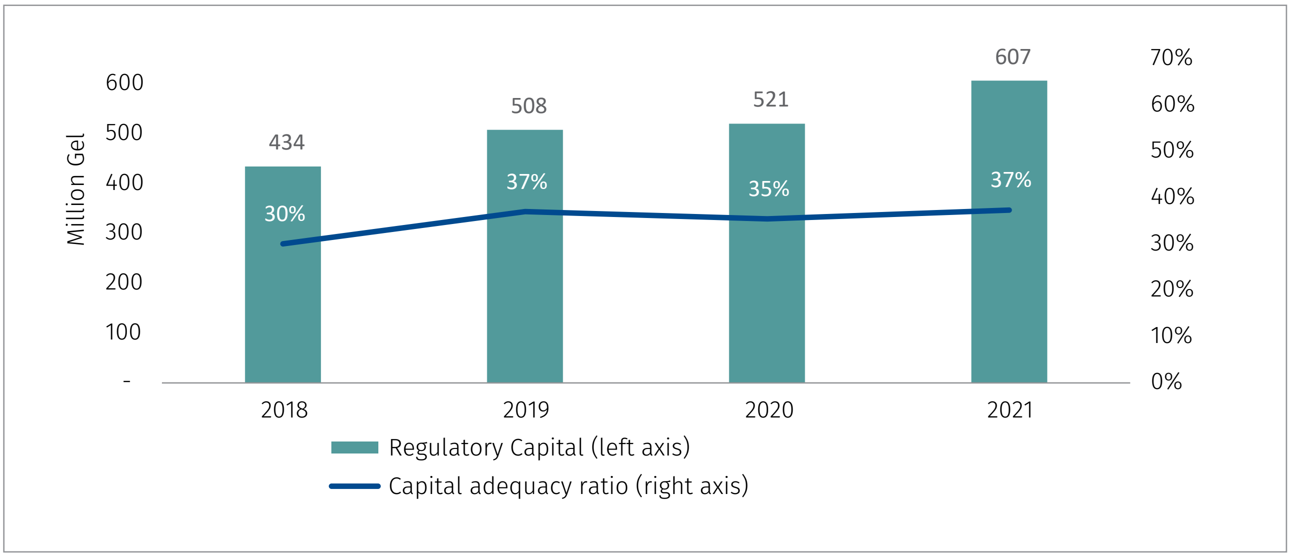
DIAGRAM N 6.13 NON-RESIDENT FUNDS



Source: NBG

Following the regulatory reforms, the microfinance sector faced the pandemic in a highly capitalized state. Adequate levels of capital served to cushion the adverse effects of the pandemic.

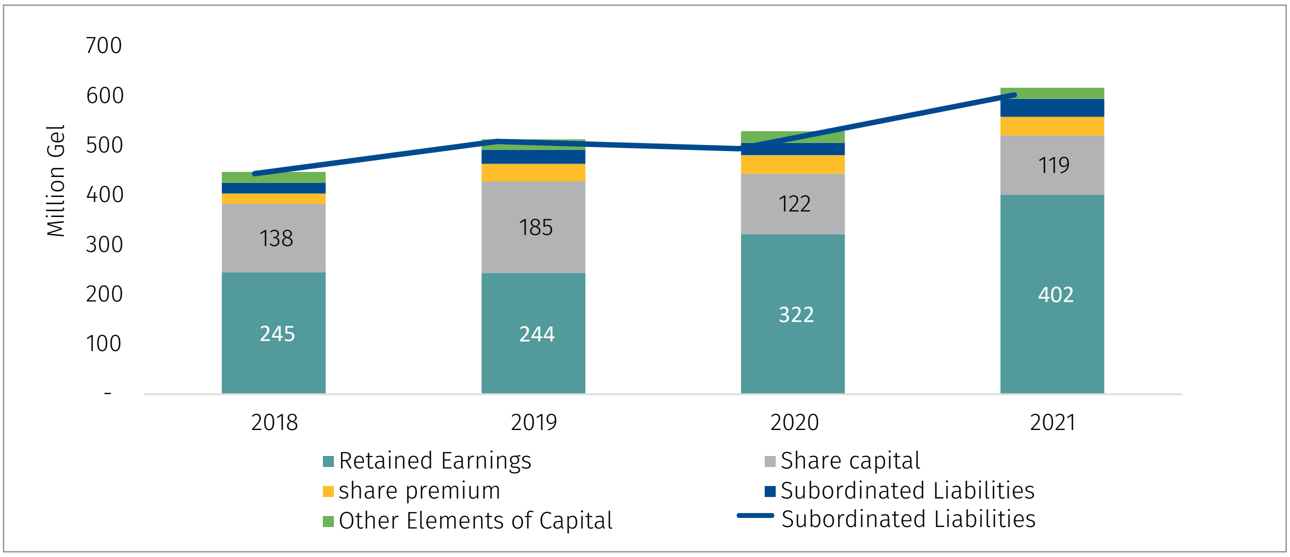
DIAGRAM N 6.14 REGULATORY CAPITAL



Source: NBG

In spite of the effects of the pandemic and the liquidation of two microfinance institutions, the sector's regulatory capital increased by 17% to GEL 86 million in 2021, at the expense of increased retained earnings and subordinated loans.

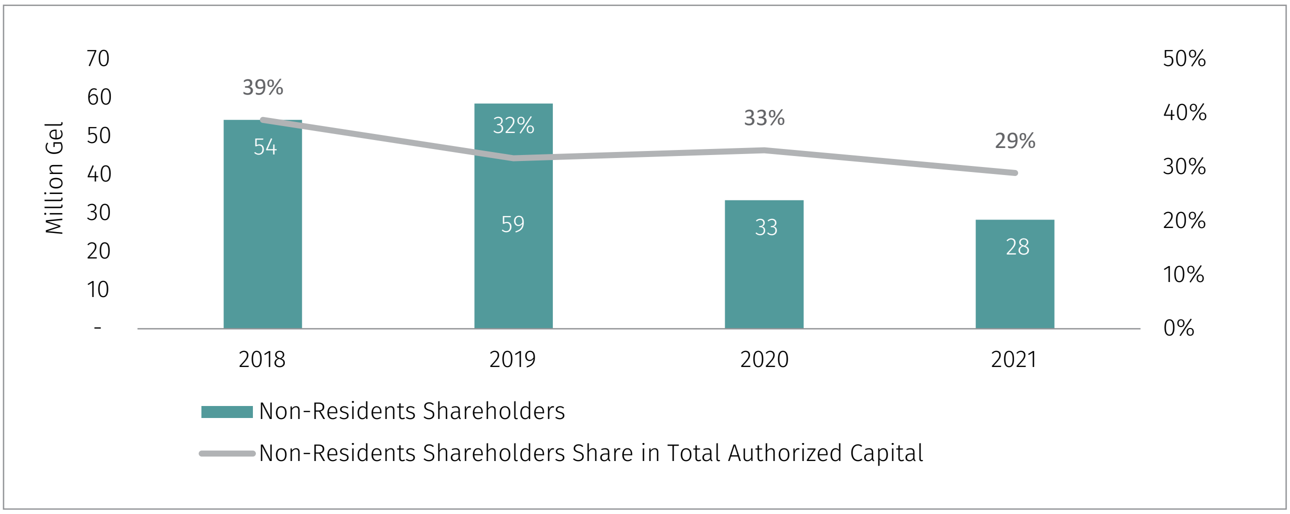
DIAGRAM N 6.15 STRUCTURE OF REGULATORY CAPITAL



Source: NBG

The reduction of the share of non-resident shareholders in the share of capital from 33% to 29% was mainly the effect of liquidation.

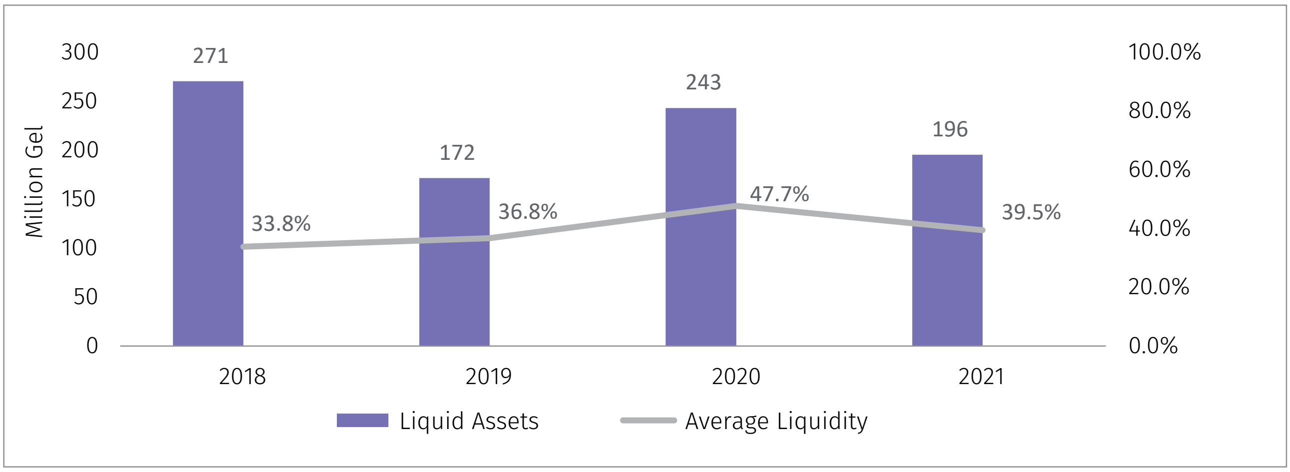
DIAGRAM N 6.16 CAPITAL STRUCTURE BY RESIDENCY



Source: NBG

Regulatory changes led to the accumulation of liquidity buffers in the sector. It is important to note that, despite the decline in liquid funds due to the growth of the loan portfolio, the sector still maintains a high level of liquidity.

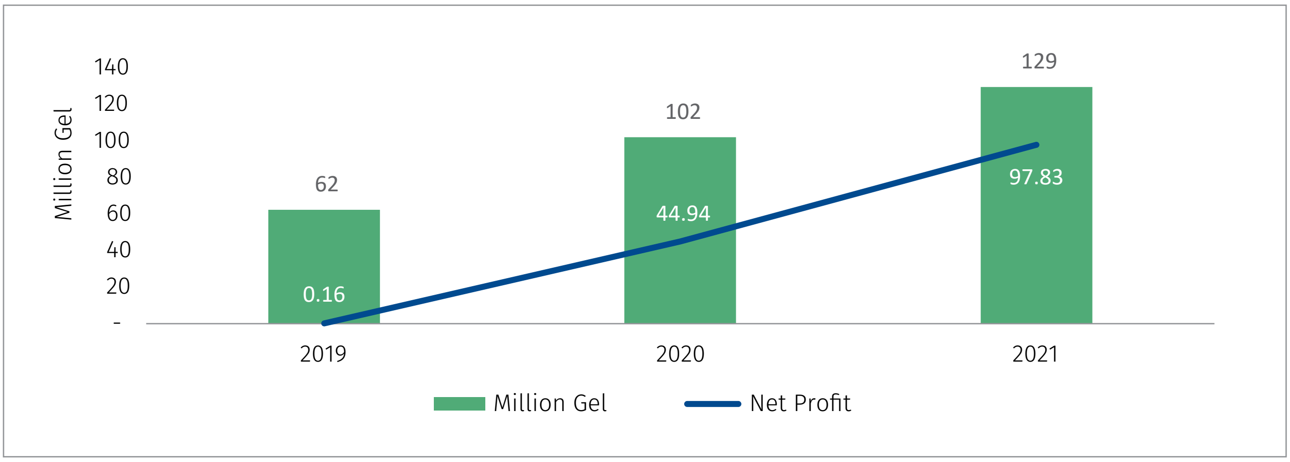
DIAGRAM N 6.17 STRUCTURE OF LIQUID FUNDS



Source: NBG

In 2020, the NBG developed additional liquidity support tools for microfinance institutions: a USD 200 million currency swap and the SME liquidity provision tool, which was an opportunity for microfinance institutions to borrow from commercial banks within the scope of an established loan portfolio. These tools remained popular in 2021, contributing to the stability of the cost of funds, and were positively assessed by the sector. The vast majority of microfinance institutions ended 2021 with a profit.

DIAGRAM N 6.18 DYNAMICS OF NET AND OPERATIONAL EARNINGS



Source: NBG

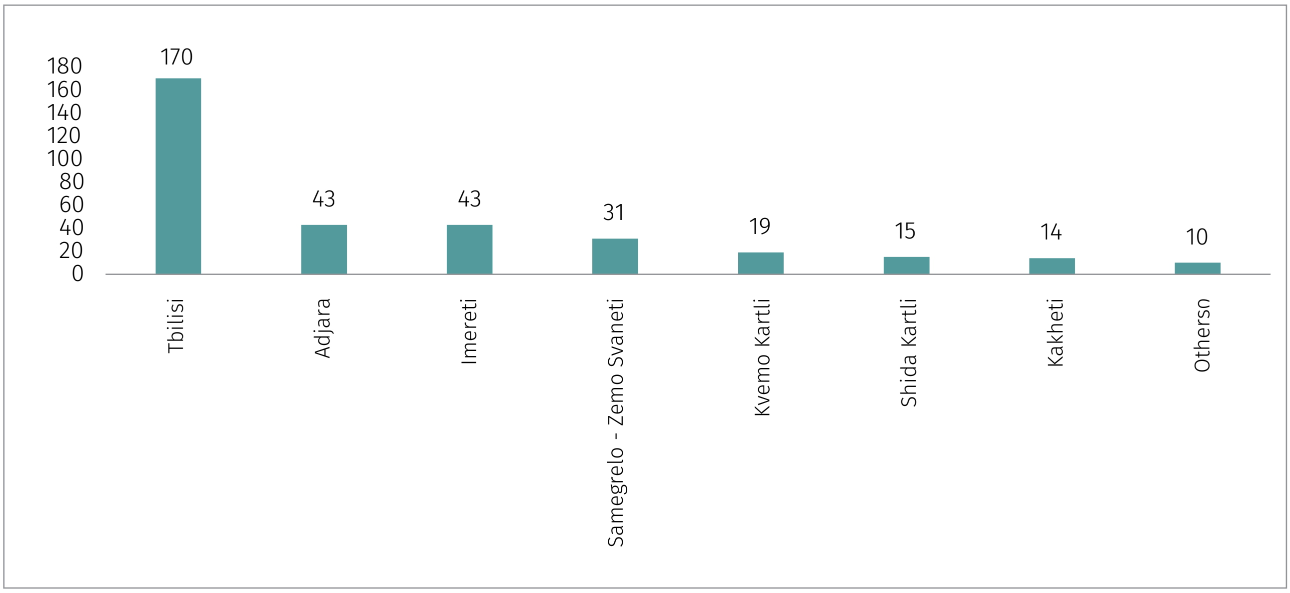
The high growth rate of the loan portfolio led to operating profits of GEL 129.3 million, which was 27% higher than the previous year. The net profit amounted to GEL 98 million.

The sector's profitability was reflected in an increase in the return on equity, which was up by 8 percentage points YoY to 18%. Return on assets also increased and stood at 6%. The increase in profitability was influenced by several factors, including the stability of the cost of funds, the growth of the loan portfolio and the improvement of quality.

6.2.2 LENDING ENTITIES

In 2021, 10 new lending entities were registered while 25 had their registration revoked. Accordingly, as of 31 December, there were 183 registered lending entities, which had branches in 345 locations across the country.

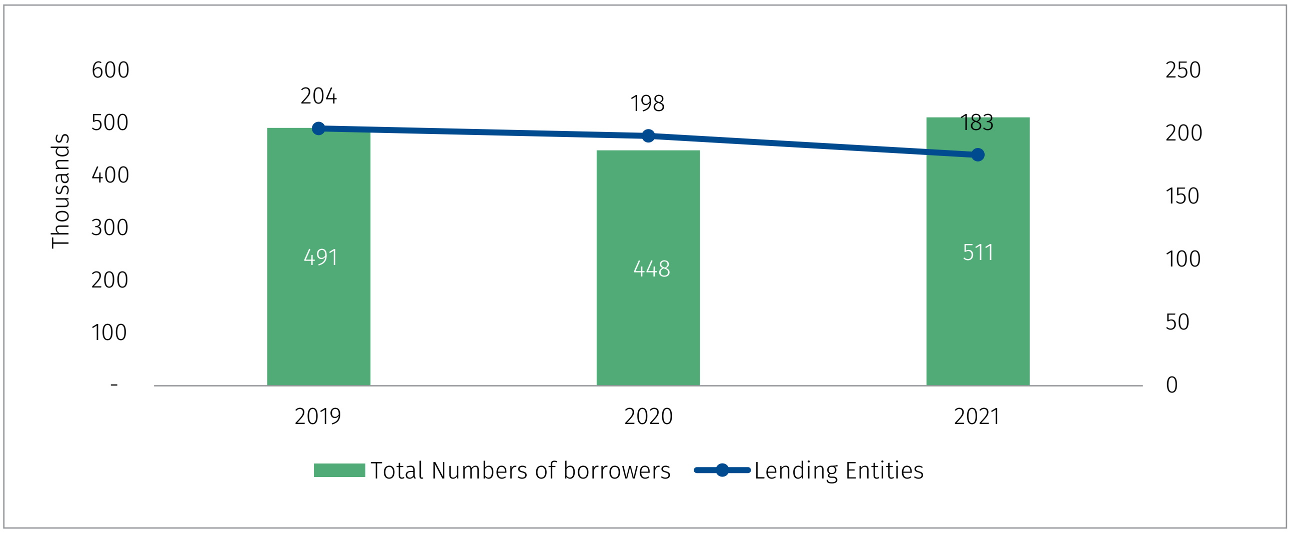
DIAGRAM N 6.19 REGIONAL DISTRIBUTION OF THE BRANCHES OF LENDING ENTITIES



Source: NBG

It is important to note that lending entities make up more than half of the total number of borrowers in the non-banking sector. These are mainly individuals, as this sector is mostly specialized in the supply of granular/small consumer lending and pawn products. In addition, lending entities also operate to collect problem consumer loans.

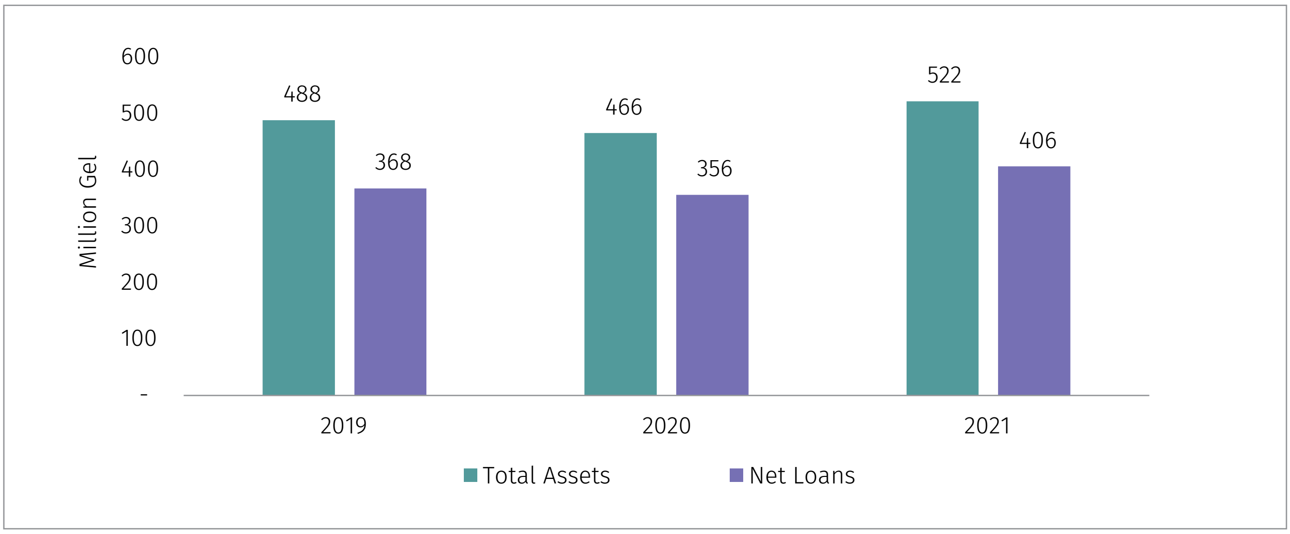
DIAGRAM N 6.20 LENDING ENTITIES AND NUMBER OF BORROWERS



Source: NBG

The reduction of the total number of lending entities by 15 units did not affect the total assets and net loans of this sector. Indeed, total assets during the year saw growth of 12%, while the growth of net loans was 14%.

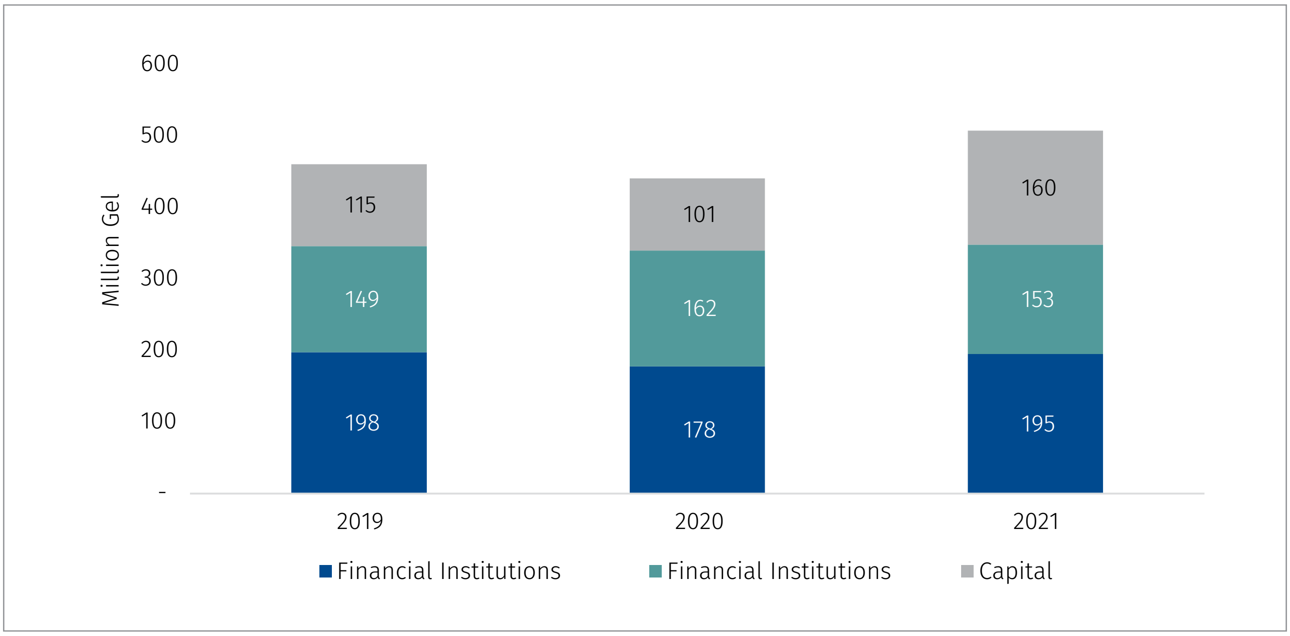
DIAGRAM N 6.21 DYNAMICS OF TOTAL ASSETS AND NET LOANS



Source: NBG

Funds from partners and financial institutions constitute the main source of funding for the lending entities sector. However, a positive trend of capital growth was evident last year.

DIAGRAM N 6.22 SOURCE OF FUNDING FOR LENDING ENTITIES



Source: NBG

As of 31 December 2021, the return on equity and assets was 39% and 10%, respectively.

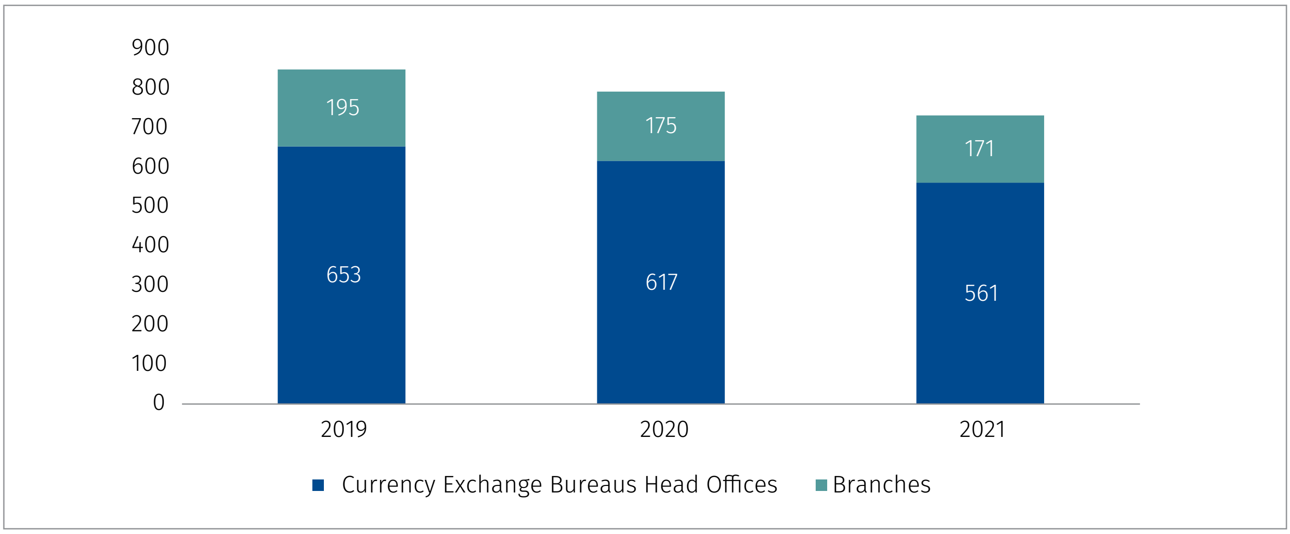
Despite pandemic-related delays, on-site inspections were conducted for 19 lending entities and 25 branches during the year. Based on the results of these inspections, actions envisaged by the relevant legislation were defined, including the revocation of the registration for seven branches.

The 2021 amendments to the Regulation on Registration, Cancellation of Registration, and the Regulation of Lending Entities by the NBG, which concern operational risks for lending entities (including the definition of accounting standards and requirements), are expected to contribute to both the recovery of the sector and the mitigation of underlying risks. They will also enhance the degree of reliability of the financial information submitted to the NBG.

6.2.3 CURRENCY EXCHANGE BUREAUS

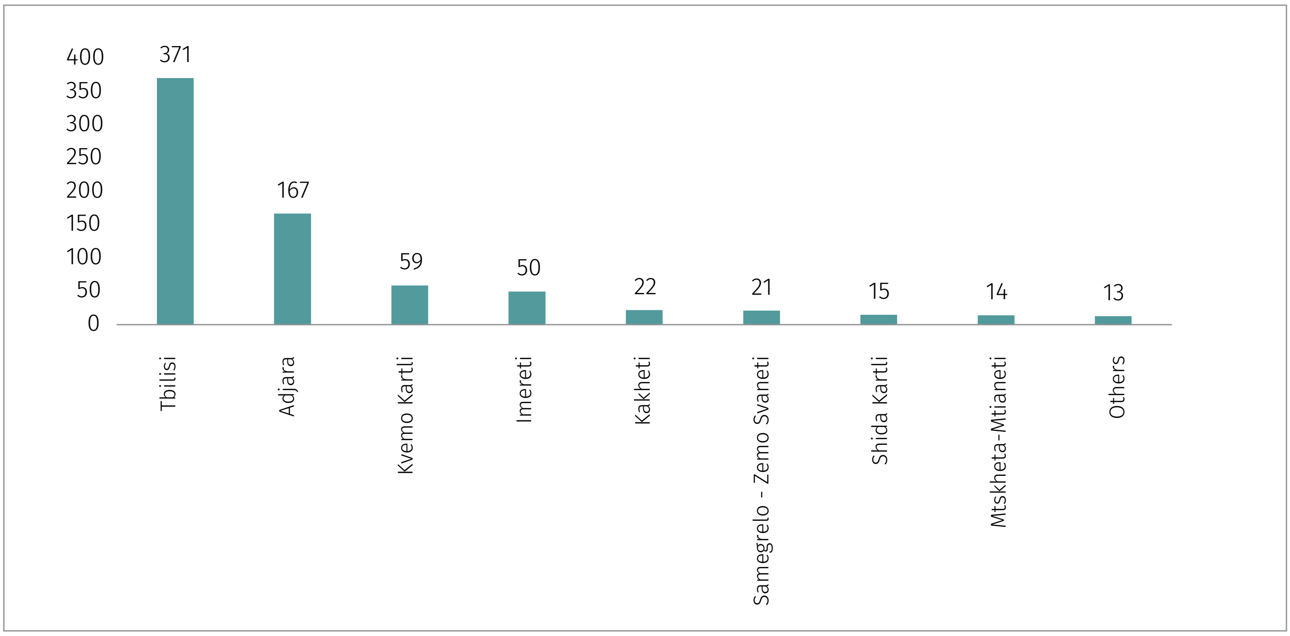
The year saw 33 currency exchange bureaus registered and 89 bureaus having their registration revoked. As of 31 December, there were a total of 561 registered currency exchange, with branches at 732 locations across the country.

DIAGRAM N 6.23 NUMBER OF CURRENCY EXCHANGE BUREAUS AND BRANCHES



Source: NBG

DIAGRAM N 6.24 REGIONAL DISTRIBUTION OF THE STRUCTURAL UNITS OF CURRENCY EXCHANGE BUREAUS



Source: NBG

Out of the 89 currency exchange bureaus that had their registrations revoked, 58 had these revoked on the basis of their own application. Most of these were located in larger cities and apparently saw a decline of business due to a reduction in tourist flows as a consequence of the pandemic. The registrations of the remaining entities were revoked due to non-compliance with the requirements established by law.

Despite the pandemic, the on-site inspections of currency exchange bureaus proceeded smoothly. The NBG inspected 198 currency exchange offices (head offices/branches) in 2021 in order to ascertain their observance of the terms of registration, to determine how they met their obligations to keep clients informed, and gauge how accurately they submitted their reports to the NBG.

6.2.4 CREDIT UNIONS

The legislative amendments of 2017 set the limit for the number of members of a credit union, and defined the principles of their operation. This meant bringing together those individuals residing in the administrative unit of the same self-governing community and uniting them on common grounds. These changes served to eliminate unsound practices established in the sector, particularly those in which credit unions had used the funds attracted as deposits from members for lending activities that were inappropriate for the purposes of the cooperative.

As of 31 December 2021, only one credit union, with assets of GEL 0.54 million, continued to operate in the market.

07

SECURITIES MARKET

7.1 LARGE-SCALE REFORM OF THE LEGISLATIVE AND REGULATORY FRAMEWORK OF THE SECURITIES MARKET

In August 2021, the NBG became an ordinary member of the International Organization of Securities Commissions (IOSCO).[81] The NBG had been granted the status of an associate member of the IOSCO in 2018, and subsequently applied for ordinary membership in the fall of 2019. Ordinary membership of IOSCO confirms that the regulatory framework of the Georgian securities market is harmonized with internationally recognized standards, while considering the level of development of the Georgian securities market. Ordinary membership of the IOSCO will increase investor trust and interest in Georgian securities, contribute to the country's international integration, and enhance the NBG's reputation as a regulator of the securities market.

The work of the Financial Sector Assessment Program (FSAP) of the International Monetary Fund (IMF) and the World Bank was successfully completed in 2021. After examining local legal, regulatory and supervisory practices, the World Bank experts assessed the Georgian securities market's compliance with international standards, including the IOSCO principles. The NBG received a positive evaluation in terms of the securities market's regulatory framework environment. According to the assessment report, since 2017, the NBG has made efficient steps in developing a proper regulatory framework and adhering to international standards.

In February 2021, the Code of Ethics and Professional Conduct for Banking and Securities Market Participants was adopted. The principles and standards envisaged by the code are based on the CFA Institute's Code of Ethics and Standards of Professional Conduct. The code sets internationally recognized standards of ethics and professionalism and ensures the ethical conduct of commercial banks, brokerage firms, asset management companies, and other affiliated parties in the financial market. Its adoption is expected to enhance the reputation of the banking sector and the capital markets, to increase consumer confidence, and to guarantee the stable and efficient functioning of the market.

The Corporate Governance Code for Issuers of Public Securities was adopted in December 2021, with the involvement and cooperation of the World Bank and the International Finance Corporation (IFC). The code is based on international best practice and improves accountability for enterprises, ensures dynamic communication with stakeholders, and guarantees investor protection. This will help enterprises to achieve their long-term goals and increase investor trust, which will ultimately contribute to broadening the investor base, including both domestic and international investors. Based on international best practice, the code incorporates the standards of different countries, international organizations and the European Union, and is in accordance with the OECD's Principles of Corporate Governance, as well as the European Commission's 2014 and 2015 recommendations.

7.2 SECURITIES MARKET INDICATORS

The local bonds market has been showing a rapid growth trend in recent years, although the pandemic and the resulting economic developments in 2021 had a mixed impact on the dynamics of the securities market.

Bond Market

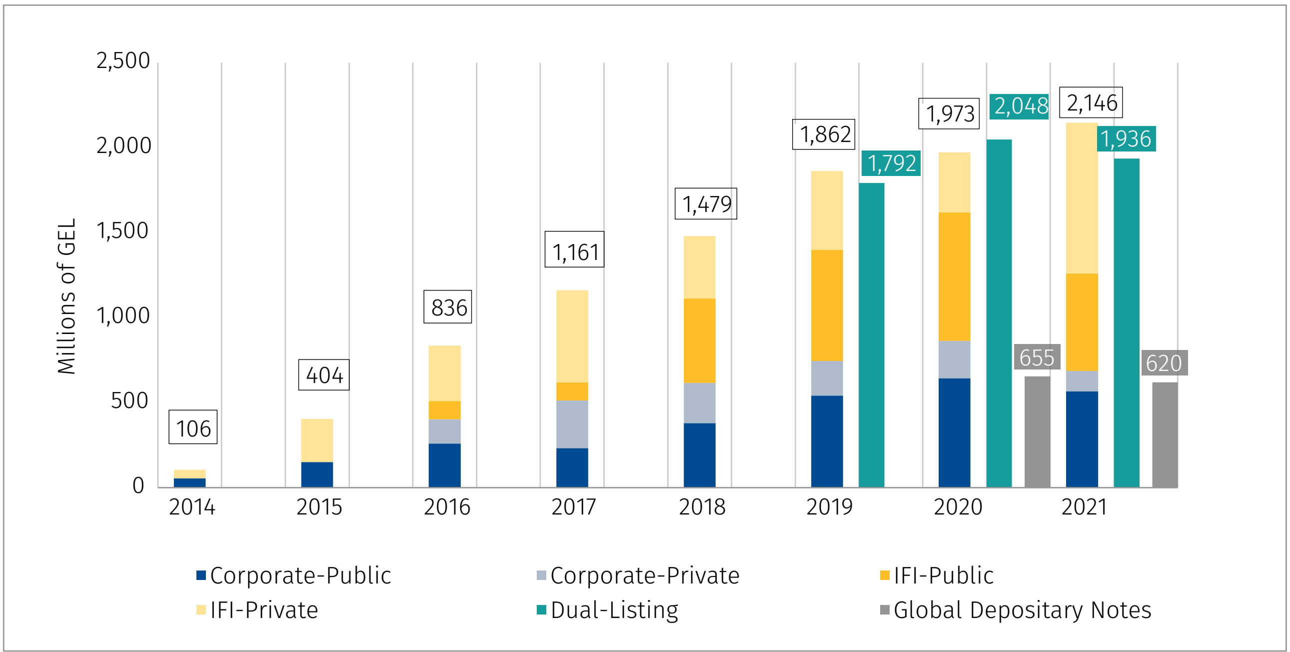
As in previous years, 2021 saw a growing trend in the bond market. This market segment grew by 8.8% and was 3.67% of GDP.[82] Some 68% of the bonds were GEL denominated and issued by international financial institutions. Notably, such issuances by international financial institutions increased significantly, while corporate ones shrank slightly.

81. The IOSCO is an international organization that promotes regulation and cooperation in securities markets and brings together securities regulators from more than 130 countries.

82. The data do not include dual-listed non-government debt securities and certificates of deposit on the Georgian Stock Exchange.

In 2019, three corporate bonds admitted to trading on international stock exchanges were dual listed. One of them is a Eurobond, for which Depositary Notes were issued with the involvement of the Central Depository of Georgia at the end of 2020. This situation remained unchanged in 2021 (see Diagram 7.1).

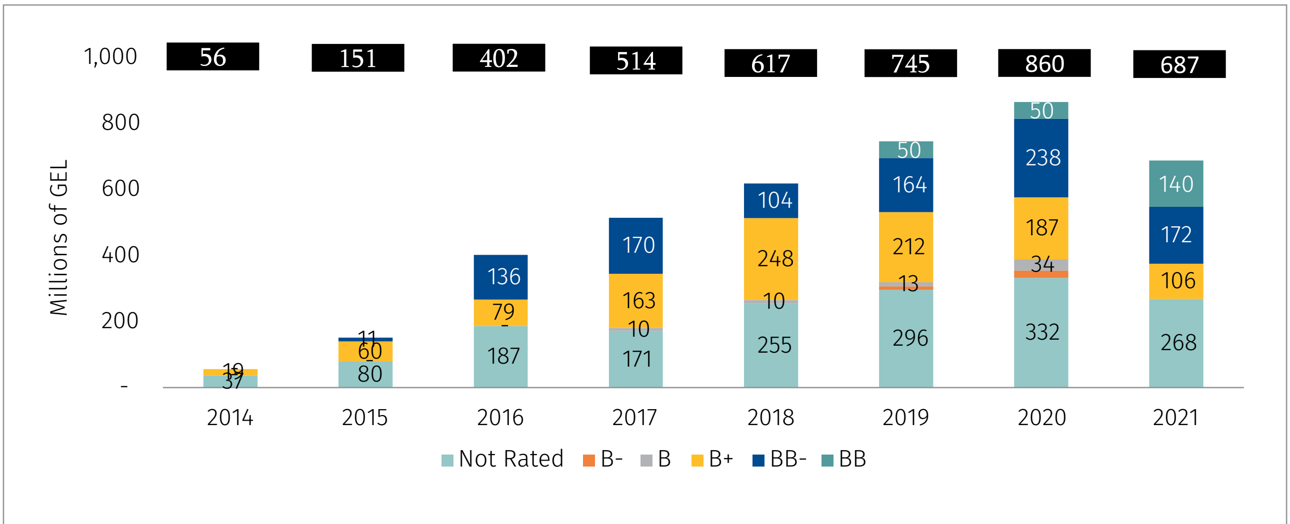
DIAGRAM N 7.1 BALANCES OF COMMERCIAL BONDS AT THE END OF PERIOD (2014-2021)



Source: NBG, Georgian Stock Exchange, Bloomberg, other public sources

Some 62% of corporate bond issuers were assigned ratings by international credit rating agencies (Fitch, Moodys, Scope) at the end of 2021 (a fall from the 67% in 2020). These account for 53% of the public bonds on the market (48% in 2020). Of the remaining public bonds with a credit rating assigned, 17% obtained a BB rating (16% in 2020) and 64% had a BB/BB- rating (61% in 2020).

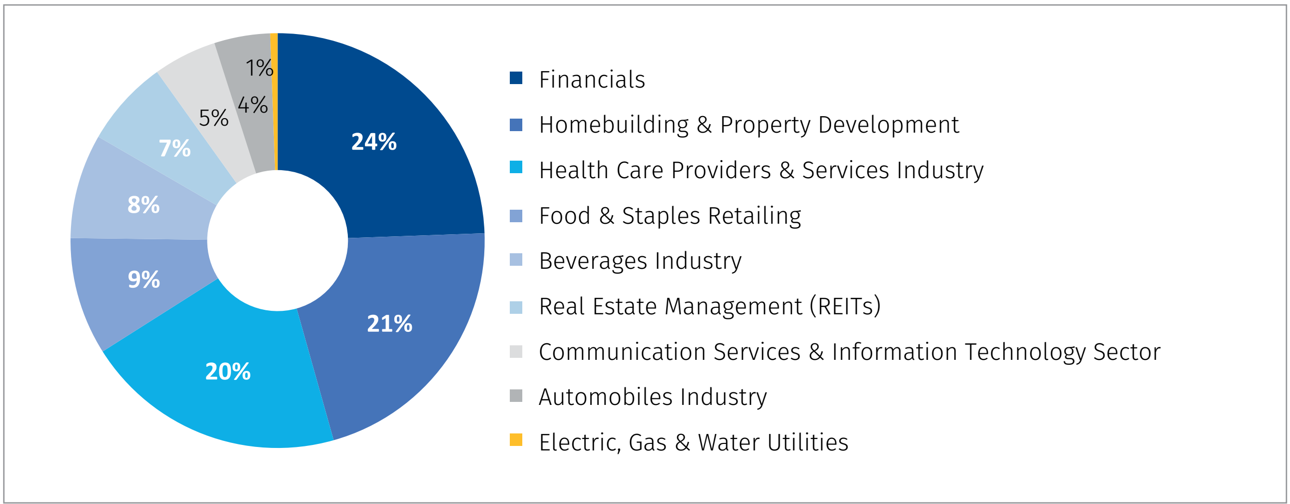
DIAGRAM N 7.2 BALANCES OF CORPORATE BONDS BY INTERNATIONAL CREDIT RATINGS (2014-2021)



Source: NBG

In 2021, nine industry sectors were represented in the corporate bond market. According to the data, the financial sector held the largest market share of 24% (leasing companies), while the combined figures for the construction, healthcare and retail industry sectors accounted for 50% of the market.

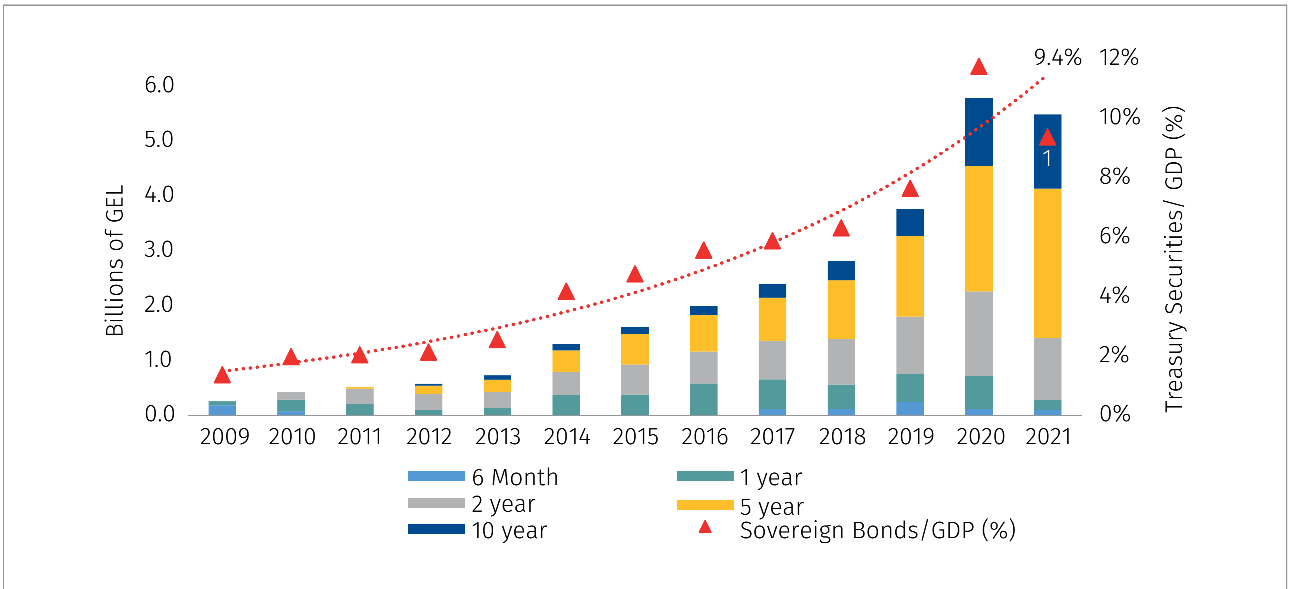
DIAGRAM N 7.3 INDUSTRY DISTRIBUTION OF CORPORATE BOND BALANCES (2021)



Source: NBG

In contrast to the 54% increase in the treasury bond market observed in 2020, this figure declined by 5.29% in 2021, with its volume reaching 9.4% of GDP (see Diagram N 7.4).

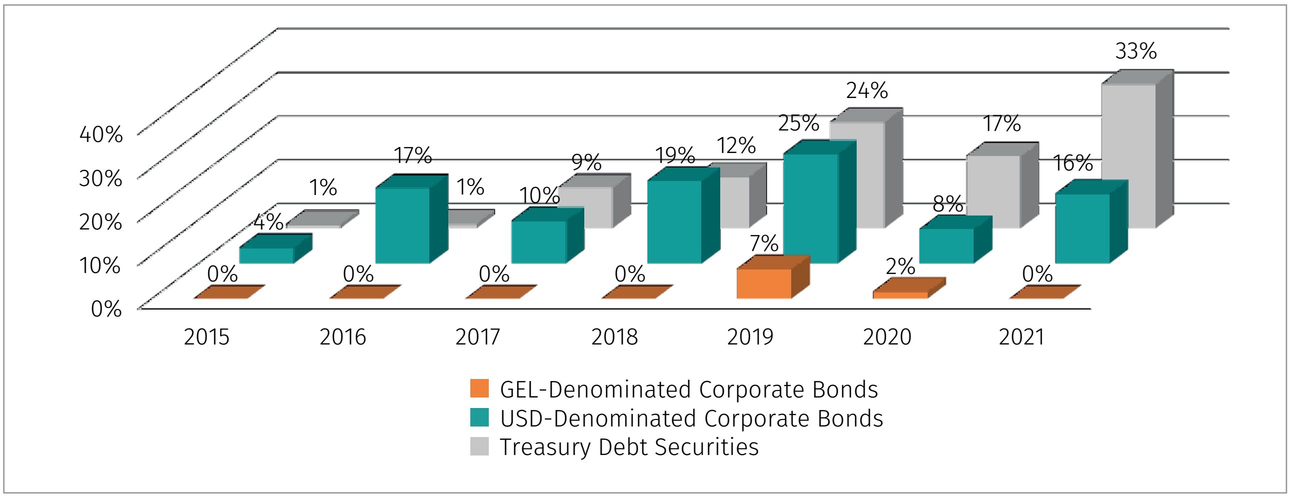
DIAGRAM N 7.4 BALANCES OF TREASURY SECURITIES BY MATURITY (2009-2021)



Source: Ministry of Finance of Georgia; GeoStat

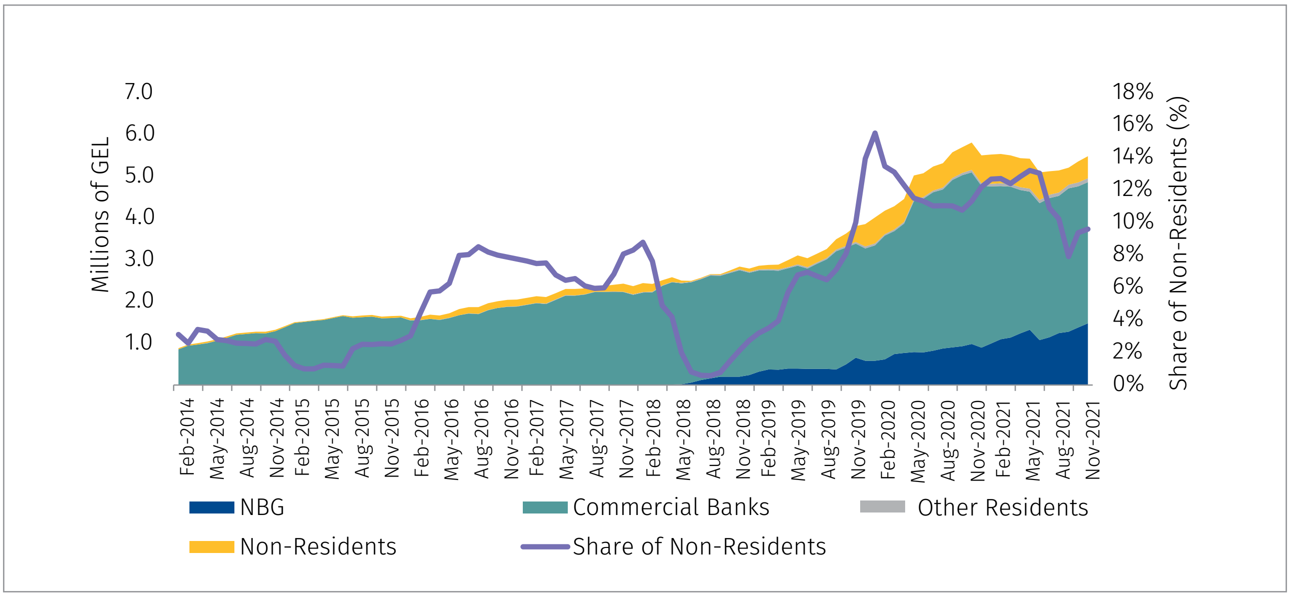
In 2021, the majority of the local market liquidity indicators improved, although these figures were scattered per segment of the bond market. On the secondary bond market, the liquidity rate of the foreign currency-denominated corporate bond segment increased by 8 percentage points. Secondary market treasury bonds transactions increased significantly in 2021 and reached 33.2%, mainly as a result of NBG transactions, while GEL-denominated corporate bonds transactions were characterized by low liquidity (see Diagrams N 7.5 and 7.6).

DIAGRAM N 7.5 SECONDARY MARKET ACTIVITY FOR DEBT SECURITIES ISSUED IN GEORGIA, (2015-2021)[83]



Source: NBG, Georgian Stock Exchange

DIAGRAM N 7.6 DISTRIBUTION OF TREASURY SECURITIES BY OWNERSHIP (2014-2021)



Source: NBG, Georgian Stock Exchange

83. The diagram shows the secondary market activity as a ratio of the secondary market transactions during the year to the average annual balances of securities.

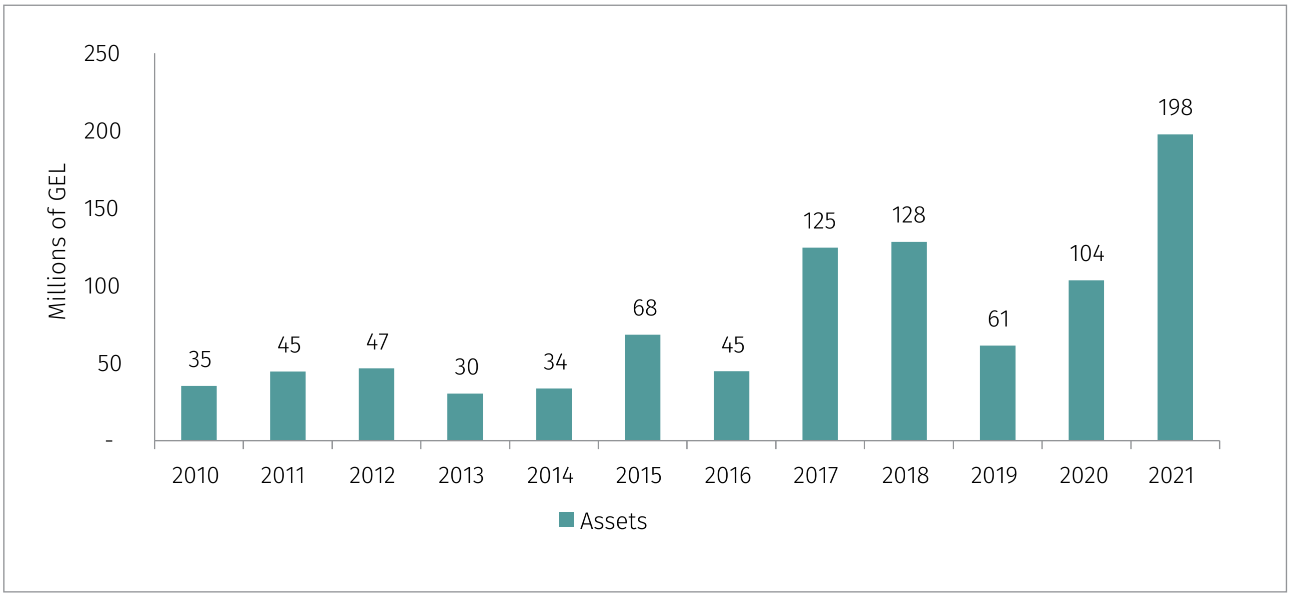
7.3 MARKET PLAYERS

By the end of 2021, two stock exchanges, one central securities depository, nine brokerage companies and three independent securities registrars were operating in the Georgian securities market. Two out of the nine brokerage companies were not members of the stock exchange.

Brokerages

As of 31 December 2021, the total assets of the operating brokerage companies amounted to GEL 198 million.

DIAGRAM N 7.7 AGGREGATE ASSETS DYNAMICS OF BROKERAGE COMPANIES BY YEAR (2010-2021)

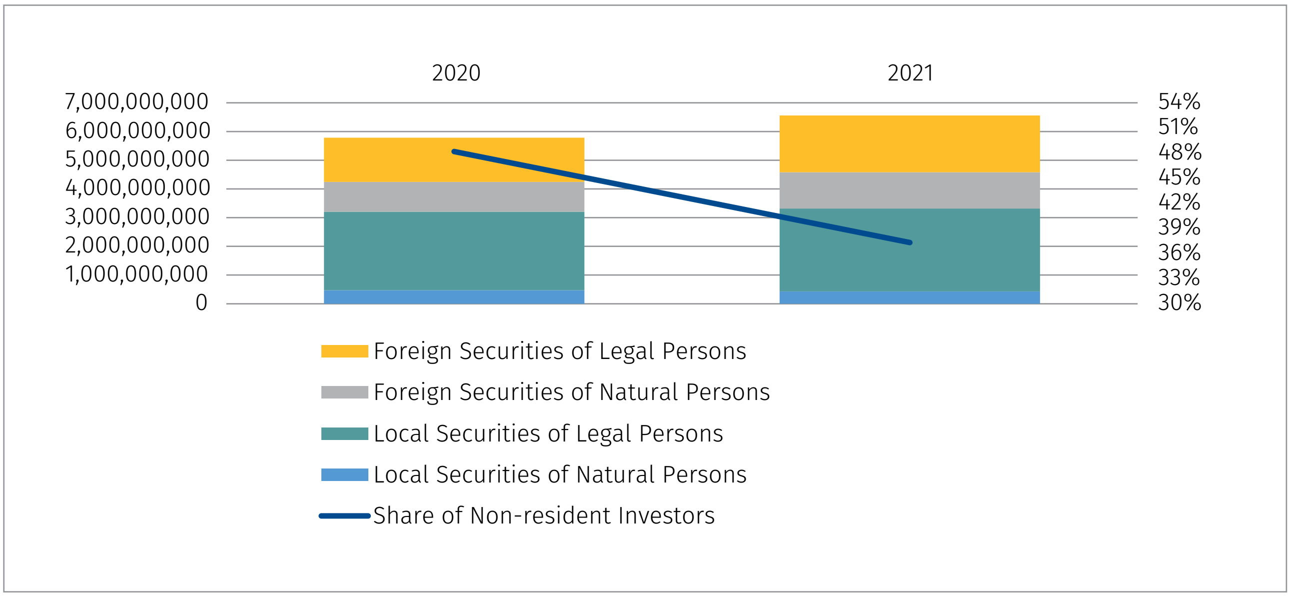


Source: NBG, quarterly and annual financial reports of the brokerages

The total value of clients' securities on the securities accounts of brokerage companies and commercial banks amounted to GEL 6.6 billion at the end of 2021 and increased by 13% since 2020 (excluding the exchange rate effect). This increase is related to foreign securities accounts. Importantly, 37% of client securities balances are of non-resident investor accounts. As of the end of 2021, the total number of clients receiving brokerage services from brokerage companies and banks was 11,371, of which the majority (86%) were resident natural persons. Compared to the end of 2010, at the end of the 2021 the number of clients of brokerage companies increased by 64%.

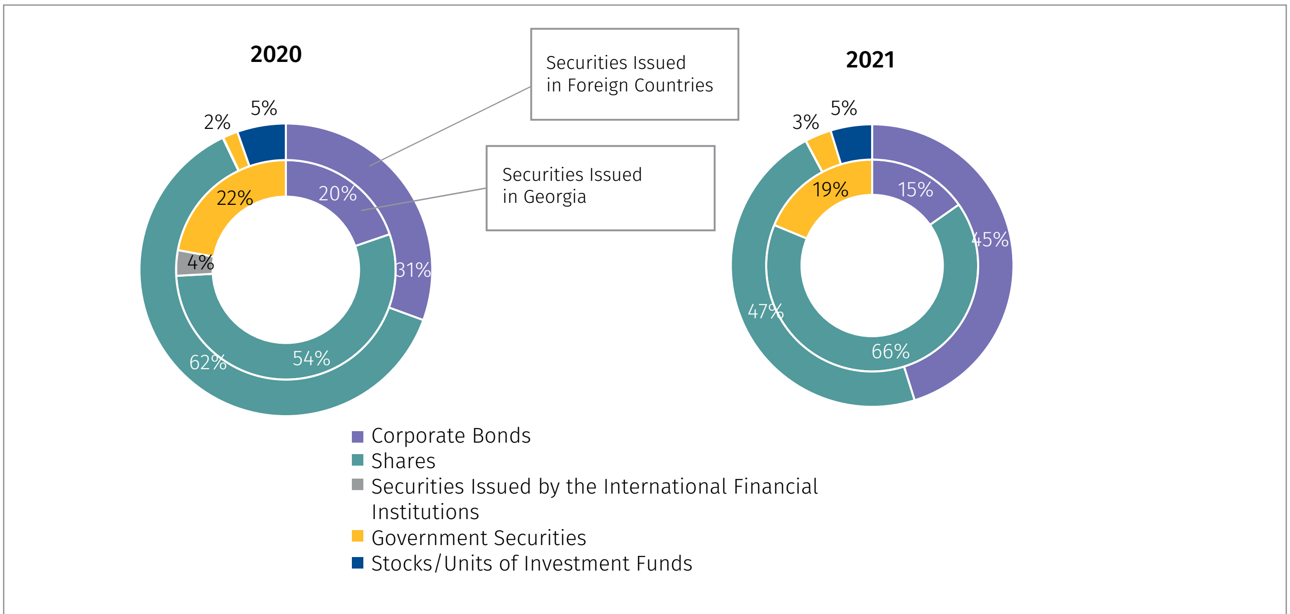
As much as 89% of client securities balances and 85% of the number of clients were concentrated in the two largest brokerage companies and their related commercial banks.

DIAGRAM N 7.8 TOTAL VALUE OF CLIENT SECURITIES ACCOUNTS IN BROKERAGE COMPANIES AND BANKS (BILLION GEL)



Source: NBG, monthly reports of brokerages and commercial banks

DIAGRAM N 7.9 DISTRIBUTION OF CLIENT SECURITIES PORTFOLIO ON SECURITIES ACCOUNTS OF BROKERAGE COMPANIES AND BANKS (SECURITIES ISSUED IN FOREIGN COUNTRIES AND IN GEORGIA)



Source: Monthly reports of brokerages and commercial banks

Stock Exchange

As of 31 December 2021, securities of 31 issuers were admitted to the trading system of the Georgian Stock Exchange. The total value of transactions recorded in trading sessions and the stock exchange during the reporting period amounted to GEL 59 million (178.7 million units of securities). Of this, a total of GEL 104 thousand was traded in stock exchange trading sessions, while the value of the stock traded was GEL 58.9 million. Recorded transactions, in addition to those by brokerage companies, include one transaction made by registrars during 2021 on 97,040 units of securities. The total value of the transactions amounted to GEL 9.7 thousand.

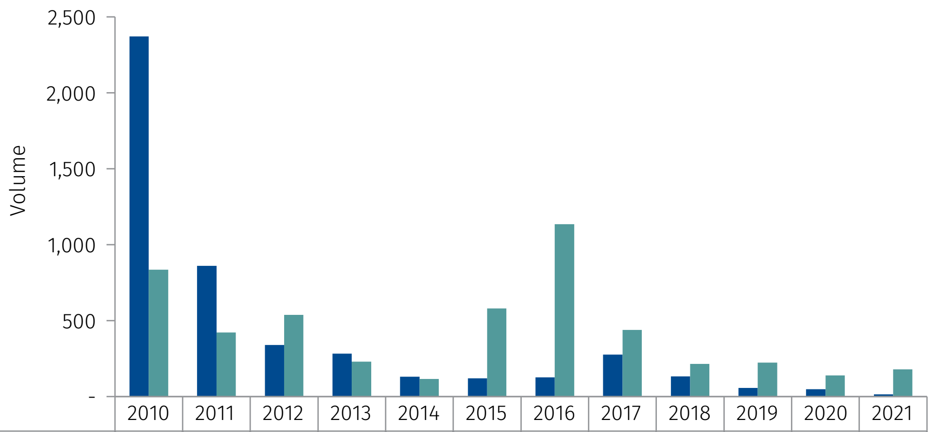
TABLE N 7.1 AGGREGATE INFORMATION BY INDICATORS OFFERED AT TRADE SESSIONS AND CARRIED OUT AT THE STOCK EXCHANGE, (2020-2021)

	Number of deals		Number of securities		Value of securities (GEL)	
YEAR	**2021**	**2020**	**2021**	**2020**	**2021**	**2020**
Stock exchange	14	48	176,775	921,086	104,078	46,135
Recorded	179	139	178,534,049	5,035,697	58,945,873	50,733,190
Total	**193**	**187**	**178,710,824**	**5,956,783**	**59,049,951**	**50,779,326**

DIAGRAM N 7.10 KEY TRADE INDICATORS (TRANSACTIONS OFFERED AT TRADING SESSIONS AND RECORDED IN THE STOCK EXCHANGE), 2010-2021

Source: Annual Report of the Georgian Stock Exchange

DIAGRAM N 7.11 ANNUAL NUMBER OF TRANSACTIONS RECORDED ON TRADING SESSIONS AND STOCK EXCHANGE (2010–2021)



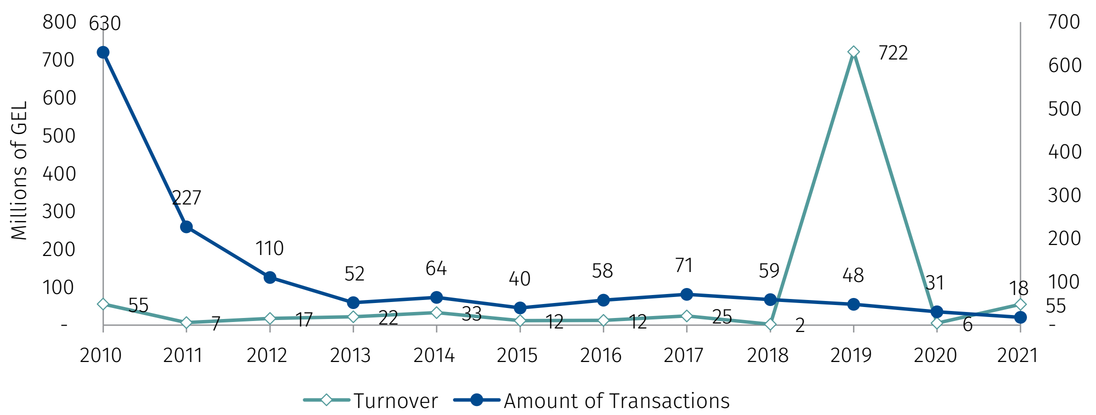
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Stock Exchange Trades	2,372	860	339	283	131	120	127	277	133	56	48	14
OTC Trades registered at the Stock Exchange	835	421	538	230	115	579	1,135	438	215	224	139	179

Source: Annual Report of the Georgian Stock Exchange

Central Depository

In 2021, 54.8 million securities and GEL 0.26 million was deposited in the Central Depository. Of this, 56% of monetary deposit transactions and 81% of the total amount were made with the participation of JSC TBC Bank. The number of transactions on securities deposited with the Central Depository decreased by 41.9% compared to the same period last year, while the number increased by 49 million units of securities. A total of 22 new accounts were opened within the Central Depository throughout 2021.

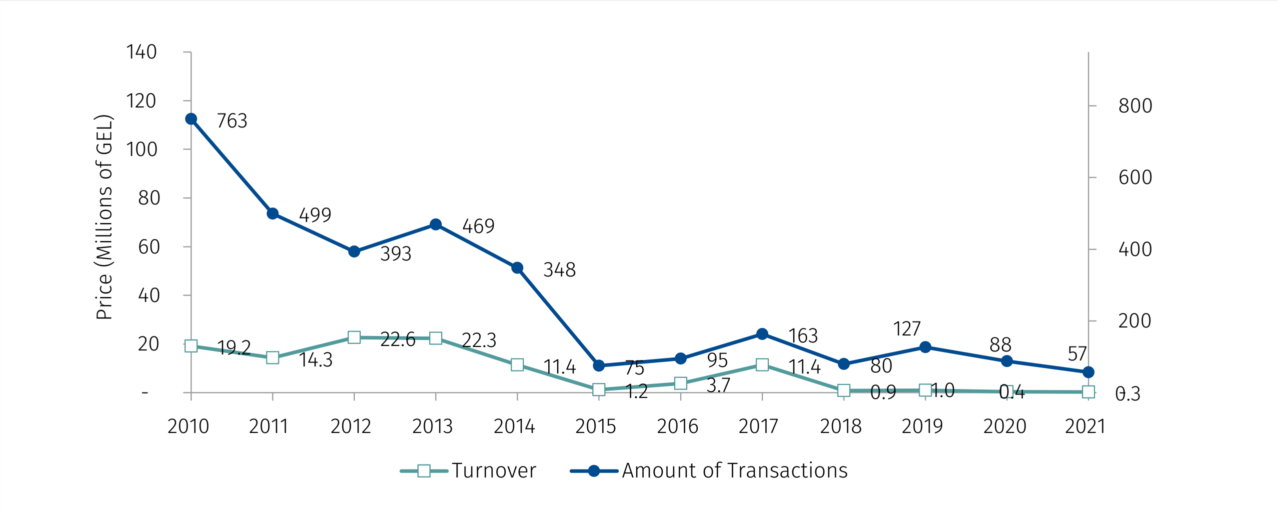
DIAGRAM N 7.12 SECURITIES DEPOSITED WITHIN THE CENTRAL DEPOSITORY BY YEAR (2010-2021)



Source: Annual Report of the Georgian Securities Central Depository

Cash flow in the Central Depository decreased by GEL 0.1 million in the reporting year. The number of financial resources transactions was 35% lower than in 2020.

DIAGRAM N 7.13 FUNDS DEPOSITED AT THE CENTRAL DEPOSITORY BY YEAR (2010-2021)



Source: Annual Report of the Georgian Securities Central Depository

7.4 OVERVIEW OF THE INVESTMENT ACTIVITIES OF THE PENSION AGENCY

Appointment of a Specialized Depositary

In 2021, the Pension Agency completed the selection process for a Specialized Depositary. The Bank of Georgia (BoG) was subsequently selected, and the Pension Agency signed a Specialized Depositary service agreement with the BoG for a period of three years.

The Specialized Depositary plays an important role in the proper functioning of the pension scheme. In accordance with the Law of Georgia on Funded Pensions and the regulatory requirements of the NBG, the Specialized Depositary, as an independent party, is required to receive, safekeep, register and verify ownership of the pension scheme's assets. The Specialized Depositary is also required to execute the instructions of the Pension Agency, provide oversight of the compliance of the implemented investment decisions with the Investment Policy Document, and monitor the requirements set by the investment policy and the law. The Specialized Depositary is a legal entity with a fiduciary obligation, and its activities are regulated by the NBG.

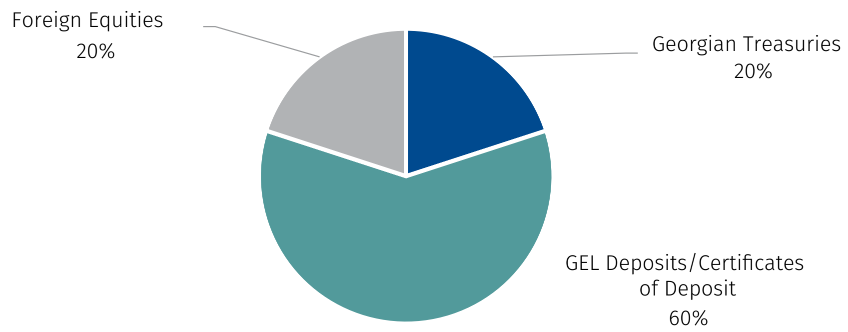
It is noteworthy that the appointment of the Specialized Depositary has permitted the Pension Agency to invest in local and international securities.

Updated Investment Policy Document

The initial process of the Strategic Asset Allocation (SAA) was completed in 2021, resulting in a benchmark portfolio for the low-risk investment portfolio and an update of the Investment Policy Document. The benchmark portfolio represents the long-term strategy for asset allocation by the Investment Board, taking into account risk appetite, investment objectives and investment horizon. The Investment Board set an annual target of at least 2% positive real return for the low-risk investment portfolio over the investment horizon (although this should not be considered a guarantee). Under the existing law, the investment goal at the end of the investment horizon was to obtain only positive real returns for the low-risk portfolio with high confidence (95%).

The updated benchmark portfolio consists of three asset classes: Georgian treasuries (20%), GEL deposits/certificates of deposit (60%), and foreign equities (20%). For each asset class, the permissible ranges of deviation from target limits were also determined.

DIAGRAM N 7.14 DISTRIBUTION OF BENCHMARK PORTFOLIO



Source: Pension Agency, Investment Policy Document

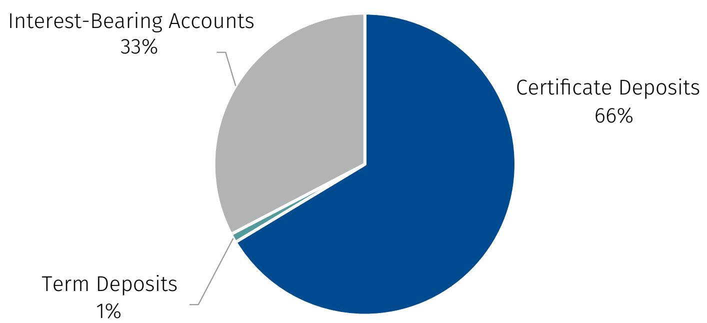
The following indices are used to estimate the Benchmark Portfolio returns:

Asset Class	Index	Weight
Georgian Treasury Bonds	Three-year or longer maturity	20&
GEL Deposits/Certificates of Deposit	Discount (no coupon) deposits/certificates of deposit, with a maturity of 1 to 3 years	30%
	Discount (no coupon) deposits/certificates of deposit, for more than 3 years	30%
Foreign shares	iShares MSCI World ETF (code URTH)	20%

Pension Fund Performance

As of 31 December 2021, the size of the pension fund reached GEL 1.98 billion and was entirely denominated in GEL. Some 67.3% of pension assets were held in certificates of deposit and term deposits, while 32.7% were held in interest-bearing current accounts.

DIAGRAM N 7.15 DISTRIBUTION OF THE PENSION ASSET PORTFOLIO, 31 DECEMBER 2021



Source: Pension Agency

The total net return generated in 2021 was GEL 161 million, equivalent to approximately a 9.5% annual return.

TABLE N 7.2 RESULTS OF THE INVESTMENT PORTFOLIO

	2021	2020	2019	Since launch*
Net earnings	**9.49%**	**12.90%**	**6.12%**	**33.44%**
Real earnings (less inflation)	-3.9%	10.3%	-0.8%	4.78%
Total expenses, million GEL	6.0	4.5	3.8	
Total size of pension fund (NAV), million GEL	1980.3	1178.0	506.8	
Share of total expenses[84] in the size of the pension fund	0.30%	0.38%	0.75%	

Source: Pension Agency

** As of 28 February 2022.*

7.5 OVERVIEW OF THE ACTIVITIES OF THE INVESTMENT FUNDS

In 2020, the regulatory framework for investment funds was completely updated. Thereafter, operating investment funds and asset management companies were given a one-year period to harmonize their activities with the updated regulatory framework.

As of 2021, a total of two private investment funds ("Gazelle Finance Georgia Ltd." and Common Investment Fund "Rushmore") were registered. As for asset management companies, one company ("Nexus Asset Management Ltd.") was registered in 2020, and a further two companies ("Foresight Investment Group Ltd." and "TBC Capital Asset Management Ltd.") were licensed in 2021.

84. From September 2021, the Pension Agency became self-funded. During the first three years of its establishment, 100% of the budget of the Pension Agency was financed from the state budget of Georgia. Under the existing law, the Pension Agency's expenses over the next 10 years should not exceed 0.5% of the pension assets, and 0.25% after the termination of this period.

08

INSPECTION AND SUPERVISION OF MONEY LAUNDERING

In line with the Supervisory Framework for Combating Money Laundering and Terrorism Financing, the risk-based supervisory strategy of the NBG set out effective supervisory measures for the entities to be supervised throughout 2021. The process of remote identification and assessment of risks, of both a sectoral nature and for each financial institution, became the basis for these measures.

In order to identify and assess risks remotely, in 2021 the NBG twice received and processed money laundering and terrorism financing risk supervision reports from each of the entities listed in Diagram N 8.1. It should be noted that the reports of lending entities were processed for the first time in 2021.

TABLE N 8.1 REMOTE SUPERVISION IN 2021

Financial Sector	Number
Commercial bank	14
Microfinance institution	38
Payment service provider	32
Brokerage	9
Currency exchange bureau	553
Securities registrar	3
Credit union	1
Lending entity	245

The supervisory actions taken during 2021 included complex and thematic, special and follow-up on-site inspections. The remote follow-up inspections introduced by the NBG significantly reduced the negative impact of the pandemic on the ongoing supervision process. The smooth conduct of anti-money laundering and anti-terrorist financing inspections during the pandemic was highlighted by the IMF and World Bank Joint Mission forming part of the 2021 Revised Financial Sector Assessment Program (FSAP) in Georgia. The assessment, which includes an evaluation of anti-money laundering and anti-terrorist financing measures, highlights the progress that has been made since the previous visit (in 2014) in parallel with the risks identified across the country. The report also reiterates the positive assessment made by the Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL). The MONEYVAL assessment concerned the development of risk-based supervision by the NBG and the strengthening of the supervisory process.

During the reporting year, in light of the identified sectoral threats and weaknesses, on-site inspections focused on the following topics:

For commercial banks:

- The process of classification of clients (including those identified/verified by remote channels) per risk, risk revaluation, and the adequacy of implementation of appropriate preventive measures.
- The process of identifying and verifying beneficial owners of clients with complex ownership structures.
- Knowledge of the bank about clients related to free industrial zones, offshore and high-risk jurisdictions, as well as transactions related to such zones and the parties involved.
- Efficiency of the risk management process associated with internet acquisition.
- Efficiency of the cash flow origination process.
- Efficiency of the process of detecting suspicious/unusual transactions (including of the process of detecting the use of fictitious companies/transit

companies, measures taken to implement UN resolutions (on TF/Proliferation), software adequacy, and bank awareness of transactions by non-profit and charitable legal entities).

For payment service providers:
- The process of classification of clients per risk, risk revaluation and the adequacy of implementation of appropriate preventive measures.
- Risks related to the products offered and the effectiveness of the measures to mitigate them.
- Efficiency of the process of detecting suspicious/unusual transactions (including measures taken to implement UN resolutions (on TF/Proliferation), and software adequacy).
- Efficiency of the risk management process related to correspondent relations.
- Verification of compliance with the instructions of the NBG (International P2P transaction and crypto-asset risk management process).
- Verification of the accuracy of compiling the reporting forms.

For brokerages:
- The process of classification of clients per risk, risk revaluation and the implementation of appropriate preventive measures.
- The process of identifying and verifying beneficial owners of clients with complex ownership structures.
- Knowledge of the brokerage company about intermediaries and the adequacy of the process of monitoring the transactions made through them.
- Efficiency of the process of detecting suspicious/unusual transactions (including measures taken to implement UN resolutions (on TF/Proliferation), and software adequacy).
- Adequacy of the risk management process related to FX activities.
- Efficiency of the cash flow origination process.
- Verification of the accuracy of filling out the reporting forms.

For microfinance institutions:
- The process of classification of clients per risk, risk revaluation and the implementation of appropriate preventive measures.
- Knowledge of the institution about international transactions (including offshore and high-risk jurisdictions).
- Efficiency of the process of detecting suspicious/unusual transactions (including measures taken to implement UN resolutions (on TF/Proliferation), and software adequacy).
- Efficiency of the cash flow origination process.
- Verification of the accuracy of filling out reporting forms.

For securities registrars:
- The process of classification of clients per risk, risk revaluation and the implementation of appropriate preventive measures.
- The process of identifying and verifying beneficial owners of clients with complex ownership structures.
- Efficiency of the process of detecting suspicious/unusual transactions (including measures taken to implement UN resolutions (on TF/Proliferation), and software adequacy).
- Verification of the accuracy of filling out reporting forms.

The lending entities sector became subject to supervision in 2020. Accordingly, the on-site inspection of companies in this sector was performed for the first time in 2021 and the NBG undertook complex inspections of the 12 largest lending entities.

In order to determine compliance with the legislation of Georgia on facilitating the prevention of money laundering and terrorism financing, 39 representatives of the financial sector were inspected in 2021. Furthermore, to correct the deficiencies identified during the inspections, the Money Laundering Inspection and Supervision Department of the NBG conducted remote follow-up inspections of 41 entities under supervision in 2021.

The total amount of fines imposed for violating the legislation of Georgia on facilitating the prevention of money laundering and terrorism financing amounted to GEL 1,709,900.

TABLE N 8.2 AMOUNT OF FINES, 2021

Financial Sector	Amount of Fine (GEL)
Commercial bank	1,117,500
Microfinance institution	386,700
Brokerage	112,500
Payment service provider	69,200
Lending entity	15,000
Currency exchange bureau	9,000

The Regulation on Determining and Imposing Fines on Non-banking Sectors under the Supervision of the NBG was amended in 2021, based on the analysis of the best practices of EU countries. This considerably improved the effectiveness of the sanctions imposed on the non-banking sector. According to the amendments, violations were divided into three categories – particularly severe, severe, and less severe – and appropriate sanctions were determined for each category of violation. Fines were additionally imposed for the recurrence and repetition of systematic violations.

It is important to note that, according to the Regulation on Publication of Information on Sanctions Imposed by the NBG on Representatives of the Financial Sector for Violation of Illicit Income Legalization and Terrorism Financing Requirements, information about a violation, with reference to the named entity, should be published on the official website of the NBG as of 1 January 2021.

In addition to the fines imposed following on-site inspections, various different corrective measures were applied to the representatives of the financial sector during 2021; moreover, a number of recommendations were developed over the year based on the results of the on-site inspections. The goal of these developments was to immediately eliminate the identified weaknesses and enhance the level of compliance among representatives of the financial sector.

TABLE N 8.3 NUMBER OF RECOMMENDATIONS, 2021

Financial Sector	Number of recommendations
Commercial bank	34
Microfinance institution	98
Payment services provider	38
Brokerages	27
Lending entity	77
Currency exchange bureau	5

Commercial banks were first asked to provide organizational and group risk assessment documents in 2020. In 2021, the Money Laundering Inspection and Supervision Department shared its recommendations based on those documents with commercial banks. The goal was for the banks to improve the perception of risks in their own organizations and to better plan measures to mitigate those risks.

In 2021, for the first time, a Commercial Bank Compliance Control System Supervision Questionnaire was distributed and a relevant analysis was prepared. The goal was to remotely assess the conformity of commercial banks' compliance control systems with anti-money laundering and anti-terrorist financing legislation, as well as with the requirements set by the National Bank and international best practice.

To help financial institutions submit the relevant information, in 2021 the NBG developed a Regulation on Commercial Banks Filling out their Anti-money Laundering and Counter-Terrorism Financing Compliance

Control System Supervision Questionnaire.

Products developed and presented by financial institutions were individually reviewed during 2021, as in the previous year, within the NBG's Regulatory Laboratory, with the active involvement of the Money Laundering Inspection and Supervision Department. A Regulation on Performing Preventive Measures Electronically was also approved in 2021, with the purpose of facilitating reporting entities having in place the necessary procedures for electronic identification/verification and measures to prevent money laundering and terrorist financing.

The NBG attaches special importance to the implementation of preventive supervisory measures as these ensure the orderly advising of representatives of the financial sector about supervisory expectations and serve to raise their level of compliance. To enhance the culture of compliance in the sectors under the supervision of the NBG, the following guidelines were developed in 2021:

- A Guide to the Warning Signs of Money Laundering and Terrorism Financing. This guide is to help the entities under the NBG supervision to effectively manage the monitoring process of business relations with their clients. The document sets out a non-exhaustive list of warning signs that a reporting entity should consider when attempting to detect suspicious/unusual transactions.
- A Guide to Typologies of Money Laundering and Terrorism Financing. This document serves to help financial institutions to effectively manage the monitoring process of business relations with their clients. The guide provides an overview of money laundering and terrorist financing methods based on the analysis of the warning signs identified by the NBG as part of its inspection of financial institutions and internationally known cases.

In view of the limitations triggered by the pandemic, the NBG conducted online training seminars in 2021 that served to enable the target audience to become familiar with the methodology manuals (that had been developed and updated) and other supervisory documents, and to put them into practice. The trainings were attended by representatives of payment service providers, microfinance institutions, credit unions, securities registrars, brokerages, lending entities and currency exchange bureaus. It is important to note that the training modules were specially tailored to the weaknesses and needs identified in each sector.

TABLE N 8.4 TRAINING MODULES DELIVERED IN 2021

	Microfinance institution	Payment service provider	Currency exchange bureau	Lending entity	Brokerage	Securities registrar
Compliance control system	58	35	46	53	11	5
Organizational risk assessment	58	35			11	5
Correspondent relations		35			11	5
Risk assessment, application of risk-appropriate preventive measures			46	53		
AML/CFT warning signs	52		11	36	5	7
AML/CFT typologies	52		11	36	5	7

In parallel with these training initiatives, there was intensive communication with representatives of the financial sector during 2021. Online meetings were held with financial sector representatives to share information and inform them about supervisory expectations.

In addition, the financial sector received information on relevant issues on a daily basis: including information about the effective implementation of legislative requirements and methodology guidelines in practice.

09

PAYMENT SYSTEMS

Payment systems are one of the key components of the financial system's infrastructure. The number and amount of transactions completed through these systems continues to grow worldwide. Consequently, the safe, sustainable and efficient functioning of payment systems is becoming increasingly critical for the stability of the financial system, as well as for meeting the requirements of households and businesses for electronic payments. The changes entailed by the COVID-19 pandemic have underscored the importance of digitized services, for both consumers and the national economy in general. To prevent potential malfunctions of payment systems, the design and operation of financial systems should be based on internationally recognized and widely accepted standards. Therefore, in performing its functions, the NBG considers the CPMI-IOSCO principles for financial market infrastructures, various EU Directives, and the publications of international financial institutions and the Bank for International Settlements.

In early 2021, a joint mission of the World Bank and the International Monetary Fund, working under the Financial Sector Assessment Program (FSAP), assessed Georgia's payment systems and financial market infrastructure. The 2021 FSAP report[85] notes evident positive developments in the area of payment systems since the previous mission. More specifically, the mission noted that the legal and regulatory framework has been significantly improved, and the oversight function of payment systems and the supervision function of payment service providers have been strengthened. The Payment Systems Department went through a considerable structural change during the year: two divisions were formed on the basis of a split of the former Payment Services Providers Regulation Division inside the Payment Systems Department. These new divisions are the Payment Systems Oversight Division and the Payment Service Providers Supervision Division. The purpose of these changes is to strengthen the oversight of payment systems and instruments, and to enhance the effectiveness of prudential supervision of payment services market participants.

PAYMENT SYSTEMS OVERSIGHT

Legislative Framework

Digitalized payments are a novel and innovative means of making payments that provide convenience and versatility to consumers, but these also pose risks. To promote innovation whilst containing associated risks, it is important to establish and implement a balanced and flexible legal and regulatory framework.

During 2021, the NBG continued to work on the implementation of the updated Payment Services Directive (EU (2015) 2015/2366 on payment services) with the objective to significantly update the legislation and to approximate its compliance with the Association Agreement between Georgia and the EU. We continued meeting with the private sector to discuss proposed amendments to the Law of Georgia on Payment System and Payment Services and to share ideas. These amendments, among other positive effects, will improve the access of payment service providers to payment systems, thus promoting a competitive environment, as well as strengthening the protection of consumer rights. More specifically, payment service providers will be required to respond to consumer complaints in a set timeframe, and to make sure to refund unauthorized/undue transactions in the shortest practicable timeframe. The draft law also includes provisions of the European Directive to ensure the introduction of an alternative mechanism for resolving consumer disputes, setting up a Consumer Complaints Commission for payment services. The draft also regulates the basic principles for that commission in treating and solving grievances. Moreover, an independent Commission for Dispute Resolutions will enable consumers to directly discuss disputes concerning pay-

85. Georgia - Financial Sector Assessment Program: Technical Note on Payment Systems and Financial Market Infrastructure, see https://documents.worldbank.org/en/publication/documents-reports/documentdetail/099840003012220978/p175014029297107b08e920ba260ea108d4

ment services with the commission free of charge and with much shorter deadlines as opposed to appealing to the courts.

In 2021, work was underway to implement the Strong Customer Authentication as adopted by the NBG in 2020. As had been the case with the development of the regulation, in its implementation the NBG closely cooperated with providers, delivering explanations, opinions and other types of feedback, and responding to individual and collective needs. The purpose of the regulation is to strengthen the protection of consumers, their finance and their personal information; to reduce the risk of fraud and other illegal actions; increase consumer confidence in payment services and cashless payments; while promoting financial sector stability, and efficient and reliable payment systems. The regulation also ensures the protection of users of new services in terms of account access and payment initiation.

The NBG drafted amendments to the Regulation on Card Based Payment Instruments in 2021 based on current market trends, including technological developments, as well as the needs of the private sector. The document referred to the revision of the rights and obligations of sub-acquirers and acquirers towards trade/service outlets and trading platforms. The amendment also included a strengthened protection of consumer rights (hotlines, blocking the card instrument, etc.).

In 2021, work continued on the implementation of certain articles of the Payment Account Directive (Directive 2014/92/EU). A draft regulation was developed on Access to Service Fees Related to Payment Accounts. In this regard, communication with commercial banks was ongoing to agree on the format of the information on payment accounts and service fees to be published on the website of the NBG. Following this communication, a terms of reference was developed for the automation of data receipt and its subsequent publication. We expect to complete this process and adopt the regulation during 2022.

In developing these projects, and in the framework of the EU Twinning project, the NBG enjoyed the assistance of payment services and systems experts from the Central Bank of Poland, the Financial Supervision Authority, as well as the Central Bank of Lithuania.

Assessment of the RTGS System

At the end of 2020, the NBG conducted its second self-assessment of the Real-Time Gross Settlement (RTGS) system based on the CPMI-IOSCO Principles for Financial Market Infrastructures. The document was also evaluated by a World Bank expert as part of the FSAP mission. The assessment found that the RTGS system has a solid and reliable legal framework that is in line with international best practice. The governance structure of the system is based on the principles of transparency and accountability, and there is no room for any legal uncertainty regarding the final settlement of RTGS transfers/orders, which is also in line with international best practice. System efficiency and effectiveness indicators are monitored on a regular basis. The NBG has introduced adequate measures for the identification, management and minimization of both financial (liquidity and credit risks) and non-financial risks (operational, legal, and core business risks). We identified a number of less significant discrepancies with the principles of financial market infrastructure in terms of transparency and disclosure, and the need to complete the introduction of a comprehensive risk management framework. The actions taken to eliminate these inconsistencies during 2021 included the publication of the criteria for participation in the RTGS system and information on material aspects of the operation of the system's rules (irrevocability and finality, rules for blocking and suspending a participant, exit from the system, etc.). Work was also underway to formalize the RTGS system's risk management framework, and the self-assessment of the NBG and the Private Central Depository system continued with the support of World Bank experts.

Retail Payment Systems

Based on experience, we revised the draft regulation on payment system and payment system operator oversight. The goal of this revision was to minimize systemic risks and increase the efficiency of payment systems. The legal act covers the requirements for the organizational arrangement of financial market infrastructure; financial and non-financial risk management; settlement; participant default management; system access criteria; and its efficiency and transparency. The regulation applies to all types of payment systems, including the internal systems of financial institutions. This draft regulation defines three categories of systems to be covered by oversight: those are systemically important, those that are exceptionally important, and other types of systems. In line with international best practice, those systems whose failure may pose a threat to financial stability are considered to be systemically important. An exceptionally important system is considered to be a payment system that plays an important role in the execution of retail payments, the shutdown of which may harm a wide circle of customers. To further categorize payment systems, the NBG developed a draft Regulation on Defining Subsystems of Important Systems and Granting Important System Status to a Payment System. This regulation is based on the principles of financial market infrastructure and the standards of the European Central Bank's payment system oversight. The draft regulation has been shared with market participants and consultations are underway.

Based on the monitoring of market demands and trends, fostering objective, non-discriminatory and proportionate conditions for access to the payment system is a priority area that is deemed critical for creating a competitive environment in the payment sector nationwide. Deficiencies found in the compatibility of systems could potentially have a negative impact on the efficiency of the country's payment system. The NBG will continue to work on these areas in 2022.

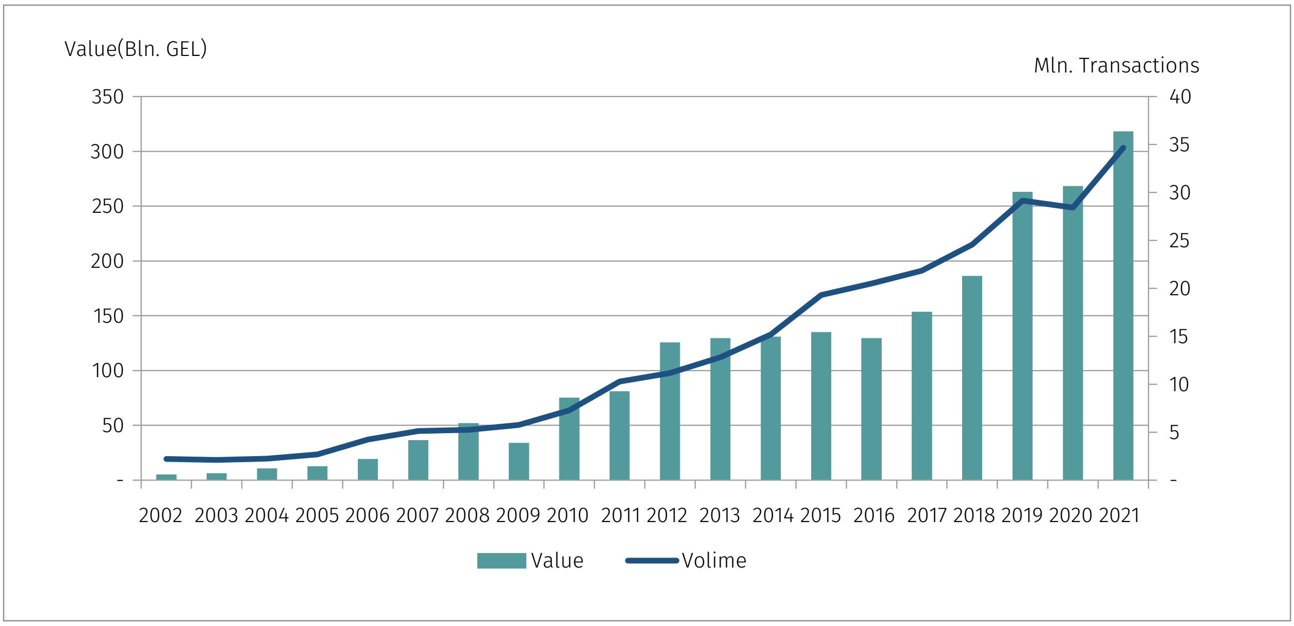
Transactions in the RTGS System

The NBG's Real-Time Gross Settlement System (RTGS) is the key mechanism for interbank payment in national currency. Its unhindered operation is therefore an important precondition for the smooth functioning of the country's financial sector and the economy as a whole. The proper functioning of the RTGS system is also important for other systems (including the GSSS and card systems) as the RTGS system provides for the settlement of operations performed through these. In 2021, as in previous years, a high degree of continuity of system operation was maintained. More specifically, access to the system for participants (banks and the state treasury) exceeded 99.9%. The RTGS system has a business continuity plan developed in accordance with international best practices, which is regularly tested according to pre-defined scenarios. The participants of the RTGS system include 14 commercial banks licensed in Georgia, the NBG and the Treasury Service of the Ministry of Finance.

In 2021, 34.7 million payment transactions were made through the RTGS system, totaling GEL 318 billion, which was 22% higher than the previous year and 19% more in total. Notably, the amount of payments among commercial banks increased by 20.6%, while the number increased by 29.4%.

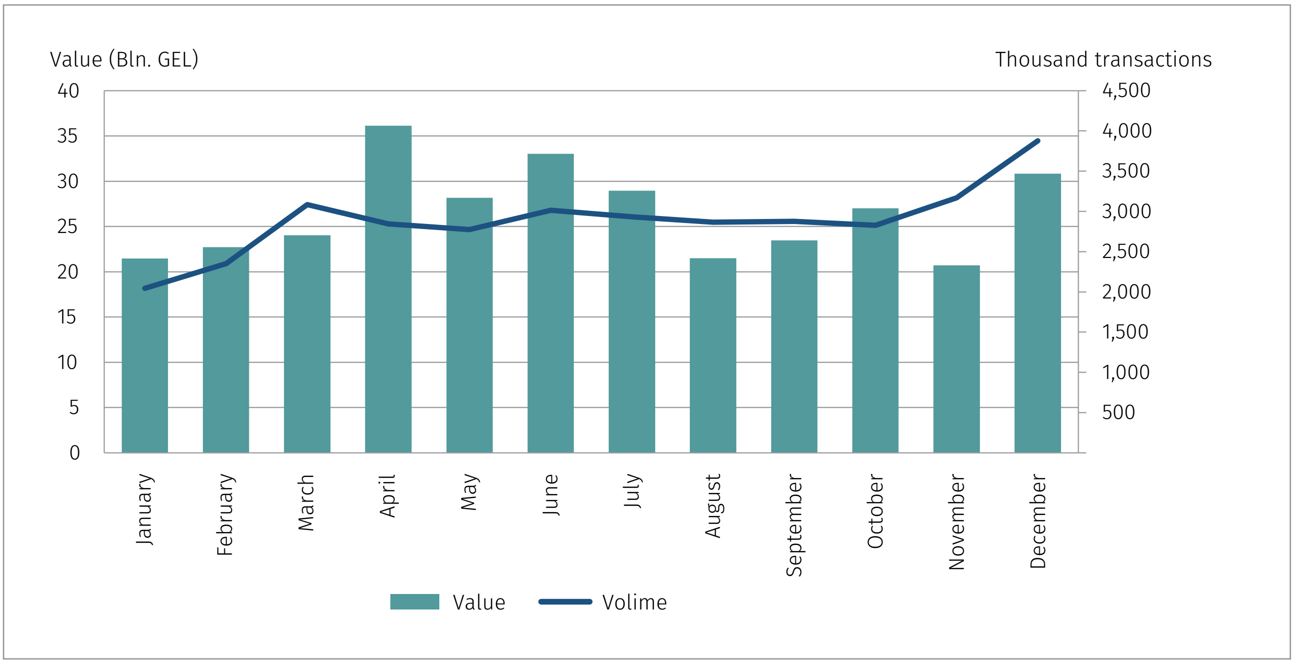
The amount and number of payments made through the RTGS system can be seen in Diagrams N 9.1-9.4 below.

DIAGRAM N 9.1 TRANSACTIONS THROUGH THE RTGS SYSTEM (2002-2021)



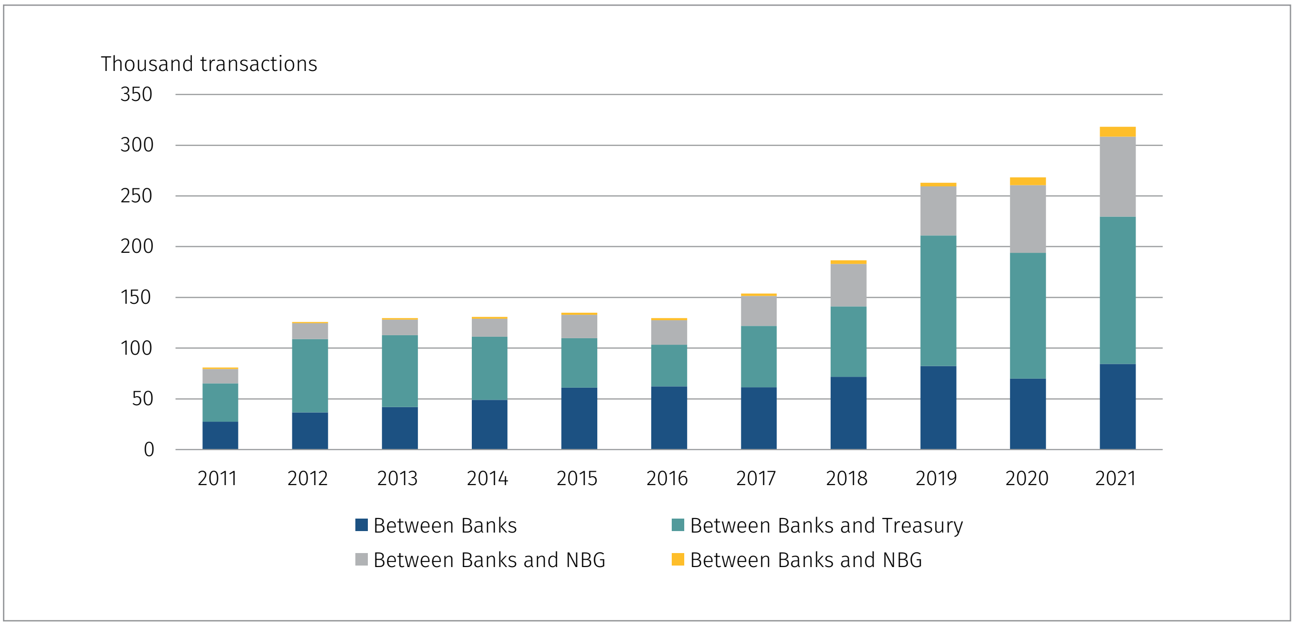
Source: NBG

DIAGRAM N 9.2 TRANSACTIONS THROUGH THE RTGS SYSTEM (2021)



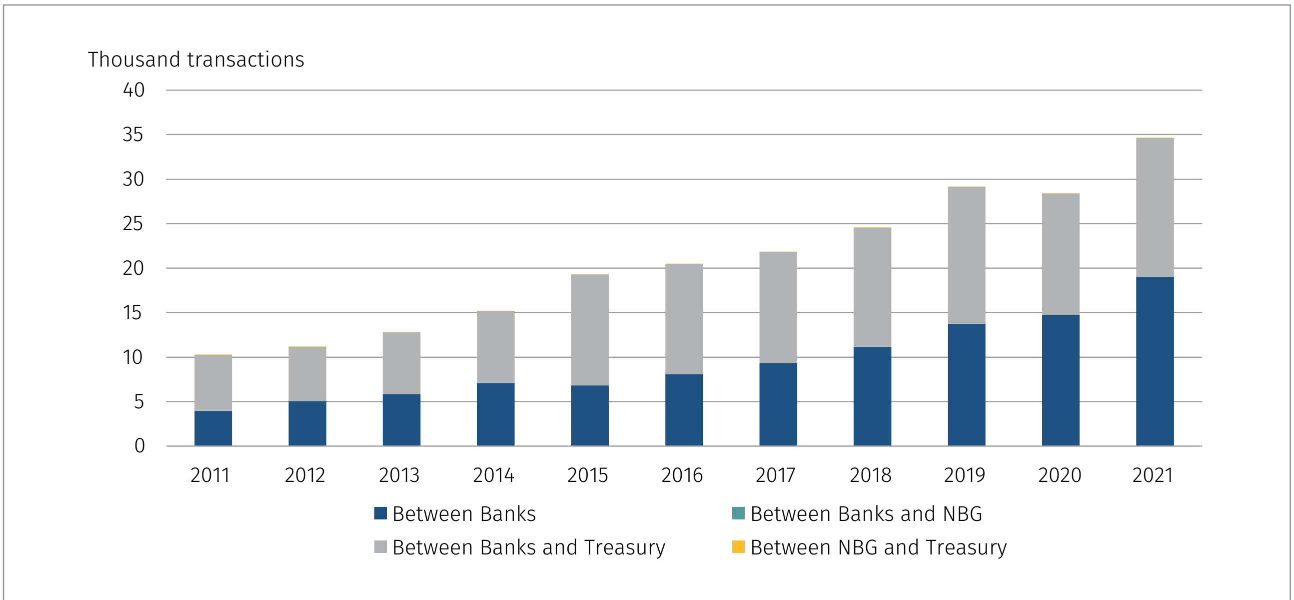
Source: NBG

DIAGRAM N 9.3 AMOUNTS OF RTGS TRANSACTIONS BY PARTICIPANTS (2011-2021)



Source: NBG

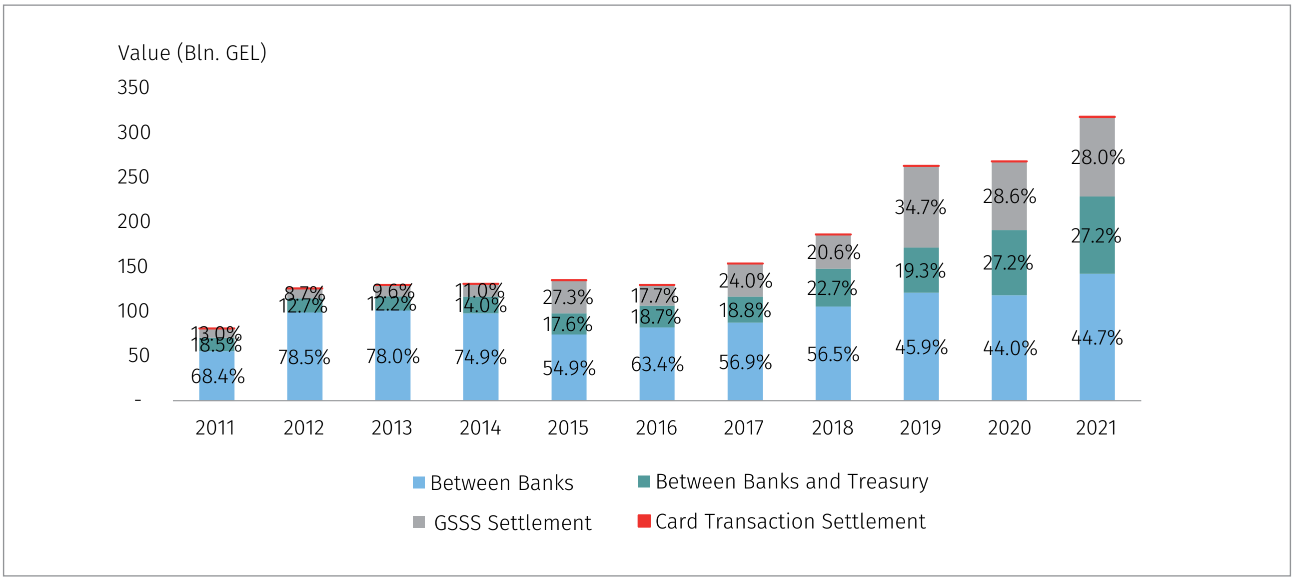
DIAGRAM N 9.4 NUMBER OF TRANSACTIONS THROUGH THE RTGS SYSTEM BY PARTICIPANTS (2011-2021)



Source: NBG

As in previous years, the role of the RTGS system as a payment mechanism for other systems continued to be important. In 2021, the amount of final settlement transactions for other systems increased by 16%, and the share of final settlement transactions for other systems in total RTGS transactions was 28%, which was 1 percentage point lower than in 2020 (see Diagram N 9.5). Such a decrease was mainly due to the 20% increase in payments between banks in the same period.

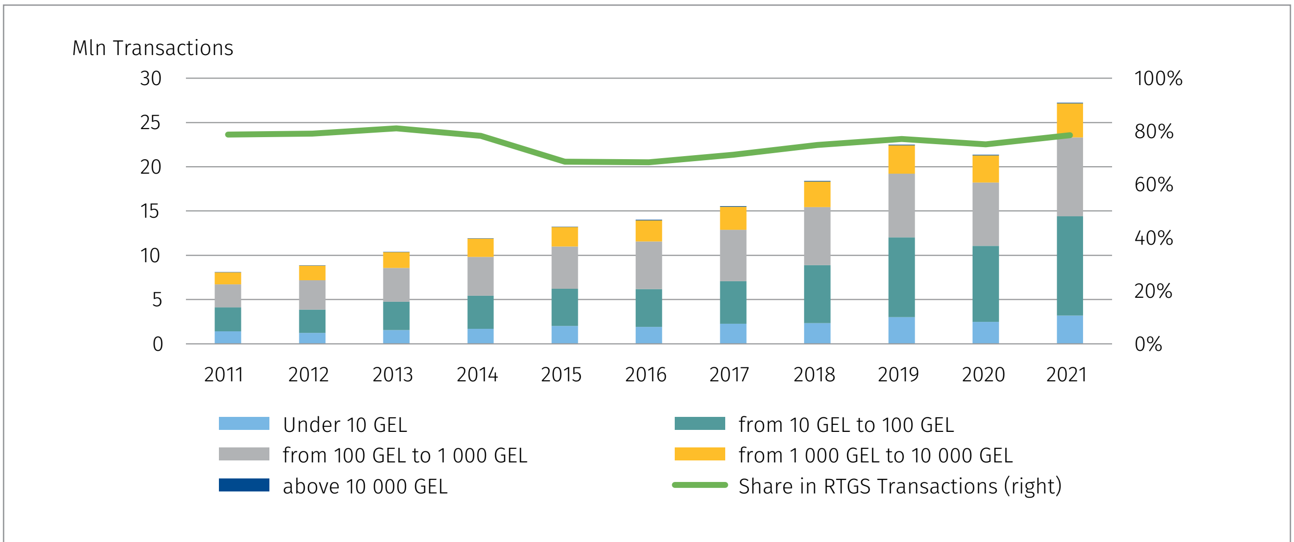
DIAGRAM N 9.5 AMOUNTS OF TRANSACTIONS THROUGH THE RTGS SYSTEM BY SETTLEMENTS (2011-2021)



Source: NBG

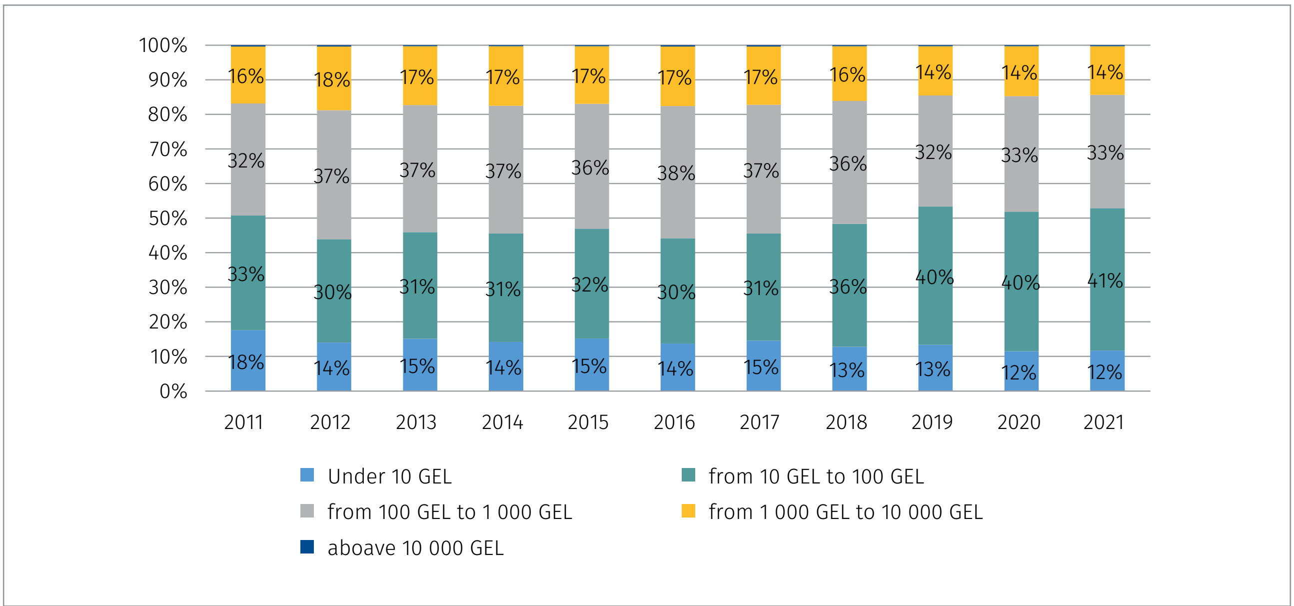
The RTGS system plays an important role in both wholesale and retail payments. In 2021, the share of payments by commercial bank clients in total RTGS payments was 28.8% in amount and 79% in quantity. The distribution of the number of retail payments by amount intervals has been relatively stable during 2011-2021. Over the last five years, there has been a stable increase in the share of payments in the range of GEL 10 to GEL 100 (see Diagrams N 9.6 and N 9.7). Since 2016, the share of payments ranging from GEL 10 to GEL 100 increased by 10 percentage points and amounted to 41%.

DIAGRAM N 9.6 NUMBER OF PAYMENTS BY BANK CLIENTS BY AMOUNT LIMITS (2011-2021)



Source: NBG

DIAGRAM N 9.7 DISTRIBUTION OF PAYMENTS BY BANK CLIENTS BY AMOUNT (2011-2021)



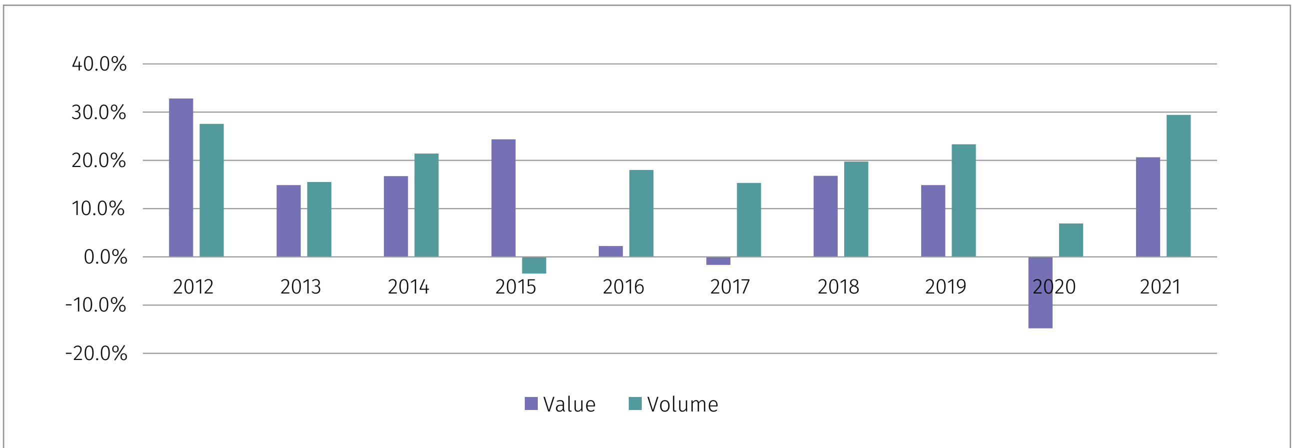
Source: NBG

Impact of the COVID-19 Pandemic on RTGS System Operations

The 2020 pandemic hit virtually all sectors of the economy, including RTGS operations. The number of payments between commercial banks and the treasury dropped drastically. Compared to 2018 and 2019 data, the growth rate of the number of customer payments between commercial banks also decreased. The growth of the amount of transactions through the RTGS system also showed a sharp decline, which was mainly due to the reduction of the growth rate of payments between commercial banks (growth of 21.3% in 2018, 41.1% in 2019, and of just 2% in 2020).

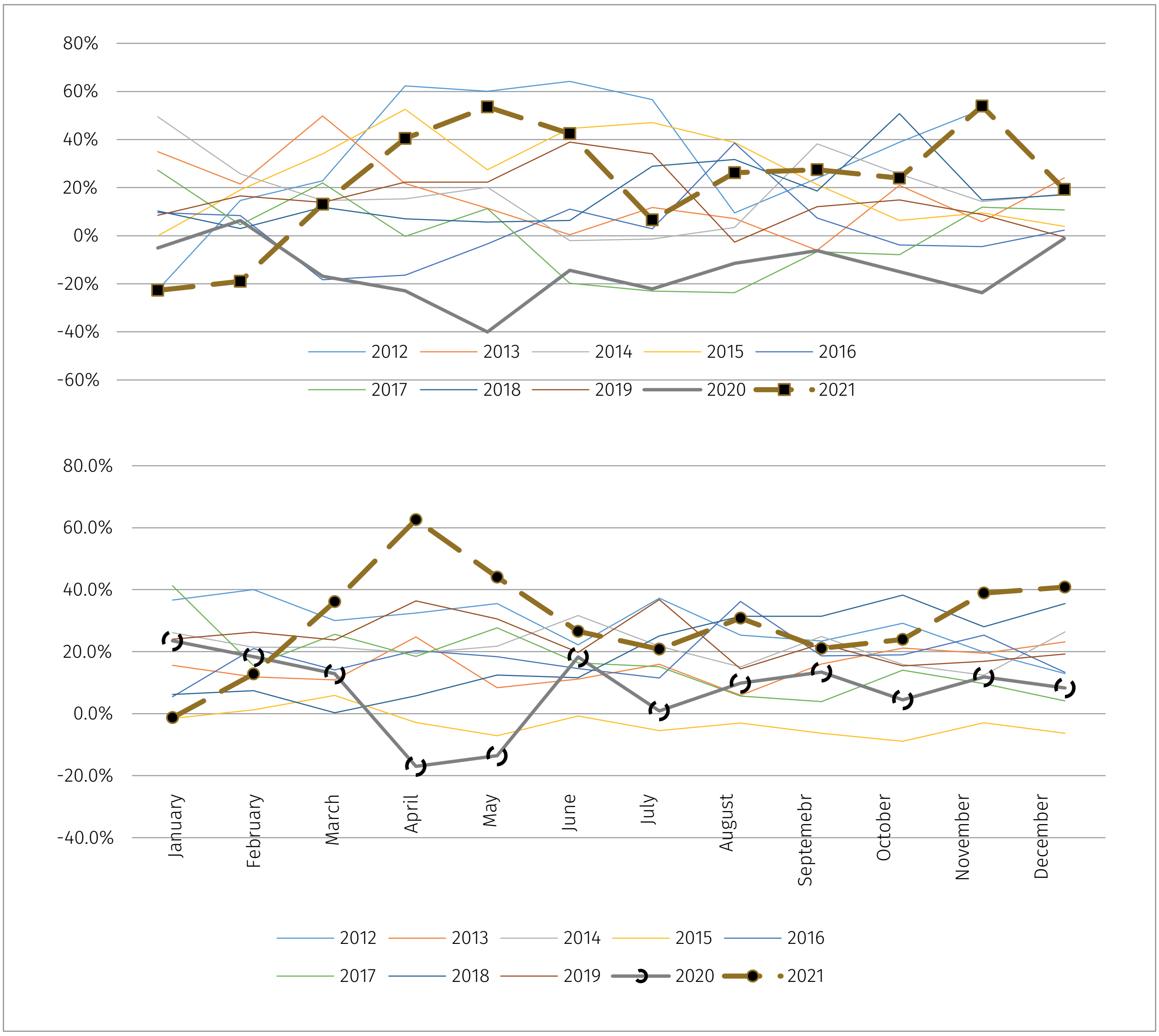
According to 2021 data, despite several waves of COVID-19 and the related restrictions imposed during the year, the dynamics of operations in the RTGS system returned to previous trends, as clearly shown in Diagrams N 9.8 and 9.9.

DIAGRAM N 9.8 ANNUAL CHANGE IN PAYMENTS BETWEEN COMMERCIAL BANKS THROUGH THE RTGS SYSTEM (2012-2021)



Source: NBG

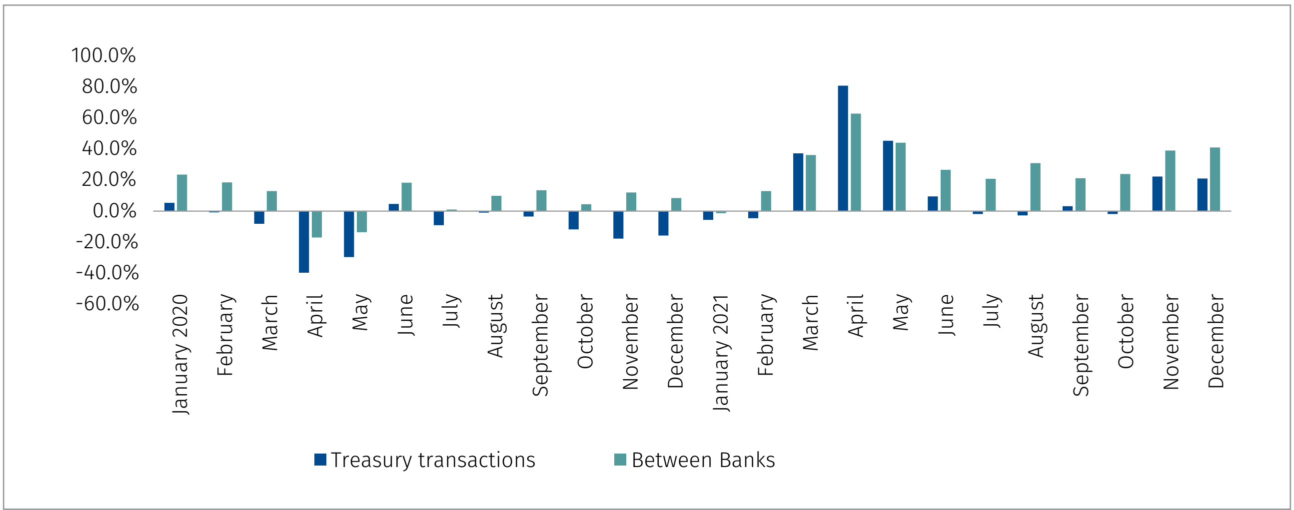
DIAGRAM N 9.9 CHANGE IN PAYMENTS BETWEEN COMMERCIAL BANKS THROUGH THE RTGS SYSTEM COMPARED TO THE CORRESPONDING MONTH OF THE PREVIOUS YEAR (2012-2021)



Source: NBG

This trend is in line with the dynamics of 2020: in contrast to the period of April-July 2020, the restrictions introduced in November-December did not lead to a reduction in either the amount or quantity of client bank payments. Presumably, this was due to several factors: on the one hand, commercial banks and clients were able to adapt to the changed conditions, after which the measures taken to combat the pandemic had only a limited impact on the initiation of payment transactions. On the other hand, at the onset of the restrictions, clients were more reluctant to incur costs. Also, during the period of restrictions imposed in the spring of 2020, a large part of bank clients had their loan payments deferred. As the impact of these factors ceased, or were considerably weakened, in 2021, the dynamics of transactions in the RTGS system returned to the pre-pandemic trends (see Diagram N 9.10).

DIAGRAM N 9.10 CHANGE IN MONTHLY PAYMENTS BY COMMERCIAL BANK CLIENTS (2020 AND 2021)



Source: NBG

Electronic Means of Payment

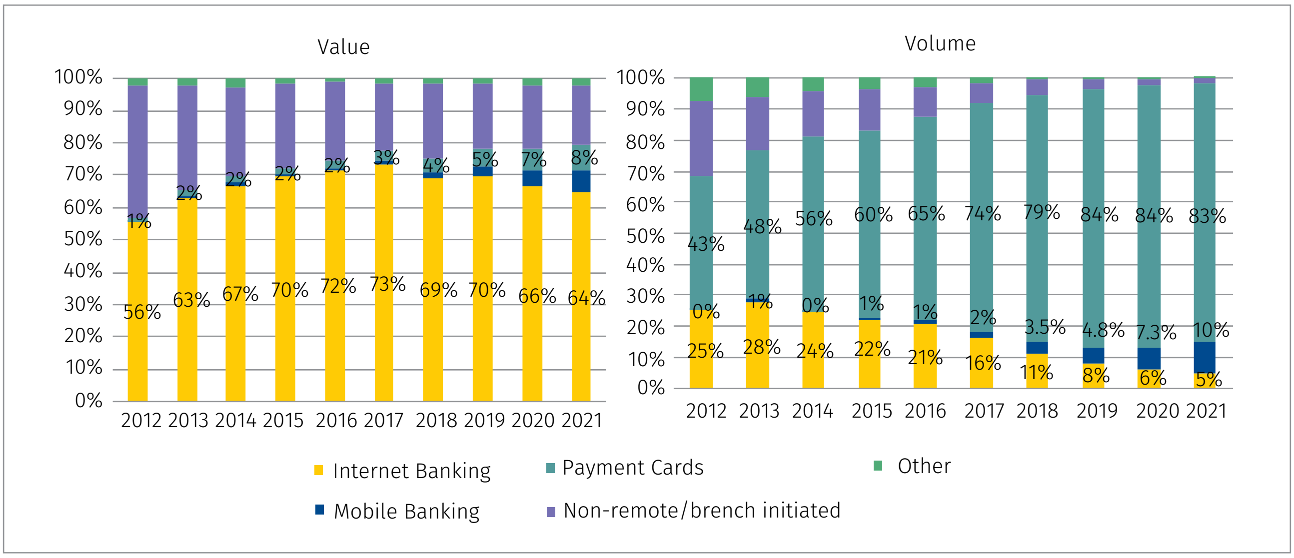
In 2021, the use of mobile bank payments grew rapidly, making these the most frequently used payment method after payment cards. Compared to the previous year, the number of payments made using mobile banking increased by 75% and accounted for 10% of total non-cash payments, which was 3 percentage points (pp) higher than the same period in 2020. Traditionally, in quantitative terms, cards instruments are the most used electronic means of payment. In 2021, the number of card payments made increased by 26% and accounted for 83% of total non-cash payments, which was 1 pp less than the same period in 2020. The number of internet banking payments increased by 3% in 2021 and accounted for 5% of the total number of non-cash payments.

In number terms, internet banking has been the most important electronic means of payment for the last 10 years. In 2021, the share of credit payment initiatives initiated through internet banking in total non-cash payments was 64%, 2 pp less than the same period in 2020. In this regard, the share of payment cards and mobile banking is relatively insignificant, although it has been growing steadily for the last five years. In 2021 overall, payments made with payment cards accounted for 8% of total cashless payments, up by 1 pp over 2020. Similarly, the share of mobile banking payments increased by 2 pp to 7% of total non-cash payments.

Notably, the amount of credit payment orders initiated by clients at the service centers of commercial banks has been steadily decreasing over the last 10 years. The aggregate data for 2021 show that these accounted for 18% of total non-cash payments, which is 2 pp lower than the 2019 figure. Nevertheless, in terms of amounts, the credit orders initiated at bank service centers are still higher than the amount of payments made through mobile banking and card instruments, and only fall short of payments made through internet banking. The picture is different when it comes to quantitative indicators: the number of payment orders initiated at banks' service centers accounted for 2% of total non-cash payments and falls behind the number of payments made through both internet banking and mobile banking.

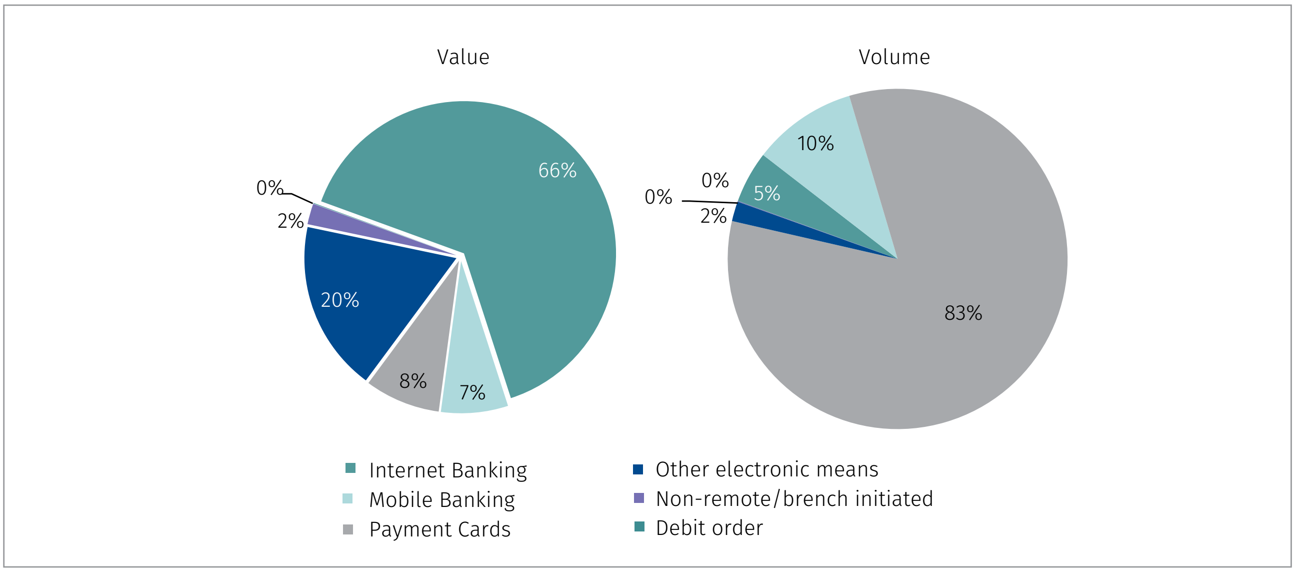
The statistics of cashless payments, in terms of their means of initiation, are shown in Diagrams N 9.11 and 9.12.

DIAGRAM N 9.11 USE OF PAYMENT INITIATION MEANS, 2012-2021



Source: NBG

DIAGRAM N 9.12 DISTRIBUTION OF CASHLESS PAYMENTS BY MEANS OF INITIATING PAYMENT ORDERS (2021)

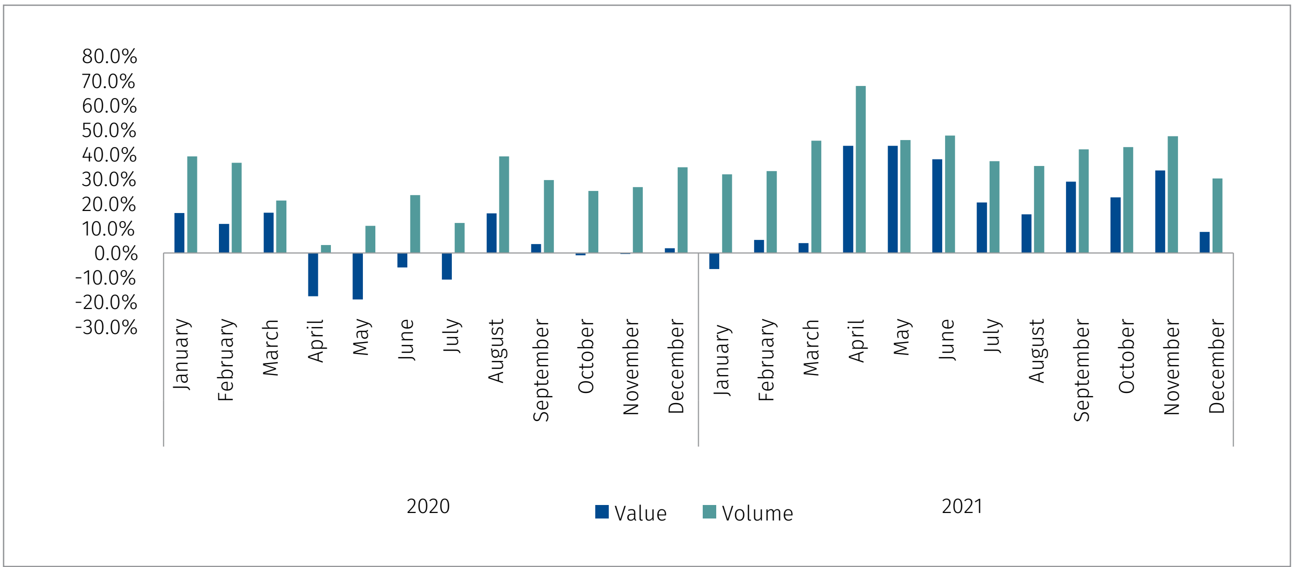


Source: NBG

The Impact of COVID-19 on Electronic Means of Payment

In 2021, a total of 70 million transactions worth GEL 134 billion were made through internet banking and mobile banking, rising by 23% and 42%, respectively, compared to the same period of the previous year. Such growth was mainly due to the impact of COVID-related restrictions seen in the period of April-July 2020. More specifically, as in the case of commercial bank client transactions performed through the RTGS system, the amount of payments made through internet banking and mobile banking sharply dropped in 2020. However, the last two months of 2020 showed that, in quantitative terms, the dynamics of payments made through internet banking and mobile banking were returning to pre-pandemic growth rates. This trend continued through 2021.

DIAGRAM N 9.13 INCREASE IN PAYMENTS THROUGH INTERNET BANKING AND MOBILE BANKING COMPARED TO THE CORRESPONDING PERIOD OF THE PREVIOUS YEAR (2020-2021)



Source: NBG

Card Instruments

The pandemic and related developments in recent years have posed serious challenges to the card instrument business. This was particularly noticeable in the spring of 2020, when both the output of the instruments and the operations performed through them were significantly reduced. The average monthly growth rate of the number of payment cards issued throughout 2021 was 9%. At the end of 2021, Georgian commercial banks issued 6.9 million payment cards, which amounted to 1.8 units per capita. The majority (93%) of the cards issued were international scheme members. Notably, commercial banks only issue credit and debit cards and issuers of electronic money card instruments are thus mainly non-bank payment service providers.[86] The annual statistics of credit cards issued are given in Table N 9.1.

TABLE N 9.1 CARDS ISSUED BY COMMERCIAL BANKS BY YEAR

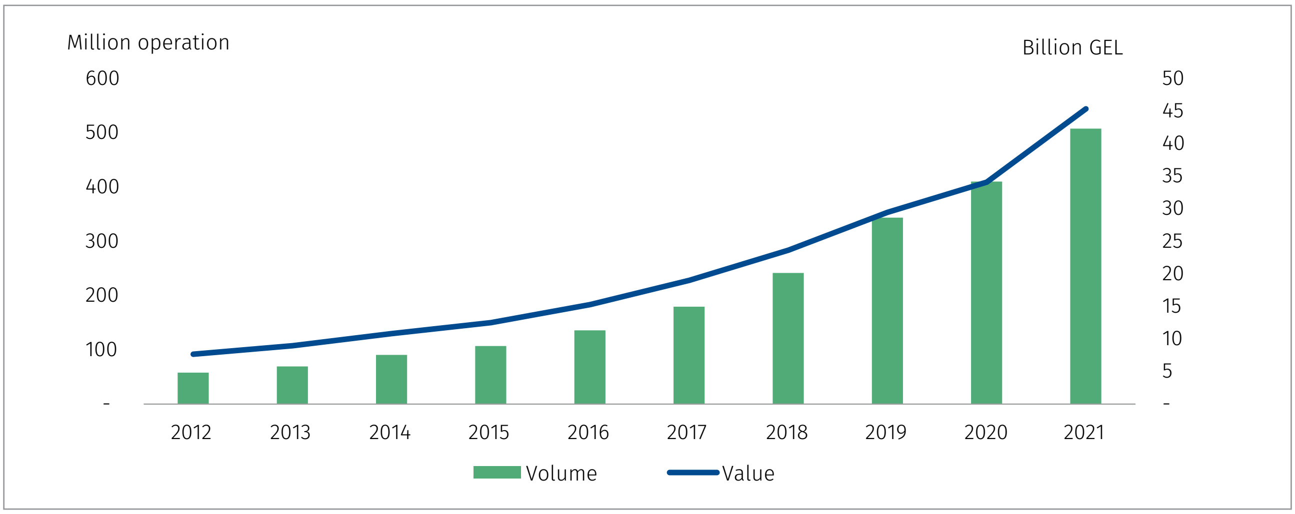
	2017	2018	2019	2020	2021
Cards issued (million cards)	9.1	7.4	6.7	6.9	6.9
including					
Credit (million cards)	0.7	0.7	0.6	0.6	0.6
Debit (million cards)	8.3	6.7	6.1	6.3	6.3
VISA scheme (million cards)	2.5	1.9	1.9	2.2	2.3
Mastercard scheme (million cards)	4.2	4.2	4.3	4.1	3.9
Local scheme member (million cards)	1.6	0.7	0.3	0.5	0.5
Issued per capita	2.4	2.0	1.8	1.9	1.8

86. Payment service providers registered with the National Bank of Georgia.

About 80% of the total number of cards issued are EMV (Europay, Mastercard and Visa) technology cards, with the majority of the remaining 20% being social and/or restricted use cards.

In 2021, a total of 507.4 million transactions were made with card instruments issued in Georgia, amounting to GEL 45.3 billion. As much as 93% of transactions, both number- and amount-wise, were performed domestically, with the remainder occurring outside the country. Some 29% of the number of transactions were performed through a mobile app. The annual dynamics of card transactions is shown in Diagram N 9.14.

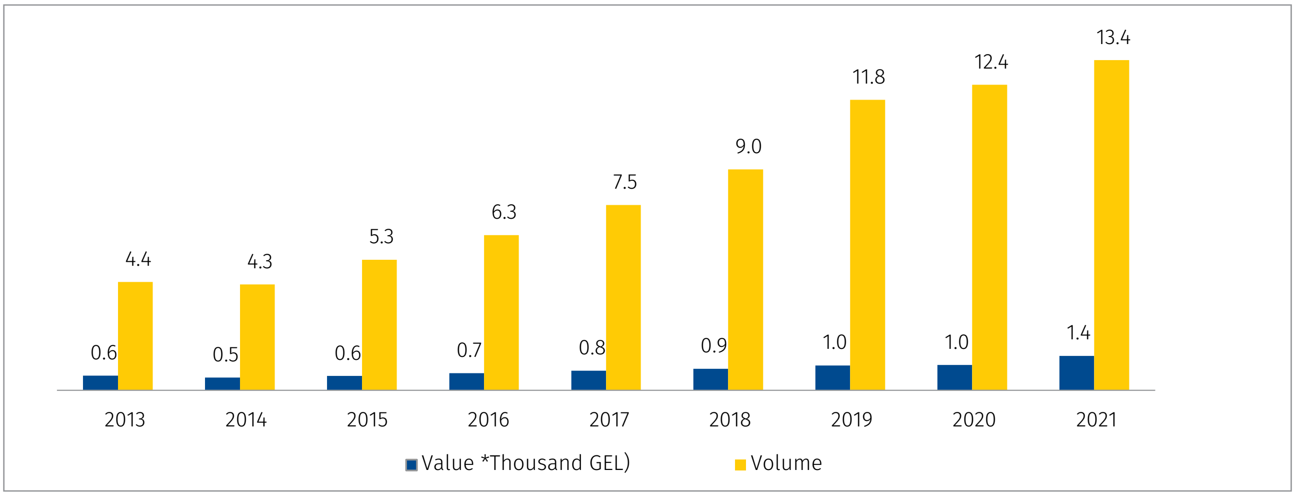
DIAGRAM N 9.14 NUMBER OF TRANSACTIONS COMPLETED WITH GEORGIAN CARDS BY YEAR



Source: NBG

Notably, almost half of the transactions (48%) were operations of up to GEL 50, and the least number of transactions (2%) were those above GEL 5,000. On average, 13.4 transactions were performed with a single card, amounting to GEL 1,400. This figure is one unit higher in number and GEL 400 more in amount compared the corresponding figure of the previous year. The data on average transactions performed with a single card are given in Diagram N 9.15.

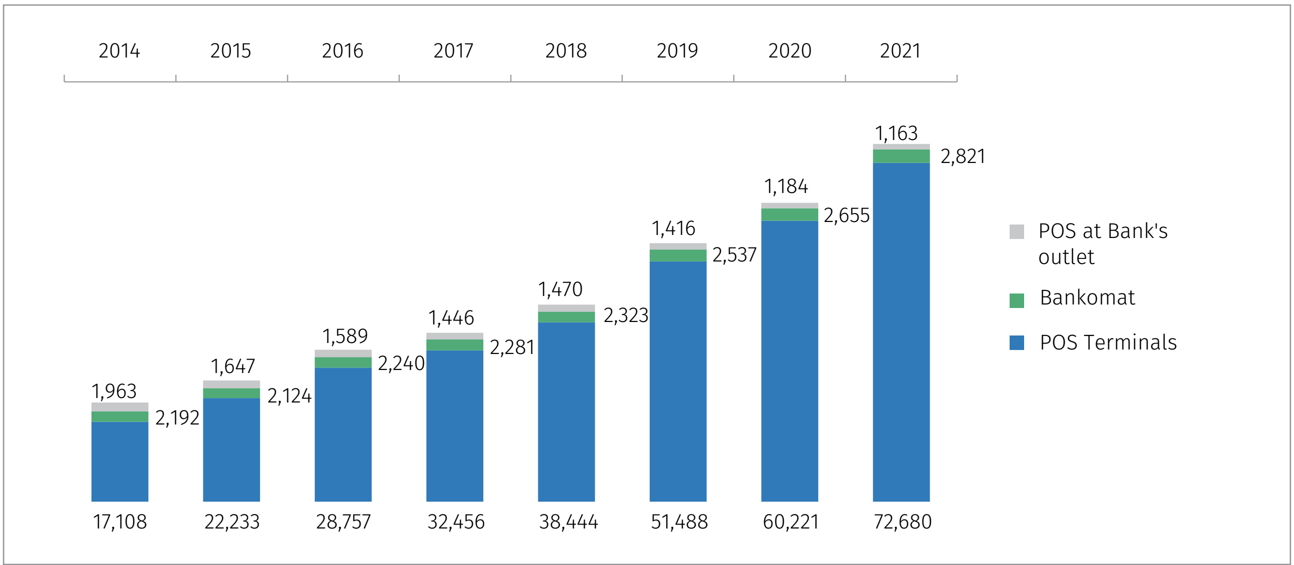
DIAGRAM N 9.15 AVERAGE TRANSACTIONS PERFORMED WITH A SINGLE CARD



Source: NBG

In 2021, of the aggregate transactions, 84% in number and 40% in amount were transactions at merchants, with the remainder being cash withdrawals. The number of e-commerce transactions amounted to 90 million, amounting to GEL 6.5 billion. As much as 79% of these transactions in number and 77% in amount were performed domestically. Approximately 58% in the number of e-commerce transactions within the country and 66% in terms of amount were gambling payments. During 2021, the number of POS terminals in the system increased by 12.5 thousand, the number of e-commerce (virtual) terminals increased by 1.5 thousand and the number of mobile terminals by 4.9 thousand. Most of the card devices are located in the capital city. The annual dynamics of card devices is shown in Diagram N 9.16.

DIAGRAM N 9.16 NUMBER OF CARD DEVICES BY YEAR (DECEMBER)



Source: NBG

As much as 94% of card transactions in quantity and 89% in amount were processed in two major processing centers[87] - Georgian Card and JSC United Finance Corporation. Most of the card transactions processed at processing companies (97% in number and 95% in amount) were done on Georgian card instruments. The number of operations performed with foreign card instruments decreased significantly since the onset of the pandemic. A total of 14.2 million transactions were made in the country with foreign card instruments, totaling GEL 2.3 billion. This figure is almost equal in quantity to the 2019 figure, but is 16% less in the amount.[88]

In 2021, commercial banks, as issuers and acquirers, continued working on meeting the requirements of newly introduced regulations. More specifically, acquirer banks have made any payments made in high-risk points of sale/service facilities more secure and have introduced one-time codes for customers to confirm such transactions. Market participants have also started working on the introduction of modern online monitoring systems in order to evaluate transactions and determine their level of risk. Acquirers have renewed contracts with sales/service facilities and shopping platforms. Market participants have introduced new versions compatible with e-commerce 3D security

87. Also registered with the NBG as payment systems.
88. Notably, the number of transactions by foreign cards in Georgia fell by 60%, and by 59% in terms of amount.

protocol legislation. Meanwhile, issuers have updated the schemes of reflecting amounts on the customer's accounts when paying in foreign currency, thus enabling customers to restrict card transactions in their preferred high-risk shopping facilities before activating the card instrument. Other important work was also done in terms of information transparency and consumer protection.

Supervision of Payment Service Providers

As of 31 December 2021, 32 payment service providers were registered with the NBG, three of which are in the process of being liquidated. In 2021, three entities were registered as payment service providers with the NBG, while two entities were deregistered and the liquidation process was initiated.

Despite the pandemic, the remote monitoring of entities continued as usual. In addition, significant structural changes were initiated in the oversight and regulation of payment systems and payment service providers. Two new units were established out of the former Payment Services Providers Regulation Division of the Payment Systems Department: the Payment Systems Oversight Division and the Payment Service Providers Supervision Division.

In 2021, work also continued on improving the regulatory framework and reporting for the oversight of payment service providers. In order to approximate to the EU Directive, work was underway on a draft regulation on the capital adequacy requirements for payment service providers. Based on the results of a simulation performed by the NBG, as well as the analysis of the financial statements of the providers, the draft regulation was improved and became more accurate. Adoption of the regulation is scheduled for 2022.

Payments by Providers (Except for Electronic Money Transactions)

In 2021, 141 million transactions worth GEL 8.1 billion were completed by payment service providers. Compared to 2020, the number of payments decreased by 1.3%, while the amount increased by 34.8%. The dynamics of providers' payments (excluding electronic money) are given in Diagram N 9.17.

Self-service kiosks are traditionally used to make payments, as these enable the initiation of electronic payments in cash. As much as 94.3% of the number of payments were made through kiosks and 95.1% of the amount, which is 1.4 and 0.3 pp less than the same figures for 2020, respectively. Payment service provider's websites are also often used to initiate payments. Transactions worth GEL 113 million (3.3 million in number) were completed through these, which was an increase of 45% and 50% over the previous year, respectively.

In 2021, the share of payments made using agents in total payments by providers changed slightly. Registered payment service providers used agents to complete 46.5% of the number of payments and 20% of the amount, being 0.3 and 1.3 pp less than the same period in 2020, respectively.

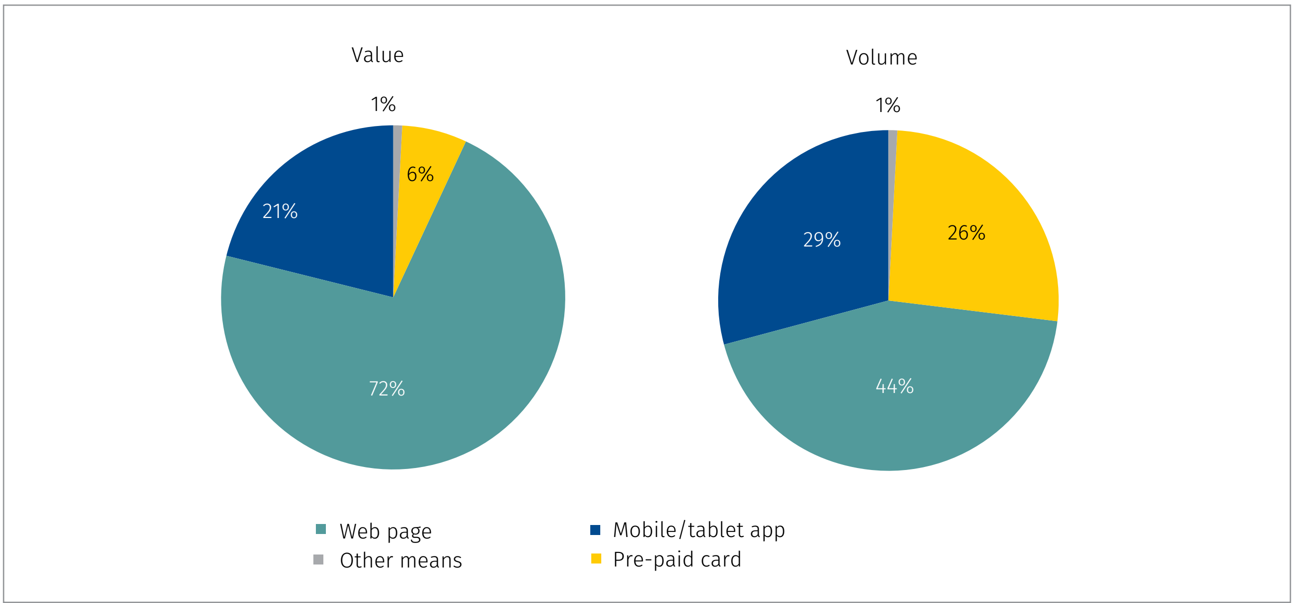
DIAGRAM N 9.17 PAYMENTS EXECUTED BY PAYMENT SERVICE PROVIDERS (EXCEPT E-MONEY)

Source: NBG

Payments with Electronic Money

As is traditional, 2021 saw prepaid transport cards retain the lead in the market of payments made with electronic money. The average amount of a single payment made using these cards is GEL 0.37, which is a figure that is radically different from other payments made with electronic money. Transport cards are widely used to pay for city public transportation, hence the number of payments made through them is much higher than those made with other electronic money. Transport cards account for 98.4% of total electronic payments in number and 10.3% in amount. Given this peculiarity, the analysis of the electronic money market below is given without considering transport cards. In 2021, GEL 257.6 million worth transactions (1.25 million in number) was paid by e-money providers. Some 43.4% of the mentioned payments (in number) and 71.5% in amount are the ones made through websites. A significant portion of e-money payments (29.1% in number and 21.4% in amount) were initiated using a mobile phone/tablet app.

DIAGRAM N 9.18 PAYMENTS WITH E-MONEY (EXCLUDING THE TRANSPORT CARD INSTRUMENT) (2021)

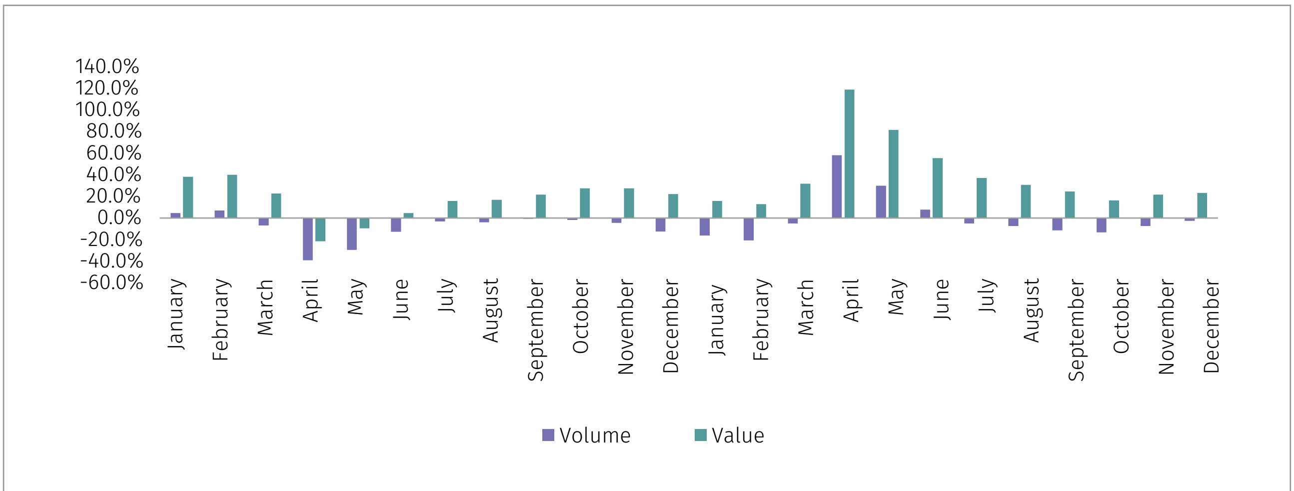


Source: NBG

The Impact of the COVID-19 Pandemic on the Operations of Payment Service Providers

The COVID-19 pandemic had a major impact on the functioning of payment service providers, including self-service kiosks that are the most commonly used means of payment. However, while both the amount and number of indicators decreased in April-June 2020, the reduction in the period of restrictions imposed in November-December 2020 only affected the number of payments. The same trend was evident in 2021, expressed in a reduced number of payments made through self-service kiosks but an increase in the amounts (see Diagram N 9.19).[89]

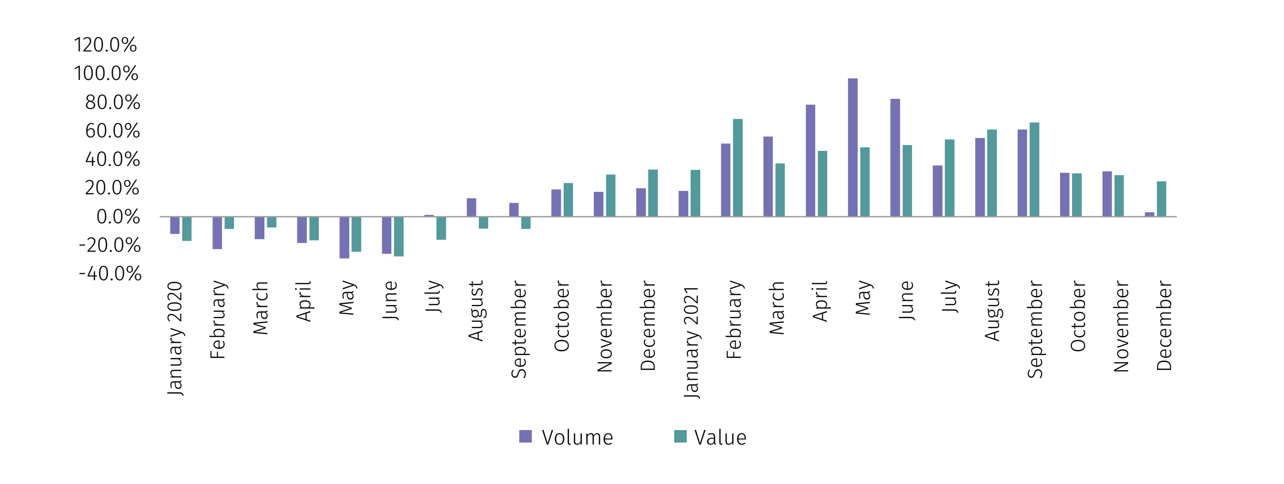
DIAGRAM N 9.19 CHANGE IN PAYMENTS MADE THROUGH SELF-SERVICE KIOSKS COMPARED TO THE CORRESPONDING PERIOD OF THE PREVIOUS YEAR (2020-2021)



Source: NBG

Starting from late 2020, both the amounts and number of payments made with electronic money accelerated. The trend has persisted in 2021, as clearly shown in Diagram N 9.20.

DIAGRAM N 9.20 CHANGE IN PAYMENTS WITH E-MONEY COMPARED TO THE CORRESPONDING PERIOD OF THE PREVIOUS YEAR (2020-2021)



Source: NBG

Payments Between Providers

When delivering payment services, providers often use intermediary providers to run their operations more efficiently. According to 2021 data, 34.7% of the total amount of orders received by providers from payers were performed using intermediary providers, which is 0.8 pp less than the same figure in 2020. As for funds transferred to recipients, 99% of payments made by providers were made in resident commercial banks of Georgia, as in the previous year.

10

DEVELOPMENT OF INFORMATION TECHNOLOGIES

In 2021, the **Infrastructure Management Division** of the Information Technology Department completed the process of upgrading the core components of the NBG data processing centers. This included the following projects:

- The outdated chillers of the cooling system, which had been operating continuously for many years, ended their service period and their manufacturer's warranty period expired. The chillers were thus replaced with completely new, state-of-the-art devices that are more energy-efficient and flexible. The upgraded cooling system will serve the NBG's data processing centers continuously for many years to come.
- The uninterrupted power supply modules and accompanying batteries were completely upgraded. This will make the power supply more efficient and reliable in the event of any power cuts.
- We completely replaced the water measuring sensors of the cooling systems in the communication racks, fire modules, access sensors, and temperature and humidity measuring sensors.
- The data processing center monitoring software was updated to the latest version recommended by the manufacturer. It monitors the data in real time and, in the event of an error, sends an appropriate response message.

As a result of these large-scale updates, the data processing centers will work fully and reliably for many years to come.

In 2021, the NBG continued to work on **cybersecurity** by introducing new products. The NBG introduced an information security incident monitoring and management system, with the following objectives:

- Creating a unified view of information security events and incidents.
- Normalizing, aggregating and correlating information security events.
- Improving the quality of processing information security events.
- Automating the detection of, and response to, information security incidents.

The Cybersecurity Division was, as usual, proactively involved in raising the cyber awareness of NBG staff. During 2021, new employees were trained in cybersecurity awareness, while current employees were regularly informed about underlying cyber threats and ways to avoid them.

The Cybersecurity Division conducted a bank-wide phishing simulation to check the level of cyber awareness and the response time of NBG employees. NBG employees were sent an illegitimate message from an e-mail address similar to that of the electronic records management system. Based on the results of this simulation, employees attended additional cyber awareness-raising training sessions.

The staff of the Cybersecurity Division also participated in a number of online conferences and seminars during the year. The involvement of the NBG in these activities was beneficial for the development of the information technologies and services of the NBG as a whole. One such highlight was the training on capacity building within the framework of the strategic partnership between Georgia and Estonia. The training covered advanced hands-on hacking, OSINT training and a CRX technical exercise that was designed to strengthen mechanisms for identifying cyber incidents and ensuring an effective response. The training helped the staff of the Information Technology Department expand their knowledge, and participants received certificates at its completion.

In 2021, the **Data Management Division** developed the following web applications:

- **UserManager** – Client Management System. This application simplifies the process of assigning roles and rights and ensures a single standard of user management for all systems. The project encompassed the study and analysis of the visitor management process.

- **DsSetReport** – At the request of the Macroeconomics and Statistics Department, a web application was developed to optimize the generation of analytical reports of the NBG. The app allows easy editing, improves current reports, and enhances the ability to generate new reports.
- **Providers** – A centralized web-app model was developed for structured data about providers registered by the NBG.
- **VMS Visitor Management System** – A new web application provides electronic control of the entry/exit registration of visitors to the NBG's offices. The app allows production of registration records, the processing of statistical data and protection against unauthorized access.

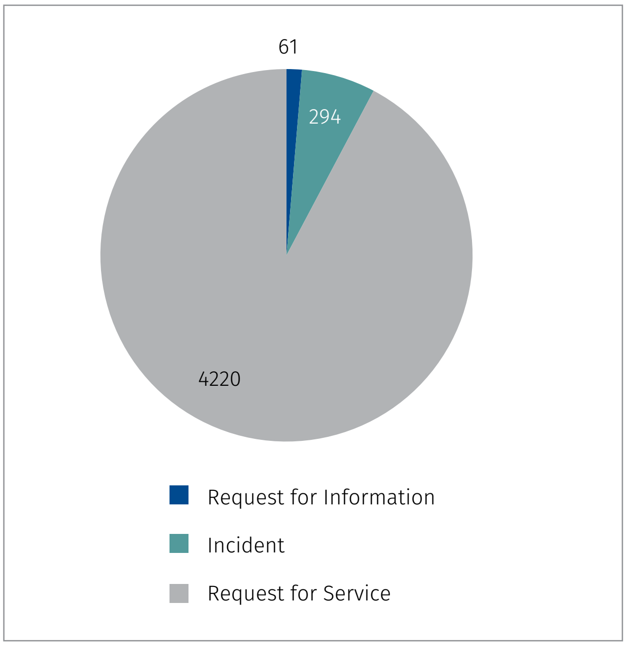
The **Applications Administration Division** made the following changes to business apps during 2021:

- **Automated Human Resource Management System (HRMS**) – The updated version includes a significant technology upgrade. Major changes were made to the HR administration and payroll modules.
- **SAP Success Factors** – A completely new management system for employee appraisal and recruitment was introduced. Through this system, employees can enter information about their goals, competencies, evaluations and development into a centralized online system, which replaces the process of working with Excel files and improves evaluation management.
- **The SWIFT** application version ISO-20022 standard underwent significant changes: a test environment was created, and a new isolated environment was arranged for a notifications archive for liquidated entities.
- **Tableau** – An updated version of the existing software offers improved capabilities and makes working with data more efficient. A new component (Tableau Prep Conductor) provides automation of multiple flow operations. It is now possible to receive immediate notification of potential data problems.

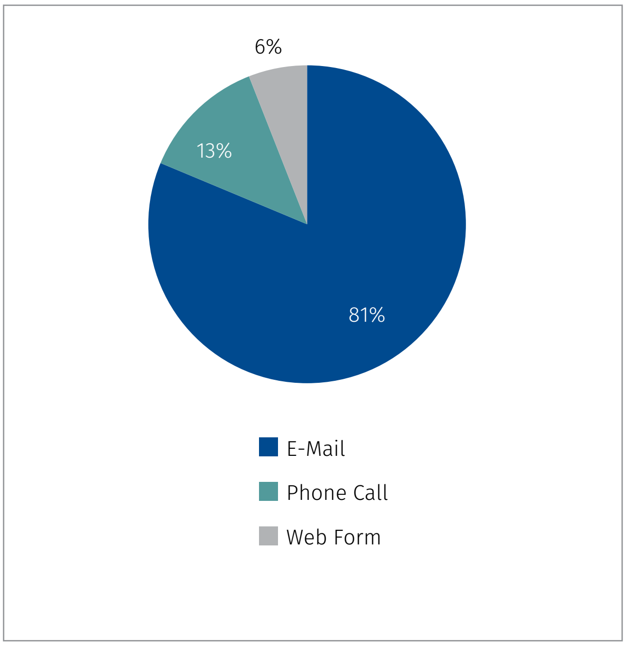
During the continued COVID-19 pandemic in 2021, the majority of the bank's staff worked remotely. Our service department thus ensured the acquisition of additional laptops for this purpose. To meet the requirements for remote work, the laptops were technically repaired and handed over to employees in the shortest possible time.

Throughout 2021, the staff of the Service Division continued to work in a force majeure situation, supporting employees 24/7. A total of 4,575 incidents/requests were registered on the Service Desk portal during the year. Most of the requests received from staff were for services. The most popular method of making a request remained sending an email message to the service desk email address.

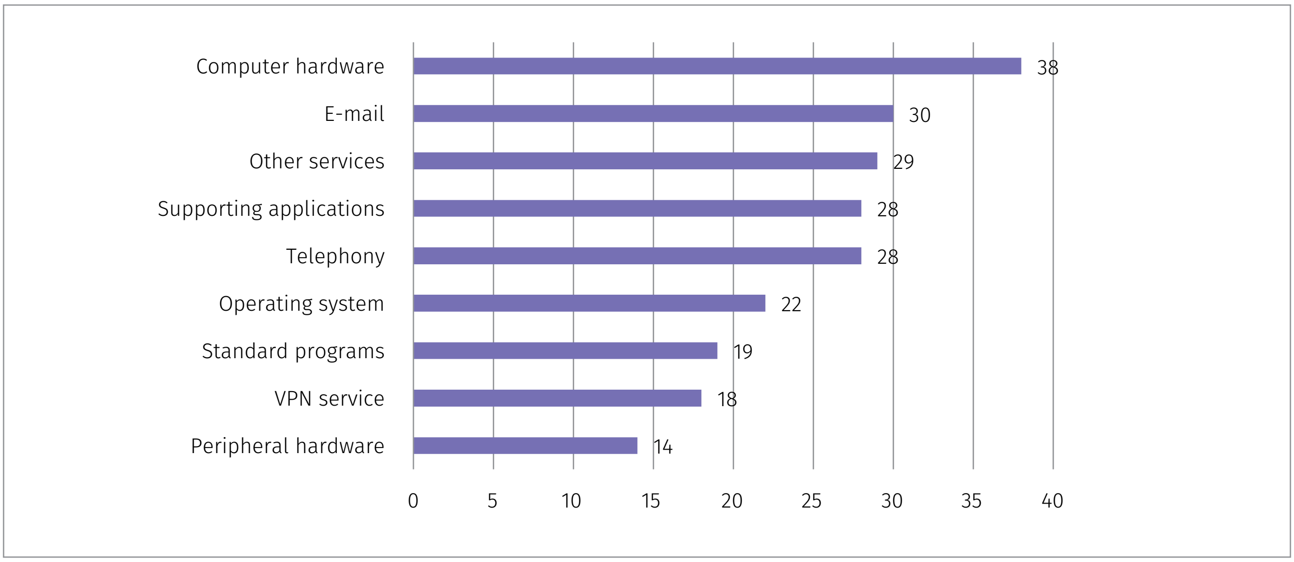
QUANTITIES BY THE TYPE OF DEMAND



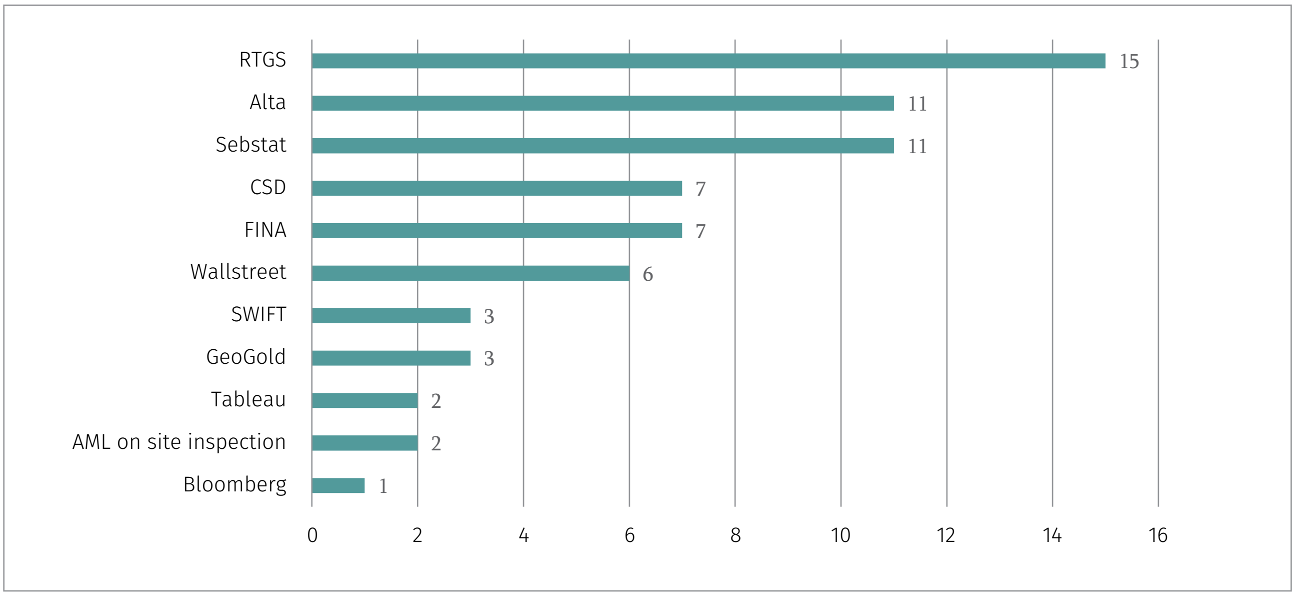
QUANTITIES BY THE SOURCES OF REGISTRATION



DUE TO THE PANDEMIC, MOST INCIDENTS WERE RELATED TO THE FOLLOWING SERVICES:

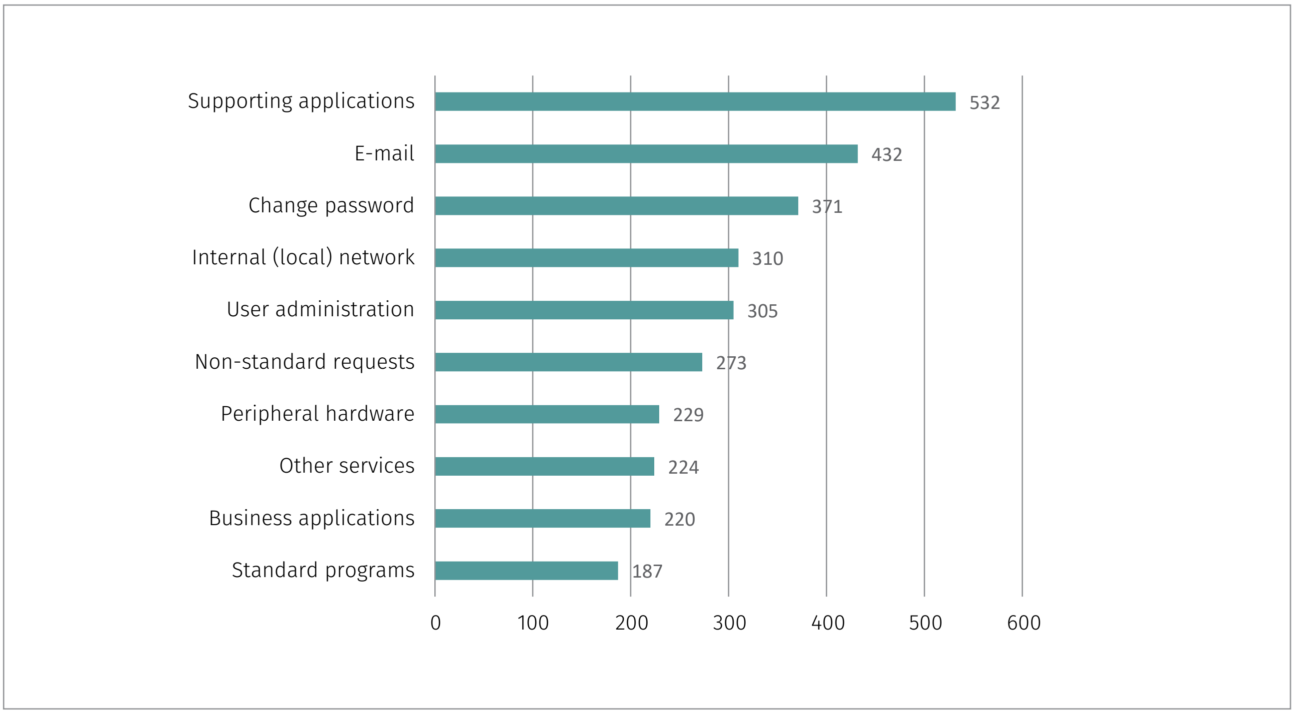


SOME 23% OF INCIDENTS RECORDED WERE ABOUT DIFFERENT BUSINESS APPLICATIONS:



As much as 86% of the incidents were resolved within the set timeframe, while 14% required more time to resolve, which was mainly due to the need for communication with third parties.

According to the Annual Report of the Service Desk, the statistics for the most requested IT services were as follows:



The figures for the distribution of incidents and requests between the divisions of the Information Technology Department are given in the table below:

IT Division	Information request	Incident	Service request
Service Division	36	175	2963
Applications Administration Division	19	78	496
Infrastructure Management Division	4	21	374
Cyber Security Division	2	6	198
Data Management Division	0	14	168

The IT Department continued working vigorously in the face of the COVID-19 pandemic. The year was a fruitful one, with various modern technologies being developed and introduced. A number of valuable projects are planned for next year to help attain the key tasks and objectives of the bank.

11

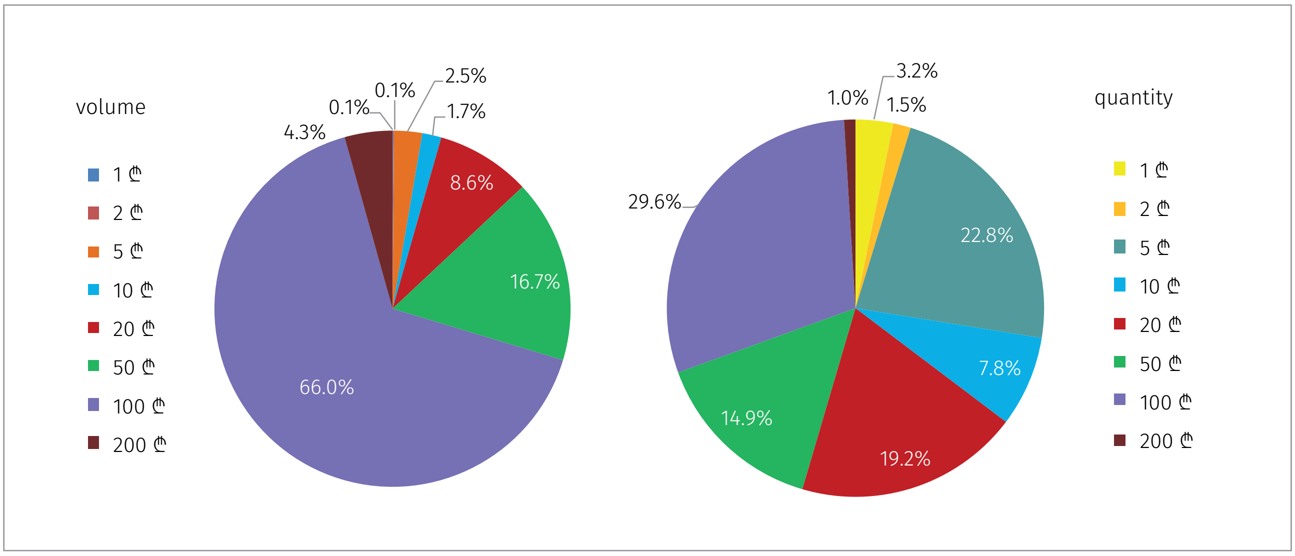
ORGANIZATION OF CASH AND EMISSION ACTIVITIES

Despite the spread of the COVID-19 pandemic, the Cash Operations and Cash Circulation Department continued to operate and perform its functions with maximum effort. The country's economy was smoothly supplied with GEL banknotes and coins. The department also worked on the production and issuance of collector coins.

The department continued to work on improving the quality of banknotes and coins in circulation, working with newly produced GEL banknotes/coins and processing those received from circulation in the prescribed manner, upgrading the functions of experts and taking care to develop a better legal framework.

As of 31 December 2021, cash in circulation amounted to GEL 4,589 million, of which banknotes accounted for GEL 4,437.3 million and coins for GEL 151.7 million (see Diagram N 11.1).

DIAGRAM N 11.1 SHARE OF BANKNOTES IN CIRCULATION BY DENOMINATIONS AS OF 31 DECEMBER 2021 *

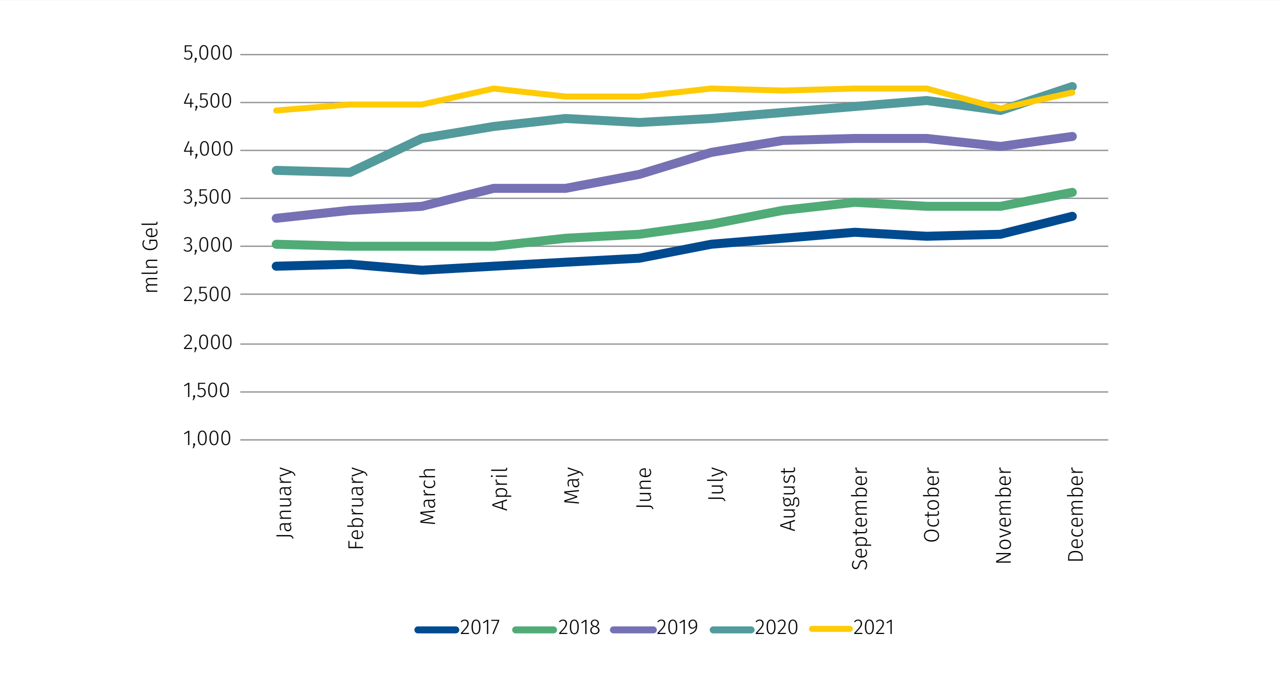


** Including the 1- and 2-lari banknotes in circulation, which ceased to be manufactured after coins of the same denomination were placed in circulation.*

Source: NBG

During the reporting period, the volume of cash in circulation decreased by GEL 72.4 million, or by 1.5% compared to the beginning of the year (see Diagram N 11.2).

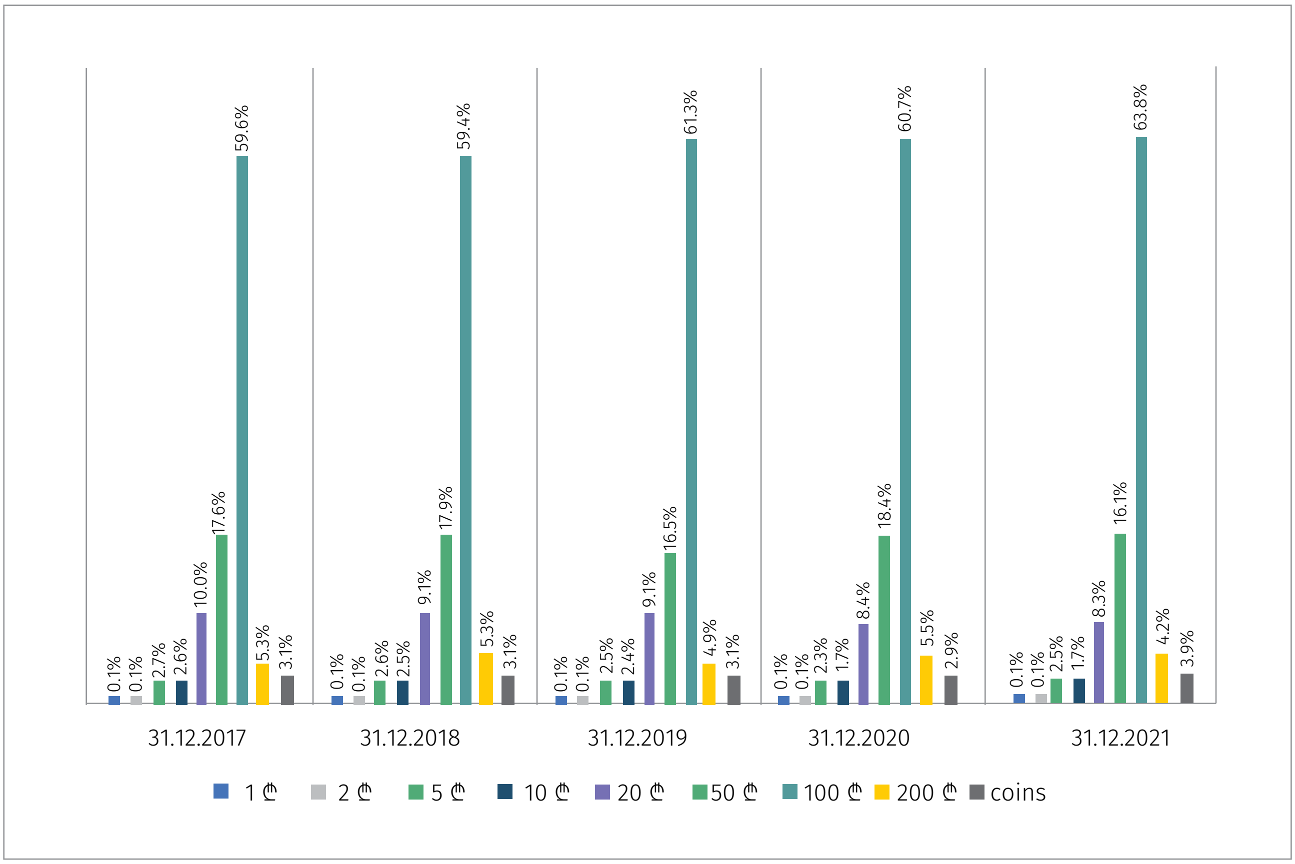
DIAGRAM N 11.2 GEL CASH IN CIRCULATION (2017-2021)



Source: NBG

The amount of banknotes in circulation decreased by GEL 89.3 million during 2021, and their share in the total amount of money in circulation was 96.7%. During this period, demand only increased for the 5 and 100 GEL denomination banknotes (rising by 6% and 3.5%, respectively), while falling for all other denomination banknotes. Demand decreased by 4.9% for GEL 10 banknotes, 2.8% for GEL 20 banknotes, 13.7% for GEL 50 banknotes and 24.7% for GEL 200 banknotes. As the total turnover reduced during the reporting period, compared to the previous year, the total amount of coins in circulation climbed by 12.5 % and their share in total turnover amounted to 3.3% (see Diagram N 11.3).

DIAGRAM N 11.3 SHARE OF BANKNOTES OF INDIVIDUAL DENOMINATIONS AND COINS IN CIRCULATION (2017-2021)*



** Including the 1- and 2-lari banknotes in circulation, which ceased to be manufactured after coins of the same denomination were placed in circulation.*

Source: NBG

We also successfully completed the process of upgrading the circulation by withdrawing the banknotes issued before 2016 and replacing them with the new versions of the GEL 5, 10, 20, 50, and 100 banknotes. At the end of the reporting period, the renewed GEL 5 banknote accounted for 86.5% of the total of that denomination banknote in circulation, the GEL 10 banknote accounted for 87.6%, the GEL 10 banknote for 58.4%, the GEL 20 banknote for 87.4%, the GEL 50 banknote for 93.3%, and the GEL 100 banknote for 92.8% (see Diagram N 11.4).

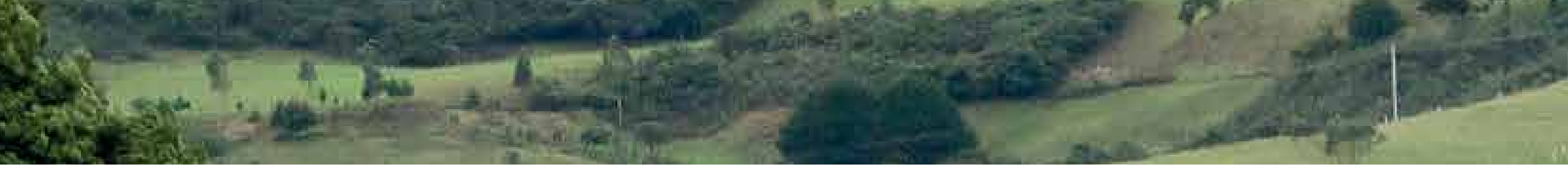
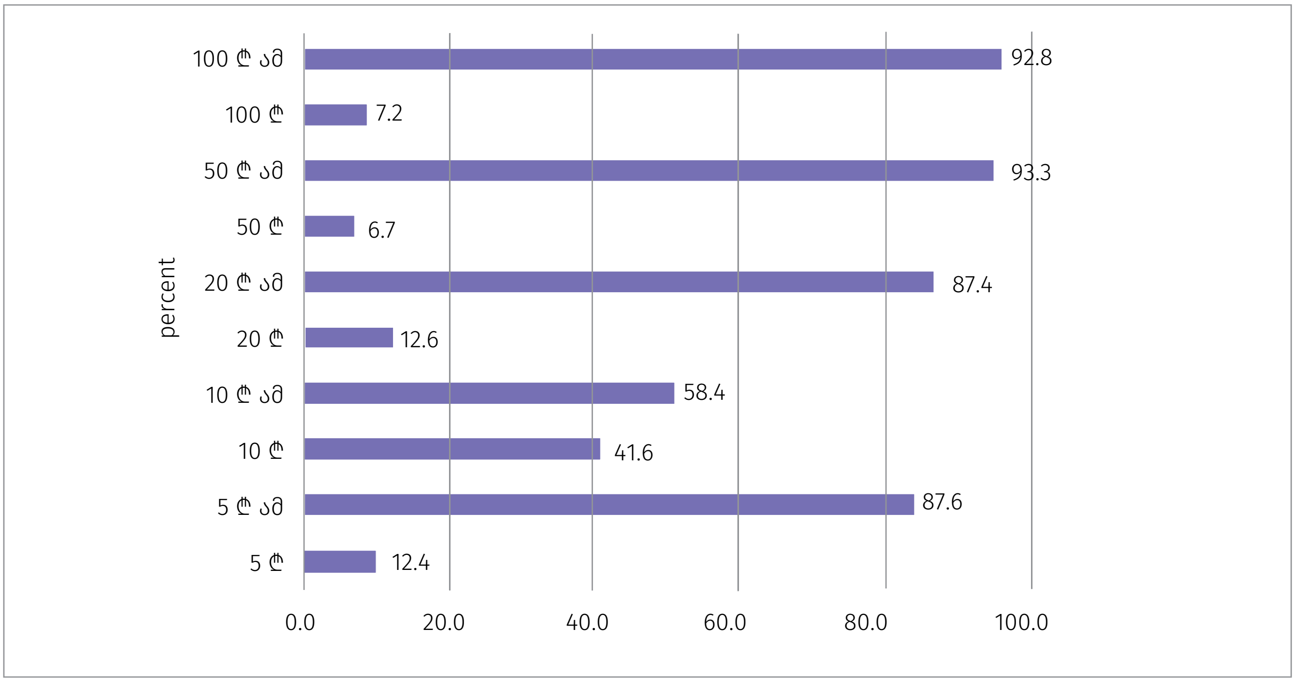


DIAGRAM N 11.4 PERCENTAGE OF GEL 5, 10, 20, 50 AND 100 DENOMINATION BANKNOTES IN CIRCULATION, ACCORDING TO MODIFICATIONS



Source: NBG

The 1995-99 issue of banknotes expired at the end of 2021. From 2022, the exchange of banknotes of this issue will only be possible through the NBG.

At the end of the reporting period, the share of the old modification banknotes (issued before 2016) by piece in relation to the new modification banknotes of the same denomination in circulation was only 12.3%.

During the reporting period, the amount of GEL 1 and GEL 2 coins in circulation increased by 14.6% and amounted to GEL 101.9 million at the end of the year. Compared to 2020, the total amount tetri coins in circulation increased by 8.8%.

To ensure the uninterrupted cash supply of the national economy and to replenish the NBG's reserves, work continued during the reporting period to produce and issue GEL banknotes and coins, and to meet related obligations. In this regard, the following important steps were taken during the reporting period:

- The production of GEL 5 and GEL 20 banknotes was completed. The design and other characteristics of the banknotes are the same as their predecessors, with the exception of the following changes: they feature the issue year (2021) and the signature of the active Governor of the NBG, and the tones of the background grids have been slightly changed, without changing their primary colors, in order to reduce the risk of the denominations interfering with each other. The circulation of these banknotes commenced on 1 July 2021.
- In conformity with the terms of the relevant contracts, a final settlement was made with partner mints following the control recalculation and sorting of the 10- and 50-tetri coins received in 2020.
- The production and delivery of 20-tetri coins is now complete. A final settlement with the partner mint will be made following the controlled counting and sorting of the received coins.

During the reporting period, work was started for producing circulation coins of three different denominations. For this purpose, a tender was announced to select partner companies and relevant agreements were concluded with those companies submitting the most competitive bids.

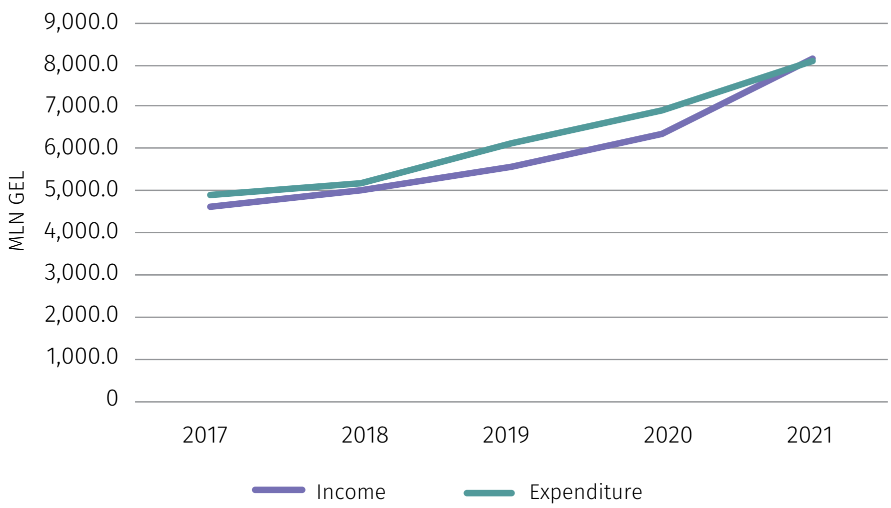
In its efforts to promote the national currency and the country as a whole, the NBG continued to issue collector coins during the reporting period (for more information on these, see the section on Collector Coins, below).

In the circumstances of the COVID-19 pandemic, the NBG continued to take preventive measures to ensure the uninterrupted supply of cash for the national economy and to minimize related risks:

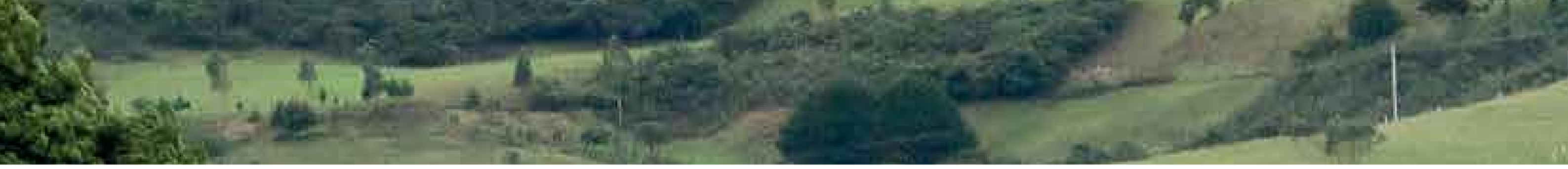
- At the onset of the pandemic, the NBG promptly developed and approved a new procedure to foster cash management, control, and quality, as well as software optimization at the external vaults of the Cash Centers, which are located at three different locations and are equipped with security measures and appropriate software. Accordingly, agreements were renewed and concluded with the commercial banks in whose territories these vaults are registered.
- The Cash Center staff who work with cash went to work on an alternating basis according to a pre-determined schedule. This work process was conducted in accordance with protocols that had been established in accordance with the recommendations of the competent agencies.
- Despite the pandemic, the Cash Center continued to operate in its offices during 2021, thereby maintaining business continuity. There was thus no lag, which had a positive impact on quantitative and qualitative performance indicators.

In 2021, compared to the previous year, the cash inflows of the NBG increased to GEL 8,132.9 million, which was 27.8% more than in 2020. The amount of cash outflows from the NBG amounted to GEL 8,062.2 million, up by GEL 17.1 million compared to the previous year. The amount of national currency received by the NBG exceeded the previous amount by GEL 70.7 million. Diagram N 11.5 shows the dynamics of GEL banknotes/coins entering and leaving the Cash Center in 2017-2021.

DIAGRAM N 11.5 REVENUES AND EXPENSES OF THE CASH CENTER IN 2017-2021



Source: NBG



During the reporting period, the NBG received USD 32.9 million and EUR 11.2 million in foreign currency, while foreign currency outflows amounted to USD 14.1 million and EUR 270,000.
We had 164 units of valuables submitted for temporary safekeeping from the courts, investigative and other administrative bodies and, of those, 139 units were issued. One unit of an internal valuable was also received for temporary storage and issued.

We issued GEL 5 and GEL 20 banknotes that were produced in 2021, amounting to GEL 725,000, to commercial banks on the condition of return for adaptation.

During 2021, out of the Cash Center's cash desk for individuals

- 16,177 units of money, amounting to GEL 194.8 thousand was exchanged
- 76.8 thousand units of collectibles, numismatic and other types of products were sold/issued, including
    - Products worth GEL 2 million were purchased in cash.
    - Products worth GEL 1.9 million were purchased through plastic card.
    - Products worth GEL 2.6 million were purchased through the online store.
    - GEL 270.4 thousand products were prepaid.
    - GEL 19.7 thousand products had after sales payment.

Significant measures were also taken during the reporting period to manage the quality of GEL banknotes. These included

- Giesecke & Devrient Currency Technology GmbH Technical Support Group, with the participation of Cash Center engineers, carried out the planned annual inspection and capital repairs of two units of BPS-M7 GEL banknote processing aggregates, and two BPS-1080 GEL banknote processing aggregates were renovated, with their banknote checking and sorting device upgraded to "BPS-M7" level. The remaining packaging devices underwent annual maintenance.
- We arranged the adaption of four BPS-M7 banknote processing systems (N M01000657, N M01000226, N M01111305 and N M01111051) to the new modifications of GEL 5 and GEL 20 banknotes, together with the representatives of Giesecke & Devrient Currency Technology GmbH, and final adjustments were made for recognizing certain banknotes as obsolete.

To ensure the proper functioning of the technical means of re-counting and processing of banknotes within the system of the NBG, the regularity of the sorting of banknotes by the technical means of recalculation and processing of banknotes was checked at regular intervals. Technical service was also provided for the "BDS-400" system for the destruction of banknotes.

To avoid defective and substandard banknotes in circulation, we arranged the control counting and sorting of issued banknotes.

The following was done for the smooth implementation of collection activities:

- Based on Decree N32 of the Governor of the NBG of 12 April 2013, the cashiers of the Cash Center were twice trained in the use of the firearms.
- An armored Mercedes car designated for the transportation of NBG valuables went through an annual checkup.
- During the reporting year, in addition to the daily shipments of material valuables, collectors also received valuables from manufacturing companies and delivered them to the vaults. These included
    - Two collections of valuables from Tbilisi Airport to the Cash Center.
    - Receiving GEL coins provided by the manufacturing company from Poti port.
    - Gold and silver collector coins on various themes were received at the Cash Center.

- A carrier company collected foreign currency from the Cash Center and took it abroad.

Expert examination of cash was undertaken throughout the year. The examination covered 6,756 suspicious banknotes sent by cash registers of the Cash Center, commercial banks, currency exchange bureaus, microfinance institutions, law enforcement agencies and individuals. The results of these examinations are shown in Table N 11.1.

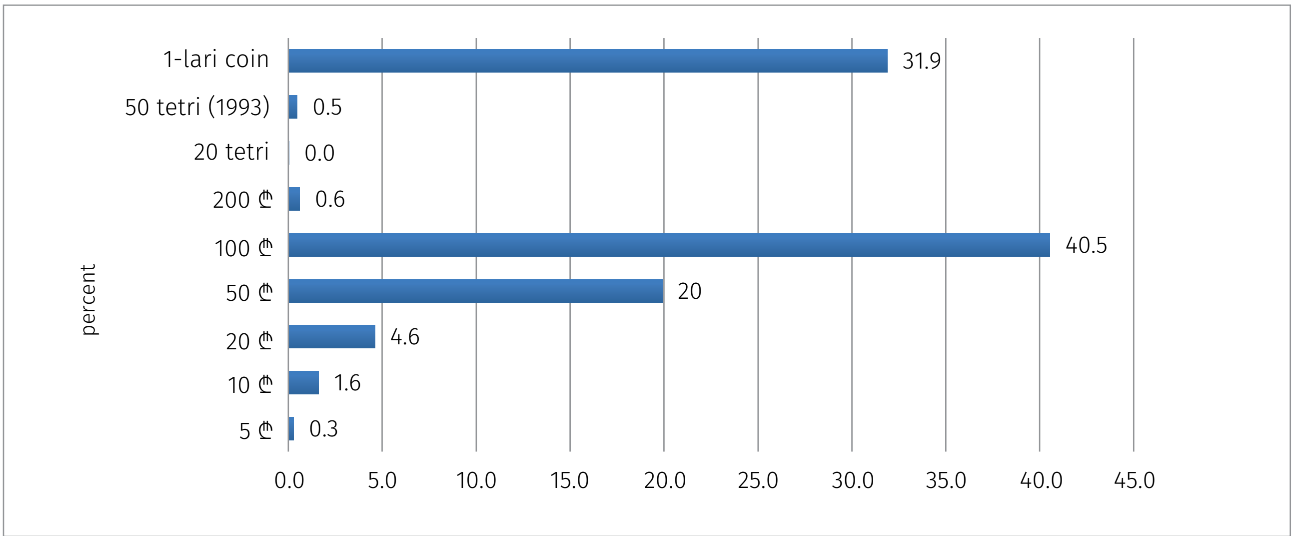
TABLE N 11.1 RESULTS OF THE EXPERT EXAMINATION OF SUSPICIOUS CASH IN 2021

	Suspicious	Counterfeit	Genuine	Unfit
GEL banknotes	4,090	2,125	1,178	787
GEL coins	1,354	1,018	336	-
USD	1,095	855	240	–
EUR	129	50	79	–
Other foreign currency	88	74	14	–
Total	**6,756**	**4,122**	**1,847**	**787**

Source: NBG

The percentage of counterfeit GEL banknotes/coins detected by denominations are seen in Diagram N 11.6.

DIAGRAM N 11.6 COUNTERFEIT GEL BANKNOTES AND COINS FOUND IN 2021 (PERCENTAGE)



Source: NBG

The number of counterfeit GEL banknotes detected in 2021 fell by 30.0% compared to the previous year, the number of counterfeit EUR banknotes decreased by 46.2%, while the number of counterfeit USD banknotes increased 2.2 times. Other counterfeit foreign currency fell by 46.0%. The number of counterfeit GEL coins has decreased 13.8 times compared to 2020. The number of counterfeit GEL banknotes and coins identified in the period 2017-2021 is shown in Diagrams N 11.7 and 11.8.

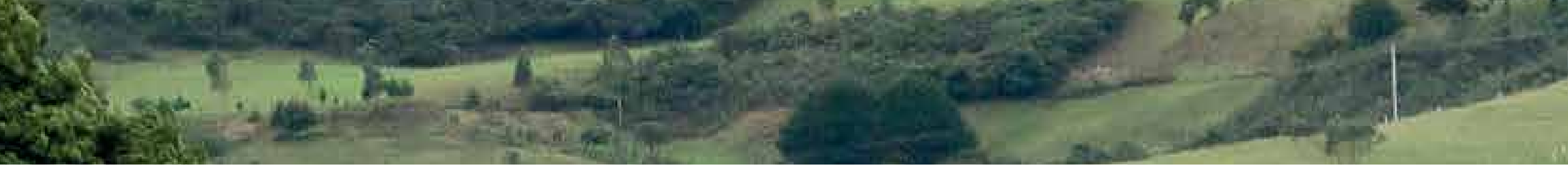
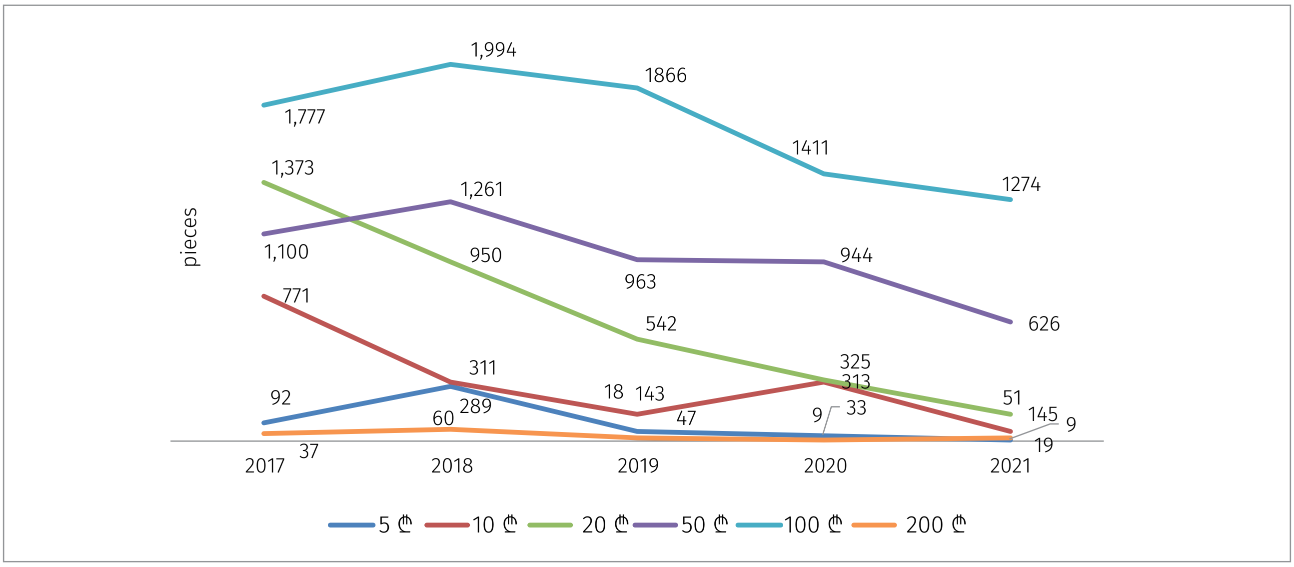
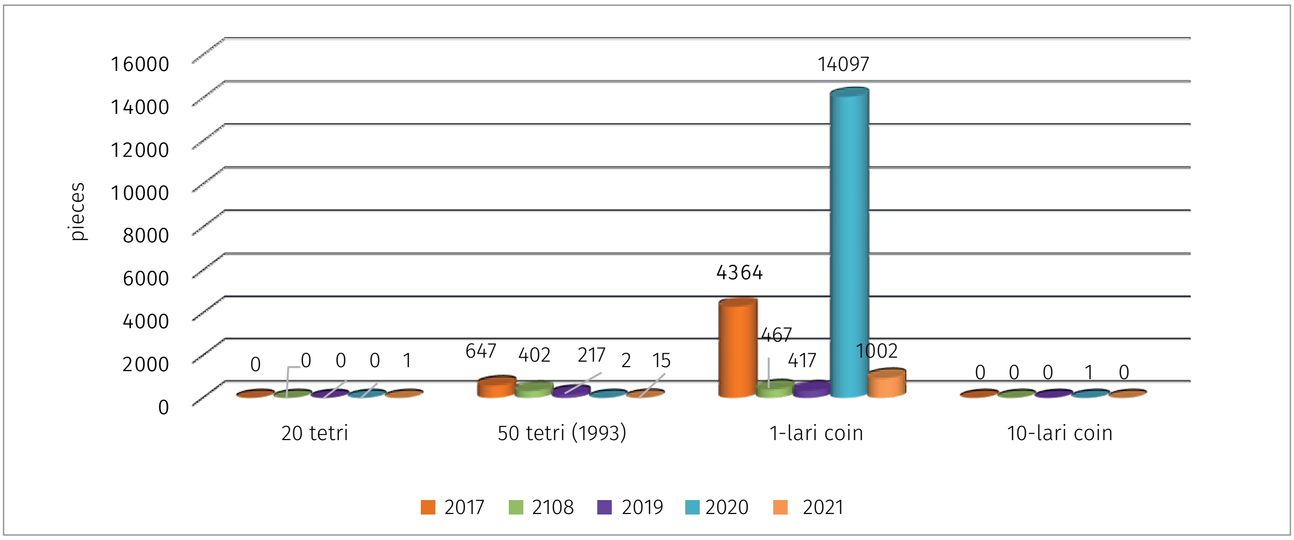


DIAGRAM N 11.7 NUMBER OF COUNTERFEIT GEL BANKNOTES FOUND IN 2017-2021



Source: NBG

DIAGRAM N 11.8 NUMBER OF COUNTERFEIT GEL COINS FOUND IN 2017-2021



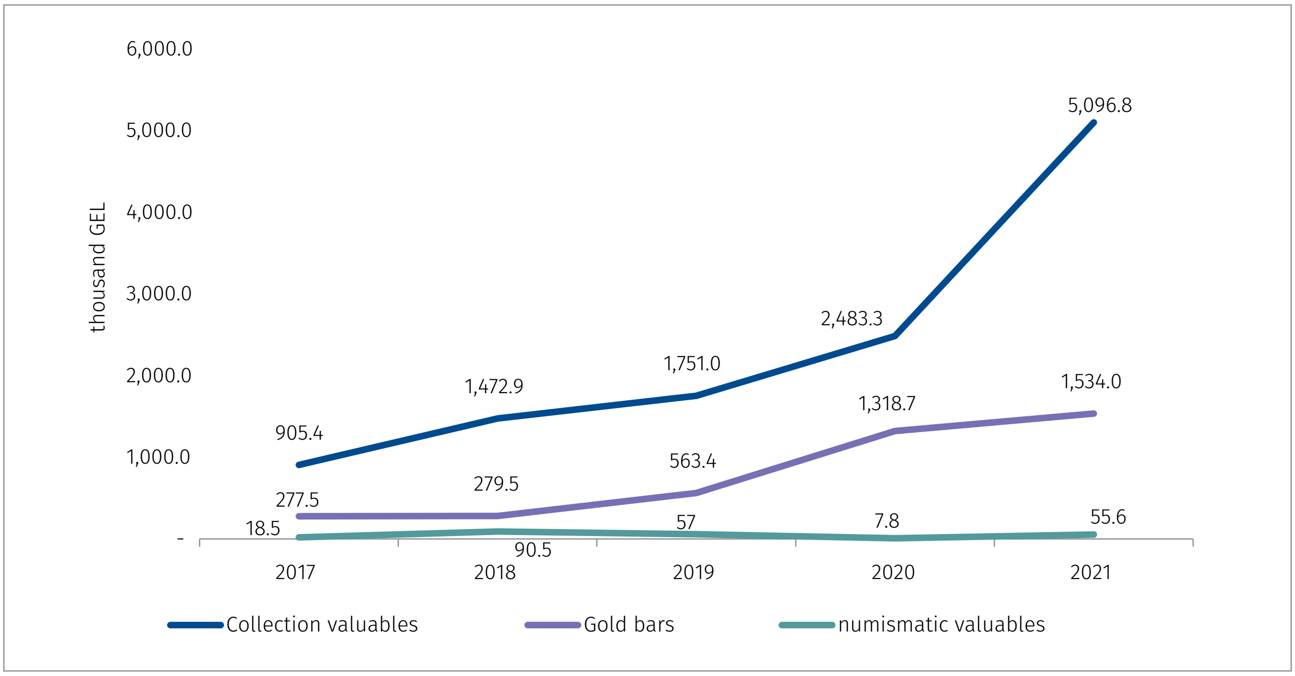
Source: NBG

We continued offering collector coins, gold bars and other numismatic valuables for sale during the reporting period.

In 2021, 76.8 thousand units of various valuables were sold, amounting to GEL 6.7 million. Of these, the revenue received from the sale of collector coins increased 2.1 times compared to the previous year. The proceeds from the sale of gold bars increased by 16.3%, while the income from the sale of numismatic valuables increased 7.1 times. Also, 74 units of other items were sold (CDs, books, boxes for valuables, etc.), amounting to GEL 1.2 thousand. Total revenue from the sale of the above valuables during the year increased by 75.5% (GEL 2.9 million).

The dynamics of valuables sold in 2017-2021 are shown in Diagram N 11.9.

DIAGRAM N 11.9 VALUABLES SOLD BY TYPE, 2017-2021



Source: NBG

The NBG's Money Museum offered educational courses to the public from 11 March to 22 October 2021, a schedule that had been impacted by observing the dynamic pandemic-related regulations. The goal of these was to promote the history of Georgian money and the development of the NBG as the central bank of the country, and to allow visitors to become familiar with its core functions. During the reporting period, the museum was happy to welcome 1,348 visitors (including 1,289 local and 59 international visitors).

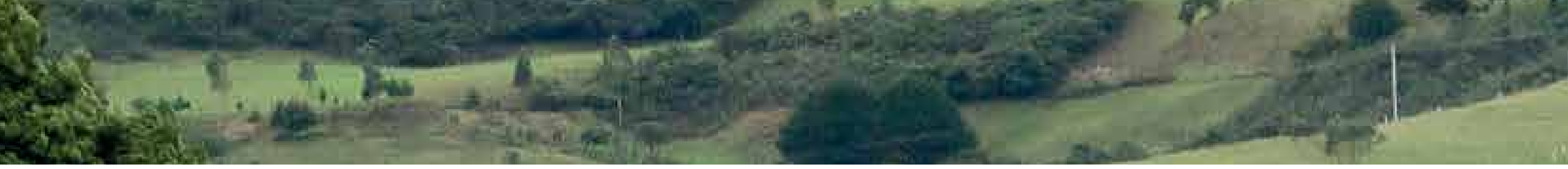
During 2021, 16 educational tours (excursions) were held at the Money Museum, which included a review of Georgian numismatics and a view of the exhibits. The courses were attended by 98 students and 18 teachers. The Money Museum also hosted the exhibition "The State Bank in the Democratic Republic of Georgia" in May 2021 to celebrate International Museum Day and the Independence Week of Georgia.

NEW EDUCATIONAL RESOURCES

It is widely known that paper money is a good way to present and showcase the country's economy, its technical capabilities, as well as its culture and art.

For this purpose, the NBG purchased Georgian and Transcaucasian bonistic samples of state and private emissions from 1918-1924, which had previously been held in private collections. We also purchased shares of Georgian banking and financial institutions, trade, industrial and transport organizations from the second half of the 19th century and the first quarter of the 20th century, as well as different types of securities from the same historical periods.

All of the exhibits of the bonistic collection are in perfect condition. The Georgian banknotes and securities in the collection are a clear representation of the Georgian economy, the history of banking and the culture of producing money in Georgia. Prior to purchasing the collection, the NBG owned a very small collection of bonistic samples, most of which were damaged and hence unable to effectively represent the characteristics and visual side of the banknotes of the relevant period. Now that we have acquired the new units, the bonistic collection of the NBG has become the richest and most complete in the country, allowing us to organize temporary and permanent exhibitions, and to publish catalogs. This, in turn, will contribute to the development of this area and raise awareness.



The NBG conveys its gratitude to the invited members of the temporary commission who were placed in charge of determining the authenticity and significance of the Georgian and Transcaucasian bonistic samples of the 1918-1924 period, which had previously been held in the private collection of citizen Mikheil Gogotishvili. The members of the commission were Nikoloz Javakhishvili, chief researcher, PhD in History and researcher of the history of Georgian Bonistics; Maia Pataridze, senior research fellow at the Numismatics Cabinet of the Georgian National Museum, PhD in History and a visiting lecturer at Ilia State University and Caucasus University, and Irakli Khvadagiani, a researcher at the Soviet Past Research Laboratory, a PhD student, visiting lecturer at Ilia State University and a researcher of the history of the Democratic Republic of Georgia, 1918-1921.

COLLECTOR COINS

The NBG continued to work on issuing collector coins during the reporting period to promote the national currency and the country as whole. The coins received great public approval, as confirmed by the sale of all the coins produced. Interest in collector coins issued by the NBG is growing. To provide greater availability of collector coins for numismatists, collectors and other interested parties, the NBG has introduced the practice of allowing pre-orders of the coins through the NBG's online store. The sale of the coins listed below and those planned for the future will be organized through such pre-orders.

XXXII Summer Olympics. A total of 1,500 silver 5 GEL coins were made dedicated to the Summer Olympic Games.

Design by Iva Janezashvili

The central composition of the coin obverse is a stylized graphic image of the architecture of the Tokyo Olympic arena. A fluttering Georgian flag is depicted in the inner part of the arena. The logo of the Georgian National Olympic Committee is placed in the central right part of the coin. The inscriptions "NATIONAL OLYMPIC TEAM OF GEORGIA" and "Summer Olympic Games" (the latter in Georgian) are inscribed in the circular arc.

The main composition of the coin reverse is a stylized image of a sports track. The inscriptions are: "5 lari" (in Georgian), the slogan of the Olympiad "DISCOVER TOMORROW" and "SUMMER OLYMPIC GAMES IN JAPAN". In the lower non-standard arc, there is a hidden image, in which the years "2020" and "2021" appear alternately when the coin is tilted at different angles – this is an original way of reflecting the postponement of the 2020 Olympic Games.

According to the terms of the contract, a relevant settlement was made with a mint for the production of this coin and the project is now complete.

100 YEARS SINCE THE ADOPTION OF THE FIRST CONSTITUTION OF THE DEMOCRATIC REPUBLIC OF GEORGIA

In 2021, we worked with the Slovak Mint, which had been selected as a partner, for the production of silver GEL 5 coins dedicated to the 100th anniversary of the adoption of the first Constitution of the Democratic Republic of Georgia. These coins were minted and delivered during the reporting period and were then presented to the public (symbolically in the city of Batumi, in the Constitutional Court of Georgia) for sale.

Design by Giorgi Apkhazava and Maia Dzidziguri

The central part of the obverse of the coin features the main composition, the interconnected letters “S”, “D” and “R” (in the Georgian alphabet), which is a combination of the initials of the words that make up the full name of the country (Saqartvelos Demokratiuli Respublika - Democratic Republic of Georgia) as it was in 1921. There is an analogue of the ornament on the first and last pages of the first edition of the 1921 Constitution placed under the composition. The inscriptions "GEORGIAN CONSTITUTION", "Saqartvelo" (in Georgian script), “GEORGIA”, “Constitution of Georgia” (in Georgian), and “1921-2021” are inscribed in a circle on the rim of the obverse.

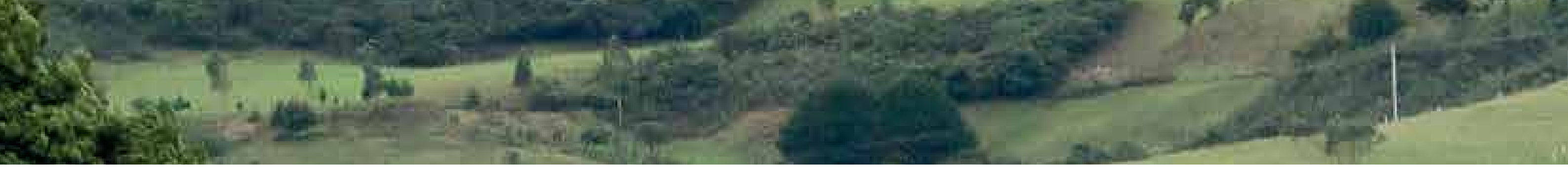
The main composition of the reverse of the coin are a number of important words and phrases, in Georgian, taken from various articles of the Constitution of Georgia in the form of a diamond-shaped figure. The reverse also features the inscription "5 lari" (in Georgian).

According to the terms of the contract, the relevant settlement was made with the mint and this project is complete.

EARTH DAY

In 2021, we worked with the Slovak Mint, selected as a partner, for the production of silver GEL 5 coins dedicated to Earth Day. The coins were minted, delivered, presented and sold during the reporting period.

Design by Onuki Naohiko on behalf of the Japanese Mint



The central part of the obverse of the coin features a branch of an olive tree. Its left side depicts an image of the Earth, with its right side illustrating the impacts of climate change, such as drought, fire, hurricanes and floods. The arc has the inscriptions "Earth Day" (in Georgian), "5 ₾", "Thank", and "Think". The combination of images and inscriptions on the obverse of the coin clearly show that we should be grateful for all that our planet gives us and think about what we can do to prevent climate change caused by global warming.

The central composition of the reverse of the coin is a set of images located in the central part, which includes Georgian ornaments in the outline of the hemisphere, a twig with green leaves, a silhouette of people and a dog and the inscription "Earth Day". The inscriptions "5 lari" (in Georgian) and "2021" are also seen. Georgian ornaments and the inscriptions "Georgia" and "Saqartvelo" (in Georgian) are depicted on the circular arc.

According to the terms of the contract, the relevant settlement was made with the mint and this project is complete.

EUROBASKET 2022

During the reporting period, we started preparing a GEL 5 silver collector coin to mark EuroBasket 2022. For this purpose, an open competition was announced, sketches were selected, and pre-orders were received so that we knew what quantity to produce. A tender was also announced to select a partner for the production and supply of these coins.

THE KINGS OF GEORGIA COIN SERIES DAVID THE BUILDER (KINGS OF GEORGIA SERIES)

During the reporting period, an open competition was announced for silver and gold coin designs on the theme of David the Builder (Kings of Georgia series). This was completed and the design sketches were selected. The Lithuanian Mint was a successful bidder, and we proceeded to conclude an agreement with them on the production of the coins. The GEL 5 coins were made, supplied, presented and sold in 2021.

Design by Nita Gongadze

The main composition of the obverse of the coin is a bas-relief of David the Builder from the fresco of Gelati Monastery (David holds a model of Gelati Monastery in his left hand and the so-called Cappa (Imperial Insignia) in his right hand). The coin bears the inscription "David the Builder" (in Georgian) and the years of his reign "1089 - 1125". The left part depicts an oak leaf with two acorns, as a symbol of the clerical reforms implemented by King David. This detail is gilded on the silver version of the coin.

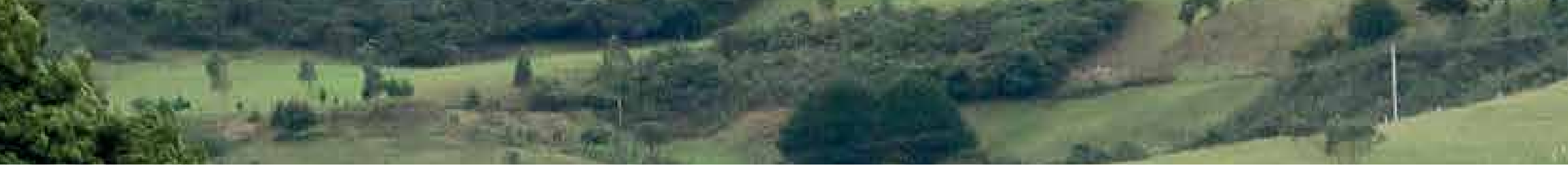
The main composition of the reverse of the coin is the image of the crown of David the Builder (reconstructed as on the fresco of Gelati Monastery). The inscriptions on the coin are: "5 lari" (in Georgian), "2021", "Saqartvelo" (in Georgian), and "GEORGIA".

The relevant settlement was made with the mint according to the terms of the contract.

KING TAMAR
(KINGS OF GEORGIA SERIES)

During the reporting period, the open competition that had been held for designing silver and gold GEL 5 coins on the theme of King Tamar (Kings of Georgia series) was followed by the selection of design sketches and partner selection procedures. In this, the Lithuanian Mint was the successful bidder, and an agreement was concluded with them. The coins were made, supplied, presented and sold during the year.

Design by Nita Gongadze



The main composition of the obverse of the coin is a bas-relief of King Tamar as seen on the fresco of the Bethania Monastery. The left side of the bas-relief features the signature of King Tamar, the inscription "Tamar Mepe" (in Georgian) on the right, with the period of her reign "XII century" and the engraved symbol of Tamar, the latter detail is gilded on the silver version of the coin.

The main composition of the reverse of the coin is the image of King Tamar's crown (reconstructed as on the fresco of the Davit-Gareji Complex, Bertubani Monastery). The inscriptions on the coin are: "5 lari" (in Georgian), "2021", "Saqartvelo" (in Georgian), and "GEORGIA". According to the terms of the contract, the relevant settlement was made with the mint.

VAKHTANG GORGASALI (KINGS OF GEORGIA SERIES)

We started preparing for the Vakhtang Gorgasali (Kings of Georgia series) 5 GEL silver and gold collector coins during the reporting period. For this purpose, an open competition was announced, relevant designs were selected, and pre-orders were received to determine the quantity to produce.

GIORGI THE BRILLIANT (KINGS OF GEORGIA SERIES)

We also started preparing for Giorgi the Brilliant (Kings of Georgia series) 5 GEL silver and gold collector coins during the reporting period. Although an open competition was announced, the results of this were not up to expectations, and thus another competition has been announced for the selection of designs.

12

INTERNAL AUDIT AND CENTRALIZED RISK MANAGEMENT

INTERNAL AUDIT

The Internal Audit Service's activities are guided by the IIA's International Standards for the Professional Practice of Internal Auditing, and the modern approach of risk-based internal auditing. Accordingly, the Internal Audit Activities Strategy was defined based on the results of the organization's risk maturity assessment. This strategy considers providing assurance on risk and control management processes, consultation services on the improvement of risk management, and using risk assessments by management for audit planning purposes. The internal audit work plan is thus primarily based on the organization's risk register and in consideration of the process of prioritizing auditees, the three-year audit cycle, the dates of the last audit, the conclusions of audits, and the status of implementing previous recommendations. In line with this strategic approach, activities aimed at encouraging the improvement of risk management were included in the Consulting Services Plan. The NBG Board approved both the Dynamic Assurance Services Plan and the Consulting Services Plan for 2021.

Considering the dynamic planning principle, which allows concentration of internal audit resources on high-risk areas, and for the purpose of reviewing the audit plan in the middle of the reporting year, the risk assessments of auditees, as defined in the Audit Universe, were analyzed.

During the year, the Internal Audit Service conducted 27 internal audits and reviews, as stipulated in the work plan approved by the Board.

The monitoring of the implementation of the recommendations provided during various audits was ongoing via the Audit Management System. Use of this system gives a possibility for auditees to update information, upload sufficient evidence and consolidate the information located in the system. During follow-up actions, the internal auditors responsible for monitoring the recommendations provided to business units, rechecked current recommendations and updated the implementation statuses.

In accordance with established practice, during 2021, following the requests of the NBG structural units, the Internal Audit Service also provided consulting services on various issues related to the draft procedures.

In addition, the Internal Audit Service conducted an assessment of compliance with the mandatory and recommended controls set out in the SWIFT Customer Security Controls Framework (of 2021), taking into account the SWIFT Customer Security Program and the Independent Assessment Framework (of July 2020).

In 2021, in connection with the certification of the NBG's compliance with the ISO 27001 standard, an external audit of the Information Security Management System was conducted. The Internal Audit Service was actively involved in this process, both remotely and during the site visit of the assessment team.

Steps were also taken in the reporting period to improve the methodological base of the Internal Audit Service, as the availability of relevant internal procedural and guidance documents is an important contributing factor to quality assurance. Considering the significant experience gained in conducting both remote internal audits and the use of the automated audit management system, a unified manual for the Internal Audit Service was developed. The first part of this guide included documents regulating the activities of the service and the procedures for the automated internal audit management system, while the second part included the updated Internal Audit Manual for the Information Security Management System of the NBG.

NON-FINANCIAL RISK MANAGEMENT

Risk management in the NBG is arranged using a three-line model of protection, which involves the redistribution of functions and responsibilities between the various branches of the bank. The first line of protection is the structural units (risk bearers), the second line is the Centralized Risk Management Department, and the third line is the Internal Audit Service.

The National Bank has in place a centralized risk management framework that provides a unified and consistent approach to identifying, analyzing, evaluating, monitoring, and responding to non-financial risks (operational and reputational). The Centralized Risk Management Department is responsible for the effective functioning and continuous improvement of the centralized risk management system at the bank.

To effectively manage the risk assessment process, the Centralized Risk Management Department regularly conducts risk and control self-assessments for each function of the NBG. Self-assessment sessions allow for continuous updating of the bank's risk register, in consideration of changes in risk probability, impact, controls, and external and internal events. The risk assessment process is meant to identify those material risks to which the bank is vulnerable.

In 2021, the COVID-19 risk event remained a significant challenge. Special attention was thus paid to assessments of the risks entailed by the pandemic, these included employee health, creating a safe work environment, arranging remote work, and risks related to business continuity.

The NBG's Incidents Management System is another tool for operational risk management. It serves to identify, fix, analyze, and identify weaknesses, and to find ways to improve its business processes to reduce any recurrence of these. During 2021, the monthly incidents management report was improved, the procedure was updated, and trainings were conducted to raise staff awareness.

To support the centralized risk management framework, the National Bank will develop internal procedures to formalize the bank's processes and achieve maximum transparency. During 2021, we continued updating current internal procedures and developed new procedures.

The centralized risk management framework includes the definition of acceptable levels of non-financial risks (risk appetite). The risk level is set on an annual basis by the NBG's Board. Overall, the NBG has a conservative approach to non-financial risks and the acceptable level is set in the low-risk zone. To comply with and maintain an acceptable level of risk, the NBG allocates adequate resources, taking care of the continuous improvement of the bank's internal control environment.

BUSINESS CONTINUITY MANAGEMENT

As the NBG is among the critical institutions of the country, it recognizes the importance of the resilience and continuity of its services. In this regard, the bank persistently plans, implements and monitors various activities. To test and assess the readiness of the NBG's resources (human, logistical and technical), a series of training, tests and practical exercises are conducted on a regular basis. The business continuity management process is regularly upgraded and advanced through these activities, which will ultimately be reflected in the continuous delivery of critical services of the NBG and in enhancing its overall resilience.

Technological advances in 2020 and the application of new solutions allowed the NBG to continue operating remotely in 2021, including for its critical services. The NBG's Business Continuity Management Committee met regularly to discuss pandemic-related risks, the situation at the bank and in the country as a whole, and to make appropriate decisions aimed at protecting the health of employees while still providing critical services on an ongoing basis.

In 2021, while the National Bank was working remotely, due attention was paid to raising the awareness of employees on information security issues, ensuring they were familiar with risks and complying with the requirements set by the bank.

Overall, the National Bank's Continuity Management System and the actions taken in this regard allowed the bank to conduct its operations smoothly and without delays, despite the pandemic.

13

PUBLIC RELATIONS AND INTERNATIONAL COOPERATION

PUBLIC RELATIONS

Considering the circumstances related to the COVID-19 pandemic, the NBG continued relying on electronic and social media as the main means of communication in 2021. Using our digital channels, we managed to keep the public informed about the various reforms and measures taken by the NBG throughout the year. Along with the publication of the Monetary Policy Report, short videos were made in which the Governor of the NBG focused on important aspects of the published report. Video recordings of the presentation of the Monetary Policy Reports were also regularly published on our official website and through social networks.

For the first time since 2005, the NBG’s website was updated. It enjoys daily visits of numerous users, both inside and outside the country, including foreign partners, investors, and representatives of international financial institutions. Increasing visitor statistics indicate higher interest from users.

The new version of the website fully meets modern digital requirements: it has a sophisticated design, it is functionally appropriate and is user-friendly in format. The new interactive website allows for two-way communication and receiving information in the desired format. Thanks to the joint efforts of the staff of the various structural units of the bank, the update of the website was successfully completed.

The advantages of the new website are as follows:

- Compatible with all gadgets and screens of any size
- Works on all web browsers and operational systems (Windows, Linux, Mac, Android, and IOS)
- Easy to navigate
- Sophisticated design
- Improved search system
- Flexible feedback form
- Integrated with social networks

As we prioritize improved financial education, we implemented a number of successful projects and activities in this area. Over 15 educational videos and two podcasts were published, and more than 30 educational articles and over 10 interesting intellectual tests were prepared in collaboration with media partners.

THE ADVANTAGES OF THE NEW WEBSITE

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- ✓ Improved search system
- ✓ Flexible feedback form
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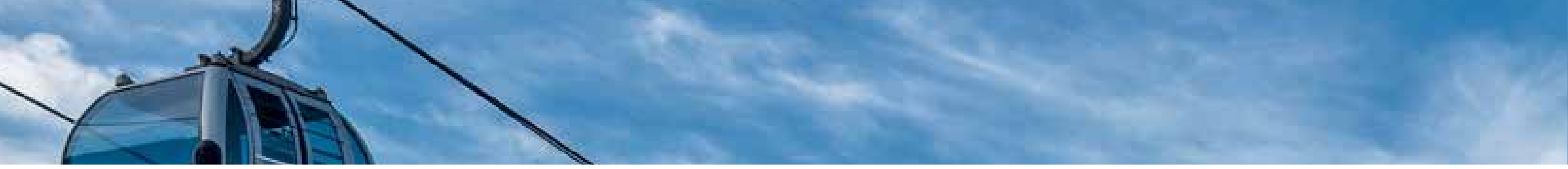
We launched another new annual campaign in collaboration with the financial sector to celebrate International Consumer Rights Day (on March 15). This event has been celebrated around the world since 1983 and is meant to raise awareness on the rights of consumers. This year’s slogan was “Know Your Rights - Be Protected!” As part of International Consumer Rights Day, various events were planned with the involvement and support of the NBG, the educational platform FinEdu.gov.ge, seven commercial banks and four microfinance institutions.

Koba Gvenetadze, the Governor of the NBG, met with the executive management of commercial banks and microfinance institutions to brief representatives of the financial sector on the NBG's initiative to mark International Consumer Rights Day. He explained that the initiative helps to raise the awareness of consumers in the financial sector about their rights.

We also held a competition for text and video materials on consumer protection with the involvement and support of FinEdu.gov.ge, seven commercial banks and four microfinance institutions. The winners of the competition were announced in two categories: (i) Blogs for works in a textual format; and (ii) "Vlogs" and "motion design" for works in a video format.



While advances in digital technology have ensured fast and efficient service, they have also triggered some higher cyber risks. Raising public awareness on the security of banking/financial information is thus one of the priorities of the NBG. A number of projects have already been implemented in this area. At the NBG's initiative, an International Cybersecurity Campaign was held for the first time in 2021. The campaign enjoyed the involvement of the financial sector of Georgia, the FinEdu education portal (www.finedu.gov.ge), the Bankers' Association and six commercial banks: TBC Bank, Bank of Georgia, VTB Bank, Liberty Bank, Basisbank and Pasha Bank. In addition, we took part in the Cybersecurity Awareness Month, which is celebrated around the world in October. This year's slogan was “Do Your Part - Be Cybersmart!” . The cybersecurity awareness campaign developed as part of this event featured interesting educational materials, tests, videos and contests. Webinars were also held on the following topics: (i) Cybersecurity as a profession; and (ii) Cybersecurity during COVID-19. About 750 interested people participated in these webinars.

The educational materials developed related to the Cybersecurity Awareness Month were published across the communication platforms of the participating organizations, as well as on various media platforms, including www.marketer.ge, www.on.ge, www.myvideo.ge, www.imovies.ge, www.adjaranet.com, and www.movement.com.ge.

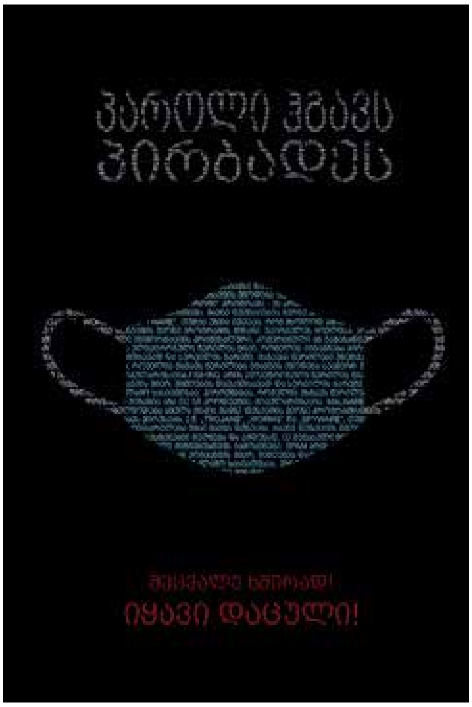
The NBG, with the involvement and support of the FinEdu educational platform, the Georgian Bankers Association and six commercial banks licensed in Georgia, also announced a competition for posters and slogans on cybersecurity. Gia Sichinava won the first place with his work: "Password is like a mask", Luka Katsadze won second place with "Don't trust anyone blindly", and third place went to Nodar Kopaleishvili for "Think before it disappears".

A joint cybersecurity print competition was organized by the NBG and the Association of Communication Agencies of Georgia (ACAG) to raise public awareness on the security of banking/financial information. Contestants designed information posters that called on citizens to be careful when sharing their personal and banking/financial information. The selected works were posted on the streets of Tbilisi and on partner media channels.

In another initiative, the NBG announced the Young Economists research paper competition to support talented students. The goal of this is to involve young people in research work. The research topics were particularly relevant to the NBG, and included financial stability, monetary policy and statistics. The competition aimed to facilitate an in-depth study of topics important to central banks. Symbolically, the competition was announced on the Bankers' Professional Day, which has been celebrated since 2001 and marks the 125th anniversary of the founding of the first Georgian bank, Noble Bank. Bankers' Professional Day is 8 November, marking the birthday of Ilia Chavchavadze, who became the founder and first leader of Noble Bank. Successful candidates in the competition have the opportunity to complete a 3-month paid internship at the NBG and, with the help of National Bank experts, to clearly formulate the goals for their respective bachelor's/master's theses while obtaining and collecting necessary data.

Cooperation with international media was further strengthened and enhanced during the year. Important in this regard is Central Banking, a reputable international publication that regularly publishes information on the NBG's projects. The financial edition of The Banker, a financial publication of the Financial Times, also featured an article by Koba Gvenetadze, Governor of the NBG.

As we prioritize transparency, we prepare various periodical and thematic publications. These include our monthly publications: Monthly Review, Macroeconomic Review and Monthly Balance, our analytical reports Financial Sector Indicators, Current Macroeconomic Indicators, and the quarterly Monetary Policy Report. Statistical data and press releases of the Monetary



Policy Committee are published promptly. The 2020 Annual Report was also published. Electronic versions of these publications are available on our official website: https://nbg.gov.ge/publications.

To introduce the NBG staff to the public, the profiles of our staff are regularly published on social media. These profiles feature information about their education and professional experience, and the successful projects implemented through their initiative and involvement. In addition, intellectual and thought-provoking posts, on topics such as the History of Georgian Money, Nobel Laureates in Economics, etc., are regularly published to mark dates of historical and national importance.

INTERNATIONAL COOPERATION

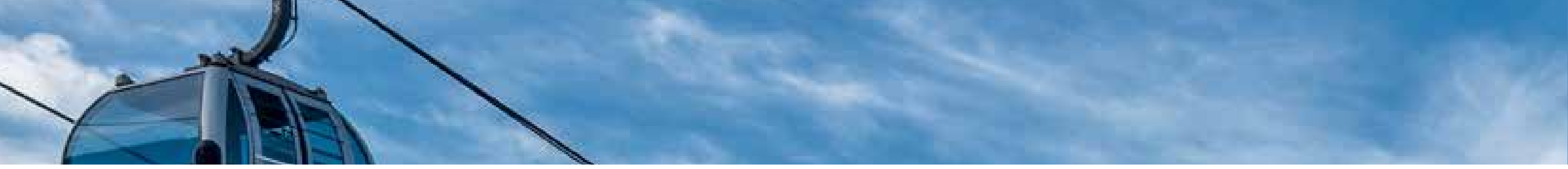
The work done by the NBG that contributes to the long-term growth of the country's economy gained international recognition in 2021. This has been confirmed by a number of reputable international organizations, including the International Monetary Fund, the World Bank, the European Investment Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, and international rating agencies.

Global Finance, a renowned international publication, named the Governor of the NBG, for the fourth year in a row, among the best governors of central banks. Global Finance first included the Governor of the NBG in its rankings in 2018. Similarly to the previous three years, Governor Gvenetadze was included in the list of central bank governors who received either “A” or “A-” ratings. The Global Finance awards are widely recognized in the international financial community and reflect the high reputation and successful performance of the awarded individuals and banks. The assessments of central bank governors are based on several policy areas as pursued by the central banks.

The NBG was also awarded two awards by Central Banking, a reputable international publication, in the categories of “Best Risk Manager of the Year” and “Most Transparent Central Bank”. The latter nomination includes three important components – education, transparency in stakeholder communication, and communication through a variety of platforms. The award ceremony was held online in June as part of Central Banking's Summer Meetings event, in which the NBG also participated. The Central Banking awards are widely recognized in the international financial community and reflect the high reputation and successful operations of the participating banks.

The NBG also won the Best Fintech Policy Award of the Year in Central Banking’s annual Fintech & RegTech competition. This competition is for central banks who are focused on modern technology innovations. This was the third Central Banking award for the NBG in 2021. In addition, Bloomberg was awarded for the introduction of the BMatch platform in Georgia by Central Banking in the category of “Financial Market Infrastructure Services”. According to Central Banking, one of the important preconditions for Bloomberg’s winning the nomination was the dynamic and fruitful cooperation it had established with the NBG.

In 2021, the NBG also participated in a number of international conferences. Governor Gvenetadze made a presentation at a Columbia University conference ded-



icated to the challenges of monetary and fiscal policy in countries with small open economies. Held online this year, the event was attended by various central bank governors, finance ministers, former bankers, academics and financial sector leaders from around the world.

The Governor of the NBG also took part in the fifth Istanbul Economic Summit to discuss the importance of the green economy and sustainable finance, and to find ways to help further develop it. The summit was attended by senior officials from the World Bank and the European Bank for Reconstruction and Development, as well as the heads of economic ministries from different countries, academia and the private sector.
Armenia hosted the Summit of Minds to discuss Challenges and Prospects in the World during the year. Governor Gvenetadze took part in this event as a keynote speaker at the direct invitation of the President of Armenia, Armen Sargsyan. The meeting was attended by representatives of different countries around the world.

In 2021, the European Bank for Reconstruction and Development (EBRD) Annual Meeting and Business Forum was held and the Governor of the NBG was invited as a speaker at the session. The event focused on the development of capital markets.

Initiated by the NBG and supported by the World Bank, a working meeting was held on the topic of "Global Economic Challenges and Their Impact on the Georgian Economy". A joint presentation from the NBG and the World Bank featured the World Bank's 2021 Global Economic Outlook and a review was prepared by the NBG. During the event, economists, financiers, industry experts, government representatives, the non-governmental sector and academia discussed current developments and prospects for the global economy, sharing their views on the potential impact on the Georgian economy. During the discussion, Ayhan Kose, Director of the World Bank's Prospects Group, presented the World Bank's June 2021 Global Economic Outlook report. The event was attended by representatives of the non-government sector, academia and international institutions.

The NBG also hosted an online forum on sustainable finance. The event was organized in cooperation with the International Finance Corporation (IFC, a member of the World Bank Group) and the IFC Sustainable Banking and Finance Network (SBFN), with the support of the Swiss State Secretariat for Economic Affairs (SECO). The online forum was attended by European and Central Asian central banks and financial market regulators, representatives of SBFN member countries, IFC experts and other stakeholders.

The NBG Governor Koba Gvenetadze also delivered a speech at a conference dedicated to the 30th anniversary of the Central Bank of Moldova. On the occasion of the anniversary, the Central Bank of Moldova organized an international conference entitled "Post-pandemic Economic Recovery: Reality and Perspective".

Other representatives of the NBG also participated in a number of important conferences held around the world during the year. The main topics of such meetings were the measures taken by the central banks during the COVID-19 pandemic, financial inclusion, and sustainable finance.

SUSTAINABLE DEVELOPMENT AND SOCIAL RESPONSIBILITY

In the context of social responsibility, the goal of the NBG is to have a positive impact on the financial sector and the economy by showing a personal example, setting high standards, and putting forward issues relevant to the general public. In so doing, the NBG is guided by the UN Sustainable Development Agenda.

Out of the seventeen UN Global Goals, the National Bank focuses on the following:
1. Quality Education (# 4)
2. Gender Equality (# 5)
3. Decent Work and Economic Growth (# 8)
4. Industry Innovation and Infrastructure (# 9)

5. Actions against Climate Change (# 13)
6. Peace, Justice, Strong Institutions (# 16)
7. Partnership to Achieve the Goal (# 17)

In 2021, the NBG took important actions towards sustainable development. Work continued on the social responsibility model and strategy, which will be duly reflected in the next three-year action plan.

According to the Corporate Social Responsibility (CSR) model, the NBG's work and projects are grouped into five areas: 1) employees; 2) management and communication; 3) the general public; 4) the market; and 5) the environment.

1. Employees

Employees are at the heart of the CSR model as they are the central support workforce of the organization. The responsibilities of the National Bank towards its employees and applicable measures are divided in two dimensions:

- Professional development – Embracing local and international training, transparent schemes for career growth, evaluation and remuneration.
- Well-being – Regarding a safe work environment, remote work opportunities, health insurance, stress management and personal development workshops, corporate discounts, employee funds, and the Ethics Commission.

In terms of professional development, online trainings were conducted for employees during the year, along with coaching sessions that serve the professional development and interests of employees.

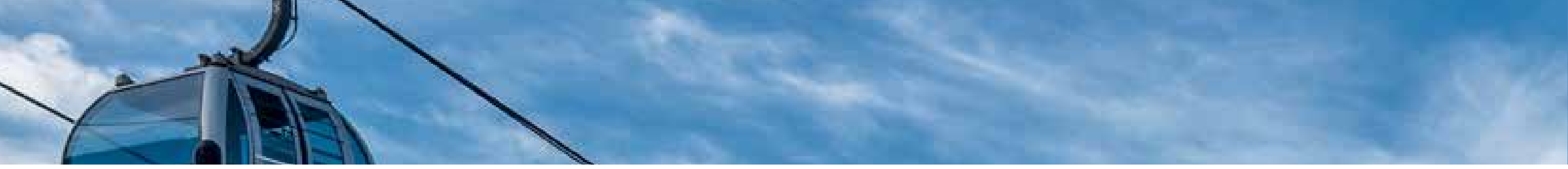
The National Bank has been operating an employee performance management and evaluation system since 2019, which facilitates transparent feedback between employees and supervisors. This system allows for impartial performance appraisal and provides a fair basis for further motivation. At the end of 2021, a digital module of the system (SAP Success Factors) was launched, making the process simpler, more efficient and transparent.

As for the welfare of the employees, the Ethics Commission has been working to protect their interests and has had a new composition since March 2021. The members of the commission are trusted employees of the bank who are elected by universal voting for a term of two years.

In 2021, in the midst of the pandemic, most NBG employees continued to work remotely. The Business Continuity Committee, based on the severity of the epidemic, set the maximum level of employees working at the bank's offices at 15-30%. All the offices and cash registers of the bank were continuously equipped with disinfectant and protective equipment. Employees obtained regular emergency information and training on safety protocols. By the end of 2021, the number of fully vaccinated employees was 86%.

2. Management and Communication

By discharging its functions, the NBG impacts not only the financial sector, but also many state or private institutions and organizations, and ultimately every citizen. As the policy of the NBG can be complex, explicit, contradictory and out-of-favor in some cases, it is thus necessary to maintain open and ongoing communication with the public to explain the decisions taken. To serve this purpose, the NBG sustains regular, transparent reporting (live reporting, social media posts, publications, research papers) and proactive, sched-



uled media activity. In addition, the bank manages to promptly respond to questions raised by the media or the public.

During 2021, the NBG aired four live presentations of its monetary policy reports, with the decisions of the Financial Stability Committee also made available.

The reputable international publication Central Banking selected the NBG among the best central banks and awarded it an award for the most transparent central bank.

One of our major undertakings was the complete update of our website for the first time since 2005, making information more accessible and structured for stakeholders, the media and the general public. The new version meets modern digital requirements, is fully customized and user friendly.

Continuing to be accountable to the public, the NBG published its first Sustainable Development Report in 2021. A Corporate Social Responsibility (CSR) section was also added to the Annual Report, summarizing the NBG's actions in that direction.

Considerable attention is also paid to internal communication. To promote sustainable development and social responsibility issues among the NBG employees, our staff magazine now features a new section "Let's talk about CSR", which shares information on the actions taken by the bank and reviews current issues.

3. The General Public

The responsibility of the NBG towards society at large is divided into two areas: (i) responsibility towards financial sector consumers; and (ii) responsibility towards the general public.

Responsibility towards consumers means protecting their rights, and we have a dedicated division for this function. The NBG also cares about the financial education of consumers and about informing them about the increasing number of cyber threats. To this end, in October 2021, the NBG initiated a month-long event on this subject for the first time in Georgia. This reached a wide audience by offering competitions and webinars and over 600 people participated.

The NBG internship programs encourage economics students and young professionals to enhance their knowledge and enjoy guidance from top industry experts, representing an invaluable experience for them. The interns are offered three-month paid internships and the selection process for these is public and transparent. In 2021, 29 students participated in our internship program.

Engagement with the general public is further encouraged through various scientific and creative competitions. Designs for our collector coins are invited through open competitions. By producing collector coins that celebrate events and personalities of national and historical importance, the NBG seeks to make a contribution to the nation's cultural heritage. In 2021, a total of five collector coins were minted. Many of these were given as gifts to people with special merits in their respective fields. The coin dedicated to the 100th anniversary of the Constitution was handed over to the descendants of the signatories of the First Constitution. A copy of the David the Builder silver coin was given to Mzekala Shanidze, a great Georgian linguist, and our King Tamar gold coin was presented to the legendary chess player Nona Gaprindashvili. Notably, the cost of the latter was fully covered by contributions made by the NBG's staff.

In addition, before New Year, the NBG employees granted the holiday wishes of the orphaned children and the elderly. Through the joint efforts of the staff, 24 children and 18 elderly beneficiaries received New Year's presents and handouts. Meanwhile, the Transfiguration Hospice received assistance in cash form.

4. The Market

The task of the National Bank is to maintain price stability and ensure the sustainability of the financial sector. In its capacity as the supreme regulatory body, the National Bank oversees and regulates the financial sector (in terms of access to financial services, responsible financing, etc.). In addition, the National Bank is responsible for the issuance and circulation of national currency and the development of new financial technologies.

In 2021, amid the pandemic, the NBG continued to manage reserves and supply liquid cash resources to the market. Its foreign exchange interventions were directed to mitigate the excessive fluctuations of the GEL. In 2021, the NBG presented its Supervisory Strategy to the financial sector. An interactive stress test web platform was launched, meant to simplify the assessment of the financial viability of commercial banks and to improve financial transparency. Meanwhile, competition policy regulations were developed to regulate competition in the market.

The introduction of Open Banking in 2021 was important for the development of financial technologies, and work was intensified on the digital GEL project.

Protecting the rights of consumers and taking care of the financial education of the public remains a priority. In 2021, the NBG approved a new regulation on the protection of consumer rights, to ensure greater protection of consumers in the financial sector. The NBG, with the FinEdu educational platform, worked intensively throughout the year to raise consumer awareness. We also initiated the introduction of the Consumer Protection Day on 15 March, and the financial sector eagerly joined this initiative.

5. The Environment

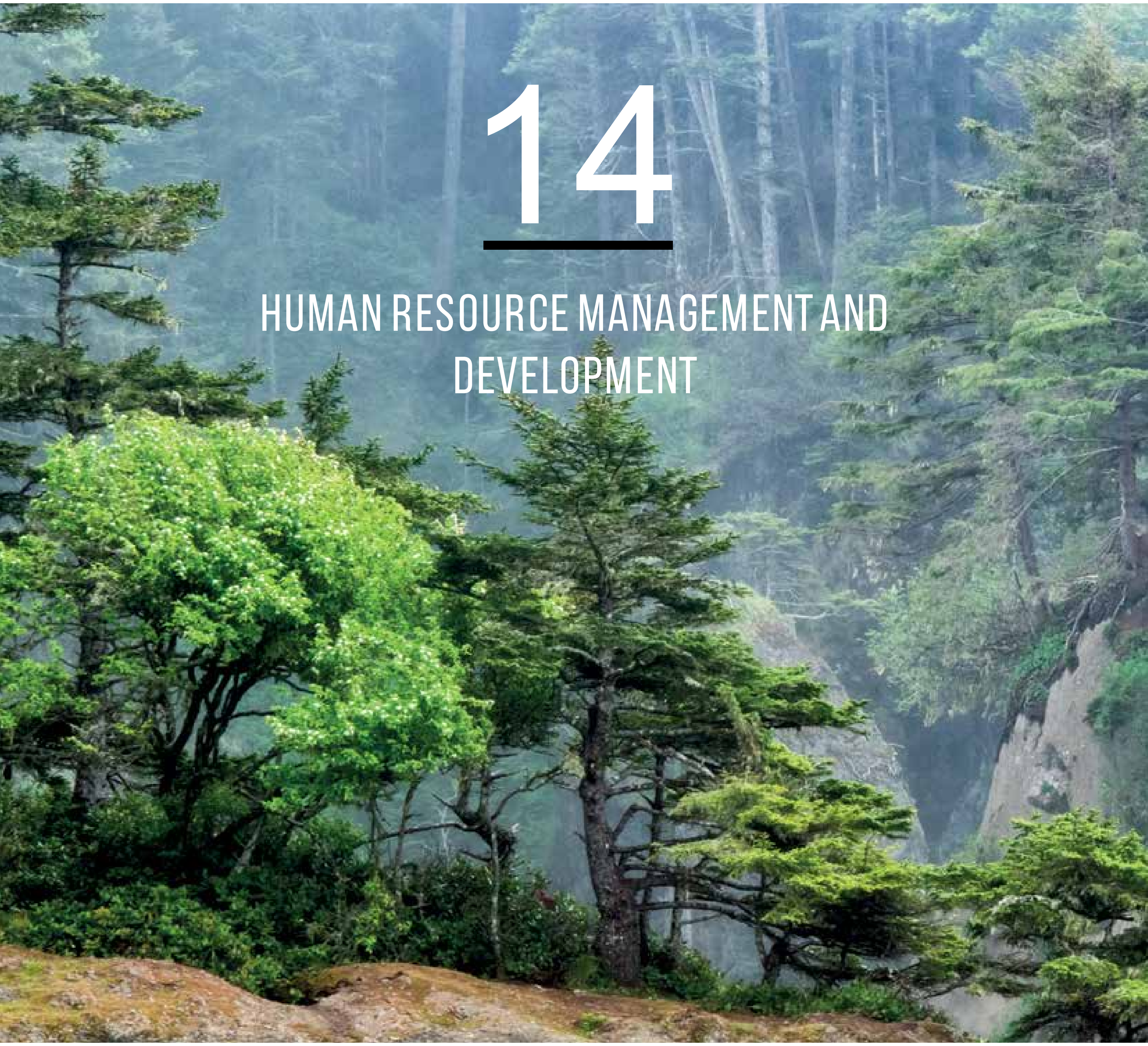
In 2021, the pandemic placed greater relevance on climate and ecosystem change and sustainable development. Earlier in the year, a second agreement was signed between the NBG and the International Finance Corporation (IFC). This stipulates the IFC's support for the NBG in developing a sustainable finance framework, developing sustainable financial products, and managing environmental and social issues in Georgia. Throughout the year, the NBG continued to share its experience in sustainable finance, both locally and internationally.

Moving to the next level of the Sustainable Banking and Finance Network (SBFN) rating system, the NBG became the co-chair of the working group in 2021.

FUTURE STEPS

Despite the limitations imposed by the pandemic in 2021, the NBG implemented several important CSR projects. In the coming years, efforts will be made to increase and expand the scope of these actions and projects. These include motivating employee volunteerism, energy efficiency initiatives, and increasing collaboration with experts.

To strengthen the CSR strategy, the following steps are planned for the next two years: to approve the 2022-2024 Action Plan, initiate an information campaign to raise staff awareness, enhance reporting to the general public and media on a variety of platforms, including through social media, and to further update the website and the Annual Report.



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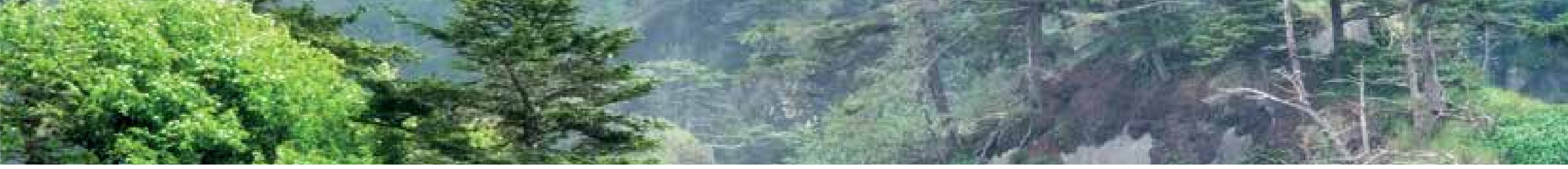
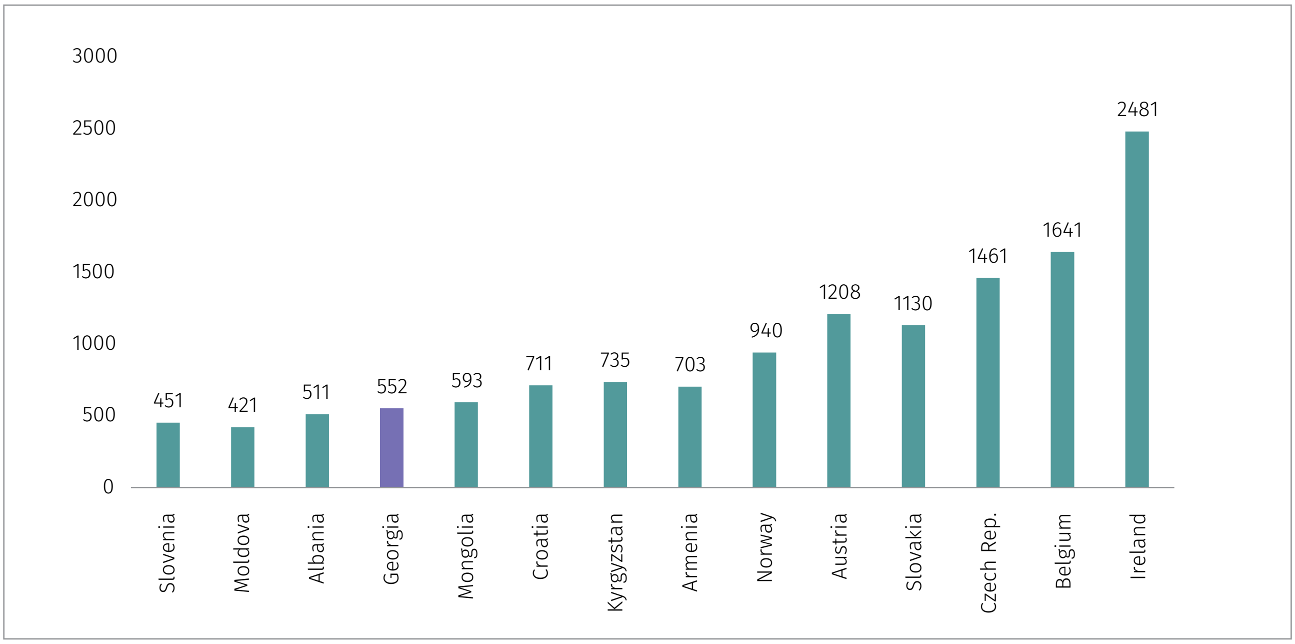
HUMAN RESOURCE MANAGEMENT AND DEVELOPMENT



STATISTICAL INFORMATION ON THE NUMBER OF STAFF

As of the end of 2021, the National Bank had 552 employees, of whom 428 were civil servants. The average age of employees was 39 years. Women made up 52% of the total staff, and 48% were men. Notably, compared to the number of employees in other central banks (taking into account the country's population and the role and functions of the regulator), the NBG maintains an adequate level of employees.

DIAGRAM N 14.1 STAFF NUMBERS IN VARIOUS CENTRAL BANKS[90]



Source: Relevant Central Banks and NBG calculations

PROFESSIONAL DEVELOPMENT OF STAFF

The year 2021 was not typical. The pandemic continued to impact the NBG's plans for the professional development of its valued staff. All seminars that had been planned by European Central Banks and financial institutions were conducted remotely.

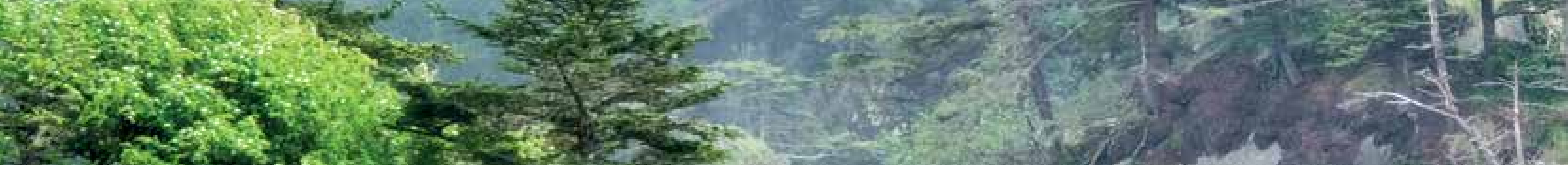
In 2021, 84 officials of the National Bank passed the certified Personal and Professional Competence Development Course. In addition, 22 managers of the bank attended the Managerial Skills Course. Both of these trainings were conducted remotely, organized by the LEPL Zurab Zhvania School of Public Administration, with the participants awarded relevant certificates after being tested.

In addition to these trainings, the staff of various NBG departments regularly conducted training and introductory presentations, though which we promote knowledge sharing across the organization.

PROFESSIONAL DEVELOPMENT OF FINANCIAL SECTOR STAFF

The NBG takes care of the professional development of both its own staff and of the employees of the banking sector as a whole. To this end, experts from the Luxembourg Financial Technology Transfer Research Agency conducted three online trainings in 2021, which were attended by employees of both the NBG and commercial banks. Also, at the initiative of the agency, representatives of the NBG and the financial sector attended e-learning courses.

90. The central banks included in the diagram implement monetary policy and oversee the banking sector in a similar manner to the NBG.



REMOTE WORK AND THE DIGITIZATION OF HR PROCESSES

The NBG was operating partially remotely during 2021. The main challenge for the HR department while working in this capacity was to maintain a positive team spirit and strengthen internal communications. Accordingly, a number of online activities were of great help: these included team building activities and meetings with psychologists and field specialists to reduce work stress.

In addition, the core activities of the HR unit were fully adapted to the remote work environment, including employee selection, their orientation/adaptation to the work environment, employee administration and the performance appraisal system.

In order to digitize HR processes, the SAP Success Factors employee performance management module was introduced at the NBG in 2021, making employee performance management, goal setting and evaluation much more flexible and efficient.

We completed evaluations of 503 NBG employees through this system. In addition, a 360-degree feedback system was piloted to assess the competencies of employees in managerial positions.

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DEVELOPMENT OF THE LEGAL FRAMEWORK

Throughout 2021, the Legal Department of the NBG was guided by the functions and key areas defined by the Statute of the NBG. Work continued on the ongoing development and improvement of the legal framework.

REFORM OF THE LEGISLATION REGULATING THE OWNERSHIP OF DEMATERIALIZED SECURITIES

The draft Law of Georgia on Ownership of Dematerialized Securities and its amendments were developed by the NBG in cooperation with the Ministry of Economy and Sustainable Development of Georgia. The package of legislative changes was initiated in the Parliament of Georgia and its committee discussions began in 2021.

The bill provides for the regulation of relations related to the ownership and circulation of dematerialized securities. These types of securities exist only as an entry in the securities account. They have emerged as modern technology has advanced and it is no longer necessary to own or register securities in material form. Therefore, the legislation has the role of proposing their regulation and clearly defining issues concerning property rights, confirmation and transfer.

It is important to have in place regulations of international standards to achieve the following goals:

- Ensuring legal clarity.
- Creating better guarantees for the protection of property rights.
- Improving the quality of investor protection.
- Eliminating gaps in the legislation and regulating all issues related to the ownership of dematerialized securities (including government securities) in a single act.
- Promoting the development of the capital market in general.

REGULATION OF COMPETITION IN THE FINANCIAL SECTOR

In 2021, important legal acts were published on the basis of the Law of Georgia on Competition. To comply with the legislative requirements, the following acts were developed: the Regulation for Submitting and Reviewing Market Analysis and Concentration Notices, approved under Decree N68/04 of the Governor of the NBG of 28 May 2021, and the Regulation on Investigation, Submission of Complaint/Application and Review of Cases Related to Potential Violation of Competition, as approved under Decree N67/04 of the Governor of the NBG of 28 May 2021.

These decrees established the methodology guidelines for market analysis, evaluation criteria and parameters; the relevant procedural rules for the submission and consideration of concentration notice; and the way the NBG reviews concentration notices, investigates and monitors the market, and manages other procedural issues. These also cover the procedures on how the parties concerned, under the NBG's supervision authority, investigate the cases and review complaints and applications on the potential violation of competition. The NBG soon applied the Regulation on Submission and Review of Market Analysis and Concentration Notice, and based on this, assessed the compatibility of a proposed concentration between JSC Credo Bank (registration number: 205232238) and JSC Finca Bank Georgia (registration number: 205235262) with a competitive environment.[91]

NEW REGULATION ON THE PROTECTION OF CONSUMER RIGHTS

Decree N32/04 of the Governor of the NBG of 9 March 2021 on the Approval of the Regulation on the Protection of Consumers' Rights as Services are Provided by

91. The NBG Resolution is available at: https://nbg.gov.ge/fm/uploads/sazedamxedvelo_politika/brdzaneba.pdf

Financial Institutions, entered into force during the year. This aimed to bring legislation in line with EU legislation and international instruments, specifically the European Parliament and Council Directive 2008/48/EC of 23 April 2008 on consumer lending agreements[92], and the Remote Marketing of Consumer Financial Services under Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002.[93] This stems from the commitment assumed by Georgia under the Association Agreement between Georgia and the European Union and the European Atomic Energy Agency and their Member States. At the same time, based on the current state of the financial sector and the study and analysis of consumer complaints in the NBG, the decree aims to create additional guarantees for the protection of consumer rights, promote competition in the market and introduce fair practices.

BANKING SUPERVISION

In 2021, significant changes in legal acts were developed and entered into force by the NBG. Under Decree N40/04 of the Governor of the NBG of 19 March 2021, an amendment was made to Decree N46/04 of the Governor of the NBG of 16 March 2018 on the Approval of the Regulation on Liquidation of Commercial Banks. The amendment covered issues related to refunds of unclaimed amounts. In addition, to have all liquidation matters in a single act and to apply them effectively, the liquidation regulation integrated each of the legal norms related to the liquidation process. In so doing, the previous Regulation on Declaring a Commercial Bank Insolvent and Bankrupt, as approved under Decree N199 of the Governor the National Bank of 23 May 2003, was annulled.

By Decree N147/04 of the Governor of the NBG of 19 October 2021, an amendment was made to Decree N 92/04 of the Governor of the NBG of 22 June 2017 on the Approval of the Regulation on Disclosure of Information by Commercial Banks within Pillar 3. The amendment adds a new spreadsheet for commercial banks to improve the transparency of their work and to bring them closer to international best practice, which includes general and quality information on retail products.

In addition, by Decree N70/04 of the Governor of the NBG of 1 June 2021, an amendment was made to the same decree, which clarified the requirement for the disclosure of environmental, social and governance (ESG) issues and concerned the format in which this information is to be disclosed. In addition, Decree N69/04 of the Governor of the NBG of 1 June 2021 amended Decree N215/04 of the Governor of the NBG of 26 September 2018 on the Approval of the Corporate Governance Code of Commercial Banks. The aim is to ensure the proper integration of environmental, social and governance (ESG) issues into the activities of commercial banks to ensure financial stability, to effectively manage ESG risks, and to improve the disclosure of information on ESG issues. By Decree N17/04 of the Governor of the NBG of 9 February 2021, the Corporate Governance Code of Commercial Banks, as approved by Decree 215/04 of the Governor of the NBG of 26 September 2018, was also amended. These amendments serve to strengthen supervisory boards, the audit, risks and remuneration committees and to address remuneration policy issues, the rights and responsibilities of a supervisory board, the terms of independent board membership, the composition of the committees, and other issues related to their functions.

In addition, by Decree N80/04 of the Governor of the NBG of 21 June 2021, due to the need to introduce additional incentive mechanisms to intensify de-dollarization measures on the liabilities side of commercial banks, an amendment was made to Decree N10/04 of the Governor of the NBG of 11 February 2011 on Approval of the Regulation on Minimum Reserve Requirements for Commercial Banks. According to the amend-

92. Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC (https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:32008L0048).

93. Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC (https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex%3A32002L0065).

ment, the norm of minimum reserve requirements for funds attracted in foreign currency is to be determined individually for each commercial bank, based on the level of their dollarization of deposits.

AMENDMENT TO THE BYLAW ON LENDING TO INDIVIDUALS

Also important is the amendment made by Decree N176/04 of the Governor of the NBG of 17 December 2021 to Decree N44/04 of the Governor of the NBG of 13 March 2020 on the Approval of the Regulation on Lending to Individuals. With this change, the maximum term of foreign currency mortgage loans was reduced from 15 to 10 years. This amendment was necessary because, from April 2021, in parallel with the recovery of the economy and the tightening of monetary policy, the growth of foreign currency mortgage loans had accelerated. Reducing the maximum maturity of foreign currency mortgages is expected to alleviate these vulnerabilities and increase borrowers' abilities to absorb stress through the possibility of loan extensions (which have been used effectively during the current pandemic). Also, reducing maturities will accelerate the amortization of loans, which, in turn, will reduce credit risks and help de-dollarization.

NON-BANKING SUPERVISION

In 2021, the legal framework was also improved for non-banking supervision. Decree N98/04 of the Governor of the NBG of 14 July 2021, amended Decree N37/04 of the Governor of the NBG of 28 February 2018 on Approval of the Regulation on Registration and Regulation of Currency Exchange Bureaus. The goal of this amendment is to exercise the supervisory powers of the NBG more effectively. The definitions of "significant share" and "joint venture partners/shareholders" were added to the definition of terms for greater clarity, and the norms regulating the registration/cancellation of currency exchange bureaus were revised. Also, a legal entity that wishes to register as a currency exchange bureau is now obligated to submit the results of a criminal record check. Among other aspects, requirements for the video surveillance of currency exchange bureaus were made clearer.

Decree N217/04 of the Governor of the NBG of 27 September 2018 on Approval of the Regulation on Registration, Deregistration and Regulation of the Lending Entity at the NBG was amended under Decree N99/04 of the Governor of the NBG of 14 July 2021. This amendment sets a new procedure for registering lending entities. The obligation to submit photographs of the interior and exterior of the operating space was added to the registration requirements. In case a legal entity wishes to register as a lending entity, the obligation to submit the results of a criminal record check was also added. Moreover, in order to ensure the redistribution of responsibilities, for those interested legal entities that have only one shareholder/partner, who is also the director of the legal entity, having a second director has become a mandatory requirement. With the above changes, the requirements for changing registration data became clearer. The grounds for refusal to register as a lending entity, cancellation of registration and requirements related to the video surveillance system of the lending entity were also clarified and expanded. These included the obligation of the lending entity not to perform its functions without a security alarm and video surveillance system installed, in accordance with the requirements of the regulation. In addition, the NBG, within the framework of the inspection of the lending entity, will be authorized to withdraw the relevant record of electronic information from the video surveillance system. The decree establishes a norm that regulates the operational risk management issues of the lending entity, including setting obligations and defining requirements to avoid the materialization of the relevant risks.

CREDIT REGISTER

To enable the effective implementation of the supervisory functions of the NBG, to alleviate the reporting burden for commercial banks, and to enable other lending entities who are members of the credit register to submit their mandatory reporting in a simple and more efficient manner, the Regulation on Creation and Use of the Credit Register was approved under the Decree N88/04 of the Governor of the NBG of 6 July 2021.

SUPERVISION OF THE SECURITIES MARKET AND INVESTMENT FUNDS

In 2021, legal acts were published concerning changes to the securities market legislation. Due to the need to develop standards of ethics and professional conduct for securities market participants, Decree N13/04 of the Governor of the NBG of 2 February 2021 approved the Code of Ethics and Professional Conduct for Banking and Securities Market Participants. The latter replaced Decree N154/04 of the Governor of the NBG of 9 July 2018 that had approved the Code of Ethics and Standards of Professional Conduct for Commercial Banks. The principles and standards set out in the new code are based on the principles of ethics and standards of professional conduct set out by the Institute for Certified Financial Analysts (CFA), which are universally recognized and accepted guidelines in the financial market. The goal of the code is to ensure the ethical conduct of commercial banks, brokerage firms and asset management companies, as well as those involved in their work, and to establish internationally recognized standards of ethics and professionalism in the financial markets. This is expected to help the banking sector and securities market have better reputations, increase consumer confidence, boost investor confidence and help the stable and efficient functioning of the banking and securities markets. The amendments to the Law of Georgia on the Securities Market regarding the issuers of public securities made it necessary to develop a corporate governance code, which would set out the clear organizational requirements that companies had to meet. For this purpose, Decree N172/04 of the Governor of the NBG of 7 December 2021 on the Approval of the Corporate Governance Code for Issuers of Public Securities was developed.

Amendments were also made to Decree N167/04 of the Governor of the NBG of 22 September 2020 on Approval of the Regulation on Licensing, Registration, Recognition and Regulation of Asset Management Companies and Decree N170/04 of the Governor of the NBG of 22 September 2020 on Approval of the Regulation on Authorization, Registration, Recognition and Regulation of Investment Funds. The purpose of these changes was to set an exceptional regulation: based on the risk-based approach, the NBG will have the right to license/register/recognize an asset management company and authorize/register/recognize an investment fund when the documents/information required by the decrees are not submitted in full; if necessary, it will set deadlines for submitting the information/documents.

Amendments were also made to Decree N24/04 of the Governor of the NBG of 7 April 2011 on the Approval of the Instruction on Opening Accounts in Banking Institutions and Decree N49/04 of the Governor of the NBG of 3 May 2012 on the Approval of the Regulation on Standard Certificates of Deposit of Commercial Banks. The changes concerned the opening of a nominal ownership account by a specialized depository service of the LEPL Pension Agency and the possibility of settling a term deposit with the LEPL Pension Agency or an asset management company through that account, as well as the possession of certificate of deposits by the LEPL Pension Agency or a pension asset management company, and related payments.

MONEY LAUNDERING AND TERRORIST FINANCING PREVENTION LEGISLATION

In order to develop and improve the legal framework of the NBG on the facilitation of the prevention of money laundering and terrorist financing, Decree N48/04 of the Governor of the NBG of 30 March 2021 on Approval of the Regulation on Performing Prevention Measures Electronically by an Accountable Entity was of importance. This sets the procedure for electronic identification/verification for accountable entities under the supervision of the NBG without direct contact with the client and/or the person acting on behalf of the client. The decree sets out the minimum measures to be taken to prevent money laundering and terrorist financing during electronic identification/verification. It regulates the authority of the NBG to introduce the process of electronic identification/verification by the accountable entity, as well as issues related to the updating of information, and the completion and termination of the electronic identification/verification process by the accountable entity.

A number of amendments were also made to align the NBG's legal acts with the Law of Georgia on the Prevention of Money Laundering and Terrorist Financing and those legal acts issued by the LEPL Georgian Financial Monitoring Service on the basis of that law. The changes made in the decrees included changes in the terminological content as well as corrections for deficiencies in practice as a result of using certain regulations. These changes, in turn, serve to provide the NBG with effective AML/CFT oversight of financial institutions. Decree N83/04 of the Governor of the NBG of 23 June 2021 approved the Regulation on Completing the Questionnaire for Supervision of the Control System for Combating Money Laundering and Terrorist Financing at Commercial Banks and the Procedure for Information Submission. The goal of the legal act was to increase the efficiency of the expertise process for policies and procedures developed by commercial banks. By completing the questionnaire provided for in this decree, commercial banks will provide detailed information on their control procedures that will ensure the adequate management of money laundering and terrorist financing risks across the company.

CHANGES IN PROCEDURES FOR IMPOSING FINES

Amendments were made in the respective procedures for fines related to the imposition of penalties for violating the requirements of the legislation of Georgia on the facilitation of prevention of money laundering and terrorist financing, violation of the requirements for the legislation on consumer protection, and violation of provisions on lending to individuals.

DEEMING INFORMATION CONFIDENTIAL AND DISCLOSING SUCH INFORMATION

In 2021, Resolution N4 of the Board of the NBG of 1 November 2021 on Approval of Regulation on Deeming Information Confidential, Disclosing Such Information, and the List of Confidential Information was published. This envisages several important changes over the previous resolution: the categories of confidential information and procedures for records management are now more specific; the article on access to confidential information was made separate and it was precisely detailed to whom confidential information of a certain category is available, etc.

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STATISTICAL WORK

Despite the global delays caused by the COVID-19 pandemic, the statistical activities of the NBG (NBG) were successful during 2021. Several projects tailored to the interests of users were successfully implemented and a technical base was prepared for the implementation of further plans.

With regard to the introduction of the modern format of Statistical Data and Metadata Exchange (SDMX), major preparatory work was undertaken during 2020-2021. On the recommendation of the International Monetary Fund's Department of Statistics, we produced the National Summary Data Page (NSDP) in accordance with modern standards, and integrated this in the website of the NBG.[94] In close cooperation with the National Statistics Office of Georgia and the Ministry of Finance of Georgia, time series were prepared for each indicator on the NSDP page to generalize the data. We also came up with a mechanism necessary for converting time series to SDMX format. These are now posted on the updated website on a regular basis.

During 2021, financial and statistical data collected from commercial banks, microfinance institutions and insurance companies were regularly analyzed, with the aim of improving the quality of transactions on financial instruments. In the Tableau-BI environment, which is a modern platform for data visualization and analysis, a control mechanism for balance sheet identity on flows and balances data was developed. This created a solid basis for the production of a financial statement on flows. Accordingly, we prepared an interactive financial statement information sheet on flows in the Tableau-BI environment, which is currently being monitored in test mode. We plan to publish a financial report on flows on the website by the end of 2022.

In 2015, the NBG introduced the NBGStat system for obtaining, processing, storing, and disseminating financial and statistical data to effectively manage the statistical business process. The NBG takes care of the quality and accuracy of the data collected in the NBGStat system on an ongoing basis. For this purpose, in 2021 we planned to produce a unified database of legal entities registered in Georgia, as this allows for amplified reliability of the financial data collected. Work on this project continues. We are also reviewing and modernizing the existing codes used for the institutional sectors in the NBGStat system. In addition, we plan to change the classifier according to the standards of the 2nd edition regarding the types of economic activities and to collect more detailed data from the financial sector.

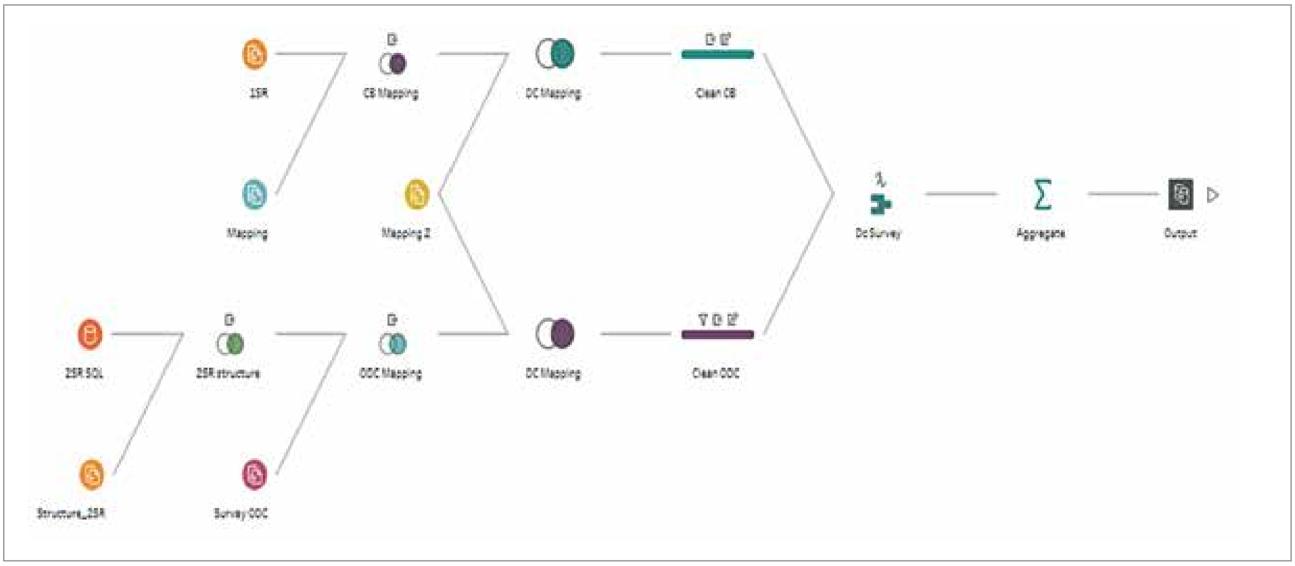
In the fourth quarter of 2021, the NBG introduced data management functionality on the data visualization and analysis platform. By using this functionality, it became possible to actively use the so-called Extract, Transform, Load (ETL) mechanism tool to process and transform particularly large data in a modern platform to enable data visualization and analysis. Using this mechanism, the process of preparing analytical review spreadsheets posted on the website was simplified and automated.

Ready-made products of ETL data streams are also being prepared and published for internal server use. These will speed up the process of preparing reports for various purposes. Preparatory work was also planned to create a unified database (big data). In 2021, several statistical reports were added to the statistics section of the NBG website. Before 2021, the statistics provided in the interactive accounts of loans and deposits as posted on the website of the NBG were only available from November 2015. However, at the request of users, work was completed in 2021 to process data from previous years as well. The interactive accounts were thus updated, with statistics on financial instruments for loans and deposits now available from 2003. The NBG also started publishing statistics on income from international travel, where such data are available, by country.

Also, at the request of the Commercial Banks Reporting Unit, mechanisms for controlling the balance sheet

94. The updated national summary data page (NSDP) is available at: https://nbg.gov.ge/en/page/nsdp

DIAGRAM N 16.1 A CONCISE ILLUSTRATION OF THE ETL FLOW OF THE DEPOSITORY CORPORATIONS REVIEW



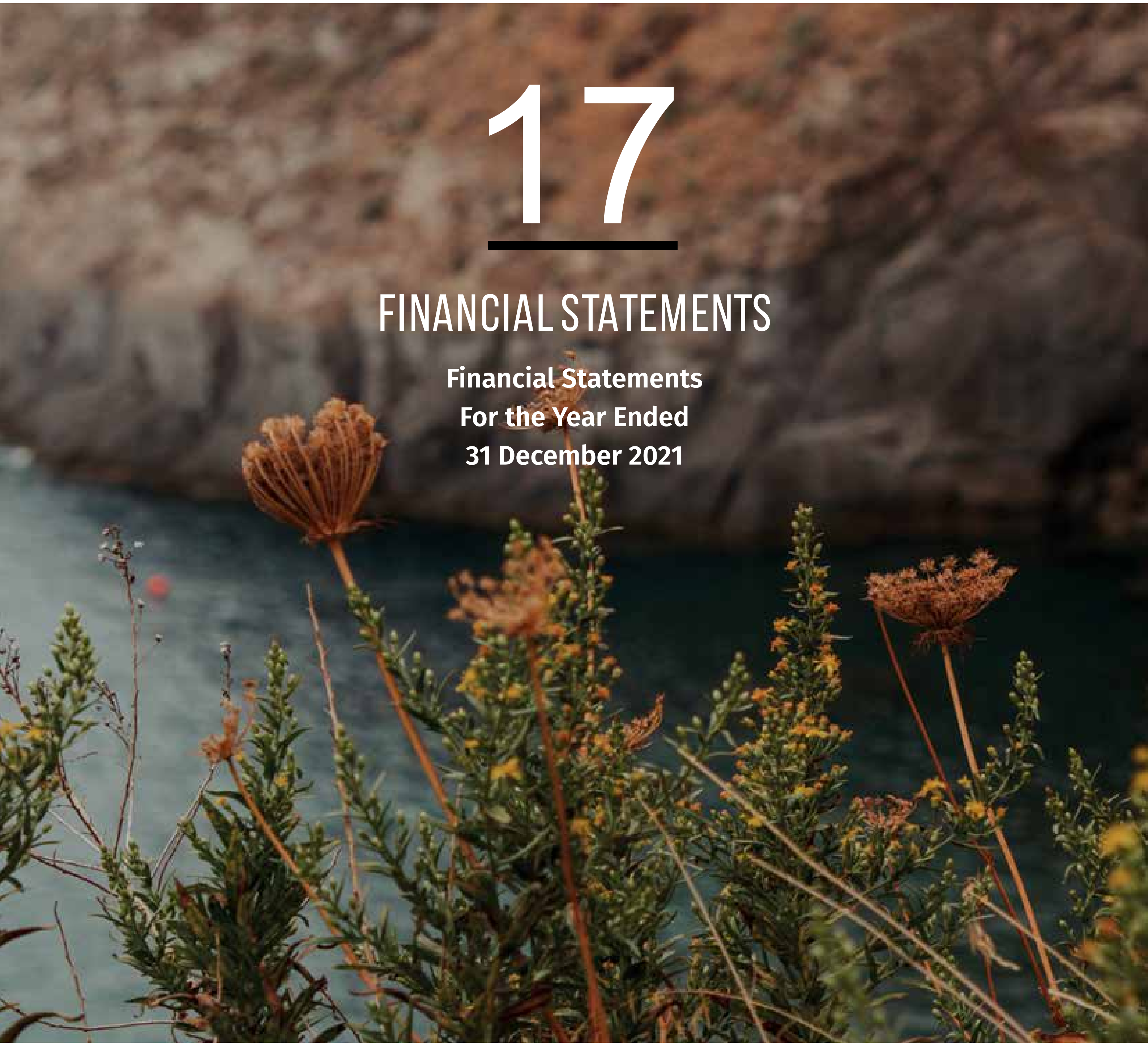
Source: NBG

identity and analyzing the data on remittances were prepared for FIM data. Relevant interactive reports were developed and are now available to the staff of the Commercial Banks Reporting Unit.

In 2021, the interactive reports on remittances, foreign exchange markets and other topics published on the website were reviewed. The data filtering mechanisms on a number of such reports were improved and their capacity was enhanced. Also, the production of the Financial Indicator Daily (FID) family of reports is being successfully developed. Data control and validation tools were developed as reports prepared based on FID data require a significant workload in terms of assessing and analyzing current dynamics in the banking system.

At the initiative of the International Monetary Fund's Department of Statistics, the process of collecting Financial Stability Indicators (FSI) began to be migrated, with the introduction of new spreadsheets based on the 2019 methodology. The FSI spreadsheets we have produced thus far are based on the 2006 methodology. In response to this initiative, major preparatory work is underway to learn and implement the new methodology. We have collected and processed the data necessary for the calculation of the new indicators. Changing the existing approaches, we have developed interactive working versions of new FSI spreadsheets. Alongside the change in methodology, the International Monetary Fund's Department of Statistics changed the FSI data collection, validation and dissemination procedures, making it necessary to recalculate existing data sets according to new tables. As a result of close cooperation with the experts of the International Monetary Fund, we have achieved greater accuracy in the historical data calculated. The updated FSI spreadsheets are scheduled for publication on the NBG website in the second quarter of 2022.

The NBG takes care of providing highly reliable statistical data to its customers on an ongoing basis. We prepare modern interactive reports with different content and loads that allow users to filter the data at their own discretion and obtain the desired result in both visual and tabular formats. In 2021, the Monetary Statistics Division was involved in the introduction of modern information processing and standardization technologies (SDMX). These were successfully implemented and earned the approval of the International Monetary Fund.



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FINANCIAL STATEMENTS

Financial Statements
For the Year Ended
31 December 2021

NATIONAL BANK OF GEORGIA

STATEMENT OF MANAGEMENT RESPOSIBILITIES
FOR THE PREPARATION AND APPROVAL OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2021

Management is responsible for the preparation of the financial statements that present fairly the financial position of the National Bank of Georgia (the "Bank") at 31 December 2021, the results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the financial statements, management is responsible for:

- Properly selecting and applying accounting policies;
- Presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Providing additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Bank's financial position and financial performance; and
- Making an assessment of the Bank's ability to continue as a going concern.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Bank;
- Maintaining adequate accounting records that are sufficient to show and explain the Bank's transactions and disclose with reasonable accuracy at any time the financial position of the Bank, and which enable them to ensure that the financial statements of the Bank comply with IFRS;
- Maintaining statutory accounting records in compliance with legislation and accounting standards adopted in Georgia which are IFRSs;
- Taking such steps that are reasonably available to them to safeguard the assets of the Bank; and
- Preventing and detecting fraud and other irregularities.

The financial statements for the year ended 31 December 2021 were authorized for issue on 18 April 2022 by the Council of the Bank.

On behalf of the Council of the Bank:

Chairman of the Council
Koba Gvenetadze

Head of Finance and Accounting Department
Andria Manelashvili

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Independent Auditors' Report

To the Council of the National Bank of Georgia

Opinion

We have audited the financial statements of the National Bank of Georgia (the "Bank"), which comprise the statement of financial position as at 31 December 2021, the statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2021, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

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 *Auditors' 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 International Code of Ethics for Professional Accountants (including International Independence Standards) *(IESBA Code)* together with the ethical requirements that are relevant to our audit of the financial statements in Georgia, and we have fulfilled our other ethical responsibilities in accordance with these requirements and 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

Management is responsible for the other information. The other information comprises the information included in the annual report, but does not include the financial statements and our auditors' report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

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

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

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

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

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

Auditors' 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 auditors' 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 scepticism 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 auditors' 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 auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

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

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

The engagement partner on the audit resulting in this independent auditors' report is:

Vakhtang Kezheradze

KPMG Georgia
Georgia, Tbilisi
18 April 2022

NATIONAL BANK OF GEORGIA
STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2021
(in thousands of Georgian Lari)

	Notes	Year ended 31-Dec-21	Year ended 31-Dec-20
Interest income from international reserves			
Cash and cash equivalents		1,014	1,663
Investments measured at fair value through other comprehensive income ("FVOCI")		65,088	123,329
Other		535	1,221
		66,637	**126,213**
Interest income from monetary policy operations			
Due from resident financial institutions		275,850	230,220
Investments measured at fair value through other comprehensive income		110,004	75,496
Negative interest on financial liabilities		17,478	4,617
		403,332	**310,333**
Other interest income			
Investments measured at amortised cost		13,906	17,290
Negative interest on financial liabilities		300	19
Other		20	3
		14,226	**17,312**
Total interest income calculated using the effective interest rate method		**484,195**	**453,858**
Interest expense from monetary policy operations			
Debt securities issued		(5,639)	(5,495)
Due to resident financial institutions		(53,026)	(41,092)
		(58,665)	**(46,587)**
Other interest expenses			
Due to the International Monetary Fund		(19,857)	(12,602)
Due to customers		-	(5,212)
Interest expense on lease liabilities		(58)	(112)
Negative interest on financial assets (International reserves)		(4,240)	(2,802)
		(24,155)	**(20,728)**
Total interest expense		**(82,820)**	**(67,315)**
NET INTEREST INCOME		**401,375**	**386,543**
Impairment recovery/(charge)	28	202	(32)
NET INTEREST INCOME AFTER IMPAIRMENT PROVISION		**401,577**	**386,511**
Net gains/(losses) from foreign currencies:			
Translation differences		(259,086)	680,748
Dealing		68,336	(22,978)
Fee and commission income	4	3,439	4,280
Fee and commission expense	4	(3,067)	(3,836)
Net realized gain on instruments measured at fair value through other comprehensive income		7,607	38,283
Net realized gain on financial instruments measured at fair value through profit or loss		13,694	23,009
Net unrealised gain/(loss) on financial instruments measured at fair value through profit or loss		14,036	(7,571)
Other income	5	2,406	1,890
NON-INTEREST (EXPENSE)/INCOME		**(152,635)**	**713,825**

The statement of profit or loss and other comprehensive income is to be read in conjunction with the notes to, and forming part of, the financial statements.

NATIONAL BANK OF GEORGIA

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2021 (CONTINUED)

(in thousands of Georgian Lari)

	Notes	Year ended 31-Dec-21	Year ended 31-Dec-20
Personnel expenses	6	(31,155)	(28,303)
General and administrative expenses	6	(12,580)	(10,640)
Money printing expenses		(25,128)	(16,848)
Depreciation and amortization	6	(7,657)	(6,240)
Other expenses		(1,093)	(930)
NON-INTEREST EXPENSES		**(77,613)**	**(62,961)**
PROFIT FOR THE YEAR		**171,329**	**1,037,375**
Other comprehensive income			
Items that are or may be reclassified subsequently to profit or loss:			
Net unrealized (loss)/gain on revaluation of investments measured at fair value through other comprehensive income during the year		(117,890)	69,591
Net realized loss on investments measured at fair value through other comprehensive income reclassified to profit or loss		(7,607)	(38,283)
Total other comprehensive (loss)/income		**(125,497)**	**31,308**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**45,832**	**1,068,683**

The financial statements as set out on pages 4 to 55 were approved by management on 18 April 2022 and were signed on behalf of the Council of the Bank by:

Chairman of the Council Department

Koba Gvenetadze

Head of Finance and Accounting

Andria Manelashvili

The statement of profit or loss and other comprehensive income is to be read in conjunction with the notes to, and forming part of, the financial statements.

NATIONAL BANK OF GEORGIA

STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2021
(in thousands of Georgian Lari)

	Notes	31-Dec-21	31-Dec-20
ASSETS:			
Foreign currency assets			
International reserves			
Cash and cash equivalents	7	3,623,929	3,602,487
Special Drawing Rights holdings with the International Monetary Fund	9	1,506,927	697,227
Assets related to derivative instruments	10	14,235	13,989
Investments measured at fair value through profit or loss	11	329,975	177,163
Investments measured at fair value through other comprehensive income	12	7,759,488	8,323,015
Other foreign currency assets			
Other assets	17	8	986
		13,234,562	**12,814,867**
National currency assets			
Monetary policy instruments			
Due from resident financial institutions	8	3,147,015	3,214,170
Assets related to derivative instruments	10	3,864	1,318
Investments measured at fair value through other comprehensive income	12	1,649,777	1,168,338
Other national currency assets			
Investments measured at amortised cost	13	161,461	201,661
Right-of-use assets	14	387	1,232
Property and equipment	15	57,297	55,529
Intangible assets	16	5,446	4,856
Other assets	17	4,586	11,380
		5,029,833	**4,658,484**
TOTAL ASSETS		**18,264,395**	**17,473,351**

The statement of financial position is to be read in conjunction with the notes to, and forming part of, the financial statements.

NATIONAL BANK OF GEORGIA

STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2021 (CONTINUED)
(in thousands of Georgian Lari)

	Notes	31-Dec-21	31-Dec-20
LIABILITIES AND EQUITY:			
LIABILITIES:			
Foreign currency liabilities			
Monetary policy instruments			
Due to resident financial institutions	18	5,120,817	5,480,533
Other foreign currency liabilities			
Due to resident financial institutions	18	224,018	103,071
Due to the Ministry of Finance of Georgia	19	788,312	788,928
Due to the International Monetary Fund	9	2,945,597	1,898,473
Other liabilities	17	3,485	6,203
		9,082,229	**8,277,208**
National currency liabilities			
Money issued in circulation	21	4,589,034	4,661,427
Monetary policy instruments			
Debt securities issued	22	59,124	59,273
Due to resident financial institutions	18	444,053	524,949
Other national currency liabilities			
Due to the Ministry of Finance of Georgia	19	894,785	661,984
Due to customers	20	605	1,394
Due to the International Monetary Fund	9	2,620	2,315
Other liabilities	17	366,951	9,579
		6,357,172	**5,920,921**
TOTAL LIABILITIES		**15,439,401**	**14,198,129**
EQUITY:			
Capital	23	15,000	15,000
Reserve fund	23	754,750	475,292
Foreign currency revaluation reserve	23	2,095,648	2,354,734
Other revaluation reserve	23	14,036	-
Revaluation reserve of investments measured at fair value through other comprehensive income	23	(54,440)	71,057
Retained earnings	23	-	359,139
TOTAL EQUITY		**2,824,994**	**3,275,222**
TOTAL LIABILITIES AND EQUITY		**18,264,395**	**17,473,351**

The financial statements as set out on pages 4 to 55 were approved by management on 18 April 2022 and were signed on behalf of the Council of the Bank by:

Chairman of the Council Department	**Head of Finance and Accounting**
Koba Gvenetadze	**Andria Manelashvili**

The statement of financial position is to be read in conjunction with the notes to, and forming part of, the financial statements.

NATIONAL BANK OF GEORGIA

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2021
(in thousands of Georgian Lari)

	Capital	Reserve fund	Foreign currency revaluation reserve	Other revaluation reserve	Revaluation reserve of investments measured at FVOCI	Retained earnings	Total equity
1-Jan-20	**15,000**	**475,292**	**1,673,986**	**2,512**	**39,749**	**100,000**	**2,306,539**
Total comprehensive income							
Profit for the year	-	-	-	-	-	1,037,375	1,037,375
Other comprehensive income							
Items that are or may be reclassified subsequently to profit or loss:							
Net unrealized gain on revaluation of investments measured at fair value through other comprehensive income during the year	-	-	-	-	69,591	-	69,591
Net realized loss on investments measured at fair value through other comprehensive income reclassified to profit or loss	-	-	-	-	(38,283)	-	(38,283)
Total other comprehensive income	-	-	-	-	31,308	-	31,308
Total comprehensive income for the year	**-**	**-**	**-**	**-**	**31,308**	**1,037,375**	**1,068,683**
Transactions recorded directly in equity							
Transfer to the Ministry of Finance of Georgia from 2019 profit under the Law* (Note 23)	-	-	-	-	-	(100,000)	(100,000)
Transfer to foreign currency revaluation reserve under the Law* (Note 23)	-	-	680,748	-	-	(680,748)	-
Transfer to other revaluation reserve under the Law* (Note 23)	-	-	-	(2,512)	-	2,512	-
Total transactions recorded directly in equity	**-**	**-**	**680,748**	**(2,512)**	**-**	**(778,236)**	**(100,000)**
31-Dec-20	**15,000**	**475,292**	**2,354,734**	**-**	**71,057**	**359,139**	**3,275,222**
Total comprehensive income							
Profit for the year	-	-	-	-	-	171,329	171,329
Other comprehensive income							
Items that are or may be reclassified subsequently to profit or loss:							
Net unrealized loss on revaluation of investments measured at fair value through other comprehensive income during the year	-	-	-	-	(117,890)		(117,890)
Net realized loss on investments measured at fair value through other comprehensive income reclassified to profit or loss	-	-	-	-	(7,607)		(7,607)
Total other comprehensive loss	-	-	-	-	(125,497)		(125,497)
Total comprehensive income for the year	**-**	**-**	**-**	**-**	**(125,497)**	**171,329**	**45,832**
Transactions recorded directly in equity							
Transfer to the Ministry of Finance from 2020 profit under the Law* (Note 23)	-	-	-	-	-	(140,000)	(140,000)
Distribution to the Ministry of Finance from 2021 profit under the Law* (Note 23)						(356,060)	(356,060)
Transfer to reserve fund from 2020 profit under the Law* (Note 23)		219,139				(219,139)	-
Transfer to reserve fund from 2021 profit under the Law* (Note 23)		60,319				(60,319)	-
Transfer from foreign currency revaluation reserve under the Law* (Note 23)	-	-	(259,086)	-	-	259,086	-
Transfer to other revaluation reserve under the Law* (Note 23)	-	-	-	14,036	-	(14,036)	-
Total transactions recorded directly in equity	**-**	**279,458**	**(259,086)**	**14,036**	**-**	**(530,468)**	**(496,060)**
31-Dec-21	**15,000**	**754,750**	**2,095,648**	**14,036**	**(54,440)**	**-**	**2,824,994**

* Organic Law of Georgia on the National Bank of Georgia

The financial statements as set out on pages 4 to 55 were approved by management on 18 April 2022 and were signed on behalf of the Council of the Bank by:

Chairman of the Council Department

Koba Gvenetadze

Head of Finance and Accounting

Andria Manelashvili

The statement of changes in equity is to be read in conjunction with the notes to, and forming part of, the financial statements.

NATIONAL BANK OF GEORGIA

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2021
(in thousands of Georgian Lari)

	Notes	Year ended 31-Dec-2021	Year ended 31-Dec-2020
CASH FLOWS FROM OPERATING ACTIVITIES:			
Interest received		565,337	468,399
Interest paid		(81,854)	(57,969)
Fees and commissions received		3,439	4,280
Fees and commissions paid		(3,067)	(3,836)
Net realized gain on financial instruments at fair value through profit or loss		13,694	23,009
Net realized gain/(loss) from dealing in foreign currencies		68,336	(22,978)
Other income received		4,080	3,669
Personnel expenses paid		(31,155)	(28,303)
Cash paid for printing money		(25,128)	(16,848)
Other general and administrative expenses paid		(12,803)	(11,569)
Net cash inflow from operating activities before changes in operating assets and liabilities		**500,879**	**357,854**
Net (increase)/decrease in operating assets:			
Due from resident financial institutions		68,929	(74,100)
Special Drawing Rights holdings with the International Monetary Fund		(883,497)	(18,656)
Assets related to derivative instruments		10,698	(15,379)
Investments measured at fair value through profit or loss		(174,052)	(2,805)
Other assets		7,523	(5,966)
Net increase/(decrease) in operating liabilities:			
Money issued in circulation		(72,394)	524,415
Due to resident financial institutions		95,462	600,558
Due to the Ministry of Finance of Georgia		316,291	(108,601)
Due to customers		(790)	(266,210)
Other liabilities		(469)	5,225
Net cash (outflow)/inflow from operating activities		**(131,420)**	**996,335**
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property and equipment		(7,208)	(4,659)
Purchase of intangible assets		(2,557)	(1,472)
Purchase of investments measured at fair value through other comprehensive income		(13,220,941)	(9,292,369)
Proceeds from redemption and sale of investments measured at fair value through other comprehensive income		12,630,788	9,481,094
Net cash (used in)/from investing activities		**(599,918)**	**182,594**
CASH FLOWS FROM FINANCING ACTIVITIES:			
Transfer to the Ministry of Finance of Georgia	23	(140,000)	(100,000)
Debt securities issued		254,212	254,628
Debt securities redeemed		(254,912)	(274,961)
Proceeds from the International Monetary Fund	9, 27	1,273,308	374,823
Repayments to the International Monetary Fund		(10,962)	-
Net cash from financing activities		**1,121,646**	**254,490**
Effect of exchange rates changes on cash and cash equivalents		(368,866)	455,520
Net increase in cash and cash equivalents		21,442	1,888,939
CASH AND CASH EQUIVALENTS, at the beginning of the year	7	**3,602,487**	**1,713,548**
CASH AND CASH EQUIVALENTS, at the end of the year	7	**3,623,929**	**3,602,487**

The financial statements as set out on pages 4 to 55 were approved by management on 18 April 2022 and were signed on behalf of the Council of the Bank by:

Chairman of the Council Department

Koba Gvenetadze

Head of Finance and Accounting

Andria Manelashvili

The statement of cash flows is to be read in conjunction with the notes to, and forming part of, the financial statements.

1. ORGANIZATION

The National Bank of Georgia (the "Bank") is the central bank of Georgia and the banker and fiscal agent of the Government of Georgia. It acts in accordance with the Organic Law of Georgia "On the National Bank of Georgia" enacted effective from 1 December 2009 (the "Law").

The responsibilities of the Bank focus on the goals of price stability, financial system stability and efficiency, national currency emission, and the efficient management of international reserves. These responsibilities are carried out as part of the broad functions described below.

Monetary policy

The main objective of the monetary policy of the Bank is to maintain price stability. Price stability implies the existence of a moderate and predictable rate of inflation, which is a necessary precondition for long run economic growth. Furthermore, the Bank supports financial system stability and promotes the country's economic growth as long as the latter objectives do not contradict with its main goal – maintaining price stability. Monetary and exchange rate policies serve the objective of preserving the purchasing power of the national currency, raising the growth potential of gross domestic product, and improving the investment climate.

Supervision and financial stability

The main objective of the Bank is to ensure the stability and efficiency of Georgia's financial system. In achieving those objectives, the Bank is responsible for the supervision and regulation of separate participants on the financial market – commercial banks, banking groups, non-bank depository institutions, micro-finance organisations, independent securities registrars, brokerage companies (except for insurance brokerage companies), the stock exchange, central depository, specialised depository, asset management companies, publicly accountable enterprises, foreign currency exchange offices, investment funds, payment system operators, payment service providers, credit information bureaus, loan issuing institutions and the Pension Agency of Georgia (with respect to its investment activities).

The National Bank of Georgia within the relevant regulatory framework supports the protection of consumer and investor rights. Moreover, the Bank, with the involvement of different stakeholders from the Government structures, the private financial sector, and civil society has developed the National Strategy of Financial Education as a complement to financial consumer protection and inclusion efforts, with a view to supporting financial stability and individuals' financial well-being.

Currency

The Bank is the only body in the country authorized to issue Georgian Lari banknotes and coins on the territory of Georgia. The Bank determines the design, composition and other features of the Georgian Lari banknotes and coins, printed and minted in leading European mints.

International reserve management

The Bank maintains a portfolio of foreign currency reserves for policy and operational purposes, for instance to protect the country from external vulnerability by maintaining sufficient liquidity to absorb shocks during a financial crisis and to support day-to-day foreign currency payment requirements of the Georgian Government and those of the Bank.

Payment systems

The Bank operates the largest payment system in the country – the Real Time Gross Settlement (RTGS), which processes and settles interbank and Government payments in national currency.

Governance

As at 31 December 2021 and 2020, the members of the Council of the Bank were as follows:

Position	Name (2021)	Name (2020)
Chairman	Mr. Koba Gvenetadze (Governor)	Mr. Koba Gvenetadze (Governor)
Member	Mr. Archil Mestvirishvili (Vice-governor)	Mr. Archil Mestvirishvili (Vice-governor)
Member	Mr. Papuna Lezhava (Vice-governor)	Mr. Papuna Lezhava (Vice-governor)
Member	Mr. Robert H.Singletary	Mr. Robert H.Singletary
Member	Mr. Nikoloz Gagua (Vice-governor)	Mr. Nikoloz Kavelashvili
Member	Ms. Ekaterine Galdava	Vacant
Member	Ms. Ekaterine Mikabadze	Vacant

During 2020, according to amendment of Law on National Bank of Georgia (“The Law”), Council of the Bank was defined to consist of 9 members (7 members before the amendment). Therefore, as at 31 December 2021, positions of 2 members of the Council were vacant (2020: 4 positions).

The Bank’s main office is located at 2 Sanapiro, Tbilisi, 0114, Georgia. As at 31 December 2021 and 2020, the Bank operates one cash service center. The Bank employed 552 and 523 personnel as at 31 December 2021 and 2020, respectively.

2. BASIS OF PREPARATION OF FINANCIAL STATEMENTS

Statement of compliance

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

The presentation of these financial statements is framed within an economic and accounting framework that fairly reflects the financial position of the Bank, and at the same time, contributes to the economic analysis of the Bank’s operations. Assets and liabilities within the statement of financial position are segregated as captions of foreign and local currencies, which better reflects economics and risks behind the Bank’s operations. The Bank’s assets in foreign currency are mainly related to its international reserve management function. At the same time, the Bank’s assets and liabilities in local currency are mainly recognised as a result of operations related to conduct of monetary policy, issue of money in circulation and other functions of the Bank, as defined by the Law. For these reasons, the economic concepts of international reserves and monetary policy are additionally grouped under the sub-captions international reserve and monetary policy instruments, respectively. Statement of Profit or Loss and Other Comprehensive Income separately presents interest income/expenses and non-interest income/expenses by functional operations of the Bank. Statement of cash flows is presented using direct method.

Basis of measurement

These financial statements are prepared on the historical cost basis, except for financial instruments measured at fair value through profit or loss and investments measured at fair value through other comprehensive income.

Functional and presentation currency

The Bank’s main objective is to maintain price stability, which implies that open-market operations play a significant role in the development of the monetary policy, accordingly, its main activity is the issuance of banknotes and coins in Georgian Lari, which is the national currency of Georgia and which has been defined as the functional and presentation currency for the purpose of these financial statements. Consequently, all balances and transactions denominated in currencies other than the Georgian Lari are considered as denominated in “foreign currency”.

These financial statements are presented in thousands of Georgian Lari (“GEL”), unless otherwise indicated.

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

3. SIGNIFICANT ACCOUNTING POLICIES

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

Financial Instruments

A financial instrument is defined as any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity.

The Bank's financial instruments are its Georgian Lari securities, foreign government, supranational or agency securities, interest rate futures and options, holdings in the International Monetary Fund (IMF), cash and cash equivalents, due from financial institutions, due to commercial banks, Ministry of Finance of Georgia, IMF and other financial assets and liabilities. The Bank accounts for its financial instruments in accordance with IFRS 9–*Financial Instruments* and reports these instruments under IFRS 7–*Financial Instruments: Disclosures* and IFRS 13–*Fair Value Measurement*.

Classification

The Bank classifies its financial assets in the following categories: measured at amortised cost (AC), measured at fair value though other comprehensive income (FVOCI) and measured at fair value through profit or loss (FVTPL). The classification depends on business model under which the financial assets are managed and their cash flow characteristics. The Bank classifies its financial liabilities as subsequently measured at amortized cost except for derivatives liabilities, which are measured at fair value through profit or loss. Classification of the financial assets and the financial liabilities are determined at initial recognition.

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

– the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
– the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

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

– the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
– the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

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

– Interest income using the effective interest method;
– Expected credit losses (further referred to as "ECL") and reversals; and
– Foreign exchange gains and losses.

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

All other financial assets are classified as measured at FVTPL.

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

Business model assessment

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

– Objectives of holding the portfolio;
– Frequency, value and timing of sales (both past and future);
– How the performance of the business model and financial assets are evaluated and reported to the Bank's key management personnel;
– The risks that affect the performance of the business model, in particular, the way in which those risks are managed (to meet the objectives);
– How managers of the business are compensated; e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
– Whether collection of contractual cash flows (e.g. interest income received) represents significant part of the portfolios returns.

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

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

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

– contingent events that would change the amount and timing of cash flows;
– leverage features;
– prepayment and extension terms;
– terms that limit the Bank’s claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
– features that modify consideration of the time value of money – e.g. periodical reset of interest rates.

Initial recognition of financial assets and liabilities

The Bank recognises financial assets and liabilities in its statement of financial position when it becomes a party to the contractual obligations of the instrument. Regular way purchases and sales of financial assets and liabilities are recognised using settlement date accounting.

Financial assets and liabilities are initially recognised at fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss. The accounting policies for subsequent re-measurement of these items are disclosed in the respective accounting policies set out below.

Derecognition of financial assets and liabilities

Financial assets

The Bank derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred to another party or in which the Bank neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognises its retained interest in the asset and an associated liability for amounts it may have to pay.If the Bank retains substantially all the risks and rewards of ownership of a transferred financial asset, the Bank continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

On derecognition of a financial asset in its entirety, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised in other comprehensive income and accumulated in equity is recognised in profit or loss.

On derecognition of a financial asset other than in its entirety (e.g. when the Bank retains an option to repurchase part of a transferred asset), the Bank allocates the previous carrying amount of the financial asset between the part it continues to recognise under continuing involvement, and the part it no longer recognises on the basis of the relative fair values of those parts on the date of the transfer. The difference between the carrying amount allocated to the part that is no longer recognised and the sum of the consideration received for the part no longer recognised and any cumulative gain or loss allocated to it that had been recognised in other comprehensive income is recognised in profit or loss. A cumulative gain or loss that had been recognised in other comprehensive income is allocated between the part that continues to be recognised and the part that is no longer recognised on the basis of the relative fair values of those parts.

Financial liabilities

The Bank derecognises financial liabilities when, and only when, the Bank's obligations are discharged, cancelled or they expire. 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. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit and loss.

Measurement principles

Fair value

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 in the principal, or in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the Bank measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active, if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

When there is no quoted price in an active market, the Bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all the factors that market participants would take into account in these circumstances.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price, i.e., the fair value of the consideration given or received. If the Bank determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument, but no later than when the valuation is supported wholly by observable market data or the transaction is closed out.

The Bank uses quoted market prices to determine fair value of the Bank's investment securities. The quoted market prices for international securities are provided daily by Bloomberg and are based on current bid prices. In Management's opinion, such prices reflect reasonably the value of investments in international securities, considering the current market information and the accounting policies established by the Bank's Management.

If the market for investments is not active, the Bank establishes fair value by using discounted cash flow analysis and other relevant valuation techniques. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, reference to the current fair value of another instrument that is substantially the same and discounted cash flow analysis, making maximum use of market inputs and relying as little as possible on entity-specific inputs.

Amortised cost

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument.

Financial assets

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand in foreign currency, unrestricted balances on correspondent accounts and amounts due from financial institutions, including time deposit accounts and overnight deposits, that mature within ninety days from the date of origination and are free from contractual encumbrances. Cash and cash equivalents are subsequently measured at amortised cost.

Membership in the International Monetary Fund (the "IMF") and other international financial institutions

Based on the provision of Article 5 of the Law, being the representative of Georgia, the Bank may undertake obligations and carry out operations related to participation of Georgia in the activities of international organizations (i.e. the IMF, World Bank), including payment of membership fees to such organizations.

Financial assets measured at amortised cost

In the normal course of business, the Bank maintains loans, deposit, current accounts, and other receivables for various periods with financial institutions. Objective of the business model under which these assets are managed is achieved by collecting contractual cash flows. Contractual terms of these assets give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. Amounts due from financial institutions and other financial assets are considered in this category. The Bank's investments measured at amortised cost also include Georgian Government bonds.

Any premium or discount of the instruments representative of debt measured at amortised cost is recognised with the calculation of the amortised cost by applying the effective interest rate method, recognising the accrued interest in respective caption of the statement of profit or loss and other comprehensive income. The effective interest method uses the rate inherent in a financial instrument that discounts the estimated future cash flows over the expected life of the financial instrument so as to recognise interest on a constant-yield basis.

Investments measured at fair value through profit or loss

The Bank's investments measured at FVTPL comprise part of international reserves managed by the Bank for International Settlements ("BIS") which represent investments placed in the Bank for International Settlements Investment Pool (BISIP K). The objective of the business model under which the investment is managed is achieved by collecting contractual cash flows. However, contractual terms do not give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Derivative financial instruments

The Bank uses interest rate futures and options contracts on overseas exchanges to manage interest rate risk on its portfolio of foreign securities. Exchange traded interest rate futures are futures contracts with an underlying instrument that pays interest, which allows investor to lock in the price of an interest-bearing asset for a future date. An interest rate option on exchange traded interest rate futures is a financial derivative that allows the holder to benefit from the changes in interest rates. The Bank also uses foreign currency derivative instruments to manage currency risk for some of its foreign currency investments.

Interest rate futures and options positions are classified as at fair value through profit or loss (FVTPL). Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently re-measured to their fair value at each reporting date. The positions are marked to market on the reporting date at the relevant bid price provided by Bloomberg and valuation gains and losses taken to net unrealized gain/loss from securities and derivatives in the statement of profit or loss and other comprehensive income. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative.

Investments measured at fair value through other comprehensive income

The Bank's investments measured at FVOCI comprise Georgian and foreign governments', international financial institutions' and agency debt securities. The securities are either part of the Bank's international reserve portfolio or represent monetary policy instruments. The objective of the business model under which the debt securities are managed is achieved by both collecting contractual cash flows and selling financial assets. The debt securities are classified as investments measured at FVOCI given that their contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Expected credit losses

The Bank recognises loss allowances for expected credit losses (ECL) on the debt financial instruments that are measured at amortised cost or FVOCI.

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

- debt investment securities that are determined to have low credit risk at the reporting date; and
- other financial instruments on which credit risk has not increased significantly since their initial recognition

The Bank considers debt investment securities to have low credit risk when their credit risk rating is equivalent to the globally understood definition of 'investment grade'. Considering the Bank's strict investment guidelines, which propose holding of extremely high credit-rated investments, financial instruments held as international reserves are considered to have low credit risk. In addition, the Bank considers exposure to the Georgian Government, which is denominated in Georgian Lari, to have low credit risk. Such approach reflects the general assumption that sovereign debt denominated in local currency is considered to have an extremely low risk of default (usually referred to as "risk-free" from market participant perspective) as well as the fact that due to the unique link between the Bank and the Government of Georgia, the Bank maintains the main current account of the Ministry of Finance of Georgia. The Bank does not apply the low credit risk exemption to any other financial instruments.

ECL calculation

Lifetime ECLs are the ECLs that result from all possible default events over the expected life of the financial instrument. 12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the Bank in accordance with the contract and the cash flows that the Bank expects to receive);
- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows;

Credit-impaired financial assets

At each reporting date, the Bank assesses whether financial assets carried at amortised cost and debt financial assets carried at FVOCI are credit impaired. A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.
Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Bank on terms that the Bank would not consider otherwise;
- it becoming probable that the borrower will enter bankruptcy or other financial reorganisation; or
- the disappearance of an active market for a security because of financial difficulties.

All financial assets measured at amortised cost or FVOCI, which are overdue for 90 days or more, are considered to be in default except for exposure to the Government of Georgia which would be considered to be in default if overdue for more 180 days. This represents a rebuttal of the presumption of IFRS 9 that the default does not occur later than when the financial asset is 90 days past due. However, it reflects the circumstances of the Government's budgetary approval processes and the Bank's unique relationship with the Government as it acts as the banker and fiscal agent of the Government.

Presentation of allowance for ECL in the statement of financial position

Loss allowances for ECL are presented in the statement of financial position as follows:

- financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- debt instruments measured at FVOCI: no loss allowance is recognised in the respective caption of the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the revaluation reserve of investments measured at fair value through other comprehensive income.

Write-offs

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

Recoveries of amounts previously written off are included in caption for impairment (recovery)/charge in the statement of profit or loss and other comprehensive income.

Financial liabilities measured at amortised cost

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 the Government, amounts due to resident financial institutions, amounts due to customers, debt securities issued, liabilities to the International Monetary Fund and other financial liabilities. These are initially recognised at fair value of the consideration received less directly attributable transaction costs. After initial recognition, these financial instruments are subsequently measured at amortised cost using the effective interest method.

Money issued in circulation

Money issued in circulation represents banknotes and coins issued by the Bank in accordance with the Law and its function as the central bank. Banknotes and coins in circulation are recorded in the statement of financial position at their nominal value net of cash in the Bank's cash offices.

The expenses for the production of notes and coins are expensed as incurred.

When notes and coins are returned to the Bank by the commercial banks they are removed from money in circulation and depending on their condition or legal tender status, are either sent for destruction or held by the Bank as cash in vaults outside of the statement of financial position.

Provisions (included in other liabilities)

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 obligation can be made.

Non-monetary gold and other precious metals (included in other assets)

Gold investment coins and gold bars are recognised and subsequently measured according to IAS 2-*Inventories* requirements. Gold investment coins and gold bars initially are measured at cost, including expenses on minting, transportation and other direct costs, subsequently measured at the lower of costs and net realizable value. When investment coins and bars are sold, gain or loss is recorded in profit or loss. Expenses on other commemorative coins and bars are recognised as current expenses when produced and reflected in the statement of profit or loss and other comprehensive income.

Property and equipment

Property and equipment are carried at historical cost less accumulated depreciation and any recognised impairment loss, if any. Land is not depreciated.

Where an item of property and equipment comprises major components having different useful lives, they are accounted for as separate items of property and equipment.

Depreciation is charged on the historical cost of property and equipment and is designed to write off assets over their useful economic lives. Depreciation commences on the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and ready for use. Depreciation is charged to profit or loss on a straight-line basis at the following annual prescribed rates:

	%
Buildings	2
Computers, office equipment and fixtures	10-20
Vehicles and other	20

Expenses related to repairs and maintenance are charged when incurred and included in other expenses unless they qualify for capitalization.

The carrying amounts of property and equipment are reviewed at each reporting date to assess whether they are recorded in excess of their recoverable amounts. The recoverable amount is the higher of fair value less costs to sell and value in use. Where carrying values exceed the estimated recoverable amount, assets are written down to their recoverable amount; impairment is recognised in the respective period in the statement of profit or loss and other comprehensive income. After the recognition of an impairment loss the depreciation charge for property and equipment is adjusted in future periods to allocate the assets' revised carrying value, less its residual value (if any), on a systematic basis over its remaining useful life.

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 amortization 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 five years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortization periods and methods for intangible assets with finite useful lives are reviewed at least at each financial year-end.

Right-of-use assets under lease

From time to time, the Bank may lease particular assets for its administrative purposes.

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

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

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

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

The Bank presents right-of-use assets as separate line-item and lease liabilities in 'other liabilities' in the statement of financial position.

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

Taxation

According to the Organic Law of Georgia "On the National Bank of Georgia", assets, property and income of the Bank, as well as its activities and operations are exempt from all taxes and other levies.

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 expense

Revenue is recognised when the Bank satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to counterparties. An asset is transferred when (or as) the counterparties obtain control of that asset.

Interest and similar income and expense

For all financial instruments that are measured at amortised cost or fair value through other comprehensive income interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or a shorter period, where appropriate, to the gross carrying amount of the financial asset or the amortised cost of 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 gross carrying amount of the financial asset or the amortised cost of 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 income or expense.

Interest income recognition base

The original effective interest rate is applied to the gross carrying amount (carrying amount without reduction by expected credit loss allowance) of financial assets for which:

– credit risk has not increased significantly since initial recognition;
– credit risk has increased significantly since initial recognition, but which are not credit-impaired

For financial assets which are credit-impaired, the original effective interest rate is applied to the net carrying amount (carrying amount after reduction by expected credit loss allowance)

Presentation of negative interest on financial asset and liabilities

Negative interest on financial assets is considered as expense and is presented under interest expenses as a separate line-item. Similarly, negative interest on financial liabilities is considered as income and is presented under interest income as a separate line-item.

Fee and commission income and expense

The Bank earns fee and commission income from a diverse range of services it provides to its counterparties. Fee and commission income includes cash operations fees and fund transfer fees, which are recognised as the services are provided. Fee and commission expense consists of cash operation, settlement fees and fees paid to the external manager, which are recognised as expense as the services are rendered.

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 nominal currency converted into the functional currency rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency rate of exchange ruling at the end of reporting date. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. Gains and losses resulting from the translation of foreign currency transactions are recognised in the statement of profit or loss and other comprehensive income as net gains (losses) from foreign currencies - translation differences.

(in thousands of Georgian Lari)

Differences between the contractual exchange rate of a transaction in a foreign currency and the Bank's exchange rate on the date of the transaction are included in net gains (losses) from dealing in foreign currencies.

Rates of exchange

The exchange rates used by the Bank in the preparation of the financial statements as at year-end are as follows:

	31-Dec-21	31-Dec-20
GEL/1 US Dollar (USD)	3.0976	3.2766
GEL/1 Euro (EUR)	3.5040	4.0233
GEL/1 Australian Dollar (AUD)	2.2482	2.5118
GEL/1 Canadian Dollar (CAD)	2.4208	2.5616
GEL/1 Special Drawing Right (SDR)	4.3354	4.7192

Offset of financial assets and liabilities

Financial assets and liabilities are offset and reported net in the statement of financial position when the Bank has a legally enforceable right to set off the recognised amounts and the Bank intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. In accounting for a transfer of a financial asset that does not qualify for de-recognition, the Bank does not offset the transferred asset and the associated liability. No offset of financial assets and liabilities have been made as of reporting period.

Reclassification of financial assets

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

Areas of significant management judgment and sources of estimation uncertainty

The preparation of the Bank's financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities at the reporting date and the reported amount of income and expenses during the period ended. Management evaluates its estimates and judgments on an ongoing basis. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

Significant areas of critical judgments and estimates are described in the following notes:

- Classification of financial assets: assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial assets are solely payments of principal and interest on the principal amount outstanding – Note 3
- Application of low credit risk exemption and rebuttal of the presumption that the default does not occur later that when the financial asset is 90 days past due – Note 3
- Fair valuation of financial instruments - Note 27

Application of new and revised International Financial Reporting Standards (IFRSs)

New and revised standards:

The following are effective from 1 January 2021:

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

(in thousands of Georgian Lari)

The amendments mentioned above did not have significant effect on the Bank's financial statements.

The following new and amended standards are not expected to have a significant impact on the Bank's financial statements. The pronouncements are effective for annual periods beginning after 1 January 2021:

– Onerous Contracts – Cost of Fulfilling a Contract (Amendments to IAS 37)
– Property, Plant and Equipment: Proceeds before Intended Use (Amendments to IAS 16)
– Reference to Conceptual Framework (Amendments to IFRS 3)
– Classification of Liabilities as Current or Non-current (Amendments to IAS 1)
– IFRS 17 Insurance Contracts and amendments to IFRS 17 Insurance Contracts;
– Annual Improvements to IFRS Standards 2018 – 2020 (Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards, IFRS 9 Financial Instruments, IFRS 16 Leases and IAS 41 Agriculture);
– Disclosure of Accounting Policies (Amendments to IAS 1 and IFRS Practice Statement 2) ;
– Definition of Accounting Estimates (Amendments to IAS 8);
– Deferred Tax related to Assets and Liabilities arising from a Single Transaction (Amendments to IAS 12);
– Covid-19-Related Rent Concessions beyond 30 June 2021 (Amendment to IFRS 16);

4. FEE AND COMMISSION INCOME AND EXPENSE

Fee and commission income and expense comprise:

	Year ended 31-Dec-21	Year ended 31-Dec-20
Fee and commission income:		
Funds transfer	2,927	2,295
Cash operations	488	1,961
Other	24	24
Total fee and commission income	**3,439**	**4,280**
Fee and commission expense:		
Fees paid to external manager	(1,646)	(1,420)
Custodian and settlement fees	(1,067)	(1,379)
Cash operations	(354)	(1,037)
Total fee and commission expense	**(3,067)**	**(3,836)**

The Bank owns and manages a real-time gross settlement system, which is an interbank payment system for national currency settlement operations. Funds transfer represents the billing fees paid by the participants for settlement transactions.

5. OTHER INCOME

Other income comprises:

	Year ended 31-Dec-21	Year ended 31-Dec-20
Gain from sale of commemorative coins	2,321	1,198
Revenue from fines	19	656
Other	66	36
Other income	**2,406**	**1,890**

(in thousands of Georgian Lari)

6. OPERATING EXPENSES

Operating expenses comprise:

	Year ended 31-Dec-21	Year ended 31-Dec-20
Salaries and bonuses	29,395	26,887
Paid vacation and sick leave	1,760	1,416
Total personnel expenses	**31,155**	**28,303**
Subscription to information services	2,967	2,668
Software maintenance fees	2,553	1,803
Social benefit expenses	2,290	2,184
Utilities	1,739	1,255
Repairs and maintenance	668	414
Security	522	522
Fuel expenses	187	149
Legal and consultancy	180	120
Business travel and related expenses	163	139
Personnel training	-	185
Other	1,311	1,201
Total general and administrative expenses	**12,580**	**10,640**
Depreciation charge (Note 15)	5,819	4,738
Amortization charge (Note 16)	1,838	1,502
Total depreciation and amortization charges	**7,657**	**6,240**

7. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as at 31 December 2021 and 2020 comprise:

	31-Dec-21	31-Dec-20
Cash on hand in foreign currencies	1,221,357	1,604,147
Current accounts	1,603,024	1,349,538
Time deposits with credit institutions	799,548	648,802
Total cash and cash equivalents	**3,623,929**	**3,602,487**

As at 31 December 2021 and 2020, GEL 2,278,849 thousand and GEL 1,847,489 thousand, respectively, were placed in current accounts and time deposits up to ninety days with six (31 December 2020: six) internationally recognised banks and central banks from the Organization of Economic Co-operation and Development member countries (OECD).

As at 31 December 2021 and 2020, annual interest rate range of time deposits with credit institutions varied from 0.11% to 0.23% and 0.19% to 0.33%, respectively.

8. DUE FROM RESIDENT FINANCIAL INSTITUTIONS

Due from resident financial institutions as at 31 December 2021 and 2020 comprise:

	31-Dec-21	31-Dec-20
Due from resident financial institutions under monetary policy instruments		
Refinancing loans	2,071,194	2,150,473
Fixed rate loans	633,539	482,949
One-month open market instruments	401,049	400,705
Overnight loans	41,233	180,043
Total due from resident financial institutions under monetary policy instruments	**3,147,015**	**3,214,170**

(in thousands of Georgian Lari)

Refinancing loans are the Bank's Monetary Policy instruments that are issued to Georgian commercial banks for liquidity purposes and have 7 days of maturity. Similar to refinancing loans, through one-month open market instruments, overnight loans and fixed rate loans the Bank supplies short-term liquidity to Georgia's banking system.

As at 31 December 2021 and 2020, respectively, the Bank had a concentration of refinancing loans of GEL 1,892,090 thousand due from three resident commercial banks at annual interest rates of 10.5%-10.62%, and GEL 1,954,929 thousand due from three resident commercial banks at annual interest rates of 8.001%-8.05%, respectively.

As at 31 December 2021 and 2020, the Bank had a concentration of overnight loans of GEL 40,012 thousand due from one resident commercial bank at annual interest rate of 11.25% and GEL 180,043 thousand due from one resident commercial bank at annual interest rate of 8.75%, respectively.

As at 31 December 2021 and 2020, the concentration of one-month open market instruments was GEL 295,773 thousand due from two resident commercial banks at an annual interest rates of 10.59%-10.71%, and GEL 320,563 thousand due from one resident commercial bank at an annual interest rate of 8.033%, respectively.

As at 31 December 2021 and 2020, the concentration of fixed rate loans was GEL 512,937 thousand due from two resident commercial banks at an annual interest rate of 10.1984% and GEL 383,675 thousand from two resident commercial banks at an annual interest rate of 8.036%, respectively.

For none of the exposures due from resident financial institutions has credit risk increased significantly since initial recognition. For credit risk disclosure, see note 28.

Collateral and other credit enhancements

The eligible type of collateral and criteria for each type of collateral is defined by the Council of the Bank.

The accepted types of collateral are: a) debt securities issued by the Bank and by the Government of Georgia, denominated in Georgian Lari; b) debt securities issued by international financial institutions, denominated in Georgian Lari; c) debt securities issued in accordance with the "Law of Georgia on Securities Market" by resident and non-resident legal entities and securities issued as a private placement till 1 January 2018, denominated in Georgian Lari, but excluding debt securities issued by the commercial banks operating in Georgia; d) claims to eligible loan assets of commercial banks; e) foreign currency deposits in the Bank; In special cases, the Council of the Bank may determine other type of assets for loan collateral; haircuts to each type of collateral are periodically defined by the Monetary Policy Committee (MPC) of the Bank to the nominal amount of eligible assets. The Bank has the first lien on borrowers' assets according to the Law.

As at 31 December 2021 and 2020 types and fair values of financial assets pledged for amounts due from resident financial institutions were as follows:

	31-Dec-21	**31-Dec-20**
Loan portfolio of commercial banks	2,282,228	1,863,617
Government securities (treasury bills/notes)	1,196,058	1,537,824
Debt securities issued by the Bank (Certificates of Deposit)	-	7,454
Bonds issued by International Financial Institutions and development banks, denominated in GEL:		
European Bank for Reconstruction and Development (EBRD)	-	212,739
Netherlands Development Finance Company	61,230	-
Bonds issued by private sector	21,025	23,651
	3,560,541	**3,645,285**

(in thousands of Georgian Lari)

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

As described in the table above the Bank receives collateral in the form of financial instruments in respect of the instruments due from resident financial institutions. Similar arrangements, if considered as master netting arrangements, do not meet the criteria for offsetting in the statement of financial position. This is because the Bank obtains a right of set-off of recognised amounts that is enforceable only following an event of default, insolvency or bankruptcy of the counterparties. The Bank and its counterparties do not intend to settle on a net basis or to realise the assets and settle the liabilities simultaneously.

9. SPECIAL DRAWING RIGHTS HOLDINGS WITH THE INTERNATIONAL MONETARY FUND

Balances with the International Monetary Fund (the "IMF") comprise:

	31-Dec-21	31-Dec-20
Assets:		
Special Drawing Rights (SDR) holdings	**1,506,927**	**697,227**
Liabilities:		
IMF current accounts		
Current account # 1	2,606	2,302
Current account # 2	14	13
	2,620	**2,315**
Borrowings from the IMF		
Extended Fund Facility (EFF)	1,447,066	1,218,979
General SDR allocation	1,357,442	526,029
Special SDR allocation	141,089	153,465
	2,945,597	**1,898,473**
Total due to the IMF	**2,948,217**	**1,900,788**
Off-balance sheet balances:		
IMF Quota	1,042,446	920,893
Security held in custody by the Bank in respect of IMF quota and as collateral of IMF granted facilities	(3,425,367)	(2,695,502)

SDR Holdings

SDR holdings represent the account of the Bank with the IMF used for borrowings and settlements with the IMF. SDR holdings are primarily obtained from the SDR allocations provided by the IMF under its Articles of Agreement. Interest accrued in respect of SDR holdings is calculated using the rate set by the IMF weekly on the basis of short-term market rates in major money markets. The annual nominal interest rate range on the SDR holding in 2021 and 2020 was 0.050%-0.1150% and 0.050%-0.750%, respectively.

IMF current accounts

The Bank is required to maintain two separate accounts: IMF current account number 1 and IMF current account number 2. IMF current account number 1 is for settlement of the IMF's operational transactions, whereas IMF current account number 2 is used for operational expenses incurred by the IMF in Georgian Lari.

IMF granted facilities

Facilities received from the IMF include the Extended Fund Facility (EFF) loan with a carrying amount of GEL 1,447,066 thousand as at 31 December 2021 (31 December 2020: GEL 1,218,980 thousand). The EFF provides assistance to Georgian authorities in support of their comprehensive program to preserve macro and financial stability and advance structural reforms to bolster growth. The 36-month Extended Fund Facility (EFF) was approved on 12th of April 2017 with access of SDR 210.4 million (100 percent of quota). On 14th of April 2020 an augmentation of access of 130 percent of quota was approved, bringing total access under the EFF to SDR 484 million (230 percent of quota) and during 2021 SDR 78 million was used out of it by the Bank (2020: SDR 79 million). Repayments started in 2021 and the loan is projected to be fully covered by 2031. The lending rate is tied to the IMF's market-related interest rate, known as the basic rate of charge linked to the Special Drawing Rights (SDR) interest rate, which amounted to 1.0770% as at 31 December 2021 (31 December 2020: 1.080%).

All facilities received from the IMF are denominated in SDR.

SDR allocations

The SDR allocation is an unsecured, interest bearing distribution of SDRs by the IMF through general and special allocations. The general allocation is made by the IMF according to the Articles of Agreement to all participants in its SDR Department in proportion to countries' quotas in the IMF. General allocations to Georgia were made in 2009 (SDR 111,419 thousand) and 2021 (SDR 201,658 thousand). In 2009, the Fourth Amendment to the IMF Articles of Agreement providing for a special one-time allocation of SDRs entered into force, according to which Special SDR allocation of SDR 32,540 thousand was made to Georgia. Members and prescribed holders may use their SDR holdings to conduct transactions with the IMF. The Bank treats the allocation as a foreign currency liability to the IMF.

Georgia, as a member country of the IMF and a recipient of the allocations, is obliged to pay to the IMF an amount equal to its net cumulative allocation and any other amounts that may be due and payable because of the membership termination or liquidation of the IMF's SDR Department.

The annual interest rate range on the SDR allocation in 2021 and 2020 was 0.050%-0.1150% and 0.050%-0.750%, respectively.

IMF Quota

The IMF Quota of Special Drawing Rights (SDR) of 210,400 thousand, represents the membership subscription of Georgia with the IMF which is non-interest bearing and is effective from 26 January 2016 as a result of the 14^{th} General Review of Quotas by the Board of Governors of the IMF, the Fund's highest decision-making body. The IMF receives its resources from its member countries. Each member country of the IMF is assigned a quota, based broadly on its relative position in the world economy. A member's quota delineates basic aspects of its financial and organizational relationship with the IMF. As the Bank is a fiscal agent between the Government of Georgia and the IMF, this instrument is not presented on the statement of financial position.

Security held in custody by the Bank in respect of the IMF Quota and as collateral of the IMF granted facilities

Security held in custody comprises GEL 1,042,446 thousand in respect of the IMF Quota and GEL 2,382,901 thousand held as collateral for the IMF granted facilities (GEL 3,425,367 thousand in total). The security was issued by the Government of Georgia in 1992 in settlement of the IMF Quota. The security used as collateral includes the total nominal value of the IMF granted facilities to Georgia: to the Bank and to the Government. Nominal value of the security is changed annually according to the revaluation and at the time of facility receipt from the IMF General Resources Account by the facility amount. As this security is held by the Bank in custody, it is accounted for as an off-balance sheet item and presented at nominal value.

(in thousands of Georgian Lari)

10. ASSETS RELATED TO DERIVATIVE INSTRUMENTS

	Book value 31-Dec-21	Notional principal 31-Dec-21	Book value 31-Dec-20	Notional principal 31-Dec-20
Assets related to derivative instruments under international reserve management				
Interest rate futures				
Futures margin	**10,994**		**22,365**	
FX-Forward				
FX-Forward assets	380		587	
Amount receivable	-	614,161	-	581,432
Amount payable	-	(605,891)	-	(590,442)
Net FX-Forward	**380**	**8,270**	**587**	**(9,010)**
Interest rate futures assets	2,861	213,734	249	-
Interest rate futures liabilities	-	(5,983,634)	(9,212)	(3,935,524)
Net interest futures position	**2,861**	**(5,769,900)**	**(8,963)**	**(3,935,524)**
Net assets related to derivative instruments under international reserve management	**14,235**	**(5,761,630)**	**13,989**	**(3,944,534)**
Assets related to derivative instruments under monetary policy operations				
FX SWAPs				
FX SWAP assets	3,864		1,318	
Amount receivable	-	431,333		134,610
Amount payable	-	(427,469)		(133,292)
Net FX SWAPs	**3,864**	**3,864**	**1,318**	**1,318**
Net assets related to derivative instruments under monetary policy operations	**3,864**	**3,864**	**1,318**	**1,318**

At their inception, derivatives often involve only a mutual exchange of promises with little or no transfer of consideration. However, these instruments frequently involve a high degree of leverage and are very volatile. A relatively small movement in the value of the asset, rate, or index underlying a derivative contract may have a significant impact on the profit or loss of the Bank.

The futures contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. The futures contracts are transacted in standardised amounts on regulated exchanges and are subject to daily cash margin requirements. The credit risk related to future contracts is considered minimal because the cash margin requirements of the exchange help ensure that these contracts are always honored and are settled on a net basis.

The Bank has been trading Eurodollar Futures since March 2012, as part of active portfolio management. This financial instrument is listed on CME (Chicago Mercantile Exchange & Chicago Board of Trade), hence it is exchange traded and standardized. Eurodollar Futures remain the most liquid and actively traded money market derivatives contracts. Each Eurodollar contract's underlying is a 3-month Eurodollar time deposit with notional amount of USD 1 million. When trading Eurodollar futures, the Bank is facing the credit risk only of the clearing house, where purchases and sales of Eurodollar futures offset one another.

The Bank is taking positions in Eurodollars for hedging purposes, by means of buying/selling US Treasuries or Spread Products (Agency and Supranational Securities) and entering opposite positions of corresponding amounts of Eurodollar Futures, matching the risk (duration and curve). The main purpose of such strategies is to reduce the portfolio's exposure to interest rate risks and to benefit from credit spreads.

Eurodollar futures held in the Bank's portfolio are not held for trading purposes, i.e. the Bank does not aim to make profits from favorable movements in their prices.

11. INVESTMENTS MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS

As at 31 December 2021, investments measured at fair value through profit or loss comprised funds managed by the BIS (Bank for International Settlements). It refers to the investment placed in the Bank for International Settlements Investment Pool (BISIP CNY), a fund comprising Chinese government bonds (CGBs), managed for the investment of international reserves of central banks, with the main objective of transferring know-how and providing consulting services to the Bank. The quota holders of the fund may request partial or complete withdrawal of their investments at any time. As at 31 December 2021, total amount of funds managed by BIS amounted to GEL 329,975 thousand.

As at 31 December 2020, investments measured at fair value through profit or loss managed by the BIS referred to investment placed in the Bank for International Settlements Investment Pool (BISIP K), comprising US treasury and European Agency bonds of GEL 177,163 thousand.

(in thousands of Georgian Lari)

12. INVESTMENTS MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

As at 31 December investment securities measured at fair value through other comprehensive income comprised:

	31-Dec-21	31-Dec-20
Government securities		
US Department of Treasury, Washington	4,628,393	5,074,444
Government of Canada, Ottawa	338,487	225,278
Government of Sweden	43,282	49,141
Government of Denmark	30,907	32,744
Australian Government, Canberra	-	662,094
	5,041,069	**6,043,701**
Supranational securities		
Asian Development Bank, Manila	257,546	54,350
European Investment Bank, Luxembourg	202,220	69,791
European Stability Mechanism	184,537	-
Nordic Investment Bank	53,436	-
African Development Bank, Abidjan	48,652	59,847
International Bank for Reconstruction & Development, Washington	47,364	15,721
Bank for International Settlements, Basle	46,084	65,517
Inter-American Investment Corporation	34,288	5,950
New Development Bank, Shanghai	9,813	6,907
EUROFIMA, Basel	-	50,833
International Finance Corporation, Washington D.C.	-	13,926
Inter-American Development Bank, Washington D.C.	-	13,366
	883,940	**356,208**
Agency and other securities		
Kommuninvest I Sverige AB, Orebro	201,781	92,104
CDP Financial In, Montreal	176,821	131,326
Landeskreditbank Baden-Wuerttemberg Foerderbank	119,108	71,768
Kreditanstalt fuer Wiederaufbau, Frankfurt	117,742	124,165
CPPIB Capital Inc, Toronto	98,554	144,719
Province of Ontario Canada, Toronto	93,817	13,050
Bank Nederlandse Gemeenten, Den Haag	93,786	163,709
Province of Quebec Canada, Quebec	93,573	68,919
Erste Abwicklungsanstalt, Dusseldorf	89,114	63,379
Korean Development Bank	71,204	75,489
Province of Alberta Canada	58,604	77,231
SNCF Reseau EPIC	53,425	57,781
Municipality Finance PLC , Helsinki	50,714	45,081
Canada Housing Trust No 1	48,574	-
Svensk Exportkredit AB, Stocholm	48,418	118,500
Queensland Treasury Corp	46,460	20,127
Oesterreichische Kontrollbank AG, Vienna	45,088	48,931
OMERS Finance Trust	41,029	10,024
Other	286,667	596,803
	1,834,479	**1,923,106**
Total investments measured at fair value through other comprehensive income in foreign currency	**7,759,488**	**8,323,015**
Marketable government securities in national currency		
Georgian government bonds	1,649,777	1,168,338
Total investments measured at fair value through other comprehensive income in national currency	**1,649,777**	**1,168,338**

(in thousands of Georgian Lari)

Analysis of interest rates (coupon) and maturities on investments measured at fair value through other comprehensive income comprise:

	31-Dec-21		31-Dec-20	
In foreign currency:	**Interest rate p.a.**	**Maturity**	**Interest rate p.a.**	**Maturity**
Government securities	0.125%-2.50%	2022-2026	0.125%-5.75%	2021-2025
Supranational securities	0.25%-3%	2022-2025	0.25%-6%	2021-2025
Agency and other securities	0.25%-5%	2022-2026	0.25%-5.25%	2021-2025
In national currency:				
Government bonds	7%-12.3%	2022-2028	6.75%-14.375%	2021-2028

Investments measured at fair value through other comprehensive income include funds managed under the RAMP program, which corresponds to the outsourcing of the management of a portion of the international reserves to the World Bank treasury specialized in portfolio management (external manager), with the main objective of transferring know-how and providing consulting services to the Bank. The manager receives a management fee, established in the contract, and is evaluated based on the net asset value of the transferred funds. The assets within the external manager portfolio are held on behalf of the Bank, under the responsibility of a global custodian selected for the purpose of investing in and reinvesting the securities. The Bank may, from time to time, by notice to the external manager, make additions to, or reductions of, the investment amount. As at 31 December 2021, total amount of funds managed under the RAMP was GEL 684,561 thousand (31 December 2020: GEL 720,204 thousand).

For none of the financial assets measured at fair value through other comprehensive income has credit risk increased significantly since initial recognition, see also note 28.

13. INVESTMENTS MEASURED AT AMORTISED COST

	31-Dec-21		31-Dec-20	
	Carrying value	**Nominal value**	**Carrying value**	**Nominal value**
Georgian Government securities				
Georgia government bonds	161,461	160,846	201,661	200,846
Total investments measured at amortised cost in national currency	**161,461**	**160,846**	**201,661**	**200,846**

Analysis of interest rate (coupon) and maturity of investments measured at amortised cost:

	31-Dec-21		31-Dec-20	
	Interest rate p.a.	**Maturity**	**Interest rate p.a.**	**Maturity**
Georgian government bonds	8.109%	2022-2025	8.610%	2021-2025

Georgian government bonds in national currency represent interest bearing securities issued by the Ministry of Finance of Georgia according to the agreement formed between the Government of Georgia and the Bank in March 2006 to convert, without cash settlement, borrowings of the Government of Georgia into debt securities. The security was issued exclusively for the Bank and is a non-transferable, a non-tradable instrument. Therefore, the investment is carried at amortised cost. The government bonds are repaid by issuance of new bond instrument in the amount of GEL 40,000 thousand annually, which are classified as investments measured at fair value through other comprehensive income. Interest rate of the bond is subject to annual repricing considering market rates.

For none of the financial assets measured at amortised cost has credit risk increased significantly since initial recognition, see also note 28.

(in thousands of Georgian Lari)

14. RIGHT-OF-USE ASSET

The Bank leases premise for administrative purposes for part of its personnel and recognises respective right-of-use asset and lease liability.

Change in the outstanding balance of the related right-of-use asset is provided below:

	2021	2020
Balance as at 1 January	**1,232**	**2,077**
Depreciation charge for the year	(845)	(845)
Balance as at 31 December	**387**	**1,232**

Change in outstanding balance of lease liability is provided below:

	2021	2020
Balance as at 1 January	**1,152**	**1,877**
Interest expense for the year	58	112
Repayments for the year	(837)	(837)
Balance as at 31 December	**373**	**1,152**

15. PROPERTY AND EQUIPMENT

	Land and buildings	Computers, office equipment and fixtures	Vehicles and other	Assets under construction	Total
At initial cost:					
1-Jan-20	**52,652**	**16,538**	**20,370**	**63**	**89,623**
Additions	-	2,226	221	1	2,448
31-Dec-20	**52,652**	**18,764**	**20,591**	**64**	**92,071**
Additions	196	319	7,102	-	7,617
Disposals	-	(432)	(1,417)	(28)	(1,877)
31-Dec-21	**52,848**	**18,651**	**26,276**	**36**	**97,811**
Accumulated depreciation:					
1-Jan-20	**(7,287)**	**(7,700)**	**(16,817)**	**-**	**(31,804)**
Depreciation charge	(1,050)	(2,542)	(1,146)	-	(4,738)
31-Dec-20	**(8,337)**	**(10,242)**	**(17,963)**	**-**	**(36,542)**
Depreciation charge	(1,050)	(2,820)	(1,949)	-	(5,819)
Disposals	-	430	1,417	-	1,847
31-Dec-21	**(9,387)**	**(12,632)**	**(18,495)**	**-**	**(40,514)**
Net book value:					
As at 31 December 2021	**43,461**	**6,019**	**7,781**	**36**	**57,297**
As at 31 December 2020	**44,315**	**8,522**	**2,628**	**64**	**55,529**

(in thousands of Georgian Lari)

16. INTANGIBLE ASSETS

	Software and other
At cost:	
1-Jan-20	**14,037**
Additions	1,378
Disposals	(223)
31-Dec-20	**15,192**
Additions	2,429
Disposals	(61)
31-Dec-21	**17,560**
Accumulated amortization:	
1-Jan-20	**(9,057)**
Charge for the year	(1,502)
Disposals	223
31-Dec-20	**(10,336)**
Charge for the year	(1,838)
Disposals	60
31-Dec-21	**(12,114)**
Net book value:	
As at 31 December 2021	**5,446**
As at 31 December 2020	**4,856**

17. OTHER ASSETS AND LIABILITIES

	31-Dec-21	31-Dec-20
Other assets in foreign currency:		
Prepayments	-	977
Other debtors	8	9
Total other assets in foreign currency	**8**	**986**
Other assets in national currency:		
Prepayments	3,528	8,133
Inventory	575	617
Commemorative gold coins and gold bars	307	1,982
Loans to employees	149	162
Other debtors	101	642
	4,660	**11,536**
Allowance for expected credit losses on other assets	(74)	(156)
Total other assets in national currency	**4,586**	**11,380**

As at 31 December 2021 and 2020, other financial assets, net of loss allowance, amounted to GEL 183 thousand and GEL 1,633 thousand, respectively.

Allowance for expected credit losses on other assets represents allowance for expected credit losses on loans to employees and other debtors. The movements in allowance for expected credit losses are presented in note 28.

Other liabilities comprise:

	31-Dec-21	31-Dec-20
Other liabilities in foreign currency:		
Amounts due to suppliers	2,886	5,587
Other liabilities	599	616
Total other liabilities in foreign currency	**3,485**	**6,203**
Other liabilities in national currency:		
Profit to be transferred to the Ministry of Finance of Georgia	356,060	-
Amount due to suppliers	4,921	5,071
Liability for realized banknotes and coins	1,893	1,782
Other liabilities	4,077	2,726
Total other liabilities in national currency	**366,951**	**9,579**
Total other liabilities	**370,436**	**15,782**

As at 31 December 2021 other financial liabilities amount to GEL 12,361 thousand (31 December 2020: 15,782).

(in thousands of Georgian Lari)

18. DUE TO RESIDENT FINANCIAL INSTITUTIONS

Due to resident financial institutions comprise:

	31-Dec-21	31-Dec-20
Due to resident financial institutions under monetary policy instruments		
Correspondent accounts in national currency	362,853	446,249
Overnight deposits in national currency	81,200	78,700
Total due to resident financial institutions under monetary policy instruments in national currency	**444,053**	**524,949**
Obligatory reserves of banks in foreign currency	5,120,817	5,480,533
Total due to resident financial institutions under monetary policy instruments	**5,564,870**	**6,005,482**
Due to resident financial institutions, other		
Correspondent accounts in foreign currency	181,271	89,741
Special deposits of commercial banks in foreign currency	42,747	13,330
Total due to resident financial institutions, other	**224,018**	**103,071**
Total due to resident financial institutions	**5,788,888**	**6,108,553**

As at 31 December 2021 and 2020, included in due to resident financial institutions are balances with the three largest local commercial banks of GEL 4,288,445 thousand and GEL 4,469,736 thousand, respectively, that represent 74.08% and 73.17% of the total balance due to resident financial institutions.

Resident commercial banks are required to maintain obligatory reserves with the Bank. As at 31 December 2021, the obligatory reserves are calculated as 5% of their eligible liabilities denominated in national currencies (31 December 2020: 5%), and from 10% to 25% of their eligible liabilities denominated in foreign currencies, which depend on the deposit dollarization rate of a particular commercial bank (31 December 2020: 25%). For foreign currency borrowed funds with a remaining maturity of 1-2 years, the reserve requirement amounts vary from 10% to 15%, depending on the deposit dollarization rate of a particular commercial bank (31 December 2020: 15%). As at 31 December 2021 and 2020, the annual interest rate on GEL denominated obligatory reserves was 10.5% and 8%, respectively. As at 31 December 2021 and 2020, annual interest rate on USD/EUR denominated obligatory reserves were -0.25%/-0.7% and -0.25%/-0.7% respectively. Borrowings with remaining maturities of over one year in the national currency and over two years in a foreign currency are exempt from reserve requirements.

19. DUE TO THE MINISTRY OF FINANCE

	31-Dec-21	31-Dec-20
Due to the Ministry of Finance of Georgia		
Current accounts in foreign currency	788,312	788,928
Current account in national currency	894,785	661,984
Total due to the Ministry of Finance of Georgia	**1,683,097**	**1,450,912**

20. DUE TO CUSTOMERS

	31-Dec-21	31-Dec-20
Due to customers in national currency		
Due to international organizations	605	1,394
Total due to customers in national currency	**605**	**1,394**

(in thousands of Georgian Lari)

21. MONEY ISSUED IN CIRCULATION

Money issued in circulation represents the amount of national currency of Georgia issued by the Bank. Movements during the year ended 31 December 2021 and 2020 were as follows:

	2021	2020
Balance as at 1 January	**4,661,427**	**4,137,012**
Banknotes issued into circulation	8,190,450	6,973,721
Coins issued into circulation	85,740	54,257
Banknotes withdrawn from circulation	(8,279,816)	(6,456,882)
Coins withdrawn from circulation	(68,767)	(46,681)
Balance as at 31 December	**4,589,034**	**4,661,427**

22. DEBT SECURITIES ISSUED

	Interest rate p.a.	Maturity	Nominal value	Carrying value
Certificates of deposit as at 31-Dec-21	9.45%-10.39%	28 Jan-25 Mar, 2022	60,000	59,124
Certificates of deposit as at 31-Dec-20	8.01%-8.13%	28 Jan-25 Mar, 2021	60,000	59,273

23. EQUITY

As stated in the Law, the Bank's capital is comprised of its subscribed and fully paid-up capital and reserve fund.

Authorised capital

The authorised and fully paid-up capital of the Bank is GEL 15,000 thousand as at 31 December 2021 and 2020.

Capital management

The Bank defines capital as its total equity measured in accordance with IFRS. According to Article 24 of the Law dated 1 December 2009 (N2186) the net income of the Bank for each financial year is calculated as the sum of net operational profit or loss and unrealised gain or loss from revaluation. Net operational profit or loss shall be calculated after deducting from revenues of the reporting year all operating expenditures intended for the core activities. Retained earnings are transferred to different reserves based on the requirements of the Law and after approval of the Council. Following approval of the annual report of the Bank by the Council the remaining portion of the retained earnings is transferred to the State budget within six months after the end of financial year.

Reserve fund

According to the amended Article 25 of the Law the Reserve Fund should make up 15% of the reserve money, which comprises the national currency in cash put into circulation by the Bank together with the correspondent accounts of commercial banks in national currency, and is established by allocations from the realised profit for the year, which comprises net profit for the year excluding net foreign currency translation and other revaluation gains and losses. The Council is entitled to determine the establishment of the Reserve Fund of less than 15% of the reserve money.

The Reserve Fund may only be used to offset losses of the Bank. With the specific objective of maintaining stability of the financial system, as well as fostering sustainable economic growth in the country, the Council is entitled to take a decision on the distribution of the Reserve Fund. Following the transfers to the Reserve Fund, the residual balance of realised profit of the Bank shall be transferred to the State Budget of Georgia.

In 2021, the Bank transferred to reserve fund GEL 60,319 thousand from realized profit of 2021 and GEL 219,139 thousand from realized profit of 2020, (which was included in Retained Earnings as at 31 December 2020) respectively.

In accordance with Article 25(c) of the Law, residual amount of GEL 356,060 thousand from realized profit of 2021 is distributed to the Ministry of Finance and will be transferred within 6 months after year end. Residual amount of GEL 140,000 thousand from realized profit of 2020 (which was included in Retained Earnings as at 31 December 2020) was distributed and transferred to the Ministry of Finance of Georgia in 2021.

Foreign currency and other revaluation reserves

According to the Article 25(a) of the Law, the Bank transfers the net unrealized gains from foreign currency revaluation to the foreign currency revaluation reserve and net unrealized gains arising from changes of the FVTPL financial assets' market prices are transferred to the revaluation reserve created for this purpose. These special reserves shall be used for counteracting (compensating) future losses.

During 2021, net unrealized loss on translation of foreign currencies of GEL 259,086 thousand was transferred from the Foreign Currency Revaluation Reserve to Retained Earnings (2020: unrealized gain of GEL 680,748 thousand was transferred from Retained Earnings to Foreign Currency Revaluation Reserve). During 2021, other revaluation gain of GEL 14,036 thousand was transferred from retained earnings to Other Revaluation Reserve (2020: other revaluation loss of GEL 2,512 thousand was transferred from Other Revaluation Reserve to Retained Earnings).

Revaluation reserve for investments measured at FVOCI

This reserve records fair value changes of investments measured at FVOCI.

24. COMMITMENTS AND CONTINGENCIES

In the normal course of operations, the Bank is a party to financial instruments with off-balance sheet commitments. The Bank uses the same risk management policies in undertaking off-balance sheet commitments as it does for on-balance operations.

Capital commitments

No material capital commitments were outstanding as at 31 December 2021 and 2020.

Operating environment

As an emerging market, Georgia does not possess a well-developed infrastructure that would generally exist in a more mature market economy. Therefore, especially sharp changes of operating environment (including global environment) could affect the Banks results and financial position in a manner not currently determinable.

Over the last few years the Government of Georgia and the Bank have made a number of developments that positively affect the overall investment climate in Georgia, specifically implementing the reforms necessary for creating efficient banking, judicial, taxation and regulatory systems, as well as, using various measures to fulfill the liquidity needs of the economy and to stabilize the exchange rate of the national currency. This has resulted in a stable macroeconomic environment with higher real growth rates and inflow of foreign investments. The existing tendency aimed at the overall improvement of the economy is expected to persist.

However, future development of the economy of Georgia is largely dependent upon these reforms and developments, and the effectiveness of economic, financial and monetary measures undertaken by the Government and the Bank.

(in thousands of Georgian Lari)

Management believes that all the necessary measures are implemented to support the Bank's role in maintaining macroeconomic and financial stability.

In response to Covid-19 pandemic, the Bank has set up temporary liquidity instruments to avoid or minimize the negative impact of potential future liquidity risks in the banking sector. From April 2020, in addition to standard refinancing loans, the Bank provides liquidity support to the market through FX SWAP operations. FX SWAP operations are monetary policy instruments aimed at delivering liquidity to the market. Through the FX SWAP transactions, the Bank buys foreign currency with the national currency for a period of one month at a spot rate, provided that it is sold back at the predetermined forward rate.

Legal proceedings

The Bank is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material effect on the financial position or the results of operations of the Bank. Management is of the opinion that no material unaccrued losses will be incurred and, accordingly, no provision has been made in these financial statements.

Credit commitments and contingent liabilities

As at 31 December 2021 and 2020, the Bank has no material credit commitments and contingent liabilities.

25. RELATED PARTY TRANSACTIONS

The Bank, as a state entity, is related to the Government of Georgia entities. To achieve its policy objectives, the Bank maintains a position of structural and functional independence from the Government of Georgia through its ability to fund its own operations without external assistance and through its management and governance.

Under key management personnel are regarded those persons having authority and responsibility for planning, directing and controlling the activities of the Bank, directly or indirectly. Key management personnel comprise the members of the Council, Chief Executive Officer and heads of departments.

In the normal course of its operations, the Bank enters into transactions with related parties, and material transactions and balances are presented in these financial statements, based on substance of the relationship, and not merely the legal form.

The Bank had the following transactions outstanding with related parties:

	Year ended 31 December 2021		Year ended 31 December 2020	
	Related party transactions	**Total category as per statement of profit or loss and other comprehensive income**	**Related party transactions**	**Total category as per statement of profit or loss and other comprehensive income**
Key management personnel compensation:				
– *short-term employee benefits*	(4,254)	(31,155)	(3,922)	(28,303)

(in thousands of Georgian Lari)

		31-Dec-21		31-Dec-20	
	Notes	**Related party balances**	**Total category as per statement of financial position**	**Related party balances**	**Total category as per statement of financial position**
Statement of financial position					
Assets:					
Investments measured at fair value through other comprehensive income in national currency- *Government of Georgia*	12	1,649,777	1,649,777	1,168,338	1,168,338
Investments measured at amortised cost in national currency- *Government of Georgia*	13	161,461	161,461	201,661	201,661
Loans to employees-key management personnel	17	74	149	-	-
Liabilities:					
Due to the Ministry of Finance	19	1,683,097	1,683,097	1,450,912	1,450,912
Statement of profit or loss and other comprehensive income					
Interest income		123,928	484,195	92,786	453,858
- Government of Georgia		*123,910*		*92,786*	
- Key management personnel		*18*		-	

In 2021, unrealized fair value loss on government securities measured at fair value through other comprehensive income amounted to GEL 33,433 thousand (2020: gain of GEL 4,917 thousand).

(in thousands of Georgian Lari)

26. LIABILITIES RELATED TO FINANCING ACTIVITIES

Table below shows reconciliation of movements of liabilities to cash flows arising from financing activities:

			Cash		Non-Cash				
	Note	**1-Jan-2021**	**Interest Paid**	**Net Proceeds from financing activities**	**Accrued Interest**	**Translation Differences**	**Distribution to the Ministry of Finance from 2020 profit**	**Distribution to the Ministry of Finance from 2021 profit**	**31-Dec-2021**
Liabilities arising from financing activities:									
Debt securities issued	22	59,273	(5,088)	(700)	5,639	-	-	-	59,124
Due to the International Monetary Fund	9	1,900,788	(19,997)	1,262,346	19,857	(214,777)	-	-	2,948,217
Other Liabilities	23	-	-	(140,000)	-	-	140,000	356,060	356,060

			Cash		Non-Cash				
	Note	**1-Jan-2020**	**Interest Paid**	**Net Proceeds from financing activities**	**Accrued Interest**	**Translation Differences**	**Distribution to the Ministry of Finance from 2020 profit**	**Distribution to the Ministry of Finance from 2021 profit**	**31-Dec-2020**
Liabilities arising from financing activities:									
Debt securities issued	22	79,149	(5,039)	(20,332)	5,495	-	-	-	59,273
Due to the International Monetary Fund	9	1,284,863	(11,729)	374,823	12,602	240,229	-	-	1,900,788
Other Liabilities	23	-	-	(100,000)	-	-	100,000	-	-

27. FAIR VALUE OF FINANCIAL INSTRUMENTS

IFRS defines fair value as the price that would be received to sell an asset or paid to transfer a liability in orderly transactions between market participants at the measurement date.

Fair value of the Bank's financial instruments measured at fair value on a recurring basis

Some of the Bank's financial instruments are measured at fair value at the end of each reporting period. The following table gives information about how the fair values of these financial assets are determined (in particular, the valuation techniques and inputs used).

Financial instruments measured at fair value are broken down for disclosure purposes into a three level fair value hierarchy based on the observability of inputs:

- Quoted prices in an active market (**Level 1**) – Valuations based on quoted prices in active markets that the Bank has the ability to access for identical assets or liabilities. Valuation adjustments and block discounts are not applied to these financial instruments. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuations of these products do not require a significant amount of judgment. This level entails financial instruments under international reserve portfolio which are classified as derivative financial instruments, investments measured at fair value through profit or loss and investments measured at fair value through other comprehensive income. The instruments are valued on a daily basis, based on the bid prices obtained from Bloomberg at the closing of the markets of the current day.
- Valuation techniques using observable inputs (**Level 2**) – Valuations based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include the following:

  a) quoted prices for similar assets or liabilities in active markets;
  b) quoted prices for identical or similar assets or liabilities in markets that are not active;
  c) inputs other than quoted prices that are observable for the asset or liability, for example:

     - interest rates and yield curves observable at commonly quoted intervals;
     - implied volatilities; and
     - credit spreads;

  d) market-corroborated inputs

Georgian government securities, measured at fair value through other comprehensive income, are measured using observable inputs under Level 2, in particular market yields on similar securities issued by the Georgian government. For fair value assessment, a discounted cash flow model is used based on a current interest rate yield curve appropriate for the remaining term to maturity.

- Valuation techniques incorporating information other than observable market data (**Level 3**) – Valuations based on inputs that are unobservable and significant to the overall fair value measurement. The Bank does not have any financial instruments valued based on unobservable inputs.

The Bank considers that the accounting estimate related to valuation of financial instruments where quoted markets prices or other observable inputs are not available is a key source of estimation uncertainty because: (i) it is highly susceptible to change from period to period because it requires management to make assumptions about interest rates, volatility, exchange rates, the credit rating of the counterparty, valuation adjustments and specific feature of the transactions and (ii) the impact that recognising a change in the valuations would have on the assets reported in the statement of financial position as well as its profit or loss could be material.

(in thousands of Georgian Lari)

The table below analyses financial instruments measured at fair value at 31 December 2021 and 2020, by the level in the fair value hierarchy into which the fair value measurement is categorised. The amounts are based on the values recognised in the statement of financial position:

Financial Assets	Note	Fair value as at		Fair value hierarchy	Valuation techniques and key inputs	Significant unobservable inputs
		31-Dec-21	31-Dec-20			
International reserves						
Derivative financial assets	10	14,235	13,989	Level 1	Quoted bid prices in an active market	N/A
Investments measured at fair value through profit or loss	11	329,975	177,163	Level 1*	Quoted bid prices in an active market	N/A
Investments measured at fair value through other comprehensive income	12	7,759,488	8,323,015	Level 1	Quoted bid prices in an active market	N/A
Monetary policy instruments						
Investments measured at fair value through other comprehensive income	12	1,649,777	1,168,338	Level 2	Market interest rate for similar instruments	N/A
Derivative financial assets	10	3,864	1,318	Level 1	Quoted bid prices in an active market	N/A

** The Bank's investments measured at fair value through profit or loss comprise part of international reserves managed by the Bank for International Settlements ("BIS"), which represents investments placed in the Bank for International Settlements Investment Pool (BISIP CNY) (31 December 2020: BISIP K). The investments represent instruments which, have quoted prices in active markets that the Bank has the ability to access for identical assets or liabilities. Therefore, the investment's fair valuation is considered to be Level 1 within fair value hierarchy.*

There were no transfers between Level 1, 2 and 3 during the years ended 31 December 2021 and 2020.

Gains and losses included in other comprehensive income relate to investments measured at fair value through other comprehensive income and are reported as changes in revaluation reserve of investments measured at FVOCI.

Net unrealized gain/(loss) from securities and derivatives included in profit or loss relates to derivative financial assets and investments measured at fair value through profit or loss as changes in fair value during the year ended 31 December 2021.

Fair value of financial assets and financial liabilities that are not measured at fair value on a recurring basis (but fair value disclosures are required)

For fixed interest-bearing financial assets and liabilities that have a short-term maturity, it is assumed that the carrying amounts approximate their fair value. This assumption is also applied to demand deposits and savings accounts without maturity.

For variable interest-bearing financial assets (Georgian government bond classified as investments measured at amortized cost) and liabilities (borrowings from the IMF), it is assumed that the carrying amounts approximate their fair value. Moreover, management of the Bank believes that due to their specific nature, borrowings from the IMF represent a separate segment of borrowings from international financial organizations to support developing countries. As a result, these borrowings were considered to have been received in an "arm's length" transaction.

28. RISK MANAGEMENT

Introduction

The activities of the Bank are exposed to various types of risks. These include financial risks in the form of market, credit, and liquidity risks. The Bank's activities are also exposed to a diverse range of non-financial risks. Due to its unique role and functions, the Bank's risk management and control is not only based on the institutional risk and return considerations, but also takes into account the national interest, in line with its statutory responsibilities prescribed in relevant legislation. The Bank views risk management as an integral part of overall management process and an essential element of good corporate governance. The Council of the Bank is ultimately responsible for the oversight of the risk management framework, overseeing the management of the key risks and reviewing its risk management policies and procedures.

To support the effective and efficient risk management system the Bank established a three lines of defense model. The model allocates clear roles and responsibilities for business departments, risk management, and internal audit.

First line of defense: Departmental management

The first line of defense (the Bank's departments) is responsible to identify, assess, and manage the risks in their respective departments by designing, implementing and maintaining an adequate and effective systems of control.

Second line of defense: Centralized risk management function

The second line of defense (Centralized Risk Management Department) is responsible to define and implement an effective non-financial risk management framework that is consistent with standards and approaches of best international practices. The Centralized Risk Management Department provides independent forward-looking assessment of the risks, facilitates, risk management processes and provides business continuity support. The department is accountable to the Governor of the Bank.

Third line of defense: Internal audit

Internal Audit represents the third line of defense, which ensures the effectiveness, and appropriateness of the risk management and internal control systems. Internal audit examines both the adequacy of internal controls and the Bank's compliance with the procedures on a regular basis and reports its findings and recommendations to the Chairman of the Council.

Organization of risk management department

Nature of risk	Management	Guidelines policies issued by	Supervision
Financial risks	At department level	Monetary policy committee International reserve management committee	Board
Non-financial risk	At department level	Centralized risk management department	Internal Audit, Audit Committee

Financial risks

The Bank uses financial instruments as a means of achieving its monetary policy objectives and for managing international reserves. These two portfolios have different risk policies and characteristics, both of them are managed by the financial market department. The description of financial risks below presents the main risks to which these two portfolios of financial instruments are exposed, as well as the management policy of these risks.

(in thousands of Georgian Lari)

Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

The table below shows the maximum exposure to credit risk for financial instruments of the Bank for which impairment requirements are not applied:

Foreign currency assets	Notes	Maximum exposure 31-Dec-21	Maximum exposure 31-Dec-20
International reserves			
Assets related to derivative instruments	10	14,235	13,989
Investments measured at fair value through profit or loss	11	329,975	177,163
National currency assets			
Monetary policy instruments			
Assets related to derivative instruments		3,864	1,318
Total credit risk exposure		**348,074**	**192,470**

Exposure to credit risk for instruments where impairment requirements are applied are represented by carrying amounts of the respective assets in the statement of financial position.

International reserve portfolio

According to the Law, the Bank is eligible to hold and manage an international reserve portfolio. The Bank maintains a portfolio to support its monetary and exchange policies and normal functioning of domestic and foreign payments. Reserves are also employed to protect the country from external vulnerability by maintaining sufficient liquidity to absorb shocks during a financial crisis. Therefore, the multiple objectives of holding international reserves feature safety, liquidity, and profitability. Hence, assets under the international reserve portfolio are invested on a conservative basis to facilitate these objectives, with an emphasis on liquidity and capital preservation. For instance, the Bank's Investment Guidelines prioritizes the preservation of capital and a high level of liquidity of reserves. Once these conditions are met, return is to be maximized.

The portfolio is managed in line with investment guidelines approved by the Council. The Reserve Management Committee (the "Committee") of the Bank is responsible for monitoring and implementation of risk mitigation measures prescribed in the investment guidelines and making sure that the Bank operates within the established risk parameters. Typical activities of the Committee are reviewing the monthly reports, approving the list of eligible counterparties, approving changes to the strategy before submitting them to the Council and occasionally making important tactical decisions on asset allocation. The Risk Management and Control Division (the "Division") of the Bank is responsible for the overall day-to-day risk management and compliance functions, ensuring the implementation of common principles and methods for identifying, measuring, managing, and reporting risks.

Monetary policy portfolio

The monetary policy is executed mainly through financial instruments such as Georgian government securities, loans to commercial banks, certificate of deposit and minimum reserve requirements for commercial banks. The monetary policy committee is responsible for monitoring and implementation of risk mitigation tools, such as collateral requirements for refinancing loans.

a) Financial instruments under the international reserves portfolio

In order to control the credit risk of the financial instruments used in the international reserves operations, the strategic asset allocation limits the exposures to credit risk of countries, counterparties and issuers, by setting concentration limits and minimum long-term credit rating, established by the international rating agencies (Standard & Poor's, Moody's and Fitch). For instance, investment guidelines clearly define the minimum level of the credit rating for investing in any debt Instruments

(Bonds, Bills) as well as for bank deposits and other financial instruments as A-. However, minimum credit rating of BBB is acceptable for counterparties used only for Nostro accounts.

Additionally, the investment guidelines limit the concentration into non-benchmark financial instruments and the portfolio is diversified into various money market instruments, as well as fixed income and floating rate securities (Government Bonds, Agencies including Regional Governments and Supranational Securities) and other liquid, highly secure instrument types.

While selecting the Bank's counterparties, the counterparty's credit rating, the country of its residence, the volume of its assets and capital, the experience of working in international markets and with corporate clients and the spectrum of the services and instruments offered to its clients are taken into consideration. In case of downgrade of the long-term credit rating of the Bank's counterparty by the above-mentioned rating agencies, the counterparty will be withdrawn from the list of eligible counterparties.

When different credit ratings are designated by the rating agencies (Standard & Poor's, Moody's and Fitch) for the assets, the second-best credit rating is used for credit risk assessment.

(in thousands of Georgian Lari)

Credit quality analysis

The table below shows, by class of financial instruments, gross carrying amount of assets within the international reserve portfolio for which impairment requirements are applied:

	31 December 2021				31 December 2020			
	12-month ECL	**Lifetime ECL not credit-impaired**	**Lifetime ECL credit-impaired**	**Total**	**12-month ECL**	**Lifetime ECL not credit-impaired**	**Lifetime ECL credit-impaired**	**Total**
Cash and cash equivalents (excluding cash on hand)								
AAA	1,595,101	-	-	1,595,101	1,034,722	-	-	1,034,722
AA	170,100	-	-	170,100	400,030	-	-	400,030
A	637,371	-	-	637,371	563,229	-	-	563,229
BBB	-	-	-	-	359	-	-	359
Gross carrying amount	**2,402,572**	**-**	**-**	**2,402,572**	**1,998,340**	**-**	**-**	**1,998,340**
Loss allowance	-	-	-	-	-	-	-	-
Net carrying amount	**2,402,572**	**-**	**-**	**2,402,572**	**1,998,340**	**-**	**-**	**1,998,340**
Special Drawing Rights holdings with the International Monetary Fund								
AAA	1,506,927	-	-	1,506,927	697,227	-	-	697,227
Gross carrying amount	**1,506,927**	**-**	**-**	**1,506,927**	**697,227**	**-**	**-**	**697,227**
Loss allowance	-	-	-	-	-	-	-	
Net carrying amount	**1,506,927**	**-**	**-**	**1,506,927**	**697,227**	**-**	**-**	**697,227**
Investments measured at fair value through other comprehensive income								
AAA	6,803,394	-	-	6,803,394	7,363,058	-	-	7,363,058
AA	947,006	-	-	947,006	913,925	-	-	913,925
A	9,088	-	-	9,088	46,032	-	-	46,032
Net carrying amount - fair value	**7,759,488**	**-**	**-**	**7,759,488**	**8,323,015**	**-**	**-**	**8,323,015**
Loss allowance (recognised in other comprehensive income)	(218)	-	-	(218)	(337)	-	-	(337)

b) Financial instruments under the monetary policy portfolio

Credit risk is associated with open-market operations and facilities that inject liquidity to the financial system. The Bank's securities portfolio is comprised exclusively of securities issued by the Government of Georgia, considered as assets with low credit risk. To mitigate the risk associated with loans to banking institutions, the Bank requires collaterals eligible according to their credit quality, which are valued at market prices at the time of their receipt and subject to the application of discounts or haircuts according to the instrument specific characteristics.

The Bank classifies its financial assets other than international reserves as follows:

AAA grade – borrowers with excellent financial performance, having no changes in the terms and conditions of loan agreements and no overdue in principal and interest.

AA grade – borrowers with stable financial performance, having no changes in the terms and conditions of loan agreements and no overdue in principal and interest.

A grade – borrowers with satisfactory financial performance, having changes in the terms and conditions of loan agreements and no overdue in principal and interest.

B grade – loans issued to borrowers with satisfactory financial performance, having changes in the terms and conditions of loan agreements and overdue in principal and interest.

It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. The attributed risk ratings are assessed and updated regularly.

(in thousands of Georgian Lari)

The table below shows, by classes of financial instruments, gross carrying amounts of monetary policy and other financial assets, for which impairment requirements are applied, based on The Bank's internal credit rating system:

	31 December 2021			31 December 2020		
	12-month ECL	Lifetime ECL credit-impaired	Total	12-month ECL	Lifetime ECL credit-impaired	Total
Foreign currency assets						
Other financial assets						
AAA grade	-	-	-	977	-	977
B grade	8	-	8	9	-	9
Gross carrying amount	**8**	**-**	**8**	**986**	**-**	**986**
Loss allowance	-	-	-	-	-	-
Net carrying amount	**8**	**-**	**8**	**986**	**-**	**986**
National currency assets						
Monetary policy instruments						
Due from financial institutions						
AAA grade	3,147,015	-	3,147,015	3,214,170	-	3,214,170
Gross carrying amount	**3,147,015**	**-**	**3,147,015**	**3,214,170**	**-**	**3,214,170**
Loss allowance	-	-	-	-	-	-
Net carrying amount	**3,147,015**	**-**	**3,147,015**	**3,214,170**	**-**	**3,214,170**
Investments measured at fair value through other comprehensive income						
AAA grade	1,649,777	-	1,649,777	1,168,338	-	1,168,338
Carrying amount - fair value	**1,649,777**	**-**	**1,649,777**	**1,168,338**	**-**	**1,168,338**
Other national currency assets						
Investments measured at amortized cost						
AAA Grade	161,461	-	161,461	201,661	-	201,661
Gross carrying amount	**161,461**	**-**	**161,461**	**201,661**	**-**	**201,661**
Loss allowance	-	-	-	-	-	-
Net carrying amount	**161,461**	**-**	**161,461**	**201,661**	**-**	**201,661**
Other financial assets						
A Grade	101	-	101	648	-	648
B Grade	-	149	149	-	156	156
Gross carrying amount	**101**	**149**	**250**	**648**	**156**	**804**
Loss allowance	-	(74)	(74)	-	(156)	(156)
Net carrying amount	**101**	**75**	**176**	**648**	**-**	**648**

(in thousands of Georgian Lari)

The following table shows reconciliation of opening and closing balances of the loss allowance by classes of those financial instruments for which expected credit losses are recognised:

	2021			2020		
	12-month ECL	**Lifetime ECL credit-impaired**	**Total**	**12-month ECL**	**Lifetime ECL credit-impaired**	**Total**
Foreign currency assets						
International reserves						
Investments measured at FVOCI						
Balance at 1 January	**337**	**-**	**337**	**301**	**-**	**301**
New financial assets recognised	116	-	116	190	-	190
Remeasurement of loss allowance	(74)	-	(74)	(51)	-	(51)
Foreign exchange and other movements	(6)	-	(6)	17	-	17
Financial assets that have been derecognized - repayment	(155)	-	(155)	(120)	-	(120)
Balance at 31 December	**218**	**-**	**218**	**337**	**-**	**337**
National currency assets						
Other national currency assets						
Other assets						
Balance at 1 January	**-**	**156**	**156**	**-**	**161**	**161**
New financial assets recognized	-	-	-	-	-	-
Remeasurement of loss allowance	-	(56)	(56)	-	-	-
Financial assets that have been derecognized - repayment	-	(26)	(26)	-	(5)	(5)
Balance at 31 December	**-**	**74**	**74**	**-**	**156**	**156**
Total balance at 1 January	**337**	**156**	**493**	**301**	**161**	**462**
Total balance at 31 December	**218**	**74**	**292**	**337**	**156**	**493**

Excessive risk concentration

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

In order to minimize excessive concentrations of risks, the Bank's policies and procedures include specific guidelines to focus on maintaining a low credit risk profile. The concentration risks by counterparties and asset quality are disclosed in relevant notes to the financial statements.

(in thousands of Georgian Lari)

Geographical concentration

The Bank's financial assets and liabilities are generally concentrated in Georgia, except for the international reserve portfolio and borrowings from the IMF. The below table provides information on geographical concentration for these financial assets and liabilities outside of Georgia:

As at 31 December 2021	**Notes**	**US**	**EU***	**Australia**	**Canada**	**International**	**Other**	**Total**
Assets:								
International reserves								
Cash and cash equivalents (excluding cash on hand)	7	117,659	1,816,828	8	1,901	-	466,176	2,402,572
Special Drawing Rights holdings with the IMF	9	-	-	-	-	1,506,927	-	1,506,927
Assets related to derivative instruments	10	-	-	-	-	-	14,235	14,235
Investments measured at fair value through profit or loss	11	-	-	-	-	329,975	-	329,975
Investments measured at fair value through other comprehensive income	12	4,628,393	1,113,351	62,567	1,003,701	837,856	113,620	7,759,488
		4,746,052	**2,930,179**	**62,575**	**1,005,602**	**2,674,758**	**594,031**	**12,013,197**
Liabilities:								
Due to the IMF	9	-	-	-	-	2,948,217	-	2,948,217
Net position		**4,746,052**	**2,930,179**	**62,575**	**1,005,602**	**(273,459)**	**594,031**	**9,064,980**

As at 31 December 2020	**Notes**	**US**	**EU***	**Australia**	**Canada**	**International**	**Other**	**Total**
Assets:								
International reserves								
Cash and cash equivalents (excluding cash on hand)	7	136,471	1,525,764	355	59	-	335,691	1,998,340
Special Drawing Rights holdings with the IMF	9	-	-	-	-	697,227	-	697,227
Assets related to derivative instruments	10	-	-	-	-	-	13,989	13,989
Investments measured at fair value through profit or loss	11	-	-	-	-	177,163	-	177,163
Investments measured at fair value through other comprehensive income	12	5,074,444	1,285,632	701,550	852,010	290,692	118,687	8,323,015
		5,210,915	**2,811,396**	**701,905**	**852,069**	**1,165,082**	**468,367**	**11,209,734**
Liabilities:								
Due to the IMF	9	-	-	-	-	1,900,788	-	1,900,788
Net position		**5,210,915**	**2,811,396**	**701,905**	**852,069**	**(735,706)**	**468,367**	**9,308,946**

*EU-including Norwegian agency securities.

(in thousands of Georgian Lari)

Liquidity risk

Liquidity risk considers the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

a) Financial instruments under the international reserve portfolio

The purpose of the management of the liquidity risk is to ensure that the Bank fulfills all the financial commitments that it has assumed. Accordingly, the Bank diversifies maturities and also establishes limits aiming to ensure that the securities purchased may be traded in the secondary market without causing abrupt changes in the prices of the assets. Due to these guidelines, even securities with longer maturities have immediate liquidity.

The Bank's Monetary Policy and International Reserves Management Committees set limits on the minimum proportion of maturing funds available to cover cash outflows. The liquidity management policy of the Bank requires:

- Projecting cash flows by major currencies and considering the level of liquid assets necessary in relation thereto;
- Maintaining a diverse range of funding sources;
- Managing the concentration and profile of debts;
- Maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any interruption to cash flow; and
- Maintaining liquidity and funding contingency plans.

The Financial Markets Department receives information from business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future operations. The Bank's liquidity risk relates to foreign currency cash flows.

The table below summarizes the maturity profile of the Bank's financial liabilities in foreign currency as at 31 December 2021 and 2020 based on contractual undiscounted repayment obligations. The financial assets in foreign currencies are presented in "less than 3 months" category on the basis that the Bank can realize them within the period not exceeding 3 months to meet the liquidity requirements:

As at 31 December 2021	Notes	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Foreign currency assets						
International Reserves						
Cash and cash equivalents (excluding cash on hand)	7	2,402,572	-	-	-	2,402,572
Special Drawing Rights holdings with the IMF	9	1,506,927	-	-	-	1,506,927
Assets related to derivative instruments	10	14,235	-	-	-	14,235
Investments measured at fair value through profit or loss	11	329,975	-	-	-	329,975
Investments measure at fair value through other comprehensive income	12	7,759,488	-	-	-	7,759,488
Other foreign currency assets						
Other financial assets	17	8	-	-	-	8
Total foreign currency assets		**12,013,205**	**-**		**-**	**12,013,205**
Foreign currency liabilities						
Due to resident financial institutions	18	5,344,835	-	-	-	5,344,835
Due to the Ministry of Finance	19	788,312	-	-	-	788,312
Due to the IMF	9	1,503,790	69,556	744,590	725,797	3,043,732
Other liabilities	17	1,159	2,325	-	-	3,485
Total foreign currency liabilities		**7,638,096**	**71,881**	**744,590**	**725,797**	**9,180,364**
Net position		**4,375,109**	**(71,881)**	**(744,590)**	**(725,797)**	**2,832,841**

(in thousands of Georgian Lari)

As at 31 December 2020	Notes	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Foreign currency assets						
International Reserves						
Cash and cash equivalents (excluding cash on hand)	7	1,998,340	-	-	-	1,998,340
Special Drawing Rights holdings with the IMF	9	697,227	-	-	-	697,227
Assets related to derivative instruments	10	13,989	-	-	-	13,989
Investments measured at fair value through profit or loss	11	177,163	-	-	-	177,163
Investments measure at fair value through other comprehensive income	12	8,323,015	-	-	-	8,323,015
Other foreign currency assets						
Other financial assets	17	8	-	978	-	986
Total foreign currency assets		**11,209,742**	**-**	**978**	**-**	**11,210,720**
Foreign currency liabilities						
Due to resident financial institutions	18	5,583,604	-	-	-	5,583,604
Due to the Ministry of Finance	19	788,928	-	-	-	788,928
Due to the IMF	9	682,474	22,189	556,641	717,720	1,979,024
Other liabilities	17	1,688	4,398	117	-	6,203
Total foreign currency liabilities		**7,056,694**	**26,587**	**556,758**	**717,720**	**8,357,759**
Net position		**4,153,048**	**(26,587)**	**(555,780)**	**(717,720)**	**2,852,961**

b) Financial instruments under the monetary policy portfolio

Considering the characteristics of a monetary authority, which includes controlling the liquidity of the financial system, the Bank is not exposed to the limitations resulting from a mismatch between assets and liabilities in local currency. All monetary policy instruments, except for obligatory reserve are short term.

Market risk

Market risk is the risk that the value of financial instruments will fluctuate due to changes in market variables such as interest rates and foreign exchanges rates. Market risks comprise currency risk, interest rate risk and other price risk. Market risk arises from open positions in interest rate, currency and equity financial instruments, which are exposed to general and specific market movements and changes in the level of volatility of market prices.

a) Financial instruments under the international reserve portfolio

Market risk implies possible losses due to variations in the price of investments.

The Strategic Asset Allocation (SAA) process limits the market risk based on the risk tolerance of the Bank. Strategic benchmarks are defined for individual portfolios to maximize returns, after assessing various interest rate scenarios, while staying within the market risk limit. Currency exposures are defined based on the analysis of the foreign debt and diversification effects are also considered to decrease overall currency risk (refer to note about currency risk below).

All portfolios, except for the Working Capital, EUR Investment portfolio (since 15 December 2015) and AUD investment portfolio (since February 2021), are actively managed versus strategic benchmarks. Active market risk versus benchmarks is defined during the risk budgeting process and active market risk limits are established for each portfolio through limiting ex-ante tracking error and duration deviation. Regular stress testing is conducted to assess resilience of active portfolios to market shocks.

Strategic Benchmark Durations and Active Market Risk Limits for the international reserve portfolio are as follows:

	2021		2020	
Tranches	**Benchmark Duration (Duration Deviation Limits)**	**Ex-Ante Tracking Error Limits**	**Benchmark Duration (Duration Deviation Limits)**	**Ex-Ante Tracking Error Limits**
Liquidity Portfolio in USD	6 months (+/-3 Months)	15 Basis Point	1 year (+/-3 Months)	10 Basis Point
Investment Portfolio in USD*	9 months (+/-3 Months)	30 Basis Point	1,5 year (+/-3 Months)	15 Basis Point
Investment Portfolio in CAD	9 months (+/-3 Months)	30 Basis Point	1,5 year (+/-3 Months)	15 Basis Point

** Due to the annual SAA decision, the Benchmark Durations for the Liquidity Portfolio in USD and Investment Portfolios in USD and CAD have been decreased from March 2021.*
** Since March 2021, Investment Portfolio in USD includes supranational sub-portfolio with 9 months benchmark duration and 15 bps TE limit.*

Market risk is monitored through the daily measurement of the duration and composition of currencies, and by the follow-up of ex-ante tracking error. The international reserve management daily report, prepared by the Financial Market Department, includes the measurements of performance and risk in an absolute manner and as compared to a benchmark, and presents an evaluation of the implemented investment strategy.

The Bank's exposure to fair value interest rate risk arises principally through its investment in International reserves portfolio, which are exposed to fluctuations because of changes in market interest rates.

Interest rate risk for Foreign Currency Reserves is the risk of changes in fair value of financial instruments due to changes in market interest rates.

The Bank's internally managed Foreign Currency Reserve's portfolio is divided into tranches and the Bank measures interest rate risk for its tranches, in all currencies, based on a 1% change in interest rates that indicates a change in the fair market value of financial instruments per 1% change in market yields. The fair market values of tranches held by the Bank are exposed to fluctuations, however these variations would not affect the ability of the Bank to fulfil its obligations.

Market yield sensitivity of the Bank's International Reserve tranches

The table shows the sensitivity of reserve tranches to a 1% increase or decrease in market yields to the asset values (figures are provided in thousands of USD):

	2021		2020	
Currency	**Increase in Market Yield**	**Sensitivity of asset value**	**Increase in Market Yield**	**Sensitivity of asset value**
Investment Tranche in USD*	1%	(13,079)	1%	(30,005)
Investment Tranche in AUD	1%	-	1%	(3,302)
Investment Tranche in CAD	1%	(1,428)	1%	(1,496)
Liquidity Tranche in USD	1%	(3,449)	1%	(4,469)
Investment Tranche in CNY (2020: USD) External (BIS)	1%	(3,171)	1%	(508)
Working Capital Tranche in USD	1%	(17)	1%	(35)

	2021		2020	
Currency	**Decrease in Market Yield**	**Sensitivity of asset value**	**Decrease in Market Yield**	**Sensitivity of asset value**
Investment Tranche in USD*	1%	13,366	1%	30,945
Investment Tranche in AUD	1%	-	1%	3,398
Investment Tranche in CAD	1%	1,457	1%	1,540

(in thousands of Georgian Lari)

Liquidity Tranche in USD	1%	3,517	1%	4,578
Investment Tranche in CNY (2020: USD) External (BIS)	1%	3,341	1%	516
Working Capital Tranche in USD	1%	17	1%	36

b) Financial instruments under the monetary policy portfolio

For open-market operations, this risk is mainly associated with changes in the market value of Georgian government bonds, and the change in value of collaterals received in liquidity injection transactions. For collaterals the risk of value loss is mitigated by using margins and haircuts that write-down their value and allow the effective amount lent to be lower than the collateral received.

The interest rate sensitivity of the Bank's financial assets and liabilities

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair value of financial instruments. The following table demonstrates the net effect of 1% change in interest rates, with all other variables held constant, on the Bank's statement of profit or loss, taking into account the effect of derivatives.

	2021		2020	
Currency	**Increase in interest rate**	**Sensitivity of net interest income**	**Increase in interest rate**	**Sensitivity of net interest income**
USD	1%	36,283	1%	33,583
SDR	1%	(14,387)	1%	(12,012)
EUR	1%	4,608	1%	3,053
AUD	1%	-	1%	7,610
CAD	1%	4,861	1%	3,096
GEL	1%	44,559	1%	39,978
Other	1%	5,863	1%	1,947

	2021		2020	
Currency	**Decrease in interest rate**	**Sensitivity of net interest income**	**Decrease in interest rate**	**Sensitivity of net interest income**
USD	1%	(36,283)	1%	(33,583)
SDR	1%	14,387	1%	12,012
EUR	1%	(4,608)	1%	(3,053)
AUD	1%	-	1%	(7,610)
CAD	1%	(4,861)	1%	(3,096)
GEL	1%	(44,559)	1%	(39,978)
Other	1%	(5,863)	1%	(1,947)

The sensitivity of equity is calculated by revaluing fixed rate investments measured at fair value through other comprehensive income at 31 December 2021 and 2020 for 1% change in interest rates:

Currency	***2021***		***2020***	
	Increase in interest rate	***Sensitivity of equity***	***Increase in interest rate***	***Sensitivity of equity***
USD	1%	72,753	1%	72,529
EUR	1%	-	1%	-
AUD	1%	-	1%	7,606
CAD	1%	4,842	1%	3,095
GEL	1%	16,498	1%	11,683

Currency	***2021***		***2020***	
	Decrease in interest rate	***Sensitivity of equity***	***Decrease in interest rate***	***Sensitivity of equity***
USD	1%	(72,753)	1%	(72,529)
EUR	1%	-	1%	-
AUD	1%	-	1%	(7,606)
CAD	1%	(4,842)	1%	(3,095)
GEL	1%	(16,498)	1%	(11,683)

(in thousands of Georgian Lari)

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign currency exchange rates. Subject to the currency structure of assets, the value of assets of the Bank is exposed to the risk of changes in exchange rates of main foreign currencies. Within the overall exposure and to a limited extent, foreign currency risk can be partially mitigated by holding assets across a diversified portfolio of currencies. Since 14 December 2015, the target currency composition is 80% USD, 10% EUR, 10% Other (Canadian dollars, Chinese yuan and other currencies up to 10%). Under SAA, +/–10% is allowed for the U.S. dollar, the Euro, and other currencies' target currency composition.

Sensitivity to foreign currency

The table below provides the concentration of the Bank's financial assets and liabilities by major currencies and analyses of the effect of a 1%, 5% and 10% movement of the currency rate against Georgian Lari, with all other variables held constant, on the statement of profit or loss and other comprehensive income. A negative amount in the table reflects a potential net reduction in the statement of profit or loss and other comprehensive income, while a positive amount reflects a net potential increase.

As at 31 December 2021	**USD**	**EUR**	**SDR**	**AUD**	**CAD**	**Other**	**Total**
Foreign currency assets	8,346,127	2,309,178	1,506,927	8	486,068	586,254	**13,234,562**
Foreign currency liabilities	(4,554,046)	(1,581,096)	(2,945,597)	-	-	(1,490)	**(9,082,229)**
Net position	**3,792,081**	**728,082**	**(1,438,670)**	**8**	**486,068**	**584,764**	**4,152,333**

As at 31 December 2020	**USD**	**EUR**	**SDR**	**AUD**	**CAD**	**Other**	**Total**
Foreign currency assets	8,633,286	2,218,135	698,205	760,984	309,577	194,680	**12,814,867**
Foreign currency liabilities	(4,822,737)	(1,542,680)	(1,898,473)	-	-	(13,318)	**(8,277,208)**
Net position	**3,810,549**	**675,455**	**(1,200,268)**	**760,984**	**309,577**	**181,362**	**4,537,659**

	Effect on total comprehensive income and equity						
	31-Dec-21						
	USD	**EUR**	**SDR**	**AUD**	**CAD**	**Other**	**Total**
Increase in currency rate of 1%	37,921	7,281	(14,387)	-	4,861	5,848	**41,524**
Increase in currency rate of 5%	189,604	36,404	(71,933)	-	24,303	29,238	**207,616**
Increase in currency rate of 10%	379,208	72,808	(143,867)	1	48,607	58,476	**415,233**
Decrease in currency rate of 1%	(37,921)	(7,281)	14,387	-	(4,861)	(5,847)	**(41,523)**
Decrease in currency rate of 5%	(189,604)	(36,404)	71,933	-	(24,303)	(29,239)	**(207,617)**
Decrease in currency rate of 10%	(379,208)	(72,808)	143,867	(1)	(48,607)	(58,476)	**(415,233)**

(in thousands of Georgian Lari)

	Effect on total comprehensive income and equity						
	31-Dec-20						
	USD	EUR	SDR	AUD	CAD	Other	Total
Increase in currency rate of 1%	38,105	6,755	(12,003)	7,610	3,096	1,814	**45,377**
Increase in currency rate of 5%	190,527	33,773	(60,013)	38,049	15,479	9,068	**226,883**
Increase in currency rate of 10%	381,055	67,546	(120,027)	76,098	30,958	18,136	**453,766**
Decrease in currency rate of 1%	(38,105)	(6,755)	12,003	(7,610)	(3,096)	(1,814)	**(45,377)**
Decrease in currency rate of 5%	(190,527)	(33,773)	60,013	(38,049)	(15,479)	(9,068)	**(226,883)**
Decrease in currency rate of 10%	(381,055)	(67,546)	120,027	(76,098)	(30,958)	(18,136)	**(453,766)**

Other Risks

Settlement risk

Settlement risk (i.e., the risk that the counterparty may not be able to complete a transaction) is mitigated in a number of ways. The Bank will only transfer funds after sufficient collateral has been secured. For outright transactions in securities, settlement risk is eliminated through the use of systems that are based on delivery versus payment, that is, the simultaneous exchange of securities and cash. Additionally, the settlement of the cash component is performed through the payment system referred to as Real Time Gross Settlement, which is owned and managed by the Bank, which determines the position of each participant in real time on an individual payment-to-payment basis. This automatically avoids overdrafts and as it simultaneously uses accounts in the Bank as settlement asset, it mitigates credit risk.

Non-financial risks

Non-financial risks to which the Bank is exposed are: reputational and operational risks. Operational risks are originated from inadequate or failed internal processes, people and systems or external events. The Bank is exposed to the following sub-categories of operational risks: legal, information technology, human resources, security (physical and information), project, third-party, business continuity, fraud and compliance risks. Realizing the non-financial risks may generate financial loss, damage to reputation or failure in achieving the Bank's business objectives. Hence, the Bank developed Centralized Risk Management (CRM) system in order to minimize the impact of non-financial risks and ensure solid internal control system.

CRM framework is comprised of non-financial risks management, incident management and business continuity systems and is supported by internal control system of procedures. Non-financial risk assessment is based on qualitative method (5-scale) method and includes all bank-wide processes, where risks could jeopardize the achievement of the objectives. Incident Management system captures and analyzes incidents in order to avoid the repetitive occurrence of incidents. To expand and improve operational risk assessment, the Bank selected and accepted quantification method - Standardised Measurement Approach (SMA). In order to finalize the implementation, the Bank will continue working on financial loss data, consequent processes and procedure development. Business continuity management system continuously improves the resilience of the Bank's critical processes and provides adequate procedures, regular testing and expansion of scenarios. Throughout 2021, due to the pandemic the Bank continued its activities, including critical services, through remote work. Additional technical resources, processes and procedures were introduced, staff trainings were provided to support the continuity of the Bank services and functions.

The Bank defined the aggregate level (Risk Appetite) of non-financial risks the Bank is willing to assume within its risk capacity to achieve its strategic objectives and goals. Overall, the Bank has conservative approach to operational and reputational risks and operates within low-risk appetite and tolerance levels. Hence, the Bank makes resources available and sets effective governance processes to control and maintain non-financial risks at low risk level. Risk appetite statement is reviewed and approved annually by the Council of the Bank.

29. EVENTS AFTER THE REPORTING PERIOD

Up to the date these financial statements were authorized for issue, no significant subsequent events have occurred that require adjustment of, or disclosure in, these financial statements.

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