ANNUAL REPORT 2016

PASHA Bank
New heights. Together.

MOUNT EVEREST
8,848 metres (29,029 ft)

CONTENT

OVERVIEW

K2
8,611 metres (28,251 ft)

FINANCIAL HIGHLIGHTS
(GEL '000)

Net Profit

GEL 4,881

Total Comprehensive Profit

GEL 5,103

Gross Loans:

GEL 97,210

Cost to Income:

64%

Total Assets:

GEL 282,485

ROAE:

5%
(Based on total comprehensive income)

*NPL to Gross Loans: **

0%

All figures are presented as of 31 December 2016, if not indicated otherwise, and are based on the audited financial statements for the year ending 31 December 2016. The official GEL/USD exchange rate on 31 December 2016 was 2.65.

**Assessed as per the Bank's internal grading methodology (principal amount of 100% cash covered NPLs is not considered as NPL).*

KANGCHENJUNGA
8,586 metres (28,169 ft)

FOREWORD BY THE CHAIRMAN OF THE SUPERVISORY BOARD OF PASHA BANK GEORGIA

Last year was an unqualified success for PASHA Bank in all three countries of operation. Despite the challenging banking environment, we managed to produce record earnings in each of our target markets.

In 2016, region-wide market turbulence continued with the Azerbaijani banking sector in particular coming under the dual pressure of worsening asset quality and depreciating AZN. The Banking Regulator had to step in and facilitate bail out of a number of banks. Overall, the number of banks in Azerbaijan declined from 43 to 32 over the course of the year. While a clearly negative development in and of itself, PASHA Bank Azerbaijan, due to its strong financial position and market leading franchise, benefited to some extent from the turmoil. Clients of the weaker financial institutions, faced with wholesale rearrangement of the banking landscape, took flight to quality, with PASHA Bank Azerbaijan being the main beneficiary in the process. We succeeded in attracting a large number of high-quality corporate clients from competing banks to the extent that a sizable portion of the interest income generated in 2016 came from the clients acquired from other banks during the year. With net income of over USD 38 mln and ROAE of 32%, 2016 was one of the most successful years on record to date.

With the oil price recovering and the government embarking upon a number of large scale initiatives aimed at diversifying the economy away from a reliance on oil and gas revenues, the economy and the banking system seem to have stabilized. Encouraging signs notwithstanding, 2017 is still likely to bring some economic contraction, with growth expected to resume in 2018. We hope to be able to build on successful client acquisition efforts of last year and further diversify the borrower base in the current period.

Operating environment in Turkey was also quite challenging, with the Turkish Lira continuing on the downward trend vs. USD. Unlike Azerbaijan, increase of energy prices usually has a negative effect on economic growth in Turkey, with the country being a major energy importer. These difficulties notwithstanding, 2016 was the most successful year ever for PASHA Bank Turkey, which generated net income of USD 4.6 mln and ROAE of 6.8% respectively.

We expect the past successes to translate into a profitable current year on the back of a wide range of initiatives aimed at institution-building and further development of market coverage capability and expertise at PASHA Bank Turkey.

Like Azerbaijan and Turkey, Georgia was also not immune to the external shocks which have put its currency under severe pressure in the last couple of years. The prudent macro-economic response of the National Bank of Georgia focused on inflation targeting. The NBG refrained from interventions in the currency market, letting the currency depreciate vs. USD to its new point of equilibrium. This approach on the one hand allowed the NBG to maintain foreign currency reserves largely intact, while the sharp currency depreciation absorbed the worst of the external shock and enabled the economy to generate albeit low single-digit but growth nonetheless. Given this backdrop, there was limited demand for corporate lending in Georgia, with the banking sector's growth largely driven by retail banking. Considering the fact that the penetration of the corporate banking measured by loan to GDP ratio is twice that of retail banking, the latter is expected to lead the growth in the foreseeable future with corporate banking expanding in line with GDP growth.

The difficult operating environment negatively affected PASHA Bank Georgia's ability to grow its loan portfolio. Apart from this metric, all financial and operational milestones for 2016 were reached. PASHA Bank Georgia produced a record net profit of USD 1.8 mln and ROAE figures of 5%, respectively.

2017 is the last year of the current strategic period for PASHA Bank Georgia. This year we have to identify the development priorities that we will adhere to in the next (2018-2020) strategic period. The planning process assisted by strategic consultants, is well under way. The first half of the year will be used to finalize the business model for the next period. In the second half, we will identify a market entry strategy for several segments, such as SME banking, that we are currently actively evaluating and hope to designate as segments of interest for PASHA Bank Georgia in the next strategic period. This is an exciting

and highly educating exercise involving the Bank's management as well as the senior staff of PASHA Holding. We hope to arrive at a business model that will afford us an opportunity to compete successfully on a well-developed banking market like Georgia's. While this process takes place, the Bank will maintain its focus on serving its corporate customers - striving to reach New Heights Together. We hope 2017 will be every bit as successful as last year turned out to be.

Mir Jamal Pashayev
Chairman of the Supervisory Board of PASHA Bank Georgia
1 May, 2017

FOREWORD BY THE CHAIRMAN OF PASHA BANK GEORGIA BOARD OF DIRECTORS, CEO

PASHA Bank Georgia ended the year with the highest net profit figure achieved since opening for business in Georgia four years ago. For a second year running we were able to generate positive return for shareholders, firmly establishing the Bank as a specialized corporate segment player.

Our success notwithstanding, 2016 was a difficult year for the Georgian banking sector as a whole. External shocks that led to drastic GEL devaluation in 2015 persisted throughout 2016. The economy grew at a modest 2.7% per annum which translated into sluggish demand for corporate banking products and services. The corporate banking portfolio of the banking sector remained flat. The growth driver was retail banking and, to a lesser extent, SME and micro segments.

Lackluster demand for corporate banking services put a downward pressure on the interest rates with certain competitors' deals priced even below the sovereign cost of borrowing. Continuing exchange rate volatility kept the demand for loans almost exclusively in the realm of GEL-denominated lending. Unlike in previous years, when GEL loans usually priced in double digits were in less demand as opposed to foreign currency loans priced in single digits, customers woke up to the potentially disastrous effects of foreign currency borrowing. Many customers, especially larger corporates, converted all or substantial parts of their foreign currency-denominated interest bearing liabilities into GEL, pricing differential between and GEL and USD-denominated lending notwithstanding. The situation was aggravated by the lack of GEL-funding that has been felt throughout the banking sector for the last couple of years. This is a trend likely to persist for the foreseeable future as the sources of GEL funding remain few and far between. The Larization Program, in force since January 2017, has further increased the demand for GEL.

In the face of these difficulties PASHA Bank Georgia chose to place an emphasis on the maintenance of the portfolio quality, even if this had to come at the expense of loan portfolio growth. PASHA Bank Georgia managed to generate the highest ever net profit of GEL 4.8 mln in its history of operating in Georgia. Our return on average equity of 5% is also the highest ever. In a no-growth environment, we were able to exceed budgeted profitability metrics through proactive yield management within the confines of our current portfolio, as well as placing strong focus on GEL lending which, due to the scarcity of the latter, generated better returns than foreign currency lending for the reporting period. Subdued economic growth also adversely affected the loan syndication market. There were relatively few mega projects launched in 2016 that would have required a creation of a lending syndicate. Constrained portfolio growth prevented us from diluting high portfolio concentrations on certain individual clients and industries. This is a negative development we countered by intensifying post-disbursement monitoring efforts with an eye towards spotting and reacting to the warning signs at the first hint of the trouble. Such a proactive approach to portfolio management enabled us to finish the year with the market leading NPL rate of 0 assessed as per Bank's internal grading methodology.

Over the course of last year the Bank took a further step forward in terms of institutional development. Main improvements were done in adopting best practices in corporate governance. Activities of main governing bodies of the Bank expanded further. A regular compliance, risk management and internal controls reporting was instituted and takes place at regular intervals giving the Bank's management real-time updates on respective matters. Last year we placed an extra emphasis on the project concerned with formulation and update of normative documentary base by formalizing and describing main business processes of the Bank. Another major development of last year is the upgrade of our regulatory reporting systems which have moved from a manual to automated basis, reducing the human error risk (operational risk) in the process. Also group-wide revenue and cost synergy projects took off in earnest resulting in significant and systematic capturing of the synergistic potential across the group on revenue as well as the cost sides.

Our close cooperation with PASHA Bank Azerbaijan expanded as well. We extensively utilized a risk transfer approach, whereby PASHA Bank Georgia provides funding for existing clients of PASHA Bank Azerbaijan active in Georgia, secured by letters of guarantee issued by PASHA Bank Azerbaijan. This is something we hope to intensify further as the regional businesses turn to Georgia in search of growth and yield.

On the liability side, we have benefited to some extent from the mentioned higher interest rate environment as this has enabled us to attract foreign currency denominated deposits from the Azerbaijani corporates.

The difficult operating environment of 2016 once again brought into the spotlight the relative strengths and weaknesses of our current business model. A number of initiatives aimed at transforming the business model to encompass business segments other than corporate were launched. This work will be bought to completion over the course of 2017. The goal is to identify the optimal business model for the 2018-2020 strategic period and, should the decision be made to change the business model, prepare for the rollout before the current year is out.

Shahin Mammadov
Chairman of PASHA Bank Georgia Board of Directors, CEO
1 May, 2017

PASHA BANK GEORGIA AT A GLANCE

PASHA Bank is a Baku-based financial institution operating in Azerbaijan, Georgia and Turkey, providing corporate and investment banking services to large and medium-sized enterprises.

We have been operating in Georgia since 2013. As of 31 December 2016, the Bank's total assets exceeded GEL 282 million (c.a. USD 107 million).

Being a regional bank, we leverage our experience in various markets to offer our clients tailor-made products and services incorporating the best global practices.

We have developed certain competitive advantages in particular product lines, such as debt capital market operations, where we draw on our significant experience in this area gained over the years in the capital markets in Azerbaijan. We place special emphasis on the development of trade finance business as our presence in the region's three major economies puts us in a position to create a unique value proposition for our client-base.

We strive to build a franchise renowned for relationship banking, providing our clients with top-level services and advice.

Shareholder Structure

JSC PASHA Bank Georgia is a wholly owned subsidiary of OJSC PASHA Bank.

Mission

We treat our clients and partners with hospitality and double attention, focusing on mutual prosperity. We put our clients' interests at the cornerstone of our corporate strategy, and look to achieve New Heights Together and to contribute to the sustainable growth of each and every client.

Vision

We strive to contribute to the growth and development of the Georgian and regional economy through the funding of value accretive projects while at the same time providing top-quality service both locally and regionally. We are committed to our long standing philosophy of doing business in an ethical, reliable and sustainable manner.

For more information please visit: pashabank.ge

PASHA HOLDING

PASHA Bank is ultimately owned by PASHA Holding - a diversified investment group with interests in banking, insurance, property development, construction, tourism and other sectors. As of December 31st, 2016, the total assets of PASHA Holding stood at approximately USD 4 billion, while its capital reached approximately USD 0.8 billion (based on audited IFRS financial statements and the exchange rate is USD/AZN 1.7707). The group operates in three countries, Georgia being its first geographic expansion, which was followed by Turkey. The total number of employees within the Group exceeds 5,000.

PASHA Holding Companies

PASHA Insurance is the very first member of PASHA Holding, incorporated in early 2006. The Company is the largest insurance services provider in Azerbaijan with a gross written premium (GWP) of USD 61 million, as of December 31st, 2016 (based on audited IFRS financial statements and the average exchange rate applied is USD/AZN1.5973).

The life insurance business line was added to PASHA Insurance's existing offerings in 2010, incorporated as a separate legal entity - PASHA Life.

PASHA Construction is one of the largest businesses of its kind in Azerbaijan. As of the end of 2016 its completed project portfolio exceeds 1,180,000m2 worth of projects, with further 830,000 m2 currently under construction. These developments include retail, residential, office space, hotels and large mixed-use properties. The list of the successfully completed projects includes, but is not limited to - Absheron JW Marriott Hotel and Residences, Four Seasons Hotel, Port Baku Towers, Shuvelan Shopping Center, Nizami Residence, Baku Business Center and Chinar restaurant.

PASHA Travel provides a wide range of travel and hospitality services to corporate and retail customers.

Kapital Bank, being a universal bank, provides a wide range of banking services both to corporate and individual clients, with a distinct focus on the retail business. Kapital Bank boasts the most extensive branch network in Azerbaijan. The Bank is rated 'BB-' by Standard & Poor's Ratings (as of July 2016) and Ba3 by Moody's Investors (as of January 2017).

PASHA Bank was incorporated in 2007. The Bank focuses on delivering the best in-class banking services to the rapidly growing corporate sector of Azerbaijan. Standard & Poor's assigned PASHA Bank a long-term rating of 'BB-' (of December 2016). Likewise, Fitch Ratings assigned PASHA Bank a long-term rating of 'BB-' (as of March 2016).

PASHA Bank is operating in three main economic markets of the region: Azerbaijan, Georgia and Turkey.

For more information please visit: pashaholding.az

PASHA BANK AZERBAIJAN

PASHA Bank is the leading corporate bank in Azerbaijan. Established in 2007, it offers all major financial services, including investment banking, trade financing and asset management, to a range of clients, from large corporates to small and medium enterprises. The Bank works particularly closely with companies operating in the non-oil sectors of the economy, including agriculture, transportation, construction and retail, which are vital for helping Azerbaijan to diversify its economy.

PASHA Bank became the largest private bank in Azerbaijan by total equity in 2013 and has been maintaining this position since then. It has been one of the top five private banks by assets since 2010 to the time of this writing.

PASHA Bank is headquartered in Baku and has a total of 7 business centers across Azerbaijan. PASHA Bank opened for business in Georgia in 2013, followed by Turkey in 2015. The long-term regional vision envisages creating interconnected banking operations that will facilitate rapidly growing trade and deal flow between Baku, Tbilisi and Istanbul, the three most vibrant markets of the region.

In addition to international industry recognition, PASHA Bank has received strong ratings from international ratings agencies (see p.12).

Financial Highlights as of 31 December 2016

Net Profit: USD 38,205
Gross Loans: USD 509,388
Total Assets: USD 1,640,286
ROAE: 32%
Cost to Income: 27%
NPL to Gross Loans: 13%

The average exchange rate applied to profit and loss items is USD/AZN 1.5973 and for balance sheet items is USD/AZN 1.7707

Source: Unconsolidated audited IFRS Financial Statements, all figures in thousands.

For more information please visit: pashabank.az

PASHA BANK TURKEY

PASHA Yatırım Bankası A.Ş. is the first foreign Bank of Turkey, founded in Istanbul on 25 December 1987 and which started its banking operations on 1 March 1988. In December 2014, the acquisition of 79.92% of the bank's shares by PASHA Bank OJSC was approved, thus PASHA Group started to control the Bank. During 2015 PASHA Bank OJSC increased its shareholding in PASHA Yatırım Bankası A.Ş. taking its stake to 99.9%.

PASHA Bank Turkey serves entrepreneurs in the corporate and commercial segments with investment banking products in an effort to contribute to the development of trade between Turkey, Azerbaijan, and Georgia, and to provide resources and guidance to businesses investing in the region. Along with corporate banking products, PASHA Bank Turkey provides its customers with services to create alternative financing to conventional credits within the framework of investment banking activities.

To that end, it has activities in various fields of investment banking such as IPO consultancy, financial/strategic partnership, divestiture, restructuring, preparing structured product packages and organizing the sale of these products to investors.

PASHA Bank Turkey is a member of Borsa İstanbul A.Ş. and is authorized to operate in bond and repo markets. It is authorized by the Capital Markets Board for the following activities: The Activity of Execution of Orders; The Activity of Dealing on Own Account; The Activity of Intermediation for Public Offering; Limited Custody Service; and Ancillary Services.

Financial Highlights as of 31 December 2016

Net Profit: USD 4,635
Total comprehensive income: USD 4,663
Gross loans: USD 114,762
Total Assets: USD 144,680
ROAE: 6.8%
Cost to Income: 45.0%
NPL to Gross Loans: 0%

The exchange rate as of 31 December 2016 is USD/TL 3.5192

Source: Audited IFRS Financial Statements, all figures in thousands.

For more information please visit: pashabank.com.tr

GEORGIAN BANKING SECTOR - YEAR IN RETROSPECT

Based on the GeoStat data, the real GDP growth in 2016 equaled 2.7%. Georgian exports decreased 4.1% and imports increased 27.7% compared to 2015. The economic stance of Georgia remains weak with further deteriorating trade balance; however fiscal performance has been in surplus and quite strong.

In the 1st half of 2016, the inflation pressures eased, even reversed, and inflation rate equaled 1.8% in December 2016. The NBG brought the refinancing rate down from 8% to 6.5% over the course of 2016 and then, on the backdrop of raising inflationary expectations for 2017, revised it upward again to 6.75% in January 2017.

At the end of 2016, the Government of Georgia announced a set of measures aimed at strengthening the national currency and improving trade balance. These measures included introduction of excises on imported goods such as automobiles, petroleum products and cigarettes, ban on financial institutions issuing loans up to GEL 100,000 in foreign currency, and a subsidy program to help the population convert their USD denominated loans into GEL at preferential foreign exchange rates. These measures came into effect in early 2017 and their real effect remains to be assessed, although the first quarter of 2017 has already seen a strengthening national currency. There has also been a major shift in the tax regime, with the application from beginning 2017 of a so called "Estonian model", introducing a 0% profit tax for Georgian businesses when profits are reinvested. The model will be applicable to financial institutions, including banks and insurance companies, starting 1 January 2019. The major objective of the new tax regime is to stimulate growth of business.

In general, the banking system of the country has proven its resilience with positive credit & deposit growth and NPLs at a manageable level of 7.3% as of 31 December, 2016, although the corporate loans segment has over 14% NPLs.

In 2016, the deposit base of the banking system grew in real terms (11%) to GEL 16.9 billion, new deposits of holders in foreign currency being the main driver behind the growth.

The loan portfolio of the banking system has continued to expand - 18% real growth in loans to households was the main driver behind that growth. The corporate loans segment grew 6.8% in 2016. Total loan portfolios of banks reached GEL 18.9 billion as of 31 December, 2016.

The market average ROA is 2.76% and ROAE 19.21%.

The sources are NBG, GEOSTAT and PASHA Bank estimates.

MAKALU
8,485 metres (27,838 ft)

FINANCIAL SUMMARY

Based on IFRS financials for the year ended 31 December 2016, PASHA Bank has closed the year with GEL 282,485 thousand (USD 106,598 thousand) of total assets (practically no change compared to end of prior year), GEL 179,201 thousand (USD 67,623 thousand) of total liabilities (around 2.7% less than end of prior year) and GEL103,284 thousand (USD 38,975 thousand) of total equity. Total comprehensive income over the year was GEL 5,103 thousand (2015: GEL 1,696 thousand).

The dynamics in assets is characterized by:

- No growth in the loan portfolio. GEL 95,090 net loans as of 31 December 2016 (GEL 108,602 on 31 December 2015). This is mainly due to a general slowdown in the economy, aftermath of the foreign exchange shocks and pre-election uncertainties in the first half of the year, causing businesses to moderate their appetite for borrowing;

- Significant increase in interbank deposits and cash equivalents. GEL 90,860 thousand as of 31 December 2016 (GEL 43,434 thousand on 31 December 2015). This was conditioned by inactivity on the lending part, so practically all available funds have been channeled to interbank market to ensure earning the margin.

- Decrease in investments in securities. GEL 91,880 thousand as of 31 December 2016 (GEL 123,320 thousand on 31 December 2015). This was purely the result of the gradual maturing of placements in state discount and coupon bonds held under the refinancing scheme. Some additional investments were undertaken in corporate securities on the local market, such as certificates of deposits and corporate coupon securities of reputable issuers.

The dynamics in liabilities is characterized by:

- Outstanding balance due to banks decreased compared to prior year end, mainly due to fewer borrowings of GEL from NBG through the refinancing scheme. Total due to banks stood at GEL 131,681 thousand as of 31 December 2016 (GEL 161,929 thousand on 31 December 2015). The Parent Bank is still the major source of USD funds and amounts due to Parent outstanding on 31 December 2016 constituted over 37% of total due to credit institutions (44% on 31 December 2015).

- An increase in customers' accounts balance to GEL 46,024 thousand as of 31 December 2016 (GEL 21,288 thousand on 31 December 2015). The major factor here was the inflow of USD depositors from Azerbaijan, both legal entities and individuals.

The composition of PASHA Bank's assets is as follows:

	31 December 2016	31 December 2015
Investment securities	33%	44%
Loans to customers	34%	38%
Amounts due from credit institutions	29%	7%
Cash and cash equivalents	3%	8%

Table 1

The quality of assets held on PASHA Bank's balance sheet remains strong, with 0% NPL (assessed as per Bank's internal grading methodology) and 2.2% (1.3% if provision against the accrued interest of one fully cash covered loan is disregarded) LLA rate on portfolio of loans as of 31 December 2016 (31 December 2015: 0% and 1.2% respectively). Investments in securities are comprised of state securities and bonds of Azerbaijani and Georgian corporations and banks classified as loans and receivables. No indicators of impairment existed as of 31 December 2016. All interbank placements are made only with reputable local banks strictly within prescribed limits.

Based on PASHA Bank's 2016 annual IFRS financial statements, the total comprehensive profit for the year amounted to GEL 5,103 thousand (USD 1,926 thousand), translating into ROAE of 5% (2015: 2%).

Overall performance in terms of P&L has been good. Total interest income of GEL 23,320 thousand (USD 8,800 thousand) was 22% more than in 2015 and net interest income before provisions equaled GEL 16,587 thousand (USD 6,259 thousand), a 26% growth compared to the prior year.

PASHA Bank's operating income in 2016 reached GEL 18,165 thousand (USD 6,855) against 14,154 thousand (USD 5,922 thousand) in 2015, a 28% increase.

PASHA Bank's personnel and administrative expenses during 2016 amounted to GEL 5,183 thousand (USD 1,955 thousand) and GEL 4,309 thousand (USD 1,626 thousand) respectively, which represented a 15% and 16% increase from the prior year. The cost to income ratio constituted 64% in 2016 (2015: 71%).

The trade finance portfolio (guarantees and letters of credit) of PASHA Bank stood at GEL 13,344 thousand (USD 5,035) as of 31 December 2016, marking an over 40% decrease compared to the previous year end. This was the result of the early termination of a guarantee by one of the clients with outsized concentration in the trade finance portfolio. The current strategy followed by PASHA Bank management in this regard is to continue active promotion of trade finance products to stimulate regional trade.

FX gains, GEL 947 thousand, increased nearly 60% in 2016 compared to the prior year, underlining PASHA Bank's good potential on the FX market provided that the customer base demonstrates a further increasing trend.

The Bank's capital adequacy ratios are well above the minimum NBG requirements with 42% and 46% of the risk weighted assets for total capital and tier 1 capital respectively (31 December 2015: 44% and 41% respectively).

**all figures were presented as of 31 December 2016 if not indicated otherwise and are based on the audited IFRS financial statements for year ending 31 December 2016. The official GEL/USD exchange rate on 31 December 2016 equaled 2.65 (31 December 2015: 2.39).*

CORPORATE BUSINESS MODEL

PASHA Bank is a pure-play corporate bank specialized in providing corporate banking services to large and medium sized enterprises. This puts us in a somewhat unique position as far as the Georgian banking sector is concerned as we are the only independent specialist corporate bank currently operating in Georgia.

This business model by its very nature stipulates that the credit risk exposure of the Bank, at any given time, is spread over a relatively small number of counterparties. Significant risk concentrations can be observed as far as individual borrowers or a group of related borrowers are concerned, in addition to material exposures to particular sectors of the economy. High risk concentration calls for the introduction of counterparty default risk assessment and transaction structuring standards that by necessity are more stringent than could conceivably be the case with banks that operate a universal or retail banking business model.

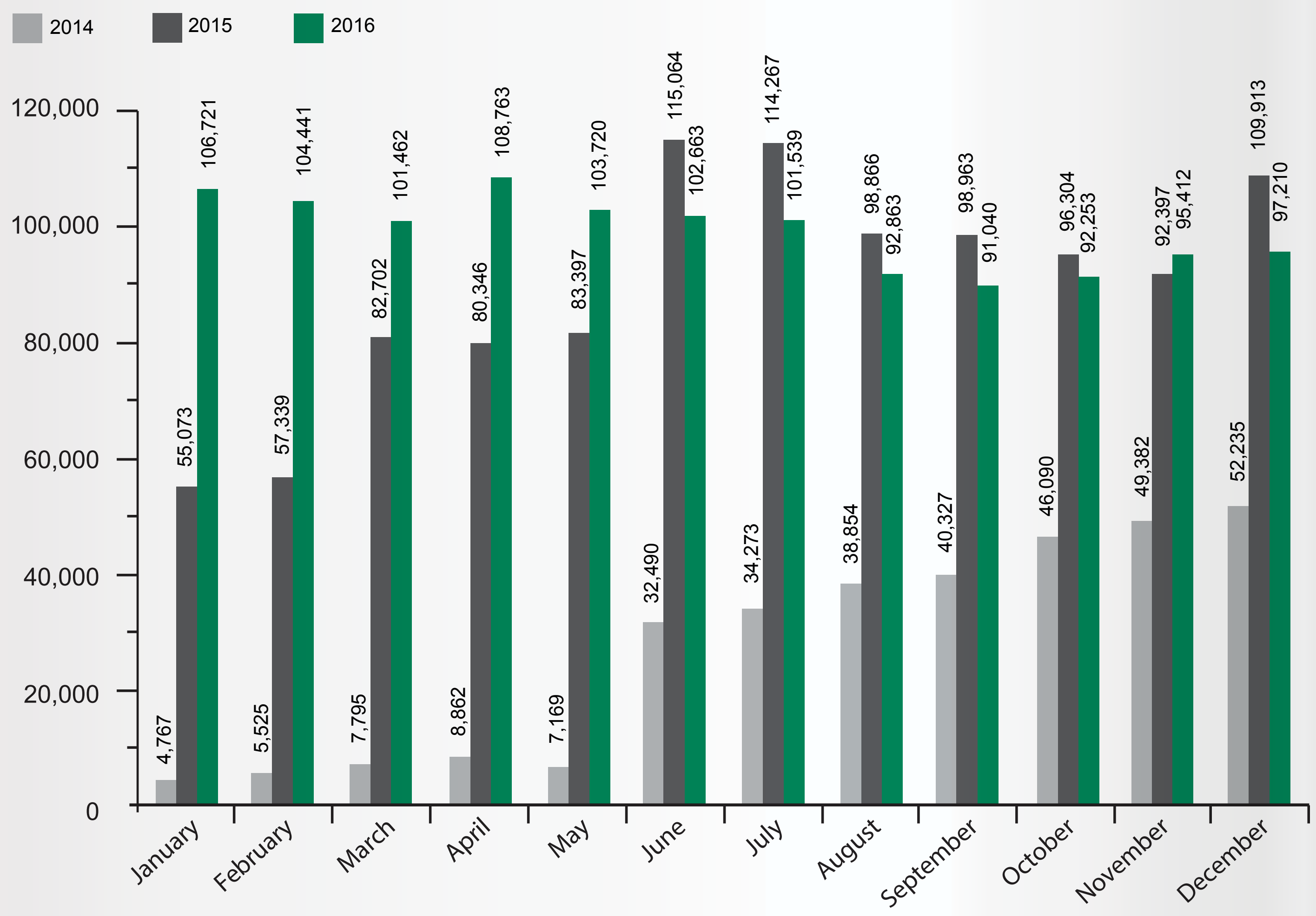
Apart from investing a significant amount of time and effort in counterparty assessment and structuring, the Bank mitigates the risks stemming from its business model by holding high levels of capital. While extremely high levels of capitalization do impact our profitability in a negative manner, we feel that holding meaningful buffers of capital to absorb possible losses represents a virtual necessity at this stage of our corporate existence. This structural issue is currently further exacerbated by the fact that we are a newly formed organization with a portfolio growing from a rather small base.

Since early of 2016, the Bank began a process of strategic planning for the 2018-2020 strategic period. Throughout the process we keep an open mind with respect to the business model that we will rely on in the next strategic period. All the possible options are on the table, ranging from transforming into a universal bank to adding a few additional business lines i.e. SME.

Monthly Gross Loan Portfolio in 2014, 2015 and 2016

Source: IFRS. (GEL '000)

Chart 1



On the liabilities side, we are heavily reliant on wholesale funding, as the pricing differential between corporate and retail loans precludes us from raising significant volumes of customer deposits. Universal banks are capable of paying depositors comparatively high interest rates, investing the relatively expensive funds raised this way into high margin retail products. Our business model effectively prevents us from pursuing the same strategy. To avoid excessive reliance on interbank markets, we source the lion's share of our foreign currency funding from the Parent while utilizing our capital and borrowings from the NBG to fund the GEL-denominated portion of the loan portfolio.

Operating environment and results

The operating environment in 2016 was a difficult one for the banking sector as a whole. The drastic devaluation of GEL against USD presented the sector with a set of formidable challenges. With c.a. 65% of the sector's loan portfolio being US Dollar-denominated and imports exceeding exports by several degrees of magnitude, a lot of borrowers saw their cost of servicing their dollar debts skyrocket. Non-performing loan levels increased sector-wide and banks' P&Ls were impacted by a two-fold effect of nominal increase in loan loss provisions aggravated by the increase in the GEL value of US Dollar-denominated provisions.

GEL devaluation fundamentally changed the way corporate borrowers approach foreign currency risk management. Prior to the dramatic GEL devaluation seen in last 24 months, similar instruments denominated in GEL and USD were usually priced in a way that GEL borrowing was by 200-300 basis points more expensive than USD funds. Due to the price differential, corporate borrowing mostly took place in Dollars- corporates preferring lower priced Dollar loans encouraged by the historical stability, in relative terms, of the GEL-USD exchange rate. Following the devaluation, the corporates bore the brunt of the detrimental effects the mismatch of GEL-denominated revenues and USD-denominated debt payments had on their financial position given the FX fluctuations of the magnitude seen recently. Reassessment of the dangers inherent to currency mismatch led the corporates to demand conversion of USD liabilities into GEL-denominated instruments. Notwithstanding the fact that the newly found demand for GEL and the lack of the latter led to the widening of GEL and USD pricing to 700 to 800 basis points. Despite GEL becoming very expensive, the trend of converting USD liabilities into GEL-denominated loans continues and puts serious pressure on the banking system to secure abundant and ideally long-term GEL resource. While NBG introduced a new instrument, by substance an FX swap, to provide the banks with extra GEL liquidity in exchange for USD-denominated collateral, long GEL remained very difficult to come by. Shortages of GEL led to an overall decrease in corporate lending and further exacerbated the anemic economic growth. This overall trend is expected to persist in 2017, placing the continuous growth of corporate lending at the mercy of the availability of GEL resources. As mentioned, despite highly attractive interest rates, the demand for USD lending remains weak, with little prospect for it to pick up in the short run.

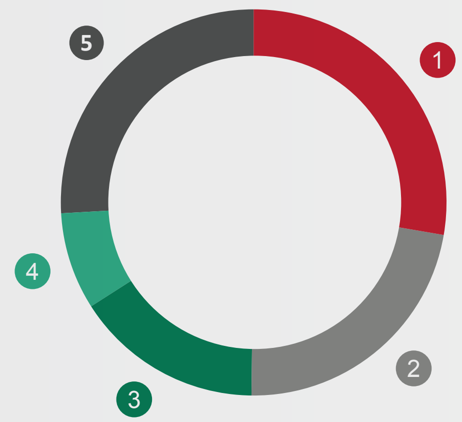
Given this backdrop and our business model, which effectively precludes us from raising GEL denominated deposits, our main source of reasonably priced GEL resources is the open market operations of NBG. The second option, borrowing GEL on the interbank market, is unreliable and expensive considering the fact that the shortage of GEL is a universal phenomenon affecting the entire banking system. As far as Dollar funding is concerned, we made great strides in diversifying our funding sources through raising a significant amount of Dollar deposits from Azerbaijani legal entities. As a result, we have somewhat decreased our reliance on Parent funding, a positive trend that we expect to continue in the immediate future. The breakdown of our funding sources is demonstrated in the table.

On the asset side of the balance sheet, the concentration of exposures remains a concern. Having said that, high concentrations are a natural occurrence for any corporate bank growing its portfolio from a very small base. We expect individual exposures to decline as a percentage of the portfolio total as we grow and new clients and industries are added to our loan portfolio. Until we reach that point though, high concentrations are remedied by an extremely strict underwriting process which places an emphasis on the cash flow generating ability of the borrowers rather than the collateral coverage of the issued debt instruments.

Funding sources as of 31 December 2016

Source: IFRS

Chart 2

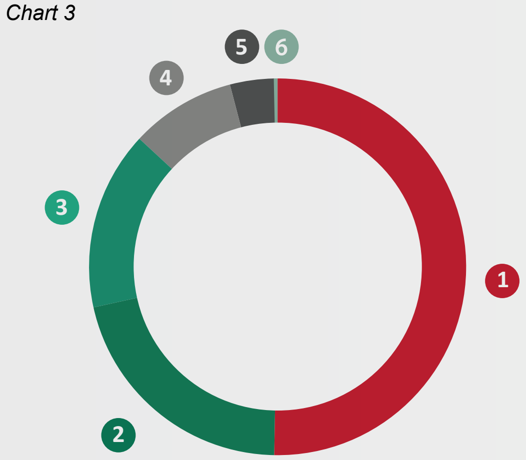


1	Parent	28%
2	Subsidiaries of PASHA Holding	22%
3	NBG	16%
4	Other Banks	8%
5	Customers	26%

Loan portfolio by industries as of 31 December 2016

Source: IFRS

Chart 3

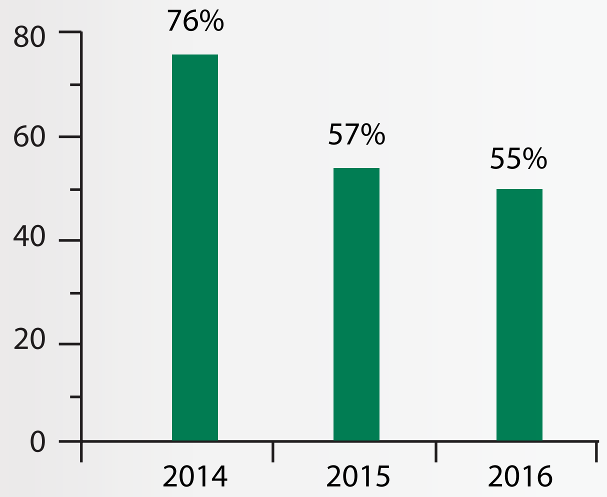


1	Trade and Services	50%
2	Non-banking FIs	21%
3	Energy	16%
4	Construction	9%
5	Mining	3.7%
6	Individuals	0.3%

INVESTMENT BANKING

As discussed above, the aggregate portion of exposure to the top three borrowing groups remains significant, although it exhibits a positive, declining trend.

Aggregate exposure to top three borrowing groups
Chart 4



The investment banking activities of PASHA Bank at the time of writing are mostly represented by debt capital market transactions and are carried out jointly by the Business Development and Treasury departments. On the back of two successful issues from the prior year, in 2016 we co-managed another large floating rate coupon bond issue in the amount of GEL 30 mln. The issuer was one of the largest Georgian utilities. The purpose of the issue on one hand was the client's desire to reduce its exposure to the foreign exchange risk through refinancing USD denominated liabilities with the proceeds of GEL bond issue. On the other hand, the issuer was testing the market's appetite for risk on a scale larger than was the case with previous DCM activities.

DCM represent a source of non-interest income for us, which helps to diversify our operating income streams. We intend to keep on developing this business line with several new issues planned for 2017. Georgian capital markets are still in their infancy, with virtually no equity capital market business to speak of. We intend to play our modest role in the development of the capital markets by helping the corporates to tap funding sources other than bank financing.

PASHA Bank Azerbaijan was one of the pioneers of DCM, as well as ECM, impacting in a major way the development of capital markets in its home country. We have unparalleled access to the institutional knowledge amassed by our Parent Bank over the years of spearheading the evolution of emerging Azerbaijani capital markets. PASHA Bank Azerbaijan's efforts in this area are widely recognized as the best in the country by a number of reputable international financial publications.

MARKETING STRATEGY AND POSITIONING

We are a pure-play corporate bank offering corporate banking services to large and medium-sized enterprises. We are also active in debt capital markets, having underwritten a number of bond issues in Georgia.

PASHA Bank is a reliable partner for other financial institutions, having already participated in a number of syndicated deals. This is the area of activity that we intend to keep a focus on going forward. The fact that we are a specialist corporate bank with no retail offering adds an additional layer of comfort for our syndicate partners, making it relatively easy to accommodate the interests of all syndicate participants. We are also nimble and fast when it comes to decision-making, which provides us with a competitive edge in the context of a syndicate.

Once our customers get to know us better, they come to realize that our brand driver is reciprocity. We are keen to provide secure growth for a reasonable price to each and every client. The Bank positions itself as a regional financial institution offering safe and fast service which caters to the needs of companies that are looking for a reliable long-term partner with a regional footprint. We listen to our clients with double attention and try to accommodate their diverse needs, placing their interests at the cornerstone of our business. Our actions reflect our corporate slogan as we continuously try to achieve *New Heights Together* with our partners.

OPERATIONS AND INFRASTRUCTURE

CHO OYU
8,188 metres (26,864 ft)

RISK AND CONTROLS

Risk-taking is inherent to most types of PASHA Bank activities. Considering the fact that we have been in operation in Georgia for a relatively short time, and our loan portfolio is growing from a very small base, any new exposure represents a much larger portion of the loan-portfolio than is the case with more established banks.

To address this relatively higher risk profile, we have a rigorous screening, assessment and monitoring process in place to minimize the chance of portfolio quality deterioration.

Risks are subject to identification, measurement, control and monitoring. All kinds of risks are ultimately managed by the Board of Directors in cooperation with the Audit Committee and Risk Management Committee. Monitoring and controlling the risks is aided by the exposure allocation limits established by the Bank. These limits reflect our business strategy, as well as the current risk appetite. The risk management process is critical for the continuing operations of the Bank, which is exposed to Credit, Market, Liquidity and Operational Risk in its daily activities.

In 2016, we created a normative base of the Bank to standardize processes, gain better risk control capability, and minimize various risks as well as their identification period.

Credit Risk

Credit risk is the risk that the Bank will incur a loss because its counterparties fail to meet their contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and industries, as well as by monitoring exposure levels and collateral portfolio. The Bank has adopted a group-wide underwriting process, which is now based on Moody's risk analysis principles and is used by all Strategic Assets of PASHA Holding. The approach calls for:

- Assigning the Internal Rating to corporates and financial institutions;

- Thorough analysis of the financial statements, key risk factors and key risk considerations of the potential borrower;

- Best practice approaches in financial forecasting and deal structuring;

- Involvement of reputable external consultants.

Provisioning

The Bank updated its loan loss provisioning standards. The methodology is applied group-wide, among all strategic assets of PASHA Holding.

Concentration

Group wide Industry Segmentation Methodology was adopted to have better understanding and control of industry exposures.

The graph below provides an illustration of the Bank's lending process currently in place:

Process flow chart for credit risk management

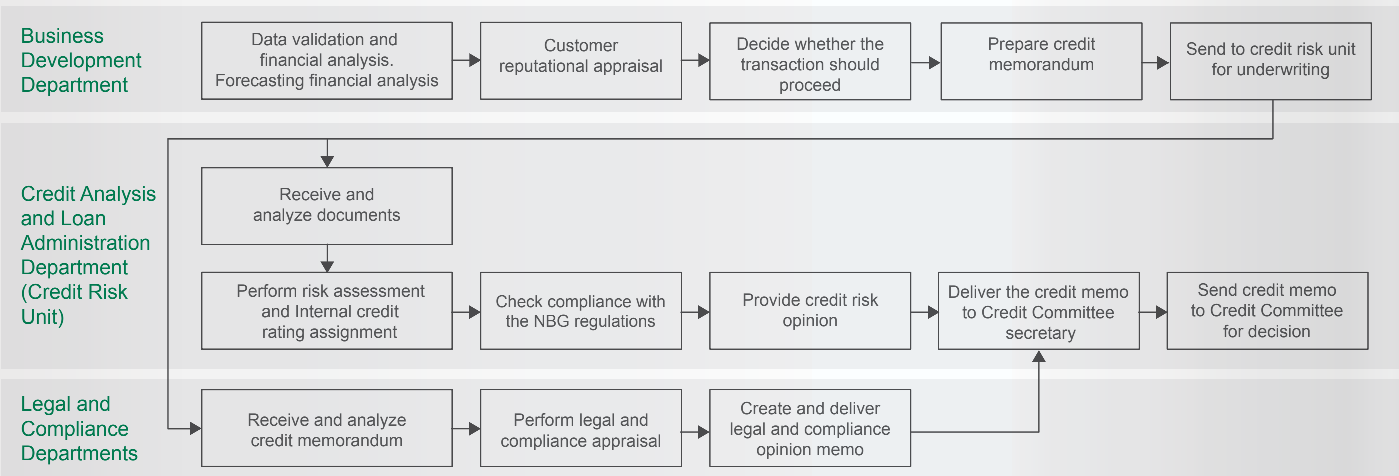


Table 2

As shown in the process flow chart for credit risk management, before the credit case is presented at a Credit Committee meeting, the borrower and its credit worthiness are assessed by three independent supporting and controlling departments besides the initiating Business Development Department.

Market and Liquidity Risk

Market Risk is the possibility for the Bank to experience losses due to factors that affect the overall performance of the financial markets. The Bank mainly focuses on the following components of market risk: currency risk, interest rate risk and liquidity risk.

Currency risk is a form of risk that arises from the change in price of one currency in relation to another. Interest rate risk arises from potential changes in market interest rates that can adversely affect the value of assets and liabilities.

Liquidity risk is the risk that the Bank does not have sufficient liquid assets available to meet all its obligations and commitments in the short term.

Market risk is managed by the Assets and Liabilities Committee (ALCO) together with the Risk Management, Treasury and Financial Management Departments. The Bank developed and approved Liquidity Risk Management Policy, Liquidity Management Procedure, and Foreign Currency Risk Management Policy to provide an institutional framework for the management of market risks.

Operational Risk

Operational risk may derive from inadequate internal processes or systems, external events, inadequate employee performance or from the breach of or non-compliance with statutory provisions, contracts and internal regulations. Operational risk includes legal risk but excludes reputational and strategic risks.

The Bank identifies and assesses the operational risk inherent in all its products, activities, processes and systems. We ensure that before new products, activities, processes and systems are introduced or undertaken, the operational risk inherent in them is subject to adequate assessment procedures. The Bank mitigates operational risks by defining, documenting and updating the relevant business processes. Furthermore, the Bank mitigates operational risk by following strict rules for the assignment of duties and responsibilities among and within the functions, and a system of internal controls and supervision.

The Bank has in place Operational Risk Management Policy and Operational Risk Assessment Methodology.

The Bank uses tools for operational risk identification and assessment, such as Data Loss Collection, Audit Findings, Risk Control Self-assessment, Key Risk Indicators, etc. for timely identification and mitigation of risks.

The Bank has bolstered its risk management capabilities through the addition of an extra head count in 2016.

Capital Adequacy and Regulatory Requirements

Following the Basel II/III requirements, compliance with which is requested by the NBG of all banks operating in Georgia, we calculate our capital requirements and risk-weighted assets separately. The Financial Management Department, in cooperation with the Risk Management, Credit Analysis and Loan Administration Departments, are responsible for ensuring that Capital Adequacy and other mandatory ratios comply with NBG requirements.

Bodies Implementing Risk Management

The Board of Directors is ultimately responsible for Risk Management; however, there are separate independent bodies which are responsible for identifying, managing, controlling and monitoring risks.

The Board of Directors is responsible for the overall risk management approach and for approving short-term and long-term risk management strategies.

There are five different committees in the Bank responsible for Risk Management: the Credit Committee, Assets and Liabilities Committee, Audit Committee, IT Committee, and the Risk Management Committee.

Credit Committee

The Credit Committee manages, monitors and controls counterparty risks and approves individual risk exposures. It is also responsible for the development of the Credit Policy of the Bank, for credit administration, underwriting standards, establishment and testing of allowances for credit losses, and controlling credit concentration and asset quality.

Asset and Liability Committee (ALCO)

The overall mandate of ALCO is to manage the Bank's Asset and Liability positions factoring in interest rate, liquidity and market risks.

ALCO also sets the assets and liabilities management strategy, and is responsible for liquidity and funding management as well the Bank's treasury function.

IT Committee

The IT Committee was established by the Board of Directors of the Bank to assess adequacy, to monitor, and to adopt decisions and recommendations regarding the following issues: develop the information technology strategy as a part of the Bank's strategic planning process; define the appropriateness of IT projects; discuss the impact of business decisions on those projects and monitor their implementation; discuss the impact of IT-based initiatives put forward by the structural units and the application of new IT initiatives; monitor the information systems for their continuous operation; ensure and monitor the functioning of IT systems and data protection; oversight of the Bank's IT and information security policies, guidelines, standards and procedures; review periodically the Bank's IT strategy and its tactical plans; carry out other duties as stipulated by legislation and internal regulations; and follow up all IT-related issues on a regular basis.

Along with the above-mentioned responsibilities, the IT Committee also ensures that all processes are in place for the detection of security breaches. Monitoring compliance with the information security policy and standards also falls within the realm of IT Committee responsibilities.

Audit Committee

The Audit Committee (AuC) has the overall responsibility for overseeing the Bank's systems of internal controls and relies heavily on an Internal Audit function to do so. It also communicates with the external auditor of the Bank, and reviews and provides comments on Audited Annual IFRS Financial Statements and Reviewed Interim Condensed Financial Statements for the half-year before their release.

Audit Committee meetings are held on a monthly basis.

Risk Management Committee

The Risk Management Committee was established by the Supervisory Board to provide assurance to the Supervisory Board that risk management and processes for control over risk are effective.

The responsibilities of the Risk Management Committee are to advise the Supervisory Board and assist in discharging its duties and responsibilities regarding risk management, i.e. where risk areas seem to require particular attention. It makes recommendations to the Supervisory Board and provides it with information to help with strategy formulation. Particular examples could include identification of the Bank's risk appetite, review of risk registers, setting of decision-making authorization limits, monitoring the performance of management, review of the findings of internal audit engagements. The Risk Management Committee ensures the overall seamless functioning of the risk management system and its compliance with the risk guidelines set by the Supervisory Board.

COMPLIANCE DEPARTMENT

The Compliance Department is responsible for compliance with laws, regulations, rules and self-regulatory organizational standards, including those related to Anti-Money Laundering (AML) and Foreign Account Tax Compliance Act (FATCA).

We are constantly strengthening our compliance-related methodologies and procedures to reflect regulatory developments. We are firmly committed to participating in international efforts to combat money laundering and the funding of terrorist activities.

Non-compliance with laws and regulations may lead to reputational damage and adverse regulatory action. Ensuring compliance with regulatory requirements may take up a substantial part of our resources. This risk is mitigated by raising staff awareness of regulatory programs by means of ongoing training and presentations.

The Bank's Board of Directors and the Supervisory Board are informed regarding compliance issues and risks identified through the Compliance Report. In 2016, the Compliance Report was discussed twice by the Supervisory Board and three times at the Board of Directors meetings.

CSR, CHARITY AND SPONSORSHIP ACTIVITIES

Responsible corporate citizenship is an organic part of the PASHA Bank brand identity and we take our duties very seriously.

Throughout 2016, the Bank was actively involved in financing educational projects. PASHA Bank congratulated its partners and clients on Easter in a socially responsible way: on behalf of its stakeholders, the Bank donated funds to charity organization SOS Children's Village that will be used to finance full-year English language courses for all university applicants living in the village.

PASHA Bank continued development of the Spotlight Marketing Library which was initiated in 2015, enabling Georgian marketers to access a wide range of professional literature. In 2016, the Bank purchased additional books for the library - doubling the amount of reading material based on the high demand demonstrated throughout 2015.

PASHA Bank made a donation to Women's Information Center on behalf of the Bank's female clients and partners on International Women's Day. These funds were later applied to organize two separate campaigns aimed at raising awareness on women's rights in Georgia.

Last but not least of the 2016 CSR activities was PASHA Bank's New Year gift for its partners and employees: the Bank planted 2017 Georgian Pine Trees near Borjomi, where 260 hectares of forest were burnt down in August 2008.

One of PASHA Bank's most distinguished sponsorship projects is Business Café, initiated by Insource and which, since the very first meeting, was exclusively sponsored by PASHA Bank through 2015 and 2016. The project facilitates experience-sharing between top managers of various organizations. It has hosted speakers, prominent business leaders, such as Lado Gurgenidze, Giorgi Kadagidze, Sandro Jejelava, Guga Tsanava, Davit Gogichaishvili, Tinatin Rukhadze and others.

In 2016, we again sponsored several sector-specific events that we partnered with in 2015: Telecommunication Meeting in Georgia, Spotlight and Golden Brand. This year we also supported the Bond Congress in Tbilisi, where the CEO and Chairman of the Board of Directors of the Bank, Shahin Mammadov, gave a speech about the Bank's experience in investment banking in Georgia as well as in Azerbaijan, where PASHA Bank is one of the pioneers in this field.

In 2016, PASHA Bank initiated the project MEETING ROOM - a cycle of business conferences that aims to bring together participants from various industries, providing a platform for sharing ideas and best practices as it relates to raising capital for a wide range of industries.

The first business conference of MEETING ROOM was dedicated to Hotel Development and took place in May of 2016. The partners of the conference were the Georgian Tourism Administration and Colliers International.

On December 6, in Radisson Blu Hotel, PASHA Bank hosted its second business conference under the auspices of MEETING ROOM, with the chosen topic "Sustainable Energy Development in Georgia - The Case for Hydro Power Plants." The conference was supported by the Ministry of Energy of Georgia, Electricity System Commercial Operator and Georgian National Energy and Water Regulatory Commission.

Helping the development of various business sectors, and the Georgian economy in general, is an indirect continuation of what we actually see as our mission – contributing to the growth of large and medium-sized enterprises by providing them with competitive corporate and investment banking services.

INFORMATION TECHNOLOGIES

The IT and Banking Systems Development Department of PASHA Bank is responsible for developing and implementing an overall information technology strategy. To that end, we are constantly on the look-out for areas where IT functionality could be upgraded to further our business objectives.

Our core system, sourced locally and upgraded continuously, enables us to fully synchronize the Bank's internal operations with the external systems critical for our corporate customers. For instance, Alta, our current core bank system, allows for seamless integration of payments between the Alta and SWIFT system as well as proprietary databases of such state institutions as the Georgian Revenue Service and State Treasury.

Providing a high-quality service to our corporate customers is a never ending challenge which spurs us on to keep investing in improving our IT functionality. Over the course of 2016, a number of major projects were undertaken with that objective in mind.

One of the key accomplishments for the period is internally developed Enterprise Resource Planning system. This project required the involvement of several departments. The system consolidates Accounting, HR, Procurement and Compliance modules. A major feature of the system is automated approval processes, requiring multiple authorization levels, thus minimizing manual work and paper-based activities. Among the features of the ERP system are: registration of suppliers and contracts, projects and events, purchase orders, mechanisms for sport and book allowance and vacation requests, etc. Document flow of Legal and Project Management Departments will be also added in the future.

Installation of a Video Conference System was made in order to enhance communication among PASHA Holding Strategic Assets, namely PASHA Bank Georgia, PASHA bank Azerbaijan and PASHA Bank Turkey. This has enabled a much closer cooperation between the SAs via quick and cheap audio-visual means of communication across a wide assortment of departments. Savings on travel have been considerable in all the connected offices.

Launch of the SharePoint intranet portal and content management system was another development aimed at increasing regional cooperation between the Strategic Assets. The Intranet Portal is common between Azerbaijan, Georgia and Turkey offices. It features an organization-wide news portal, Internal Communication tools, as well as HR section, project management module and a set of other advanced functionalities.

Another project dedicated to intra-group communication enhancement was the deployment of internal chat Lync Communication and integration with counterparties at PASHA Bank Azerbaijan. This enabled secure instant messaging between two banks in a day-to-day work setting.

The Bank has set up a fully functional compliance function conforming to FATCA requirements that outputs fully automated reports, thus eliminating the inherent risk involved in the manual processing of mandatory regulatory reports. Automatization of the FMS reporting system and automatization of the Risk Report to PASHA Holding was another regulatory project dedicated to reducing manual work and associated risks.

In order to minimize the IT service downtimes, it was decided to deploy a centralized monitoring system in the IT Department. The system is up and running, providing a helicopter view and a real time feed of IT systems conditions.

HUMAN RESOURCES

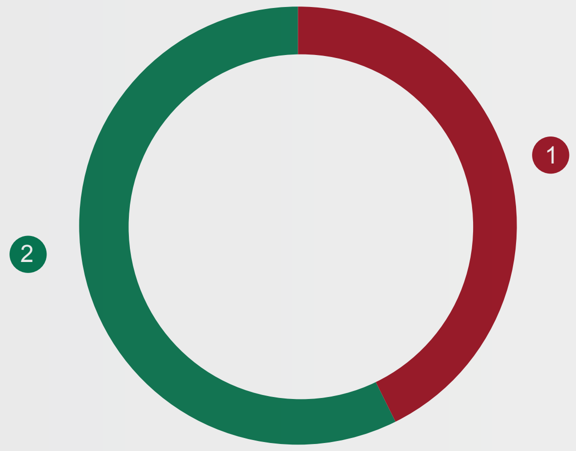
Team

At PASHA Bank, we believe that the team is our most valuable asset. We take pride from our culture of common respect, transparent relations and cooperation. We strive to ensure that each employee enjoys a healthy working environment and opportunity for professional development. A big emphasis is put on the culture within our Bank. We extend a great effort to build and maintain a solid team of professionals. We appreciate our employees and aim to help them grow and reach "New Heights. Together."

PASHA Bank is committed to hiring the best talent for our expanding business, as we recognize that our employees drive our success. Our HR projects for the strategic period 2015-2017 cover the scope of all major employee oriented issues, such as Grading, Appraisal, Bonus and Compensation Systems, financial and non-financial motivation and development of the internal culture of engagement and loyalty.

Gender balance

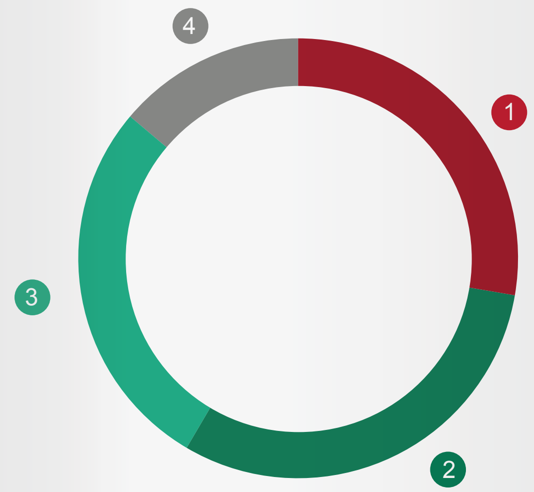
Chart 6



1	Male	43%
2	Female	57%

Length of service

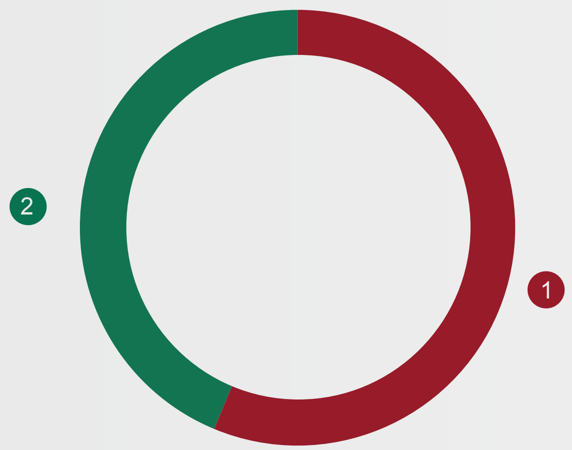
Chart 5



1	3 years	29.8%
2	2 Years	28.4%
3	1 Year	28.4%
4	Less than a year	13.4%

Gender balance in middle management

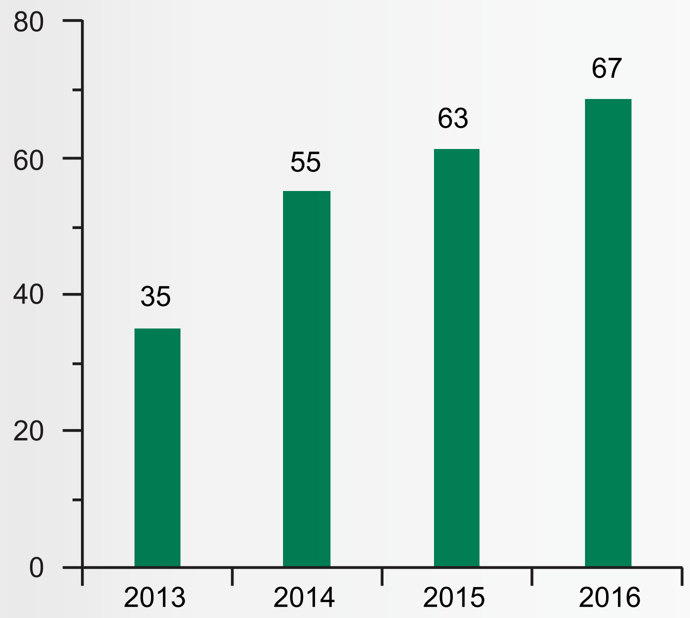
Chart 7



1	Female	56%
2	Male	44%

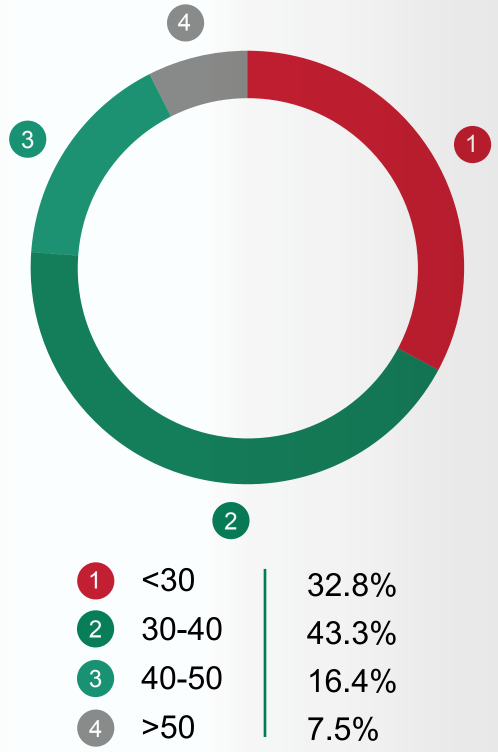
Number of employees

Chart 8



Age composition

Chart 9

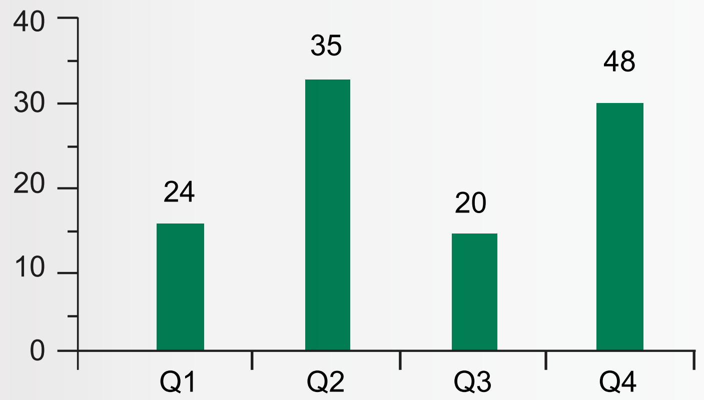


Development

We create an environment that enables professional growth and continuous learning. There are many opportunities for development that the Bank offers to the employees: professional trainings locally and abroad, full coverage of international professional certification costs, access to professional literature, English courses, courses in different hard and soft skills, etc. The total cost spent on employee training and development in 2016 is 4.4% of the total staff cost.

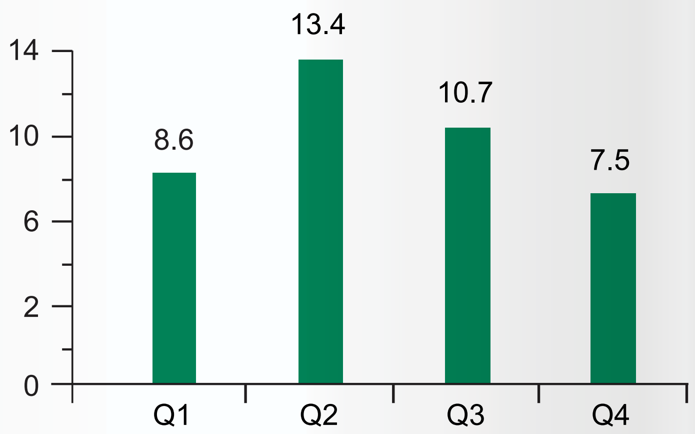
Number of people trained

Chart 10



Training hours per employee

Chart 11



Internship program

Our Internship Program for young talent has been successfully running for two years already. We have hired nine interns during this period and four were offered full-time employment and stayed on in various positions.

Our internship program allows young people to gain practical and theoretical knowledge in the field of their interest. Internship is paid and lasts for four months.

Culture

Our team members are ambassadors of our corporate culture which encourages each employee to take responsibility for their own actions as well as organizational performance. We promote a culture of transparency, ensuring fairness and social responsibility; we value people-engagement, loyalty and team spirit.

Employee recognition and motivation

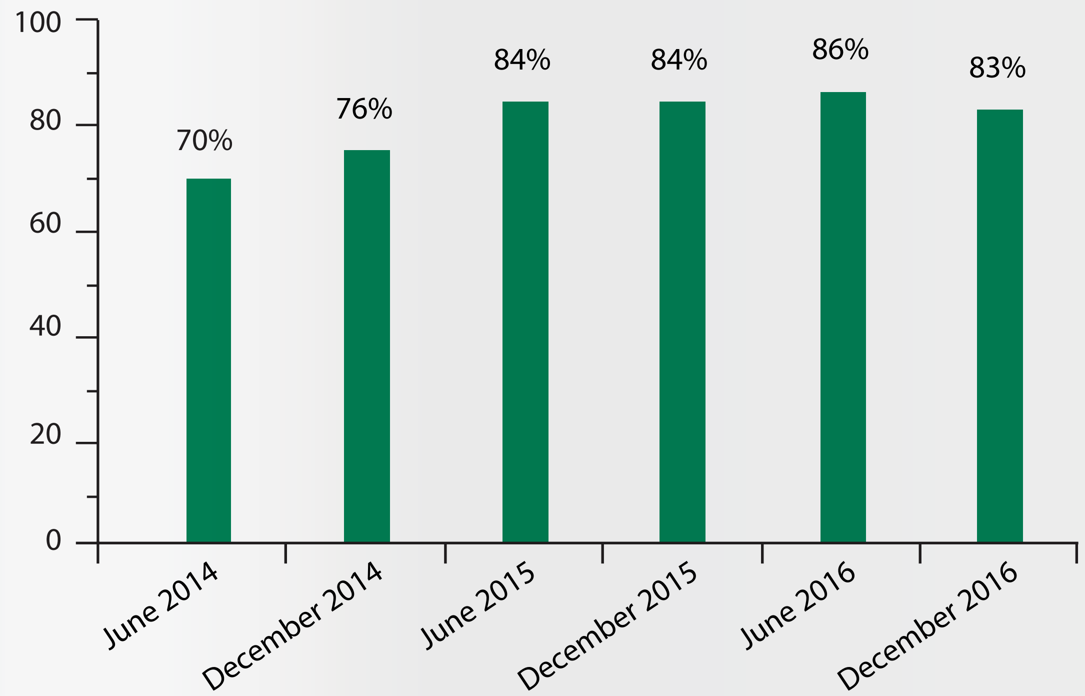
We strive to ensure that our employees are happy with their jobs. The PASHA Bank remuneration system consists of competitive salaries and variable pay that is linked to individual performance. Each year we review market remuneration data and analyze tendencies. For variable pay we use a bonus system that is linked to the portfolio growth and quality for front office employees, and to KPIs, projects and competencies for all other staff.

Employee engagement and satisfaction

We conduct an employee satisfaction survey twice a year. Based on its findings, we plan specific actions aimed at improving the experience of working for PASHA Bank. The survey comprises: team, management, loyalty, stress, development opportunities, etc. Our goal is for PASHA Bank to be recognized as one of the best places to work at in Georgia.

Employee satisfaction

Chart 12



CORPORATE GOVERNANCE

DHAULAGIRI
8,167 metres (26,795 ft)

COMMITMENT TO CORPORATE GOVERNANCE

JSC PASHA Bank Georgia defines corporate governance as a set of structures and processes for the direction and supervision of the Bank, which involves a set of relationships between the Bank's shareholders, the Supervisory Board and the Board of Directors with the purpose of creating long-term shareholder value. We view corporate governance as means to improve operational efficiency, attract financing at a lower cost and build a better reputation. We consider a sound system of corporate governance as an important contribution to the rule of law in Georgia and an important determinant of the role of the Bank in a modern economy and society.

The Bank demonstrates its commitment to best corporate governance standards by developing and furthering:

- Responsible, accountable and value-based management;

- Effective oversight and executive bodies that act in the best interests of the Bank, seek to enhance shareholder value in a sustainable manner; and

- Appropriate information disclosure and transparency, as well as an effective system of risk management and internal control.

The Bank honors and recognizes all the general principles of good corporate governance:

- Fairness: The Bank is committed to act in a fair and ethical manner towards all shareholders and stakeholders, as it believes that ethical conduct underpins good corporate governance.

- Accountability and Responsibility: The Supervisory Board of the Bank is accountable to the shareholders for the way in which it carries out its responsibilities. Similarly, the Board of Directors is responsible for the exercise of powers delegated to them and is accountable to the Supervisory Board for their achievements and performance.

- Transparency: The Bank is committed to providing accurate and understandable information to shareholders and other stakeholders on all material matters regarding the Bank, including its financial condition, performance, and ownership and governance structure in a manner easily accessible to interested parties, without giving away commercially sensitive information.

The members of the Supervisory Board and Board of Directors and all employees of the Bank are expected to act in accordance with all applicable laws and regulations and furthermore, comply with ethical standards of business conduct as defined by the Bank's Code of Ethics.

GENERAL GOVERNANCE STRUCTURE

PASHA Bank has the following governance structure:

- General Meeting of Shareholders
- Supervisory Board
- Supervisory Board Committees:
  - Audit Committee
  - HR and Remuneration Committee
  - Risk Management Committee
  - Strategy and Budget Committee
- Board of Directors

- Internal Audit Department
- Corporate Secretary

PASHA Bank has a two-tier corporate Governance structure, meaning that there is a Supervisory Board, composed solely of non-executive directors, and a Board of Directors composed solely of executive directors.

The Supervisory Board is responsible for general oversight of the Bank and of the Board of Directors. Its members are elected by the shareholders. The Supervisory Board is led by the Chairman, advises the Board of Directors and is involved in decision-making on all fundamental matters affecting the Bank.

The Board of Directors is responsible for managing the daily operations of the Bank. It is led by the Chairman of the Board of Directors, who at the same time serves as the CEO of PASHA Bank Georgia. Its members are appointed by the Supervisory Board.

The Supervisory Board consists entirely of non-executive directors (the "NEDs") and includes:

- Representatives of shareholders
- Executive directors from other banking strategic assets of the PASHA Holding

The Board of Directors consists at all times of at least three executive directors. At the time of writing its composition is as follows:

- Chief Executive Officer
- Chief Commercial Officer
- Chief Financial Officer

THE SUPERVISORY BOARD

The Supervisory Board is the key decision-making body of PASHA Bank, responsible to shareholders for creating and delivering sustainable shareholder value through providing entrepreneurial leadership and direction to the Bank. It determines the Bank's strategic objectives and policies, provides overall strategic direction within a framework of rewards, incentives and controls, demonstrates ethical leadership and promotes the collective vision of the Bank's purpose, values, culture and behaviors.

Members of the Supervisory Board act in a way that they consider, in good faith, will promote the success of the Bank for the benefit of the shareholders as a whole and, while doing so, taking into consideration the interests of other stakeholders as well.

The primary responsibilities of the Supervisory Board are reviewing and approving corporate strategy, approving the annual budget and business plan; setting objectives and monitoring performance; oversight of major capital expenditures, acquisitions and divestments; ensuring a formal and transparent system for the nomination, election, and replacement of directors; responsibility for succession planning; reviewing its own performance; overseeing the integrity of PASHA Bank's accounting and financial reporting systems; overseeing the integrity of the external audit process; overseeing the process of disclosure and communication, and being available for dialogue with shareholders; ensuring that an appropriate system of internal control is in place; responsibility for risk policy; overseeing a formal risk management process; monitoring and managing conflicts of interest and related party transactions; determining the rights and obligations of members of the Board of Directors, monitoring and supervising their activities; and responsibility for the alignment of remuneration of executive directors and other senior executives with the long-term interests of PASHA Bank and its shareholders.

The Schedule of Matters Reserved for the Supervisory Board Decision can be found on page 46.

Supervisory Board Performance

Name	Scheduled Meetings Eligible To Attend	Meetings Attended
Mir Jamal Pashayev *(Chairman)*	20	15
Jalal Gasimov *(Member)*	20	20
Taleh Kazimov *(Member)*	20	16
Cenk Eynehan *(Member)*	20	20
Nikoloz Shurgaia *(Independent Member)**	20	13

** At the General Meeting of Shareholders held on September 5th 2016, Independent member of the Supervisory Board Nikoloz Shurgaia resigned from the position.*

The Supervisory Board held 20 board meetings with 74 issued resolutions throughout 2016.
Below are highlights how the Supervisory Board discharged its duties and responsibilities:

Strategic Planning and Budget

- Monitored the Bank's achievement of strategic objectives;
- Monitored the Bank's achievement of budget;
- Discussed and approved the Budget for the year 2017;
- Discussed strategic development alternatives.

Risk Management

- Discussed and approved strategy and policies on the management of credit and operational risks of the Bank, such as the Credit Policy, the Credit Standard, the NBG Loan Loss Provisioning Methodology, the Industry Segmentation Methodology and the Operational Risk Management Policy of the Bank;
- Discussed and approved the Statute of the Credit Analysis and Loan Administration Department and the Statute of the Risk Management Department;
- Discussed and approved strategy and policies on the management of financial, market and liquidity risks of the Bank, such as the Investment Policy, the Internal Currency Position Calculation Methodology, the Liquidity Management Policy, the Tax Policy and the Foreign Currency Risk Management Policy;
- Discussed and approved the launch of the project in respect to standardization of business processes, development of policies and procedures of the Bank;
- Monitored the fulfillment of the action plan stemming from the IT audit of the Bank;
- Discussed and approved strategy and policies on the management and security of the Information Technology of the Bank;
- Discussed and approved credit facilities within its decision making limits;
- Discussed and approved Related Party Transaction within its decision making limits.

Corporate Governance

- Approved the external auditor's report;
- Reviewed Audited Annual, Interim Condensed Financial Statements and Quarterly IFRS Financial Statements;
- Reviewed the Bank's performance through continued monitoring of financial and other activities, audit findings and compliance activities;
- Discussed and approved the Corporate Governance Policy;
- Discussed and approved the Independent Board Member Definition;
- Discussed and approved amendments to statutes of the Supervisory Board and the Board of Directors;
- Discussed and approved amendments to the Schedule of Matters Reserved for the Board Decision;
- Discussed and approved the Code of Ethics;
- Discussed and prepared for the approval of the General Shareholders Meeting the Charter of the Bank;
- Approved the establishment and composition of the Supervisory Board Committees;
- Discussed and approved the statutes of the Supervisory Board Committees;
- Discussed and approved the Corporate Secretary By-Laws;
- Approved changes in the organizational structure of the Bank;
- Discussed and approved the Bank Related Party Standard;
- Reviewed the corporate governance annual self-assessment results.

Human Resources and Remuneration

- Discussed and approved the Bonus Calculation Methodology and performance appraisal ranges for shared weighted ROAE for members of the Board of Directors;
- Discussed and approved the annual bonus accrual issue for the Board of Directors and the support function;
- Discussed and approved the Bonus Calculation Methodology and Bonus Calculation Formula for Support Functions, Treasury Department and Business Development Department.

Name	Position	Date of Appointment
Mir Jamal Pashayev	Chairman of the Supervisory Board	22.10.2012
Jalal Gasimov	Member of the Supervisory Board	19.10.2015
Taleh Kazimov	Member of the Supervisory Board	17.09.2015
Cenk Eynehan	Member of the Supervisory Board	17.09.2015

MEMBERS OF THE SUPERVISORY BOARD

Mir Jamal Pashayev
Chairman of the Supervisory Board

Mir Jamal Pashayev graduated from the Physics Department at the Moscow State University in 1993, and went on to obtain his Master of Science in Engineering from the University of California in 1996, followed by a Master of Business Administration from the American University in Washington D.C. in 1998.

He joined the Mobil Corporation as a business project consultant to the company's Dallas and Washington offices in 1998 before arriving in Baku in 1999, where he took on the position of consultant to the Central Bank of Azerbaijan. He joined the European Bank of Reconstruction and Development (EBRD) as financial analyst in 2000, and was soon promoted to the position of banker on infrastructure projects. From 2005 to 2008, Mr. Pashayev was engaged in consulting activities for large-scale investment projects in the fields of infrastructure, telecommunications and financial services.

Mir Jamal Pashayev has been the Managing Director at PASHA Holding since 2006.

He is also Chairman of the Supervisory Board of PASHA Insurance, PASHA Life Insurance and PASHA Bank Azerbaijan. Mir Jamal Pashayev is also Chairman of the HR and Remuneration Committee of PASHA Bank Georgia.

Jalal Gasimov
Member of the Supervisory Board

Jalal Gasımov completed his undergraduate degree in economics at the Azerbaijan Economy University, receiving his graduate degree in Economic Relations, at the Higher Diplomatic College of Azerbaijan, and an MBA at Warwick Business School, UK.

Mr. Gasimov started his banking career at İlkbank OSJC, Azerbaijan, in 1999. In 2002-2003 he held various positions with finance and private sector companies. He worked in Azpetrol Oil Company as a Finance Director in 2003-2004 and was the Deputy Chairman of the Board of Directors of Azpetrol Holding from 2004 to 2006. He joined the Moscow Office of McKinsey & Company and served as a Consultant in 2006-2007. He held top management duties; CEO in Bank of Baku, Finance Director in CRA Group Companies, and CEO and Chairman of the Executive Board in Unibank between 2007-2015, respectively. Jalal Gasimov joined PASHA Holding as the Head of the Banking Group and Deputy CEO in 2015 and where he has been named as the First Deputy CEO effective October 17, 2016. Mr. Gasimov is Chairman of the Supervisory Board of Kapital BANK OSJC and Chairman of the Supervisory Board of PASHA Bank Turkey.

Mr. Gasimov is also Chairman of the Risk Management Committee, Chairman of the Strategy and Budget Committee and Member of the HR and Remuneration Committee of PASHA Bank Georgia.

Taleh Kazimov
Member of the Supervisory Board

Mr. Taleh Kazimov has extensive professional experience in commercial and investment banking, loans and risks management. He was appointed as CEO and Chairman of PASHA Bank Executive Board on July 1, 2015.

Prior to this appointment, Mr. Kazimov served as the Chief Investment Officer of the Bank and a member of the Executive Board responsible for business development, FIs, corporate and SME banking. Mr. Kazimov joined PASHA Bank in 2007 as Risk Manager and then promoted to the position of the Bank's Treasury Director in 2009.

Mr. Kazimov began his career in financial sector in 2004 as a Leading specialist in Treasury Department at the Bank Standard and later as the Head of accounting management and budget planning. He later has been promoted to the Deputy Director of Corporate Loans Department. In 2006 he joined Ernst and Young as an auditor and from 2007 worked as a General Director of "FinEko" Informational Analytical Agency.

Mr. Taleh Kazimov holds a bachelor degree in Automation and Computer engineering from Azerbaijan Technical University. He also pursued MBA from Azerbaijan State Oil Academy and an MBA in Finance from Georgia State University. In addition, Mr. Kazimov successfully completed the executive educational programs of London Business School in 2010 and Harvard Business School in 2012.

Mr. Kazimov is a Member of Supervisory Boards for PASHA Bank Turkey and PASHA Bank Georgia. He was appointed as member of the Supervisory Board of PASHA Bank Georgia on September 17, 2015.

H. Cenk Eynehan
Member of the Supervisory Board

Hikmet Cenk Eynehan earned a two-year degree in economics from Erasmus University in the Netherlands, and Bachelor degree in management from Monroe College in the United States of America and completed Executive MBA program at Koç University, Istanbul.

He started his banking career in 1994 and served in various management and business development capacities at DHB Bank (Nederlands) N.V. until 2001. He continued his professional career in non-financial sector during 2002-2004 and he joined Şekerbank T.A.Ş. and held executive positions in various departments from 2005 until 2010. He was Deputy General Manager in charge of Corporate Marketing & Sales of Ekspo Factoring A.Ş. from 2011 until 2013.

Mr. Eynehan has been named as General Manager and Board Member of PASHA Yatırım Bankası A.Ş. effective August 2, 2013.

He has 23 years of experience in banking and business administration. Mr. Eynehan

was appointed a Member of the Supervisory Board of PASHA Bank Georgia on September 17, 2015.

SUPERVISORY BOARD COMMITTEES

The Bank has established the Audit Committee, Strategy and Budget Committee, HR and Remuneration and Risk Management committees.

The Audit Committee of JSC PASHA Bank Georgia was established by and is accountable to the Supervisory Board for the fulfillment of its responsibilities according to the provisions of the applicable legislative acts, establishing and further controlling of the Internal Audit Department of the Bank. By bringing a systematic approach to the evaluation and improvement of risk management, control and governance processes, the Committee monitors whether structural units, employees and representative offices of the Bank follow the requirements of acting legislation. The Committee assists Supervisory Board and Board of Directors in ensuring the existence and adequacy of an effective internal control system in the Bank.

Audit Committee Composition and Meetings

The Committee consists of 3 members elected by the Supervisory Board of the Bank, the number of members should always be odd. The Committee members are appointed for a term of maximum 4 years.

The Committee meetings should be held at least once every 3 months (quarterly) and may be held more often if required.

Audit Committee Composition

Name	Date of Appointment	Scheduled Meetings Eligible to Attend	Meetings Attended
Azer Sadigov *(Chairman)*	20.10.2014	4	8
Parvin Ahadzade *(Member)*	08.06.2015	4	12
Jamil Mammadov *(Member)*	17.10.2014	4	12

Audit Committee Composition and Meetings

The main goal of the Audit Committee during the year was to establish a value adding audit activity by bringing a systematic approach to the evaluation and improvement of risk management, control and governance processes in order to provide the stakeholders of the Bank with alternative information flow. In order to achieve these objectives the Committee was mainly involved in the following:
- The Committee periodically held meetings in order to address significant issues, staffing issues, and other audit matters;
- The Committee approved the updates to the Statute of the Committee and the Statute of the Internal Audit Department of the Bank by ensuring it includes all the matters to guarantee and strengthen the organizational independence of the both, the Audit Committee and the Internal Audit Department;
- The Audit Committee reported to the Supervisory Board of the Bank on high-risk audit findings on a quarterly basis. During 2016, 4 summary reports were submitted to the Supervisory Board.

The Risk Management Committee of JSC PASHA Bank Georgia was established by the Supervisory Board in order to advise and assist the Supervisory Board in discharging its duties and responsibilities, to ensure that the processes and capabilities for identification, assessment, measurement, control, reporting and monitoring of risks are effective. The Committee ensures that the business of the Bank is being managed within the risk guidelines set by the Supervisory Board and monitors the risk management system to ensure that it is effective and achieves its purpose. It provides information to the Supervisory Board on strategy formulation, requiring management to manage risks within the Supervisory Board guidelines for risk appetite. The Committee reviews the risk management policy and strategy, and the findings of the Internal Audit Department regarding risk management. Furthermore, the Committee reviews the Bank's risk identification and assessment reports, and the risk appetite and tolerance statement. The Committee also reviews the Business Contingency Plan and evaluates the effectiveness of mitigating strategies to address the material risks to the Bank. The Committee reports to the Supervisory Board on any material change to the risk profile of the Bank.

Throughout 2016, the Committee developed or reviewed the Risk Management Committee Statute, the Risk Management Framework, the Industry Segmentation Methodology, the Credit Policy, the Foreign Currency Risk Management Policy, the Risk Governance Book and Ratios and Terms Glossary, which were approved by the Supervisory Board at the recommendations of the Committee.

The Committee reviewed Risk Reports, Liquidity Ratios Report, and IFRS 9 implementation plan.

Risk Management Committee Composition

Name	Date of Appointment	Scheduled Meetings Eligible to Attend	Meetings Attended
Jalal Gasimov *(Chairman)*	08.02.2016	6	5
Hayala Naghiyeva *(Member)*	08.02.2016	6	2
Kamala Nuriyeva *(Member)*	08.02.2016	6	6
Elman Eminov *(Member)*	08.02.2016	6	6
Nikoloz Shurgaia *	08.02.2016	6	4

** At the General Meeting of Shareholders held on September 5th 2016, Independent member of the Supervisory Board Nikoloz Shurgaia resigned from the position.*

The Strategy and Budget Committee of JSC PASHA Bank Georgia was established by the Supervisory Board of the Bank in order to advise the Supervisory Board and assist in discharging its duties and responsibilities, providing assurance that the Business Plan of the Bank is prepared in accordance with the strategy formulation process approved by the Supervisory Board, and that the Annual Budget is prepared in accordance with the budgeting process approved by the Supervisory Board. Throughout 2016, the Committee discussed reporting requirements to the Committee, reviewed reports on the status of the Bank's strategic goals and KPIs as well as on the status of the Bank's strategic projects. The Budget Variance Report was reviewed on a regular basis.

Strategy and Budget Committee Composition

Name	Date of Appointment	Scheduled Meetings Eligible to Attend	Meetings Attended
Jalal Gasimov *(Chairman)*	08.02.2016	2	2
Hayala Naghiyeva *(Member)*	08.02.2016	2	1
Sarkhan Aliyev *(Member)*	08.02.2016	2	2
Murad Ahmadov *(Member)*	08.02.2016	2	2
Turkhan Mahmudov *(Member)*	08.02.2016	2	2

The HR and Remuneration Committee of JSC PASHA Bank Georgia was established by the Supervisory Board in order to advise the Supervisory Board on the remuneration policy for the Board of Directors and senior management of the Bank and suggest a target pool for the annual bonus. The Committee reviews the remuneration policy, grading system, recruitment, retention and termination policies as well as proposals to the Supervisory Board with respect to approval of candidates to the position of Member of the Board of Directors. The Committee, together with the Risk Management Committee, at least once a year reviews the remuneration process and evaluates the effectiveness of the remuneration system.

HR and Remuneration Committee Composition

Name	Date of Appointment	Scheduled Meetings Eligible to Attend	Meetings Attended
Mir Jamal Pashayev *(Chairman)*	08.02.2016	3	2
Jalal Gasimov *(Member)*	08.02.2016	3	3
Ayten Abbasli *(Member)*	08.02.2016	3	3

Last year, the Committee developed the HR and Remuneration Committee Statute, updated KPIs for the year, reviewed strategic HR projects, activities and challenges for the coming years, discussed the results of the internal satisfaction survey, and discussed and planned the new remuneration and performance appraisal systems to be introduced in the Bank.

MEMBERS OF THE BOARD OF DIRECTORS

Shahin Mammadov
Chairman of the Board of Directors, CEO

Shahin Mammadov majored in accounting at the Azerbaijan State Economic University and obtained a diploma in 2002. In 2004, he was awarded a Master's Degree from the same university and a Ph.D. in Economy in 2010.

Mr. Mammadov held the roles of accountant and deputy chief accountant at Kochbank Azerbaijan Ltd. from 2003. He joined Deloitte & Touche in 2005 as Associate Auditor and was subsequently promoted to Audit Manager. He acquired ACCA qualification in 2014.

In 2009, Mr. Mammadov was assigned to the position of Director of the Financial Management Department at PASHA Bank head office and in 2011 he became a member of the Executive Board. In 2013, he joined the Board of Directors of PASHA Bank Georgia supervising the business development function. Since July 2014, Mr. Mammadov has been the CEO and Chairman of the Board of Directors at PASHA Bank.

George Japaridze
Member of the Board of Directors, CCO

George (Goga) Japaridze graduated from Tbilisi State University in 1996 with a Bachelor of Science degree in Biology. He went on to receive an MBA from Hofstra University's Zarb Business School in 2002. In 2016, he enrolled in and in 2017 graduated from Harvard Business School's Personal Leadership Development Executive Education Program.

Mr. Japaridze began his banking career in 2003 as an associate at Galt and Taggart Securities, the investment banking subsidiary of Bank of Georgia, before taking on the role of senior equity banker at Bank of Georgia in 2005. He held the position of principal banker at the EBRD's private equity facility from 2006 to 2011. He then moved to the role of Head of Corporate Banking at Bank Republic Société Générale Group.

Mr. Japaridze joined PASHA Bank as CCO in January 2014. Since April 2015, he also became a member of the Board of the Directors at PASHA Bank.

Chingiz Abdullayev
Member of the Board of Directors, CFO

Chingiz Abdullayev obtained his Bachelor's degree in Business Administration from the Western University of Baku, Azerbaijan, in 1999, and a Master's degree in Finance from the State Economic University of Azerbaijan in 2005.

He started his career at Baku Stock Exchange as the Head of the Listing Division in 2000. In 2003, he joined the Assurance & Advisory Service of Deloitte and for the following 10 years worked at senior positions with KPMG Russia, Moore Stephens CIS and RSM Georgia with a major focus on financial institutions, energy, trade and other industry sectors.

Chingiz Abdullayev joined PASHA Bank in 2014 as Head of the Financial Management Department. Since January 13, 2016, Mr. Abdullayev has been CFO and a Member of the Board of Directors.

THERE ARE CURRENTLY THREE COMMITTEES SUPPORTING THE BOARD OF DIRECTORS:

- **Credit Committee**
- **IT Committee**
- **Assets and Liabilities Committee**

INTERNAL AUDIT DEPARTMENT

The Internal Audit Department (IAD) of PASHA Bank is responsible for providing an objective appraisal service to the Bank's management and Audit Committee through an independent, objective assurance on the effectiveness of internal control systems in mitigating risks related with significant processes, and ensuring compliance of the Bank's financial, economic, administrative and other activities with current legislative acts and internal regulations.

The IAD is independent of the Board of Directors and reports to the Audit Committee. IAD receives feedback on the Internal Audit (IA) Annual Plan and authorization on any changes to its scope from the Audit Committee.

The day-to-day activities of the IAD are guided by the Internal Audit Policies and Procedures Manual approved by the Audit Committee in September, 2014.

Throughout 2016, the Internal Audit Department reviewed the following business processes - the establishment of correspondent relations with local and international financial institutions, foreign exchange operations, placement of interbank loans and deposits, and other treasury activities including related party transactions and avoidance of conflict of interests, and ensuring Anti-Money-Laundering (AML) frameworks are in place.

The Internal Audit Department of PASHA Bank Georgia reports to the Audit Committee on a monthly basis on the status of Critical/High Risk audit findings. The same reports are also presented to the Board of Directors and Supervisory Board with monthly and quarterly frequency, respectively.

SCHEDULE OF MATTERS RESERVED FOR THE BOARD DECISION
JSC PASHA Bank Georgia
Specific decision making limits are approved by the Supervisory Board and shown in the Bank's Decision Making and Signatory Authority Matrix

	Duties and Responsibilities	Quorum Required
1.	Strategic supervision and control of the Bank;	N/A
2.	Approval of the corporate strategy and strategic objectives, review of delivery of the strategy and performance against strategic objectives and operational plans;	Simple Majority
3.	Approval of the business plan, review of delivery of the performance against the business plan;	Simple Majority
4.	Approval of the annual budget, review of delivery of performance against the annual budget;	Simple Majority
5.	Initiation of new banking/commercial activities and termination or suspension of existing activities;	Simple Majority
6.	Establishment and liquidation of new enterprises, branches;	Simple Majority
7.	Acquisition and disposal of shares in other companies;	Simple Majority
8.	Approval of the organizational structure;	Simple Majority
9.	Approval of the Code of Ethics and whistleblowing procedures;	Simple Majority
10.	Rendering resolutions for implementation of the decision of the General Meeting of Shareholders on admission of the Bank's shares and other securities to the stock market;	Simple Majority
11.	Declaring an interim dividend and recommending a final dividend;	Simple Majority
12.	Redemption of shares by the Bank as provided under the Georgian legislation;	Simple Majority
13.	Perform strategic supervision of risk management activities;	N/A
14.	Approval of the risk appetite statement, conducting annual reviews;	Simple Majority
15.	Approval of the business continuity plan;	Simple Majority
16.	Authorization for conflicts or possible conflicts of interest and related party transactions;	Simple Majority
16.1.	Transactions with related legal entities;	Simple Majority
16.2.	Transactions with related persons;	Simple Majority
16.3.	Agreements with related legal entities;	Simple Majority
16.5.	Approval of cash covered credit products (including trade finance products) to the related party;	Simple Majority
17.	Approval of policies, standards and procedures in respect to conflicts of interest and related party transactions;	Simple Majority
18.	Approval of structure, size and composition of the Board of Directors, including appointments and dismissal of its members;	Simple Majority
19.	Determining rights and obligations of members of the Board of Directors, monitoring and supervising their activities, requesting reports from the Board of Directors;	Simple Majority
20.	Approval of succession policy and succession planning for members of the Board of Directors;	Simple Majority
21.	Conclude the labor agreements and determine remuneration packages for members of the Board of Directors;	Simple Majority
22.	Approval of the regulatory framework for determining bonuses and/or additional benefits for employees, including for members of the Board of Directors of the Bank;	Simple Majority
23.	Approval of structure, size and composition of the Supervisory Board committees, including appointments and removals of the Supervisory Board committee members; reviewing reports of the Supervisory Board committees;	Simple Majority
24.	Election of the external auditors;	Simple Majority
25.	Appointment and dismissal of trade representatives (procurators);	Simple Majority
26.	Appointment and dismissal of the Corporate Secretary;	Simple Majority
27.	Attraction of borrowings by the Bank;	Simple Majority
28.	Securing borrowings or any other liabilities of the Bank or any third party, if they fall outside the scope of the regular economic activities of the Bank;	Simple Majority

	Duties and Responsibilities	Quorum Required
29.	Granting lending and trade finance products (by amount; by maturity);	Simple majority
30.	Sale of credit asset, disregard of its amount, if: - It is a collective sale (sale of more than one credit asset at once) of credit assets; - The Bank receives loss from the sale of credit asset and the sale is above the decision-making limits of the Board of Directors;	Simple majority
31.	Approval of loan restructuring;	Simple Majority
32.	Approval of loan write-off;	Simple Majority
33.	Approval of acquisition and disposal of fixed assets and intangible assets;	Simple Majority
34.	Approval of issuance of bonds;	Simple Majority
35.	Approval of administrative expenses;	Simple Majority
36.	Approval of cash limits;	Simple Majority
37.	Implementation of equity investments in public companies;	Simple Majority
38.	Implementation of any equity investments in private companies;	Simple Majority
39.	Approval and amendment of the Bank's statute, framework and policy type of documents;	Simple Majority
40.	Determining and approving amount of minimum and maximum interest rates to be used with regard to credit recourses and deposits;	Simple Majority
41.	Determining and approving the terms and conditions to be used with regard to credit recourses and deposits to the Bank's employees;	Simple Majority
42.	Convening General Meetings, if deemed necessary for the interests of the Bank;	Simple Majority
43.	Supervision and representation of the Bank in case of conflict between the members of the Board of Directors;	Simple Majority
44.	Based on the decision of the General Meeting, procession of legal dispute against members of the Board of Directors on behalf of the Bank, submission of a claim against members of the Board of Directors without the decision of the General Meeting if the issue is related to the responsibility of members of the Board of Directors;	Simple Majority
45.	Supervising implementation of measures in accordance with results of examinations carried out by the External and Internal Audits, as well as the National Bank of Georgia;	Simple Majority
46.	Making a decision on such issues that are beyond the scope of the Board of Directors' powers;	Simple Majority
47.	Perform any other duties as required by the General Meeting.	Simple Majority

FINANCIAL STATEMENTS

MANASLU
8,163 metres (26,781 ft)

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

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

Independent Auditor's Report

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

Opinion

We have audited the financial statements of JSC PASHA Bank Georgia (the "Bank"), which comprise the statement of financial position as at 31 December 2016, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2016 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Basis for opinion

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

Responsibilities of management and the audit committee for the financial statements

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

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

The audit committee is responsible for overseeing the Bank's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

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

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

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

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

Ruslan Khoroshvili
On behalf of EY Georgia LLC
10 March 2017

STATEMENT OF FINANCIAL POSITION

As at 31 December 2016

(Amounts in tables are in thousands of Georgian Lari)

	Notes	2016	2015
Assets			
Cash and cash equivalents	5	**7,599**	22,282
Amounts due from credit institutions	6	**83,261**	21,152
Loans to customers	7	**95,090**	108,602
Investment securities	8	**91,880**	123,320
Property and equipment	9	**1,108**	2,689
Intangible assets	10	**2,060**	2,024
Deferred income tax assets	14	**924**	1,522
Other assets	11	**563**	719
Total assets		**282,485**	**282,310**
Liabilities			
Amounts due to credit institutions	12	**131,681**	161,929
Amounts due to customers	13	**46,024**	21,288
Provisions for guarantees and letters of credit		**85**	–
Other liabilities	11	**1,411**	912
Total liabilities		**179,201**	**184,129**
Equity			
Share capital	15	**103,000**	103,000
Retained earnings/(accumulated deficit)		**354**	(4,527)
Other reserves		**(70)**	(292)
Total equity		**103,284**	**98,181**
Total equity and liabilitie		**282,485**	**282,310**

Signed on behalf of the Board of Directors of the Bank on 10 March 2017:

Shahin Mammadov — Chairman of the Board of Directors

Chingiz Abdullayev — Chief Financial Officer, Member of the Board of Directors

JSC PASHA BANK GEORGIA

The accompanying selected explanatory notes on pages 56 to 87 are an integral part of these financial statements

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2016

(Amounts in tables are in thousands of Georgian Lari)

	Notes	2016	2015
Interest income			
Loans to customers		**12,785**	9,864
Investment securities		**8,382**	7,859
Amounts due from credit institutions		**2,153**	1,322
		23,320	**19,045**
Interest expense			
Amounts due to credit institutions		**(5,949)**	(5,741)
Amounts due to customers		**(784)**	(168)
		(6,733)	**(5,909)**
Net interest income		**16,587**	13,136
Provision for impairment losses on interest bearing assets	7, 8	**(1,010)**	(3,541)
Net interest income after impairment losses		**15,577**	**9,595**
Net gains/(losses) from foreign currencies:			
- dealing		**1,146**	294
- translation differences		**(199)**	300
Net fee and commission income	17	**244**	307
Other operating income		**387**	117
Non-interest income		**1,578**	**1,018**
Personnel expenses	18	**(5,183)**	(4,489)
General and administrative expenses	18	**(4,309)**	(3,721)
Depreciation and amortisation	9, 10	**(2,098)**	(1,824)
(Provision)/reversal of provision for impairment losses on guarantees and letters of credit	16	**(85)**	59
Non-interest expenses		**(11,675)**	**(9,975)**
Profit before income tax benefit		**5,480**	638
Income tax (expense)/benefit	14	**(599)**	1,624
Net profit for the period		**4,881**	**2,262**
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods:			
Net unrealized gain/(loss) on investments securities available for sale		**221**	(562)
Income tax effect on net gain/(loss) on investments available for sale	14	**1**	(4)
Total comprehensive profit for the year		**5,103**	**1,696**

The accompanying selected explanatory notes on pages 56 to 87 are an integral part of these financial statements

STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2016
(Amounts in tables are in thousands of Georgian Lari)

	Share capital	Retained earnings/ (accumulated deficit)	Other Reserves	Total Equity
1 January 2015	**103,000**	**(6,789)**	**274**	**96,485**
Profit for the year	–	2,262	–	2,262
Other comprehensive loss for the year	–	–	(566)	(566)
Total comprehensive income for the year	**–**	**2,262**	**(566)**	**1,696**
December 2015	**103,000**	**(4,527)**	**(292)**	**98,181**
Profit for the year	–	4,881	–	4,881
Other comprehensive income for the year	–	–	222	222
Total comprehensive income for the year	**–**	**4,881**	**222**	**5,103**
31 December 2016	**103,000**	**354**	**(70)**	**103,284**

The accompanying selected explanatory notes on pages 56 to 87 are an integral part of these financial statements

STATEMENT OF CASH FLOWS
For the year ended 31 December 2016
(Amounts in tables are in thousands of Georgian Lari)

	Notes	2016	2015
Cash flows from operating activities			
Interest received		**21,074**	18,975
Interest paid		**(6,522)**	(5,680)
Fees and commissions received		**591**	561
Fees and commissions paid		**(342)**	(134)
Realised gains less losses from dealing in foreign currencies		**1,146**	294
Personnel expenses paid		**(4,813)**	(3,782)
General and administrative expenses paid		**(4,205)**	(4,037)
Other income received		**387**	117
Cash flows from operating activities before changes in operating assets and liabilities		**7,316**	**6,314**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		**(49,840)**	(2,470)
Loans to customers		**16,233**	(48,635)
Net increase/(decrease) in operating liabilities			
Amounts due to credit institutions		**(46,506)**	94,544
Amounts due to customers		**22,243**	14,837
Other liabilities		**–**	(204)
Net cash (used in)/from operating activities		**(50,554)**	**64,386**
Cash flows from investing activities			
Purchase of investment securities		**(40,151)**	(139,946)
Proceeds from redemption of investment securities		**74,994**	90,432
Purchase of property and equipment		**(118)**	(280)
Purchase of intangible assets		**(308)**	(466)
Net cash from/(used in) investing activities		**34,417**	**(50,260)**
Effect of exchange rates changes on cash and cash equivalents		**1,454**	1,056
Net (decrease)/increase in cash and cash equivalents		**(14,683)**	**15,182**
Cash and cash equivalents, beginning	**5**	**22,282**	**7,100**
Cash and cash equivalents, ending	**5**	**7,599**	**22,282**

The accompanying selected explanatory notes on pages 56 to 87 are an integral part of these financial statements

1. Principal activities

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

The Bank accepts deposits and extends credit, transfers payments in Georgia and abroad, exchanges currencies and provides other banking services to its commercial customers. The Bank has one service office in Georgia as of 31 December 2016. The Bank's registered legal address is 15 Rustaveli Avenue, Tbilisi, 0108, Georgia.

As at 31 December 2016 and 2015, the Bank's 100% owner was OJSC PASHA Bank (the "Parent"), the Republic of Azerbaijan. The Bank is ultimately owned by Mrs. Leyla Aliyeva and Mrs. Arzu Aliyeva, who exercise joint control over the Bank.

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

2. Basis of preparation

General

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

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

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

3. Summary of accounting policies

Changes in accounting policies

The Bank has adopted the following amended IFRS and IFRIC which are effective for annual periods beginning on or after 1 January 2016:

Amendments to IAS 1 Disclosure Initiative

The amendments to IAS 1 clarify, rather than significantly change, existing IAS 1 requirements. The amendments clarify:

- The materiality requirements in IAS 1;
- That specific line items in the statement(s) of profit or loss and OCI and the statement of financial position may be disaggregated;
- That entities have flexibility as to the order in which they present the notes to financial statements;
- That the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss

Furthermore, the amendments clarify the requirements that apply when additional subtotals are presented in the statement of financial position and the statement(s) of profit or loss and OCI. These amendments are effective for annual periods beginning on or after 1 January 2016. These amendments do not have any impact on the Bank.

IFRS 7 Financial Instruments: Disclosures

The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. An entity must assess the nature of the fee and the arrangement against the guidance for continuing involvement in IFRS 7 in order to assess whether the disclosures are required. The assessment of which servicing contracts constitute continuing involvement must be done retrospectively. However, the required disclosures would not need to be provided for any period beginning before the annual period in which the entity first applies the amendments.

Fair value measurement

Fair values of financial instruments measured at amortised cost are disclosed in Note 20.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:
- In the principal market for the asset or liability; or
- In the absence of a principal market, in the most advanta geous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Bank. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

Fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:
- Level 1 – quoted (unadjusted) market prices in active markets for identical assets or liabilities;
- Level 2 – valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly ob servable;
- Level 3 – valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

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

Financial assets

Initial recognition

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. The Bank determines the classification of its financial assets upon initial recognition, and subsequently can reclassify financial assets in certain cases as described below.

Date of recognition

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

Loans and receivables

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

Measurement of loans and receivables originated through acquisition

In the case of loans and receivables originated through acquisition the fair value at initial recognition is measured using discounting of future cash flows expected from the financial asset. The difference between the acquisition price and the fair value is recognized in the statement of comprehensive income as gain/(loss) on initial recognition. This policy is applied equally to transactions with third parties, related parties, entities under common control and shareholders.

These loans and receivables are also measured at amortized cost using the effective interest method. Any gain resulting from revision of estimates of the future cash flows is accounted in the statement of comprehensive income within interest income from loans to customers. Any loss resulting from impairment is accounted within the loan loss provision in the statement of comprehensive income.

Reclassification of financial assets

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit or loss category in one of the following cases:

- A financial asset that would have met the definition of loans and receivables above may be reclassified to loans and receivables category if the Bank has the intention and ability to hold it for the foreseeable future or until maturity;
- Other financial assets may be reclassified to available for sale or held to maturity categories only in rare circumstances.

A financial asset classified as available for sale that would have met the definition of loans and receivables may be reclassified to loans and receivables category if the Bank has the intention and ability to hold it for the foreseeable future or until maturity.

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

Financial assets are reclassified at their fair value on the date of reclassification. Any gain or loss already recognized in profit or loss is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable.

Measurement of financial instruments at initial recognition

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

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

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

Offsetting of financial instruments

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

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

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

Impairment of financial assets

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

Amounts due from credit institutions, investment securities: loans and receivables and loans to customers

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

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account.

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

If a future write-off is later recovered, the recovery is credited to the statement of profit or loss.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable. Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of industrial average of historical loss experience for assets with credit risk characteristics similar to those in the group, due to the reason that the Bank does not have sufficient statistical data.

Derecognition of financial assets and liabilities

Financial assets

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

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

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

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

Financial liabilities

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

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

Cash and cash equivalents

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

Mandatory reserve deposit with the NBG

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

Leases

Operating − Bank as lessee

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

Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees. Financial guarantees are initially recognised in the financial statements at fair value, in "Other liabilities", being the premium received. Subsequent to initial recognition,

(Amounts in tables are in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

the Bank's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the statement of profit or loss. The premium received is recognised in profit or loss on a straight-line basis over the life of the guarantee.

Taxation

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

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

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

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

Property and equipment

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

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

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

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

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

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

Intangible assets

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic lives of 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end.

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.

3. Summary of accounting policies (continued)

Intangible assets (continued)

Share capital

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

Recognition of income and expenses

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

Interest and similar income and expense

For all financial instruments measured at amortised cost and interest bearing securities classified as trading or available-for-sale, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts.
The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the original effective interest rate applied to the new carrying amount.

Fee and commission income

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

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

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

- *Fee income from providing transaction services*

Fees arising from negotiating or participating in the negotiation of a transaction for a third party – such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses – are recognised on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding criteria.

Foreign currency translation

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

Differences between the contractual exchange rate of a transaction in a foreign currency and the NBG exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies. The official GEL exchange rates at 31 December 2016 and 2015 were 2.6468 GEL and 2.3949 GEL to 1 USD, respectively, 2.7940 GEL and 2.6169 GEL to 1 EUR, respectively and 1.4678 GEL and 1.5374 GEL to 1 AZN, respectively.

Standards issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements which may have impact on the Bank's financial statements are disclosed below. The Bank intends to adopt this standard, when it becomes effective. Management does not expect application of other new standards and interpretations to have significant impact on financial statements.

(Amounts in tables are in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Intangible assets (continued)

IFRS 9 Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments* which reflects all phases of the financial instruments project and replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting.

From a classification and measurement perspective, the new standard will require all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics. The IAS 39 measurement categories will be replaced by: fair value through profit or loss (FVPL), fair value through other comprehensive income (FVOCI), and amortised cost categories. IFRS 9 will also allow entities to continue to irrevocably designate instruments that qualify for amortised cost or FVOCI instruments as FVPL, if doing so eliminates or significantly reduces a measurement or recognition inconsistency. Equity instruments that are not held for trading may be irrevocably designated as FVOCI, with no subsequent reclassification of gains or losses to the income statement. The accounting for financial liabilities will largely be the same as the requirements of IAS 39.

IFRS 9 will also fundamentally change the approach to loan impairment. The standard will replace IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. The Bank will be required to record an allowance for expected losses for all loans and other debt financial assets not carried at FVPL, as well as for loan commitments and financial guarantee contracts. The allowance is based on the expected credit losses associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case the allowance would be based on the probability of default over the life of the asset.

IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Retrospective application is required, but restatement of comparative information is not required; the effect on the transition date – 1 January 2018 – would be recorded in retained earnings. The adoption of IFRS 9 is expected to have an effect on the classification and measurement of the Bank's financial assets, but no impact on the classification and measurement of the Bank's financial liabilities. The Bank does not expect a significant impact on its equity due to adoption of IFRS 9 impairment requirements, but it will need to perform a more detailed analysis which considers all reasonable and supportable information, including forward-looking elements to determine the extent of the impact.

IFRS 15 Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15 *Revenue from Contracts with Customers*, effective for periods beginning on 1 January 2018 with early adoption permitted. IFRS 15 defines principles for recognising revenue and will be applicable to all contracts with customers. However, interest and fee income integral to financial instruments and leases will continue to fall outside the scope of IFRS 15 and will be regulated by the other applicable standards (e.g., IFRS 9, and IFRS 16 *Leases*).

Revenue under IFRS 15 will need to be recognised as goods and services are transferred, to the extent that the transferor anticipates entitlement to goods and services. The standard will also specify a comprehensive set of disclosure requirements regarding the nature, extent and timing as well as any uncertainty of revenue and corresponding cash flows with customers.

The Bank does not anticipate early adopting IFRS 15.

IFRS 16 Leases

The IASB issued the new standard for accounting for leases – IFRS 16 Leases in January 2016. The new standard does not significantly change the accounting for leases for lessors. However, it does require lessees to recognise most leases on their balance sheets as lease liabilities, with the corresponding right of-use assets. Lessees must apply a single model for all recognised leases, but will have the option not to recognise 'short-term' leases and leases of 'low-value' assets. Generally, the profit or loss recognition pattern for recognised leases will be similar to today's finance lease accounting, with interest and depreciation expense recognised separately in the statement of profit or loss.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted provided the new revenue standard, IFRS 15, is applied on the same date.

Amendments to IAS 12 Income Taxes

In January 2016, through issuing amendments to IAS 12, the IASB clarified the accounting treatment of deferred tax assets of debt instruments measured at fair value for accounting, but measured at cost for tax purposes. The Bank does not anticipate that adopting the amendments would have amaterial impact on its financial statements.

3. Summary of accounting policies (continued)

Intangible assets (continued)

Amendments to IAS 7 Statement of Cash Flows

In January 2016, the IASB issued amendments to IAS 7 *Statement of Cash Flows* with the intention to improve disclosures of financing activities and help users to better understand the reporting entities' liquidity positions. Under the new requirements, entities will need to disclose changes in their financial liabilities as a result of financing activities such as changes from cash flows and non-cash items (e.g., gains and losses due to foreign currency movements). The amendment is effective from 1 January 2017. The Bank is currently evaluating the impact.

4. Significant accounting judgments and estimates

Estimation uncertainty

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

Allowance for loan impairment

The Bank regularly reviews its loans and receivables to assess impairment. As at 31 December 2015 total loan portfolio was assessed on collective basis (Note 7). Due to inexistence of own historical loss experience for loans to customers, the Bank used industry average loss ratios for collectively assessed loans. During 2016 the Bank adopted new methodology on financial assets impairment, which was applied to calculate allowances for loans to customer and investment securities as at 31 December 2016. The new methodology is based on loan default probability assessments. The amount of allowance for loans to customers and investment securities recognized in statement of financial position at 31 December 2016 was GEL 2,120 thousand (2015: GEL thousand 1,311) and GEL 201 thousand (2015: nil) respectively. The effect on net income from the application of the new methodology has been estimated by the Bank as additional GEL 303 thousand of impairment charge.

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. Additional details are provided in Note 20.

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2016	2015
Cash on hand	**656**	406
Current accounts with the NBG	**665**	922
Current accounts with other credit institutions	**3,778**	2,159
Time deposits with credit institutions up to 90 days	**2,500**	18,795
Cash and cash equivalents	**7,599**	**22,282**

(Amounts in tables are in thousands of Georgian Lari)

5. Cash and cash equivalents (continued)

Cash and cash equivalents comprise: (continued)

As at 31 December 2016, current accounts and time deposit accounts with credit institutions denominated in GEL represent 46.03% of total current and time deposit accounts (31 December 2015: 2.00%). The outstanding balance of current accounts with credit institutions and time deposit accounts, consist of interest bearing correspondent account balances with resident banks in the amount of GEL 447 thousand and GEL 2,500 thousand, respectively (31 December 2015: GEL 987 thousand and GEL 18,795 thousand, respectively) and non-interest bearing correspondent account balances with resident and non-resident banks in the amounts of GEL 896 thousand and GEL 2,435 thousand, respectively (31 December 2015: GEL 1,140 thousand and GEL 32 thousand, respectively).

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2016	2015
Time deposits for more than 90 days	52,576	8,542
Mandatory reserve with the NBG	30,685	12,610
Amounts due from credit institutions	**83,261**	**21,152**

Credit institutions are required to maintain a mandatory interest earning cash deposit with the NBG at the level of 7% and 20% of the average of funds attracted from customers by a credit institution for the appropriate two-week period in GEL and foreign currencies, respectively, since June 2016 (31 December 2015: 10% and 15% respectively).

Time deposits comprise of deposits in USD and GEL placed with resident and non-resident commercial banks with maturities ranging from February 2017 to December 2017 and interest rates of 4.0%5.5% on GEL deposits and 6.5%-7.2% on USD deposits (31 December 2015: deposits in USD placed with one local commercial bank with maturities ranging from February 2016 to March 2016 and interest rate of 5.5%).

7. Loans to customers

Loans to customers comprise:

	2016	2015
Private entities	66,767	70,651
Foreign state controlled entities	30,129	36,347
Individuals	314	2,915
Loans to customers	**97,210**	**109,913**
Less – allowance for impairment	(2,120)	(1,311)
Loans to customers	**95,090**	**108,602**

7. Loans to customers (continued)

The movement in allowance for impairment losses for loans to customers was as follows:

	2016		
	Legal entities	**Individuals**	**Total**
At 1 January 2016	**1,253**	**58**	**1,311**
Charge for the year	796	13	809
At 31 December 2016	**2,049**	**71**	**2,120**
Collective impairment	1,204	5	1,209
Individual impairment	845	66	911
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	8,788	66	8,854

	2014		
	Legal entities	**Individuals**	**Total**
At 1 January 2015	**399**	**–**	**399**
Charge for the year	3,483	58	3,541
Write-off	(2,629)	–	(2,629)
At 31 December 2015	**1,253**	**58**	**1,311**
Collective impairment	1,253	58	1,311

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters. The main types of collateral obtained are charges over real estate properties and guarantees from the Parent. The Bank also obtains guarantees from parent companies for loans to their subsidiaries.

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

Concentration of loans to customers

As at 31 December 2016, the Bank had a concentration of loans due from three major group of borrowers in the total exposure of GEL 53,847 thousand that represented 55.39% of the total gross loan portfolio (31 December 2015: three loans of GEL 63,039 thousand with 57.35% of the gross loan portfolio). An allowance of GEL 467 thousand (31 December 2015: 374) was recognised against these loans. Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2016, comprised GEL 846 thousand, (2015: nil).

(Amounts in tables are in thousands of Georgian Lari)

7. Loans to customers (continued)

Loans are made in the following industry sectors:

	2016	2015
Trade and services	48,881	61,775
Non-banking credit organizations	20,664	13,214
Energy	14,929	24,833
Construction	8,778	7,176
Mining	3,644	–
Individuals	314	2,915
	97,210	**109,913**

8. Investment securities

As at 31 December 2016, investment securities comprised of debt securities of the Ministry of Finance of Georgia, debt securities of the National Bank of Georgia and debt securities of companies and commercial banks registered in Georgia and Azerbaijan.

Investment securities comprise:

	2016	2015
Investment securities: loans and receivables		
Treasury bonds of the Ministry of Finance of Georgia	31,028	38,718
Certificates of deposit of financial institutions	26,543	12,204
Bonds of financial institutions	21,541	24,652
Corporate bonds	12,969	8,892
Treasury bills of the Ministry of Finance of Georgia	–	23,528
Certificates of deposit of the NBG	–	15,326
Total investment securities: loans and receivables	**92,081**	**123,320**
Less: allowance for impairment (a)	(201)	–
Total investment securities: loans and receivables	**91,880**	**123,320**

(a) The allowance for the impairment relates to the collectively impaired exposures of corporate bonds.

On 1 July 2015 the Bank's Asset and Liability Committee (ALCO) decided to reclassify all of the Bank's investment securities from the available-for-sale category into category of loans and receivables. The Bank assessed that based on the changing market conditions it is not intending to sell the securities in future and will hold them till their contractual maturities. The fair value of available-for-sale securities at the date of reclassification was GEL 94,516 thousand.

As at 31 December 2016 the carrying value and the fair value of the investment securities reclassified from the available-for-sale category into category of loans and receivables on 1 July was GEL 50,866 thousand and GEL 53,324 thousand respectively (31 December 2015: carrying value of GEL 97,121 thousand and fair value of GEL 96,321 thousand).

9. Property and equipment

The movements in property and equipment were as follows:

	Furniture and fixtures	Computers and equipment	Motor vehicles	Other equipment	Leashold improvements	Total
Cost						
1 January 2015	**1,818**	**2,279**	**116**	**447**	**1,908**	**6,568**
Additions	22	111	131	12	4	280
31 December 2015	**1,840**	**2,390**	**247**	**459**	**1,912**	**6,848**
Additions	3	37	66	27	–	133
Disposals	–	(15)	–	–	–	(15)
31 December 2015	**1,843**	**2,412**	**313**	**486**	**1,912**	**6,966**
Accumulated depreciation:						
1 January 2015	**(718)**	**(872)**	**(49)**	**(141)**	**(741)**	**(2,521)**
Depreciation charge	(455)	(575)	(59)	(91)	(458)	(1,638)
31 December 2015	**(1,173)**	**(1,447)**	**(108)**	**(232)**	**(1,199)**	**(4,159)**
Depreciation charge	(461)	(616)	(77)	(95)	(461)	(1,710)
Disposal charge	–	11	–	–	–	11
31 December 2016	**(1,634)**	**(2,052)**	**(185)**	**(327)**	**(1,660)**	**(5,858)**
Net book value:						
1 January 2015	**1,100**	**1,407**	**67**	**306**	**1,167**	**4,047**
31 December 2015	**667**	**943**	**139**	**227**	**713**	**2,689**
31 December 2016	**209**	**360**	**128**	**159**	**252**	**1,108**

(Amounts in tables are in thousands of Georgian Lari)

10. Intangible assets

The movements in intangible assets were as follows:

	Licenses	Computer software	Total
Cost			
1 January 2015	**436**	**768**	**1,204**
Additions	54	1,061	1,115
Disposals and write offs	(2)	–	(2)
31 December 2015	**488**	**1,829**	**2,317**
Additions	425	90	515
Disposals and write offs	(16)	(90)	(106)
31 December 2016	**897**	**1,829**	**2,726**
Accumulated amortization			
1 January 2015	**(59)**	**(48)**	**(107)**
Amortization charge	(49)	(137)	(186)
31 December 2015	**(108)**	**(185)**	**(293)**
Amortisation charge	(214)	(174)	(388)
Disposals and write offs	14	1	15
31 December 2016	**(308)**	**(358)**	**(666)**
Net book value:			
1 January 2015	**377**	**720**	**1,097**
31 December 2015	**380**	**1,644**	**2,024**
31 December 2016	**589**	**1,471**	**2,060**

11. Other assets and liabilities

Other assets comprise:

	2016	2015
Other non-financial assets		
Prepaid expenses	365	432
Prepayments for operating lease	170	150
Prepaid taxes other than income tax	16	106
Prepayments for acquisition of intangible assets	4	20
Other	8	11
Other assets	**563**	**719**

Other liabilities comprise:

	2016	2015
Other financial liabilities		
Other financial liabilities	223	95
	223	**95**
Other non-financial liabilities		
Payable to employees	1,150	780
Deferred income	38	35
Taxes other than income tax	–	2
	1,188	**817**
Other liabilities	**1,411**	**912**

(Amounts in tables are in thousands of Georgian Lari)

12. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	2016	2015
Time deposits of non-resident commercial banks	39,956	4,793
Time deposits of the Parent	37,617	64,086
Short-term loan from the NBG	28,030	69,700
Time deposits of resident commercial banks	14,478	15,706
Current accounts of the Parent	8,597	1,247
Overdraft from the Parent	3,003	6,397
Amounts due to credit institutions	**131,681**	**161,929**

As at 31 December 2016 the time deposits of non-resident commercial banks are comprised of USD denominated deposits of an entity under common control (2015: one USD denominated deposit of a non-resident bank). As at 31 December 2016 time deposits placed by four resident commercial banks are denominated in GEL and USD, bear interest rates ranging from 6.50% to 6.75% in GEL and from 1.60% to 2.50% in USD and mature in January 2017.

13. Amounts due to customers

The amounts due to customers include the following:

	2016	2015
Time deposits	33,492	11,149
Current accounts	12,532	10,139
Amounts due to customers	**46,024**	**21,288**
Held as security against guarantees issued (Note 16)	757	10,497

As at 31 December 2016, amounts due to customers included balances with three major customers of GEL 27,561 thousand that constituted 59.88% of the total of customer accounts (31 December 2015: 13,984 thousand that constituted 65.69% of the total of customer accounts).

An analysis of customer accounts by economic sector follows:

	2016	2015
Construction	21,071	10,893
Individuals	13,356	23
Trade and services	6,499	4,569
Insurance	4,491	–
Pharmacy	314	–
Energy	256	235
Non-banking credit organizations	37	5,511
Other	–	57
Amounts due to customers	**46,024**	**21,288**

14. Taxation

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

Following the enactment of the amendments, as at 31 December 2016 the Bank remeasured its deferred tax assets and liabilities at the tax rates that were expected to apply to the period when the asset is realised or the liability is settled. As IAS 12 *Income Taxes* requires, the Bank used 0% tax rate applicable for undistributed profits in respect of assets and liabilities expected to be realized or settled in the periods when the new regulation becomes effective starting from 1 January 2019.

The amendments to the Georgian tax law described above also provide for charging corporate income tax on certain transactions that are considered deemed profit distributions, e.g. some transactions at non-market prices, non-business related expenses or supply of goods and services free of charge. Taxation of such transaction is outside scope of IAS 12 *Income Taxes* and will be accounted similar to operating taxes starting from 1 January 2019. Tax law amendments related to such deemed profit distribution did not have any effect on the Bank's financial statements for the year ended 31 December 2016.

The corporate income tax expense for the year ended 31 December 2016 comprises of deferred tax expense of GEL 599 thousand (31 December 2015: GEL 1,624 thousand deferred tax benefit).

In 2016 and 2015 the income tax rate applicable to the Bank's income is 15%. The effective income tax rate differs from the statutory income tax rate. A reconciliation of the income tax benefit expense on statutory rates with actual is as follows:

	2016	2015
Profit before income tax	**5,480**	**638**
Statutory tax rate	15%	15%
Theoretical income tax expense at the statutory rate	**(822)**	**(96)**
Tax exempt income	243	334
Non-deductible expenses	(20)	(53)
Utilised tax losses carried forward, not recognized previously	–	335
Change in unrecognized deferred tax asset	–	1,104
Income tax (expense)/benefit	**(599)**	**1,624**

(Amounts in tables are in thousands of Georgian Lari)

14. Taxation (continued)

Deferred tax assets and liabilities as at 31 December 2016 and 31 December 2015 and their movements for the respective period:

	2014	Through statement of profit and loss	Through statement of OCI	2015	Through statement of profit and loss	Through statement of OCI	2016
Tax effect of deductible temporary differences							
Tax losses carried forward	2,185	(367)	–	1,818	(1,014)	–	804
Other liabilities	14	54	–	68	67	–	135
Gross deferred tax asset	**2,199**	**(313)**	**–**	**1,886**	**(947)**	**–**	**939**
Unrecognised deferred tax asset	(1,471)	1,471	–	–	–	–	–
Deferred tax asset	**728**	**1,158**	**–**	**1,886**	**(947)**	**–**	**939**
Tax effect of taxable temporary differences							
Property and equipment	(36)	109	–	73	153	–	226
Intangible assets	(22)	(27)	–	(49)	(3)	–	(52)
Loans to customers	(762)	368	–	(394)	217	–	(177)
Investment securities	(6)	16	(4)	6	(19)	(1)	(12)
Deferred tax liability	**(826)**	**466**	**(4)**	**(364)**	**348**	**(1)**	**(15)**
Deferred tax asset/(liability)	**(98)**	**1,624**	**(4)**	**1,522**	**(599)**	**(1)**	**924**

The Bank incurred tax losses of GEL 10,915 thousand and GEL 3,340 thousand for 2014 and 2013 which can be carried for 5 years and, will expire by 1 January 2019, if not utilized. During 2016 the Bank utilized GEL 6,760 thousand of tax losses carried forward (2015: GEL 2,233 thousand). Management evaluated and concluded that it is probable that deferred tax assets on past tax losses will be recovered, since the bank is generating taxable profit since 2015.

15. Equity

The share capital of the Bank was contributed by the Parent in GEL and they entitle to dividends and any capital distribution in GEL.

As at 31 December 2016 and 2015, the Bank's authorized, issued and fully paid capital amounted to GEL 103,000 thousand comprising of 103,000,000 common shares with nominal value of
GEL 1.00 each. Each share entitles one vote to the shareholder.

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

No dividends were declared or paid during the year ended 31 December 2016 (2015: nil)

Nature and purpose of other reserves

On 1 July 2015 the Bank reclassified all of the Bank's investment securities from available-for-sale category into category of loans and receivables. The revaluation gain/(loss) on the available-for-sale securities at the date of reclassification is gradually being re-cycled to profit and loss, as the reclassified securities approach their maturity.

16. Commitments and contingencies

Taxation

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

Management believes that its interpretation of the relevant legislation as at 31 December 2016 is appropriate and that the Bank's tax, currency and customs positions will be sustained.

(Amounts in tables are in thousands of Georgian Lari)

16. Commitments and contingencies (continued)

Taxation

Commitments and contingencies

As at 31 December 2016 and 2015, the Bank's commitments and contingencies comprised the following:

	2016	2015
Credit related commitments		
Guarantees issued	13,026	22,326
Unused credit lines	5,230	443
Letters of credit	318	359
	18,574	**23,128**
Operating lease commitments		
Not later than 1 year	1,723	1,525
More than 1 year but less than 5 years	8,016	625
Contingency over 5 years	868	–
	10,607	**2,150**
Less: provisions for guarantees and letters of credit	(85)	–
Commitments and contingencies (before deducting collateral)	**29,096**	**25,278**
Less: deposits held as security against guarantees issued (Note 13)	(757)	(10,497)
Commitments and contingencies	**28,339**	**14,781**

17. Net fee and commission income

Net fee and commission income comprises:

	2016	2015
Guarantees	285	299
Brokerage operations	152	163
Settlements operations	126	72
Cash operations	21	13
Currency conversion operations	2	–
Fee and commission income	**586**	**547**
Settlements operations	(161)	(119)
Plastic cards	(82)	(56)
Guarantees	(82)	(45)
Cash operations	(16)	(19)
Brokerage operations	(1)	(1)
Fee and commission expense	**(342)**	**(240)**
Net fee and commission income	**244**	**307**

18. Personnel, general and administrative expenses

Personnel, general and administrative expenses comprise:

	2016	2015
Salaries	3,658	3,160
Bonuses and other employee benefits	1,525	1,329
Personnel expenses	**5,183**	**4,489**
Operating leases	1,479	1,341
Professional services	1,214	912
Advertising costs	587	412
Personnel training	253	190
Corporate hospitality and entertainment	146	155
Utilities	112	122
Transportation and business trip expenses	84	117
Insurance	77	69
Security expenses	58	62
Maintenance and exploitation	37	38
Membership fees	35	35
Taxes other than income tax	19	34
Communication	3	26
Other	205	208
General and administrative expenses	**4,309**	**3,721**

19. Risk management

Introduction

The process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. Regardless of the sophistication of the measures, bank distinguishes between expected and unexpected losses. Expected losses are typically reserved for as described in credit risk policy. For unexpected losses Bank relies on its capital as a buffer to absorb such losses. The Bank is exposed to financial risk, being subdivided into credit and liquidity risk, operational risk and market risk, being subdivided into trading and non-trading risks.

Risk management structure

Board of Directors

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

19. Risk management (continued)

Risk management structure (continued)

Risk management

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

Asset and Liability Committee

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

Internal Audit

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

Audit Committee

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

Risk measurement and reporting systems

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept. The main body to which the risks are reported is ALCO. The respective meetings are held once a month.

Excessive risk concentration

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

19. Risk management (continued)

Credit risk

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

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

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

Credit-related commitments risks

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

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank internal credit review process.

Loans to customers of High grade are those for which the principal and interest are paid in a timely manner and are supported by the sound capital and paying capability of the borrower. This classification is proper when the borrower is financially strong and has sufficient capital to cushion unforeseen adverse impacts, is within its profit targets and produces cash flows sufficient to satisfy a liability on time, including the subject asset.

Standard grade is assigned to loans when they are adequately protected but potentially weak because while there was to be stable financial condition and paying capability of the borrower at the time of the loan's origination, some deficiencies or trends are now apparent which, if not corrected, might cause concern about the borrower's ability to continue to serve the loan in a timely manner.

Loans are classified as Sub-standard if they are inadequately protected by the capital and paying capability of the borrower or by the value of any supporting collateral. Sub-standard loan has such weaknesses or problems which jeopardize payments of the indebtedness or makes full repayment questionable.

(Amounts in tables are in thousands of Georgian Lari)

19. Risk management (continued)

Credit risk (continued)

		Neither past due nor impaired			
	Notes	**High grade 2016**	**Sub-standard grade 2016**	**Individually impaired**	**Total 2016**
Amounts due from credit institutions	6	83,261	–	–	**83,261**
Loans to customers	7	88,356	–	8,854	**97,210**
Investment securities	8	89,050	3,031	–	**92,081**
Total		**260,667**	**3,031**	**8,854**	**272,552**

		Neither past due nor impaired			
	Notes	**High grade 2015**	**Standard grade 2015**	**Individually impaired**	**Total 2015**
Amounts due from credit institutions	6	21,152	–	–	**21,152**
Loans to customers	7	109,913	–	–	**109,913**
Investment securities	8	117,105	6,215	–	**123,320**
Total		**248,170**	**6,215**	**–**	**254,385**

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 30 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

The Bank determines the allowances appropriate for each individually significant loan on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend pay out should bankruptcy ensue, the availability of other financial support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively assessed allowances

Allowances are assessed collectively for losses on loans to customers that are not individually significant and for individually significant loans where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no yet objective evidence of the impairment in an individual assessment. Collective assessment is performed by applying the delinquency roll rate model approach, where impairment allowances are estimated based on the percentage of assets with similar characteristics that become increasingly delinquent.

19. Risk management (continued)

Credit risk (continued)

Impairment losses on off balance sheet commitments such as guarantees and letters of credit are estimated by applying the parameters sources from on balance sheet portfolio.

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

	2016			**2015**			
	Georgia	**Other Non-OECD**	**Total**	**Georgia**	**OECD**	**Other Non-OECD**	**Total**
Assets							
Cash and cash equivalents	5,164	2,435	**7,599**	22,250	3	29	**22,282**
Amounts due from credit institutions	78,236	5,025	**83,261**	21,152	–	–	**21,152**
Loans to customers	95,090	–	**95,090**	108,602	–	–	**108,602**
Investment securities	88,860	3,020	**91,880**	117,105	–	6,215	**123,320**
	267,350	**10,480**	**277,830**	**269,109**	**3**	**6,244**	**275,356**
Liabilities							
Amounts due to credit institutions	3,500	128,181	**131,681**	85,407	2	76,520	**161,929**
Amounts due to customers	8,874	37,150	**46,024**	21,288	–	–	**21,288**
Other liabilities	223	–	**223**	91	4	–	**95**
	12,597	**165,331**	**177,928**	**106,786**	**6**	**76,520**	**183,312**
Net assets/(liabilities)	**254,753**	**(154,851)**	**99,902**	**162,323**	**(3)**	**(70,276)**	**92,044**

Liquidity risk and funding management

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

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

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on certain liquidity ratios established by the NBG. As at 31 December, these ratios were as follows:

	2016 %	**2015 %**
LK "Average Liquidity Ratio" (Average volume of liquid assets / Average volume of liabilities)	39.05	34.12

(Amounts in tables are in thousands of Georgian Lari)

19. Risk management (continued)

Liquidity risk and funding management (continued)

Analysis of financial liabilities by remaining contractual maturities

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

As at 31 December 2016	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Financial liabilities					
Amounts due to credit institutions	105,866	26,474	–	–	132,340
Amounts due to customers	29,084	15,578	1,714	–	46,376
Other financial liabilities	223	–	–	–	223
Total undiscounted financial liabilities	**135,173**	**42,052**	**1,714**	**–**	**178,939**

As at 31 December 2015	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Financial liabilities					
Amounts due to credit institutions	141,430	987	21,214	–	163,631
Amounts due to customers	20,636	2,919	–	–	23,555
Other financial liabilities	95	–	–	–	95
Total undiscounted financial liabilities	**162,161**	**3,906**	**21,214**	**–**	**187,281**

The table below shows the contractual expiry by maturity of the Bank's financial commitments and contingencies. Each undrawn loan commitment is included in the time band containing the earliest date it can be drawn down. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
2016	18,255	–	319	–	**18,574**

	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
2015	22,769	359	–	–	**23,128**

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

19. Risk management (continued)

Market risk

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

Currency risk

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

Currency	change in currency rate 2016	Effect on profit before tax 2016	change in currency rate 2015	Effect on profit before tax 2015
USD	15%/(15%)	1,070/(1,070)	15%/(15%)	105/(105)
AZN	15%/(15%)	75/(75)	15%/(15%)	15/(15)

Prepayment risk

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

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

	Decrease of net interest income
2016	1,159
2015	1,303

Interest rate risk

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

The sensitivity of the statement of profit or loss is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2016. The Bank did not hold any floating rate financial assets or liabilities in 2015.

Currency	Increase/(decrease) in basis points 2016	Sensitivity of net interest income
GEL	100/(100)	168/(168)

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

(Amounts in tables are in thousands of Georgian Lari)

20. Fair value measurements

Fair value hierarchy

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

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

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

	Fair value measurement using			
At 31 December 2016	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets for which fair values are disclosed				
Cash and cash equivalents	7,599	–	–	**7,599**
Amounts due from credit institutions	–	–	83,261	**83,261**
Loans to customers	–	–	95,090	**95,090**
Investment securities	–	3,020	88,860	**91,880**

	Fair value measurement using			
As at 31 December 2016	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets for which fair values are disclosed				
Amounts due to credit institutions	–	–	131,681	**131,681**
Amounts due to customers	–	–	46,024	**46,024**

	Fair value measurement using			
As at 31 December 2015	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets for which fair values are disclosed				
Cash and cash equivalents	22,282	–	–	**22,282**
Amounts due from credit institutions	–	–	21,152	**21,152**
Loans to customers	–	–	108,602	**108,602**
Investment securities	–	6,215	117,105	**123,320**

	Fair value measurement using			
As at 31 December 2015	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets for which fair values are disclosed				
Amounts due to credit institutions	–	–	161,929	**161,929**
Amounts due to customers	–	–	21,288	**21,288**

20. Fair value measurements (continued)

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

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

	Carrying value 2016	Fair value 2016	Unrecognised gain/(loss) 2016	Carrying value 2015	Fair value 2015	Unrecognised gain/(loss) 2015
Financial assets						
Cash and cash equivalents	7,599	7,599	–	22,282	22,282	–
Amounts due from credit institutions	83,261	83,261	–	21,152	21,152	–
Loans to customers	95,090	95,090	–	`108,602	108,602	–
Investment securities	91,880	94,704	2,824	123,320	121,500	(1,820)
Financial liabilities						
Amounts due to credit institutions	131,681	131,681	–	161,929	161,929	–
Amounts due to customers	46,024	46,024	–	21,288	21,288	–
Total unrecognised change in fair value			**2,824**			**(1,820)**

Valuation techniques and assumptions

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

Assets for which fair value approximates carrying value

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

The fair value of loans to customers is estimated by comparing market interest rates when they were first recognized with current market rates offered for similar financial assets. The majority of loans to customers outstanding as at 31 December were issued within 12 months period ended 31 December 2016 at market interest rates, while the contractual interest rates of those loans issued in 2015 approximate market interest rates as at 31 December 2016. Hence their carrying value approximates their fair value.

Investment securities

As at 31 December 2016 investment securities represent fixed rated financial assets carried at amortized cost. The fair value for investment securities loans and receivables is derived by discounting the future cash flows using current market rates for similar financial assets.

(Amounts in tables are in thousands of Georgian Lari)

21. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled. See Note 19 "Risk management" for the Bank's contractual undiscounted repayment obligations.

	2016			2015		
	Within one year	More than one year	Total	Within one year	More than one year	Total
Cash and cash equivalents	7,599	–	**7,599**	22,282	–	**22,282**
Amounts due from credit institutions	83,261	–	**83,261**	21,152	–	**21,152**
Loans to customers	50,747	44,343	**95,090**	26,130	82,472	**108,602**
Investment securities	63,163	28,717	**91,880**	62,282	61,038	**123,320**
Property and equipment	–	1,108	**1,108**	–	2,689	**2,689**
Intangible assets	–	2,060	**2,060**	–	2,024	**2,024**
Deferred income tax assets	–	924	**924**	–	1,522	**1,522**
Other assets	384	179	**563**	604	115	**719**
Total	**205,154**	**77,331**	**282,485**	**132,450**	**149,860**	**282,310**
Amounts due to credit institutions	131,681	–	**131,681**	142,147	19,782	**161,929**
Amounts due to customers	44,404	1,620	**46,024**	21,288	–	**21,288**
Provisions for guarantees and letters of credit	85	–	**85**	–	–	**–**
Other liabilities	1,411	–	**1,411**	912	–	**912**
Total	**177,581**	**1,620**	**179,201**	**164,347**	**19,782**	**184,129**
Net	**27,573**	**75,711**	**103,284**	**(31,897)**	**130,078**	**98,181**

22. Related party disclosures

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

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

The outstanding balances of related party transactions are as follows:

	2016			2015		
	The Parent	Key manage-ment per-sonnel	Entities under common control	The Parent	Key manage-ment per-sonnel	Entities under common control
Cash and cash equivalents	2,435	–	–	29	–	–
Property plant and equipment	21	–	–	–	–	–
Amounts due from credit Institutions	–	–	5,025	–	–	–
Amounts due to credit institutions	(49,218)	–	(39,956)	(71,730)	–	–
Amounts due to customers	–	(7,259)	(23,027)	–	(1)	(42)
Other liabilities	(2)	–	–	–	–	–

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

	2016			2015
	The Parent	Key manage-ment per-sonnel	Entities under common contro	The Parent
Fee and commission income	50	–	–	44
Fee and commission expense	84	–	–	53
Interest income on amounts due from credit institutions	–	–	72	–
Interest expense on amounts due to credit institutions	1,911	–	277	2,178
Interest expense on amounts due to customers	–	105	396	–
Professional fees	–	–	–	5

Compensation of key management personnel was comprised of the following:

	2016	2015
Salaries and other short-term benefits	1,251	1,029

Key management personnel as at 31 December 2016 and 2015, comprised of 3 members of the Board of Directors of the Bank.

(Amounts in tables are in thousands of Georgian Lari)

23. Capital adequacy

The primary objectives of the Bank's capital management are (i) to ensure that the Bank complies with externally imposed capital requirements set by the NBG, (ii) to safeguard the Bank's ability to continue as a going concern and (iii) to maintain sufficient capital base to achieve a capital adequacy ratio of at least 10.80% (2015: 11.4%). Compliance with capital adequacy ratios set by the NBG is monitored monthly with reports outlining their calculation reviewed and signed by the Bank's Chief Accountant or Chief Financial Officer and subsequently submitted to the NBG.

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

NBG capital adequacy ratio

The NBG requires banks to maintain a capital adequacy ratio of 10.80% (2015: 11.4%). of risk-weighted assets and Tier 1 Capital adequacy ratio of 7.2%. (2015: 7.6%). As at 31 December 2016 and as at 31 December 2015, the Bank's capital adequacy ratios on this basis were as follows:

	Notes	31 December 2016	Adjustments	31 December 2016 Per the NBG
Share capital	15	103,000	–	103,000
Prior years accumulated deficit		(4,527)	(4,632)	(9,159)
Less: Intangible assets, net	10	(2,060)	–	(2,060)
Main capital		**96,413**	**(4,632)**	**91,781**
Current year income		4,881	2,483	7,364
General reserves		2,406	(356)	2,050
Additional capital		**7,287**	**2,127**	**9,414**
Less: deductions from capital		–	–	–
Total capital		**103,700**	**(2,505)**	**101,195**
Risk weighted assets				**218,136**
Capital adequacy ratio				42.08%
Tier 1 Capital adequacy ratio				46.39%

	Notes	31 December 2015	Adjustments	31 December 2015 Per the NBG
Share capital	15	103,000	–	103,000
Prior years accumulated deficit		(6,789)	(5,063)	(11,852)
Less: Intangible assets, net	10	(2,024)	–	(2,024)
Main capital		**94,187**	**(5,063)**	**89,124**
Current year loss		2,262	431	2,693
General reserves	7	1,311	1,131	2,442
Additional capital		**3,573**	**1,562**	**5,135**
Less: deductions from capital		–	–	–
Total capital		**97,760**	**(3,501)**	**94,259**
Risk weighted assets				**215,933**
Capital adequacy ratio				43.65%
Tier 1 Capital adequacy ratio				41.27%

23. Capital adequacy (continued)

NBG capital adequacy ratio (continued)

Regulatory capital consists of main capital, which comprises share capital and retained earnings including current year profit. Certain adjustments are made to IFRS-based results and reserves, as prescribed by the NBG. The other component of regulatory capital is Additional capital, which includes subordinated debt and revaluation reserve.

Starting from 30 June 2014 the NBG requires that all banks comply with Basel II regulations in their capital adequacy assessment. This implies the minimum ratio of 10.50% for total regulatory capital coefficient, minimum 7.00% of the core Tier 1 capital coefficient and minimum 8.50 % for Tier 1 capital coefficient. As at 31 December 2016, the Bank's capital adequacy ratios on the Basel II basis were as follows:

	Notes	31 December 2016	Adjustments	31 December 2016 Per the NBG
Additional tier 1 capital	15	103,000	–	103,000
Prior years accumulated deficit		(4,527)	(4,632)	(9,159)
Less: Intangible assets, net	10	(2,060)	–	(2,060)
Current year income		4,881	2,483	7,364
Core Tier 1 capital		**101,294**	**(2,149)**	**99,145**
Tier 1 capital		**101,294**	**(2,149)**	**99,145**
Supplementary capital		2,406	(356)	2,050
Total regulatory capital		**103,700**	**(2,505)**	**101,195**
Risk weighted assets				**296,917**
Capital adequacy ratio				34.08%
Core Tier 1 capital/Tier 1 capital adequacy ratio				33.39%

	Notes	31 December 2015	Adjustments	31 December 2015 Per the NBG
Additional tier 1 capital	15	103,000	–	103,000
Prior years accumulated deficit		(6,789)	(5,063)	(11,852)
Less: Intangible assets, net	10	(2,024)	–	(2,024)
Current year income		2,262	431	2,693
Core Tier 1 capital		**96,449**	**(4,632)**	**91,817**
Tier 1 capital		**96,449**	**(4,632)**	**91,817**
Supplementary capital		1,311	1,131	2,442
Total regulatory capital		**97,760**	**(3,501)**	**94,259**
Risk weighted assets				**239,946**
Capital adequacy ratio				39.28%
Core Tier 1 capital/Tier 1 capital adequacy ratio				38.27%

ABBREVIATIONS

ACCA - Association of Chartered Certified Accountants
ALCO - Assets and Liabilities Committee
AML - Anti-Money-Laundering
AuC - Audit Committee
AZN - Azerbaijani Manat, the national currency of Azerbaijan
c.a. - circa, meaning approximately
CCO - Chief Commercial Officer
CEO - Chief Executive Officer
CFO - Chief Financial Officer
CIS - The Commonwealth of Independent States
CSR - Corporate Social Responsibility
DCM - Debt Capital Markets
EBRD - European Bank of Reconstruction and Development
ECM - Equity Capital Markets
ERP - Enterprise Resource Planing
EUR - Euro, the official currency of the Eurozone
EY - Ernst & Young
FATCA - Foreign Account Tax Compliance Act
FI - Financial Institution
FMS - Financial Management Systems
FX - Forex, the market in which currencies are traded
GEL - Georgian Lari or Lari, national currency of Georgia
GEOSTAT - National Statistics Office of Georgia
HR - Human Resources
IA - Internal Audit
IAD - Internal Audit Department
IFRS - International Financial Reporting Standards
IPO - Initial Public Offering
IT - Information Technology
JSC - joint stock company
LLA - loan-loss allowance
MBA - Master of Business Administration
MIS - Management Information Systems
NBG - National Bank of Georgia
NED - non-executive directors
NPL - non-performing loan
OJSC - Open Joint Stock Company
P&L - profit & loss
p.a - per annum
Ph.D. - Doctor of Philosophy
ROA - Return on Assets
ROAE - Return on Average Equity
SA - Strategic Asset
SME - Small and Medium Enterprise
SWIFT - Society for Worldwide Interbank Financial Telecommunications
UK - United Kingdom
USD - The US Dollar, national currency of the United States of America

01.05.2017

NANGA PARBAT
8,126 metres (26,660 ft)

PASHA Bank
New heights. Together.

PASHA Bank Georgia
15, Rustaveli ave. Tbilisi, 0108, Georgia; Tel.: +995 322 265 000; E-mail: office@pashabank.ge pashabank.ge

PASHA Bank Azerbaijan
13 Yusif Mammadaliyev Street, Sabail District, Baku City, AZ 1005, the Republic of Azerbaijan; Tel: (+994 12) 496 50 00; E-mail: office@pashabank.az pashabank.az

PASHA Bank Turkey
Maslak, A.O.S. 55.St. No: 2, 42 Maslak Office 3, floor:7/205, 34398 Sariyer / İstanbul - Turkey;
Tel.: +90 (212) 345 07 11 – 705 89 00; E-mail: info@pashabank.com.tr pashabank.com.tr