ANNUAL REPORT 2017

In year 2017 PASHA Bank financed planting of 3,700 trees in different parts of Georgia.

PASHA Bank
New heights. Together.

CONTENT

OVERVIEW

FINANCIAL HIGHLIGHTS
(GEL '000)

Net Profit

GEL 3,453

Total Comprehensive Profit

GEL 3,523

Gross Loans:

GEL 114,777

Cost to Income:

69%

Total Assets:

GEL 272,804

ROAE:

3%
(Based on total comprehensive income)

*NPL to Gross Loans:**

1.6%

All figures are presented as of 31 December 2017, if not indicated otherwise, and are based on the audited financial statements for the year ending 31 December 2017. The official GEL/USD exchange rate on 31 December 2017 was 2.59.

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

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

2017 was the last year of 2015-2017 strategic period during which PASHA Bank Georgia (hereafter the Bank or PBG) operated a pure play corporate banking model. The first year of the strategic period saw us turning the first ever profit in Georgia, which we have followed up with subsequent profitable performances in 2016 and 2017. In addition to corporate lending we have laid a foundation for positioning the Bank as a credible debt capital markets player with two successful bond underwritings under our belt. During the last strategic period formation of the Bank was completed with staffing requirements met and back office functions set up in a scalable and efficient manner. The work done positioned us for further growth in 2018-2020 strategic period which is expected to come from adding certain niche directions to our core corporate banking business. Planned expansion into these new segments calls for the development of new core competences complementing our corporate and capital markets capabilities. In 2018 we expect the headcount to increase in front as well as in back office roles, mostly driven by the above mentioned expansion. The increase in front office headcount will be supported by corresponding strengthening of our risk assessment, legal structuring, operational, reporting and other capabilities necessary to underpin the increased scale and scope of our Georgian operation.

Decision to enter additional segments was taken after a lengthy strategic alternatives review process which we completed over the course of 2017 with the help of outside consultants. We feel that successful entry into new segments with respective capital allocation is better justified by higher expected yields on the portfolio and the corresponding return on equity figures.

As the first year of new strategy, 2018 is expected to bring certain growing pains as we progress along the learning curve. To make this stage as smooth as possible, the Bank will have full support from the shareholders, both knowledge-wise and financially. On top of that, I have a full confidence in the ability of the professionals working for PBG to deliver against new, challenging strategy. While at it, we are fully aware of our responsibility to treat all stakeholders fairly and contributing our humble share to the development of the Georgian economy.

Farid Mammadov
Chairman of the Supervisory Board of PASHA Bank Georgia
10 July, 2018

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

2017 was my last year as a CEO of PASHA Bank Georgia. I would like to use the opportunity to thank the talented and hard-working team for everything we have achieved in my 3.5 years as a CEO. I would also like to welcome Arda Arkun, the incoming CEO, and wish him the best of luck with the new and ambitious strategy the Bank will embark upon beginning January, 2018. I do believe that Arda's skill set and experience, including many years spent working in our part of the world, makes him a uniquely qualified person to lead the Bank to new heights together with our clients and other stakeholders.

While the annual report is supposed to be a review of the past year, I would like to start at the beginning, when PASHA Bank Georgia first opened its doors for business in Georgia. Prior to the strategy changes discussed above, we focused on the corporate segment exclusively, leveraging our many years' worth of experience serving large corporates in Azerbaijan. The niche we originally selected, while logical considering our strength, was probably the most challenging of all. As is the feature of the emerging markets, corporate banking led the development of the Georgian banking sector. As a natural starting point for all existing and prospective players, corporate banking is a heavily concentrated and fought over segment. The best and the brightest are attracted to the corporate banking divisions of banks. Since day one, we had to think of creative ways to attract and retain top talent, a complex task further complicated by limited brand awareness in our early days on the market.

2017 was the last year of the 2015-17 strategic period. During this time, we strived to position ourselves as a reliable financial institution on the Georgian market. At the end of the strategy, our equity had reached GEL 107 million, and our gross loan portfolio GEL 114 million, with total assets exceeding GEL 272 million.

One of the biggest achievements of the strategic period 2015-2017 was establishing a strong and attractive corporate culture at PASHA Bank. Attracting and retaining the best people remains essential for the Bank's long-term success. To ensure that PASHA Bank is a great place to work, we strived to bring the Bank's values to life by organizing different team-building activities, creating a package of employee benefits, establishing internal rules and standards and supporting employees' professional development. Essential components of the Bank's HR systems were developed and implemented: compensation and reward systems, framework enabling us to manage and support performance, and motivation systems. A customized internal software solution supporting most of the HR and other business-related processes was developed. The sustainable HR function will remain an essential component of the Bank's strategy.

Looking back to those days, I am proud of how far we have come in building a competitive corporate banking operation driven by a dedicated and highly professional team. The list of our clients, which includes some of the top Georgian corporates, would have looked quite different if it were not for the time and effort invested by our corporate banking unit in developing and nurturing mutually beneficial client relationships. The success of the corporate business line, even under the constrains of the low-growth and highly competitive market, convinced us that we are more than ready to take upon ourselves greater challenges of translating our success to date to new segments and diversify from corporate banking services only.

In order to get things right from the outset, new strategy development followed a rigorous analysis of alternative development scenarios, taking into consideration our competitive advantages as well as our limitations.

To be successful, we will need to once again tap the market for the top talent which, like everywhere else in the world, is in short supply. That said, we believe that our inclusive corporate culture, great opportunities for professional development, focus on work-life balance and a plethora of benefits available for our staff makes us a premier destination for job seekers - both entry-level positions and experienced professionals alike. The recruiting effort necessary to support the roll-out of the new strategy is underway with promising initial results.

Apart from dramatically increasing the headcount, the new strategy also calls for a critical reassessment of our back office systems and IT solutions that would need to support a far higher number of transactions than was the case in the past. New products and services need to be developed, tried and tested before we feel confident enough to offer them to our clients. If anything, our focus on meeting client needs will only strengthen.

We intend to draw on the diverse experience of our people, augmented where necessary by external consultants, to make our vision a reality. The success of a corporate business line sets the bar rather high, which we need to meet and strive to surpass.

Shahin Mammadov
Chairman of PASHA Bank Georgia Board of Directors, CEO
10 July, 2018

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 2017, the Bank's total assets exceeded GEL 272 million (c.a. USD 105 million).

2017 was the last year of the 2015-17 strategic period. During this time, we established ourselves as a credible player in the corporate and investment banking segments of Georgia. We have developed mutually beneficial relationships with a number of blue chip companies, helping them to raise debt capital for furthering their corporate goals. Other than leveraging our balance sheet, we have provided our clients with ongoing financial advice, addressing most of their financial planning needs.

Apart from serving large corporates directly, we have also developed significant expertise in participating and leading syndicated deals in a variety of sectors. We were second largest participant in the largest ever M&A transaction in Georgian industrial history, which was initiated in 2017. PASHA Bank Turkey invested alongside PBG in this deal, making this the first-ever intra-group syndication for PASHA Group.

We shall keep striving 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, 2017, the total assets of PASHA Holding stood at approximately USD 4.8 billion, while its capital reached approximately USD 1 billion (based on audited IFRS financial statements and the exchange rate of USD/AZN 1.7001). 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 4,200.

PASHA Holding Companies

PASHA Insurance was 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 62 million as of December 31st, 2017 (based on audited IFRS financial statements and the average exchange rate applied of USD/AZN 1.7205).

The life insurance business line was added to PASHA Insurance's existing offerings in 2010, incorporated as a separate legal entity - PASHA Life. PASHA Life is the leading life insurance company in Azerbaijan, with a gross written premium of USD 88 million as of December 31, 2017 (based on audited IFRS financial statements and the average exchange rate applied of USD/AZN 1.7205).

PASHA Construction is one of the largest businesses of its kind in Azerbaijan, with a revenue of USD 168 million as of December 31, 2017 (based on audited IFRS financial statements and the average exchange rate applied of USD/AZN 1.7205). As of the end of 2017 its completed project portfolio exceeds 1,430,000m2 worth of projects, with further 712,000 m2 currently under construction. These developments include retail, residential, office space, hotels and large mixed-use properties. The list of 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, founded in 2003, provides a wide range of travel and hospitality services to corporate and retail customers. Today, PASHA Travel has a reputation as one of the most recognized corporate travel agencies in Azerbaijan.

PASHA Bank was incorporated in 2007. The Bank focuses on delivering the best in-class banking services to the

For more information please visit: pashaholding.az rapidly growing corporate sector of Azerbaijan. Standard & Poor's assigned PASHA Bank a long-term rating of 'BB-' (as of June 2017). Likewise, Fitch Ratings assigned PASHA Bank a long-term rating of 'B+' (as of August 2017). PASHA Bank is operating in three main economic markets of the region: Azerbaijan, Georgia and Turkey.

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 July 2017).

PASHA Investments is a captive private equity firm with a focus on growth equity type investments and with total commitment from PASHA Holding to the amount of USD 94M. Initially, the entity launched its business as an Investments and Projects Department (IPD) of PASHA Holding. In January 2018, IPD was spun-off from PASHA Holding into a separate legal entity, PASHA Investments LLC. The Company's immediate parent company is PASHA Holding LLC.

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 is headquartered in Baku and has a total of seven 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 chapter 'PASHA Holding Companies').

Financial Highlights as of 31 December 2017

Net Profit: USD 48,293
Gross Loans: USD 599,039
Total Assets: USD 2,106,988
ROAE: 20%
Cost to Income: 40%
NPL to Gross Loans: 10%

The average exchange rate applied to profit and loss items is USD/AZN 1.7205, and for balance sheet items is USD/AZN 1.7001

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., established in Istanbul on December 25, 1987, under the title of Yatırım Bank A.Ş., was the first foreign investment bank in Turkey. The Bank provided services under the management of different shareholder groups until 2015. Following the acquisition of majority shares in 2015 by the Baku-based regional financial institution PASHA Bank OJSC, the new title of the Bank became PASHA Yatırım Bankası A.Ş. and the business name became PASHA Bank.

PASHA Bank operates from its head office located in Istanbul, and has no branch offices. PASHA Bank provides services to entrepreneurs through its corporate and investment banking products, to contribute to the development of trade between Turkey, Azerbaijan and Georgia, and to provide resources and guidance to businesses investing in the region.

Financial Highlights as of 31 December 2017

Net Profit: USD 4,845
Total comprehensive income: USD 4,829
Gross loans: USD 189,042
Total Assets: USD 237,278
ROAE: 7.1%
Cost to Income: 48.0%
NPL to Gross Loans: 0%

The exchange rate as of 31 December 2017 is USD/TL 3.7719

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 GeoStat data, the real GDP growth in 2017 was 5%, which is significantly above the 2.8% reported in 2016. Exports amounted to USD 2,728 mln (a 29.1% year on year increase) and imports stood at USD 7,981 mln (a 9.4% year on year increase). In September 2017, Moody's upgraded Georgia's sovereign credit rating from Ba3 to Ba2. Fitch also revised Georgia's credit rating outlook from stable to positive in March 2018.

In 2017, inflation exceeded National Bank's target for that year of 4%, NBG responded by gradual tightening of its main policy rate, which went up from 6.5% to 7.25% by the end of the year. As 2017 drew to a close, inflation dipped below the target, fueling expectations of NBG reversing its stand on monetary policy, with rate reductions likely to follow in the second half of the year, provided inflation stays below target.

The Larization initiatives launched by the government in late 2016/early 2017 started bearing fruit with the Dollarization of system-wide deposit and loan portfolios declining from 72% and 65% to 66% and 57%, respectively.

For the first time in the last several years, the current account deficit decreased as a percent of GDP from double digits to a single figure. The reduction was driven by improving trade balance on the back of strong tourism revenues, surging by 26.9% year-on-year in 2017, and other exports. The financial account also strengthened through increasing FDI. The GEL-USD exchange rate predictably responded to these developments by the Lari strengthening vs USD in the latter months of 2017.

Banking sector portfolio growth, as in previous years, was driven by retail lending, followed by SME, with corporate lending bringing up the rear. In the corporate segment, the highest growing sectors were real estate and hospitality. The latter is of particular interest to PBG as we are working on development of a strong sectorial expertise in hotel financing. With the countrywide hotel development pipeline looking strong for the next several years, we expect to generate a sizable business from this segment.

In general, the banking system of the country has proven its resilience with positive credit & deposit growth and NPLs at a manageable level of 6% as of 31 December, 2017.

In 2017, the deposit base of the banking system grew 16.4% to GEL 19.8 billion, deposits in national currency being the main driver behind the growth.

Banking sector lending to the economy increased 17.8% year-on-year to GEL 22.3 billion. Corporate lending segment grew 5% year-on-year in 2017. The growth has been primarily driven by lending in the national currency.

The market average ROA is 2.8% and ROAE 20.7%.

The sources are NBG, GEOSTAT and PASHA Bank estimates.

PERFORMANCE REVIEW

FINANCIAL SUMMARY

Based on IFRS financials for the year ending 31 December 2017, PBG ended the year with GEL 272,804 thousand (USD 105,240 thousand) of total assets (just around a 3% decrease compared to end of prior year), GEL 165,997 thousand (USD 64,037 thousand) of total liabilities (around 7% less than end of prior year) and GEL106,807 thousand (USD 41,203 thousand) of total equity (3.4% increase year-on-year). The total comprehensive profit over the year totaled GEL 3,523 thousand (2016: GEL 5,103 thousand).

The dynamics in assets is characterized by:

- 17.5% growth in the loan portfolio vs. 5% of the market corporate segment portfolio growth with the end of year portfolio figure coming in at GEL 114,777 thousand gross loans as of 31 December 2017 vs. GEL 95,090 as of 31 December 2016;

- Some reshuffling between cash and cash equivalents and deposits placed in financial institutions - over GEL 30 million migrated by the end of 2017, from amounts due to banks, into cash and cash equivalents (mainly in the form of overnight placements);

- Decrease in the balance of investments in securities. GEL 62,033 thousand as of 31 December 2017 (GEL 91,880 thousand as of 31 December 2016). This was the result of the gradual maturing of placements in state discount and coupon bonds held under refinancing schemes.

The dynamics in liabilities are characterized by:

- The outstanding balance due to banks decreasing compared to prior year end, mainly due to fewer borrowings of GEL from NBG through refinancing schemes. The total due to banks stood at GEL 106,402 thousand as of 31 December 2017 (GEL 131,681 thousand at 31 December 2016). Parent bank is still the major source of USD funds and amounts due to the parent outstanding at 31 December 2017 constituted over 50% of total due to banks (37% at 31 December 2016).

- Increase in customer accounts balance to GEL 58,181 thousand at 31 December 2017 (GEL 46,024 thousand as of 31 December 2016). The major factor here was the cross-border inflow of USD deposits from Azerbaijan.

The composition of PBG's assets as of 31 December 2017 is as follows:

	31 December 2017	31 December 2016
Loans to customers	40%	34%
Investment securities	22%	33%
Cash and cash equivalents	16%	3%
Amounts due from credit institutions	18%	29%

Table 1

The quality of assets held on PBG's balance sheet remains strong with a 1.6% NPL and 2.7% LLA rate on portfolio of loans as of 31 December 2017 (31 December 2016: 0.9% and 2.18%, respectively). Investments in securities are comprised of state securities and bonds of Azerbaijani and Georgian corporations as well as banks classified as loans and receivables. All interbank placements are made only with reputable local banks within prescribed limits.

Based on PBG's 2017 annual IFRS financial statements, the total comprehensive profit for the year amounted to GEL 3,523 thousand (USD 1,360 thousand), translating into a ROAE of 3% (2016: 5%).

For the year ending 31 December 2017, PBG reported an IFRS total comprehensive profit of GEL 3,523 thousand (2016: GEL 5,103 thousand). The major cause of the smaller amount of reported net profit compared to the prior year was a decrease of net interest income on the loan portfolio and the reversal of previously recognized deferred tax assets. The total interest income of GEL 19,442 thousand (USD 7,507 thousand) was 17% less than in 2016 and the net interest income before provisions was GEL 15,474 thousand (USD 6,165 thousand), a 7% decline compared to the prior year.

PBG's operating income in 2017 reached GEL 17,551 thousand (USD 6,776), 3% down year-on-year.

PBG's personnel and general and administrative expenses during 2017 amounted to GEL 5,420 thousand (USD 2,092 thousand) and GEL 5,302 thousand (USD 2,047 thousand), which represented a 5% and 23% increase on the previous year. The mentioned increase in professional fees was related to the development of the 2018-20 strategy, resulting in one-off growth in general and administrative expenses. Consequently, the cost to income ratio also went up, coming in at 69% in 2017 (2016: 63%).

The trade finance portfolio of PBG stood at GEL 24,044 thousand (USD 9,283) as of 31 December 2017, representing an over 80% increase compared to the previous year end.

FX gains worth GEL 1,592 thousand increased 68% in 2017 compared to the prior year, underlining PBG'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 36% and 35% of the risk weighted assets for total capital and tier 1 capital, respectively (31 December 2016: 34% and 33%, respectively).

**All figures have been presented as of 31 December 2017 if not indicated otherwise and are based on the audited IFRS financial statements for year ending 31 December 2017.
Official GEL/USD exchange rate as of 31 December 2017 equaled 2.59 (31 December 2016: 2.65)*

CORPORATE BUSINESS MODEL

2017 was the last year of a strategic period during which PASHA Bank operated as a pure-play corporate bank specialized in providing corporate banking services to large and medium sized enterprises. In preparation for the new strategy, where we plan to diversify our business model through the addition of SME banking services and a limited retail operation, we have funded a few small transactions that could be described as SME rather than corporate exposures. The purpose of the exercise was to prepare for larger scale entry into the SME segment as well as to diversify our existing, rather concentrated corporate portfolio. High portfolio concentration is a natural corollary of a specialized corporate banking model and due to the fact that we began building our corporate portfolio from scratch just a few years ago. As the proposed strategy shift will lead to an increased number of deals that will diversify our portfolio, we feel that the risk level of individual smaller deals could be somewhat higher than was the case with our core, large corporate exposures. That said, this moderate increase in portfolio risk should be and is properly compensated for by the pricing of such exposures. The proportion of problem loans in the corporate segment of the Georgian banking system has hovered around 10% for the last several years. PASHA Bank's corresponding figure has remained significantly below the market for the entire period. We feel that by entering into a larger number of smaller deals than was the case before 2017, it will allow us to decrease the risk and increase return in the context of the total portfolio even if certain individual deals might turn out to be somewhat riskier than our risk appetite would have allowed us to take on in the past. As a result of the mentioned changes, the number of clients over the course of 2017 has increased from 37 to 49.

The number of sectors we have financed to-date has also increased in lockstep with the increase in the number of borrowers. As in previous periods, we remain open to considering funding opportunities in most economic sectors. The Bank has put significant time and effort into developing best-in-class expertise in several economic sectors that, in our view, will drive economic growth in the short to medium term perspective. The renewable energy and hospitality sectors are two examples of such focus. While our corporate banking team is still made up of generalists, we have begun the process of gradual transition to a sector-based coverage model where individual bankers specialize in one or more sectors. We hope this strategy will bear fruit in the next couple of years in light of the very strong development pipelines currently at hand in these two sectors.

As well as beginning to move towards a specialized coverage model, we have changed the organizational structure and composition of our corporate banking team while simultaneously doubling the number of bankers. Organizationally, we have also introduced changes that bring our corporate banking unit closer in look, feel and modus operandi to the best global practice. In our new organizational structure for the corporate banking division, first-year analysts represent an entry-level position open to recent graduates. The analyst program takes three years, on completion of which successful candidates are promoted to an associate banker position. While the analysts are not expected to work with the clients independently, at the associate level the bankers do already lead deals and are responsible for every aspect of a transaction cycle. Third-year associates become eligible for promotion to a principal banker position. Principal bankers are expected to be major contributors to deal origination efforts along with corporate banking division management. Principals are also expected to lead deal teams made up of analysts and associate bankers. Such complex structures are usually required in the context of the syndicated deals of which PASHA Bank is a significant participant. The new model started to be tested on the largest ever M&A transaction in Georgia that began in summer of 2017 and closed in Q1, 2018.

Unlike the previous periods, in 2017 we started intra-group syndications where PASHA Banking Group, represented by commercial banks operating in Azerbaijan, Turkey and Georgia, unite resources to take on exposures larger than each could independently handle. Apart from opening up new financing opportunities, close intra-group cooperation facilitates the exchange of institutional experience spanning three countries and jurisdictions. In addition to putting together syndicated financing for green field projects, PASHA Banking Group members started trading credit exposures among themselves. As a first transaction of that nature, PASHA Bank acquired a portion of an investment loan issued by PASHA Bank Turkey to one of its prime clients engaged in the energy field in Turkey. The practice allows PASHA Banking Group to enhance capital utilization and increase the overall return on capital.

In parallel with the initiatives described above, such as intra-group syndications and funding smaller, relatively riskier deals that are expected to bear fruit in future, we kept our focus on our core activity of funding large corporate clients throughout 2017. The year saw us turning a profit for the third year in a row from this rather competitive business line. We plan to continue serving Blue Chip clients in the future. This activity will remain our core focus for the years to come.

INVESTMENT BANKING

Operating environment

The operating environment in 2017 remained challenging, with the top two banks further consolidating their leading positions. Between them, BOG and TBC make up close to 80% of the banking sector's loan portfolio, deposits, shareholder's equity and other key metrics. TBC Bank finalized acquisition of Bank Republic, adding another 5 percentage points to its already dominant market share, becoming the largest Georgian bank in the process. For an up-start like PASHA Bank Georgia, such an oligopolistic market structure presents an extra set of challenges as we, unlike any other Georgian bank, do not have long-standing customer relationships.

In light of that and on a back-drop of anemic growth in the corporate segment, any growth on our part tends to come from winning business from our competitors. Under the circumstances, clients command a strong negotiating position, exerting a downward pressure on our portfolio yields. With this in mind, we are further doubling down on customer service quality, innovative solutions and tailored product development in order to enhance our value preposition vs competition.

With growth prospects of the corporate segment hardly expected to improve, the banks are increasingly turning their attention to retail and SME banking as engines for growth. Game changing development for the corporate segment would be the appearance in Georgia of a serious equity fund which would foster the creation of new businesses and growth of the existing ones. Unlike the developed markets, the majority of a corporation's funding comes from bank financing. Equity usually makes up only 40% or less of an average borrower's capital structure. With such high leverage levels, most bankable corporates have already exhausted or are nearing the limits of their borrowing capacity. Without meaningful equity injections, the new business banks can generate from most corporate borrowers is extremely limited. Overall, the banks have a higher ability to lend than the corresponding ability of the corporates to absorb the available liquidity.

We do not expect this to change in the near to medium term. With this in mind, we should temper our future expectations regarding the corporate segment's growth prospects. Any increase in portfolio size in excess of the market growth rates would be driven by winning business from competition. As mentioned, this is a situation where banks have limited bargaining power and have to settle on risk return combinations that would not be acceptable under more benign market conditions.

2017 was a relatively quiet year for DCM activities, with only a handful of corporates having tapped the bond markets. We expect this market to rebound in 2018 and have taken a number of steps to improve our positioning as one of the leading underwriters of corporate fixed income securities. Namely, we have increased the number of bankers that, in addition to their core corporate loan underwriting responsibilities, will also be spearheading DCM activities of PASHA Bank Georgia. We intend to advise a number of clients on substituting Dollar-denominated bank loans with Lari-denominated bonds and to handle the end-to-end process of bond underwriting. Our balance sheet size allows us to take on exposures that are meaningful for the reality of Georgian capital markets. Lari-denominated bonds, provided they are rated, are pledgeable to the National Bank of Georgia in its regular repo auctions framework. This feature is likely to make Lari-denominated bonds quite attractive to Georgian banks. We hope to retain a portion of bonds underwritten on our balance sheet while selling the balance to other Georgian banks. Capital market activities will contribute to the increase of our fee income component, which is one of our priorities for the next several years.

Our past years' experience with bond underwriting has allowed us to position ourselves as a credible investment banking player. This makes us a desired partner both for Blue Chips intent on bond issuance, and for other investment banking firms looking for partners to set up joint offerings.

MARKETING STRATEGY AND POSITIONING

Since opening its doors to customers in Georgia, PASHA Bank has been operating as 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.

Throughout these five years, PASHA Bank has become a partner of choice for its corporate customers. We have also 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 nimble and fast adds an additional layer of comfort for our syndicate partners. This is especially true when it comes to decision-making, which provides us with a competitive edge in the context of a syndicate, as well as on a stand-alone basis.

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, flexible and 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

RISK AND CONTROLS

The Bank is committed to developing sound, effective and complete risk management strategies and processes in order to assess and maintain, on an on-going basis, the amount, type and distribution of internal capital that the Bank considers adequate to cover the nature and level of the risks to which it is or might be exposed.

The strategies and processes are subject to regular internal review to ensure that they remain comprehensive and proportionate to the nature, scale and complexity of the Bank's activities.

Risk management helps to identify, assess, and manage risks stemming from the Bank's strategy. The most significant causes of value destruction are embedded in the possibility that the strategy does not support the Bank's mission and vision, and implications from the strategy. Risk management enhances strategy selection. Choosing a strategy calls for structured decision-making that analyzes risks and aligns resources with the Bank's mission and vision.

Risk management strategy supports the Bank's mission and vision, and eliminates the possibility that the Bank may not realize its mission and vision, or may compromise its values, even if a strategy is successfully carried out.

Risk management considers the possibility that the strategy is not aligned with the Bank's mission and vision, or the implications from the strategy chosen. The Supervisory Board and the Board of Directors determine if the strategy works in tandem with the Bank's risk appetite, and how it will help drive the Bank to set objectives and ultimately allocate resources efficiently.

The risk management strategy is derived from the business strategy. All factors of the business strategy are taken into account for the purpose of risk profile analysis.

The Bank manages risks following the model of Three Lines of Defense that provides an effective way to enhance communication on risk management and control by clarifying essential roles and duties. The Three Lines of Defense model enhances clarity regarding risks and controls and helps improve the effectiveness of risk management systems.

The Three Lines of Defense model distinguishes among three groups (or lines) involved in effective risk management:

- Functions that own and manage risks;
- Functions that oversee risks;
- Functions that provide independent assurance.

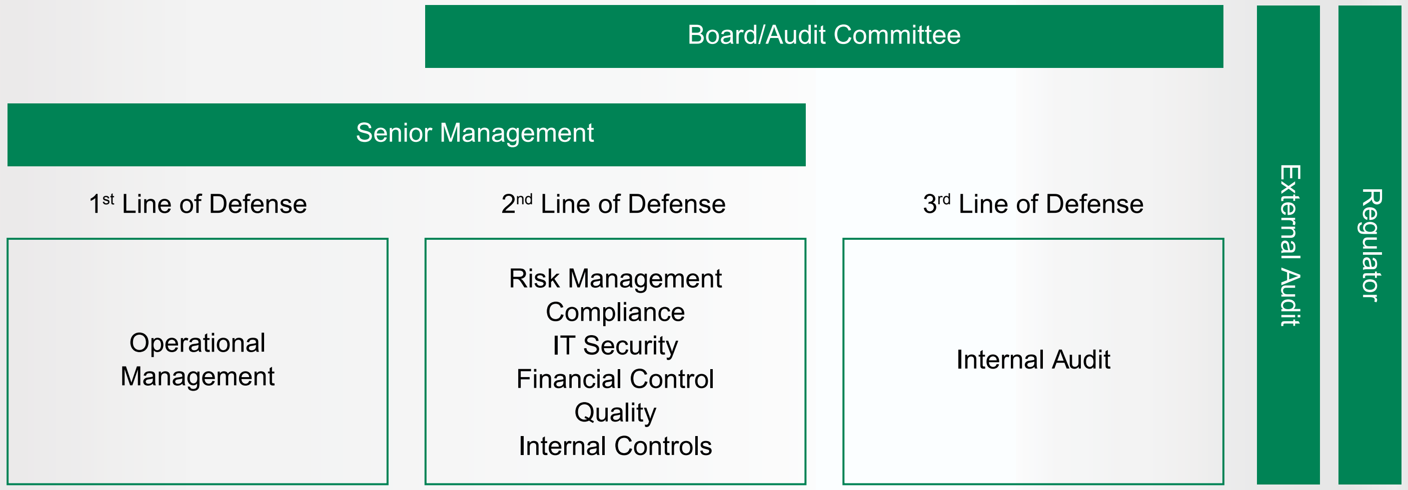


Table 2

The business lines and operations units execute the activities that create and prevent risk. The first line owns and manages risks and controls through policies, procedures, and monitoring processes within the daily operations that help prevent or mitigate risks.	The support functions in an organization include Finance, Security, Risk Management, Compliance and Legal support by monitoring and facilitating the implementation of effective risk management practices by operational management and assist the risk owners in reporting adequate risk related information.	Internal Audit is a function that is separate and independent of the first and second lines of defense. It provides assurance to the organization's Board of Directors and senior management on how effectively the organization assesses and manages its risks and also includes assurance on the effectiveness of the first and second lines of defense.
Works collaboratively with the second line to address improvements required to enhance controls and mitigate risks.	The second line is an oversight function operating under the direction of senior management.	The third line independently reviews all activities within the first and second lines of defense.
The first line reports to senior management.	In many organizations, the second line also reports to the audit committee and/or risk committee of the board.	The internal audit function's primary reporting is to the audit committee of the board, with administrative reporting to the CEO.

Risk Appetite

The Risk Appetite setting process seeks to enhance the risk management capabilities of the Bank to ensure better alignment of risk-taking with strategic objectives. Risk appetite objectives define the level of risk that the Bank is willing to accept, provide opportunities for maximization of the value within boundaries, establish systematic control of risks, and enable timely mitigation.

The Risk Appetite Statement (RAS) resides at the heart of an effective risk management program and is linked to the Bank's overall risk management philosophy and strategic ambition. The objective of developing a clearly articulated RAS is to explicitly define the level and nature of the risks that the Bank is willing to take in order to pursue its articulated mission on behalf of its shareholders, subject to constraints imposed by shareholders, debt holders, regulators, and other stakeholders.

With an RAS in place, the Bank can define specific tolerances around its performance, and in doing so, link its risk management processes to the overall management processes.

General principles of risk taking and risk management set out by the Bank are as follows:

- Prudent risk-taking with comprehensive risk assessment and control environment;
- Application of best practices in line with the complexity and size of the Bank;
- Direct risk management considerations into business planning and project development activities;
- Compliance with the requirements of NBG and guidelines from the Bank's shareholders.

The general principles of risk-taking have to be reflected in all rules and policies and applied consistently throughout the Bank. In order to set up objective criteria to measure the exposure to relevant risk factors, risk policies are represented by numerical targets/limits within the Bank's risk appetite framework.

The Bank develops the risk appetite framework based on its business and risk strategy.

The RAS includes qualitative statements as well as quantitative measures expressed relative to earnings, capital, risk measures, liquidity and other relevant measures, as appropriate. It also addresses more difficult to quantify risks, such as reputation, money laundering and financing of terrorism risks, as well as business ethics and conduct.

The credit risk appetite is defined by the Credit Policy. The credit risk appetite represents the maximum credit risk level that the Bank is able and willing to accept in order to achieve its business objectives. It contains the following elements:

- Profitability is a key objective, but credit standards must not be compromised in the pursuit of operating income. A well-balanced and high-quality credit portfolio is of the highest priority.
- Where borrowing is classed as prohibited, there is no appetite to pursue this type of business, and any exceptions in this category must be referred to the Supervisory Board.

The list below demonstrates an excerpt from RAS of PASHA Bank:

- Capital/solvency – the Bank will operate with a sufficient and comfortable capital base, not only to fulfill regulatory requirements, but to protect the Bank against potential shocks without hindering the growth potential. The Bank will regularly run stress tests to ensure its capital remains adequate.
- Profitability/earnings volatility – the Bank aims to maximize its risk-return profile over a long-term period and ensure stability in earnings over the years.
- Liquidity – the Bank will ensure abundant levels of liquidity to survive a severe 12-month market-wide liquidity stress event, and promote diversified and stable funding sources.
- Credit risk – the Bank aims to keep a well-diversified loan portfolio that delivers positive net income at a consolidated level even during severe but realistic stress events. To do so, the Bank maintains consistent underwriting standards depending on its risk appetite, not on the market opportunities; the Bank applies appropriate concentration limits and invests in and runs tight monitoring systems.
- Market risk – the Bank will ensure to keep its Value at Risk at a desired level, including the VaR under stress scenarios. The Bank will keep its currency position under review at all times to be able to hedge against potential devaluations.
- Operational risk – the Bank strives to minimize all potential losses stemming from operations, information technology and human resources. To achieve this goal, the Bank tracks operational risk at a key process level and ensures transparency at top-management.
- Regulatory risk – the Bank will ensure that the number of open regulatory findings and number of new legal matters will be maintained on an acceptable level.
- Reputational risk – the Bank has zero tolerance for headline risk associated with unacceptable business practices, privacy breaches and internal fraud.

Organizational Structure of Risk Management function

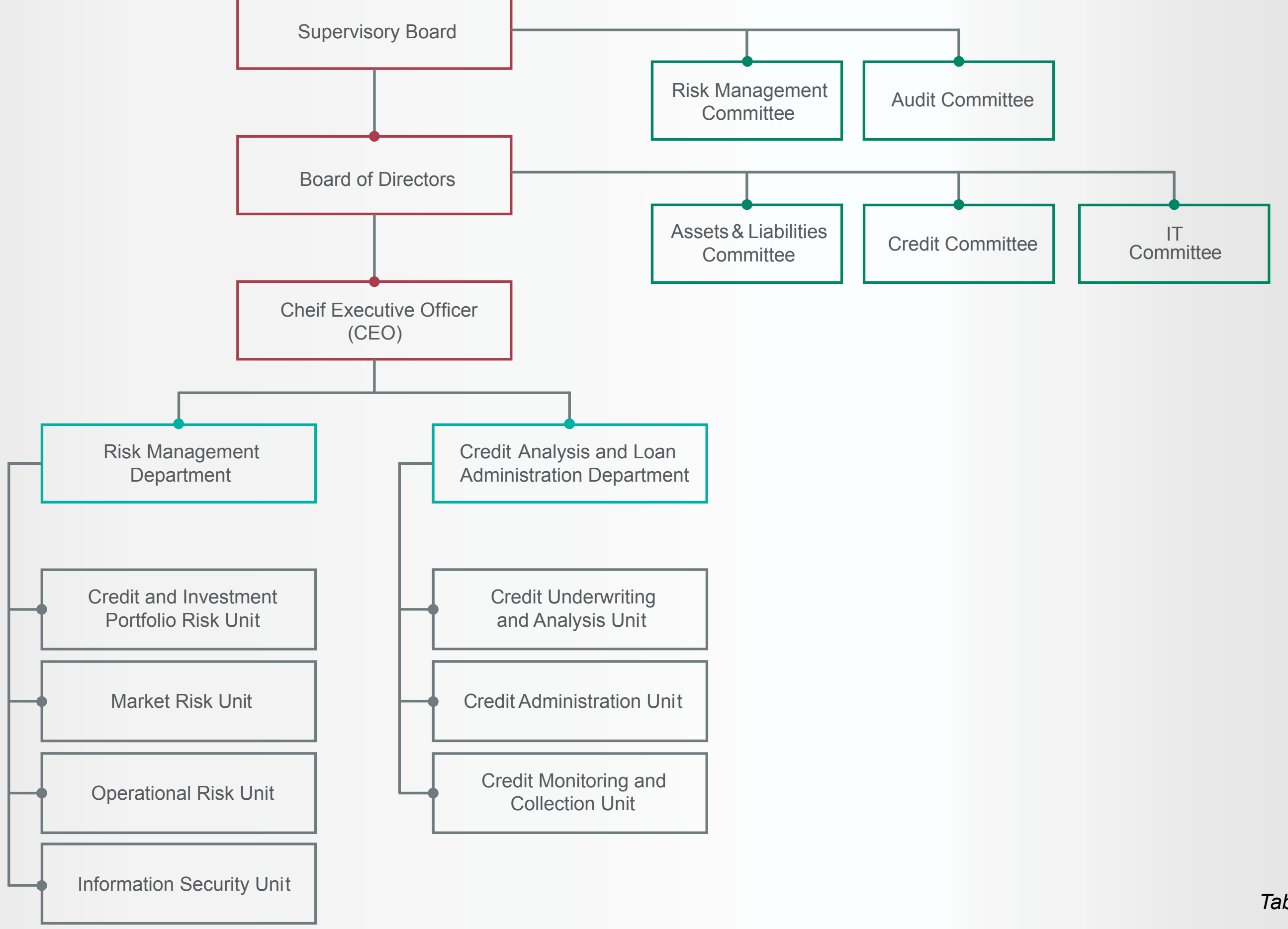


Table 3

The main roles and responsibilities for key stakeholders in the Bank's Risk Management Process are as follows:

Supervisory Board

- Approve the Bank's risk appetite and tolerance statement and risk management policies;
- Perform risk oversight to incorporate consideration of risk into strategic decision-making and to address risk interactions across business units.

Board of Directors

- Assume overall responsibility and accountability for risk management function;
- Ensure a proper balance between risk and return, consistent with the Bank's risk appetite;
- Make available the necessary resources to meet the risk management objectives and targets;
- Maintain commitment to improving risk management performance.

Risk Management Committee

- Review risk management policies, the risk governance model, risk tolerances, impact and likelihood scales, and heat map risk-rating boundaries;
- Accept the risk assessments, issue directives for risk treatment to maintain risk levels within the defined tolerance thresholds, and accept risk treatment options;
- Ensure that appropriate processes and capabilities are in place to identify, assess, measure, manage, monitor, and report risks.

Risk Function

- Develop, implement and administer the risk management (RM) program. This entails developing and maintaining RM policies, identifying key risks to be reported at the corporate level, coordinating risk management processes and procedures, tools, and information systems, risk analysis and risk treatment with risk owners, calculating the overall integrated risk portfolio, reporting on corporate risks and the risk portfolio to the Risk Management Committee, monitoring adherence to the

risk management program, and improving the risk management capability of the enterprise through communication and training;
- Establish RM communication at all levels. Gather data and develop risk reports for the Risk Management Committee and others as directed by the Risk Committee;
- Provide professional advice on RM. Provide advice and direction on current and developing RM practices, make recommendations, and implement mandated improvements;
- Analyze RM metrics and report performance. Quantify and prioritize risks, validate decision-making analytics, assumptions and methodologies, report risks and ensure that information presented for decision-making and reporting is complete and correct;
- Deploy and maintain quantitative tools and models that assist in estimating the likelihood and severity of risk events such as an event tree model;
- Facilitate the identification, measurement, monitoring and reporting of risks;
- Design/revise the RAS in accordance with the Group RAS;
- Cascade the RAS down to different levels in the organization (i.e. define the "playing field" for units);
- Continuously review/report limit status/breaches and take proactive measures to avoid RAS breaches; In case of RAS breaches, propose and execute a mitigation plan;
- Ensure incentives across the Bank are in line with the RAS;
- Ensure alignment of risk appetite, strategy and capital allocation within the Bank (including budgeting and business planning cycles);
- Assess risk culture at different levels of the Bank.

Risk Owners

Risk owners are those individuals with accountability for business activity bearing an assigned risk. Risk owners oversee the line staff performing business and risk management activities and have sufficient authority to enforce policies and procedures and authorize the expenditure of funds to handle risks within their span of control. Risk owners have the ultimate responsibility to report back to the RM function on the status of the risk and have the authority and ability to make necessary changes. Additionally, they can:

- Provide subject matter expertise for assigned risks to the RM function;
- Set direction and monitor the effectiveness of the risk management processes for assigned risks;
- Support RM function to establish standards, tools and methods for managing, treating, monitoring and reporting of assigned risk.

Risk types, management and capital allocation
Credit Risk

Credit risk refers to the threat of losses that impacts the Bank's profitability and capital position and arises from the non-performance of contractual obligations by the counterparties (or from performance that is not compliant with contract conditions.

Management of the risk (processes)

The Credit Policy and the Credit Standard of the Bank regulate lending process and contain the credit risk management principles and actions to mitigate risks inherent to lending activities.

The primary objectives of the Credit Policy are to:

- Protect the Bank from possible losses from credit activities;
- Define the basic principles of planning and organizing credit activities and building the desired loan portfolio;
- Ensure safe and efficient allocation of the Bank's capital and other funds.

The Bank follows the key principles listed below in order to realize its credit policy objectives:

- Segregation of duties: responsibilities must be strictly divided between the back office and the front office;
- Four-eye principle and the principle of prevention of conflict of interests is to be adhered to at all stages of the credit cycle;
- Risk-awareness during the credit assessment processes and, later, during the management of exposures, to avoid unnecessary impairments and losses;
- Operating with a robust and professional risk management approach and control environment as a basis of solid risk-taking and proper risk management.

The primary objectives and key principles of the Credit Policy are achieved through the following course of actions:

- Developing efficient credit policies and procedures;
- Providing appropriate instructions and trainings to relevant employees;
- Building long-term relationships with customers;
- Increasing and diversifying the customer base;
- Ensuring competitive credit terms and fair pricing;
- Ensuring efficiency of the decision-making process;
- Ensuring effective credit risk management;
- Monitoring of external factors which can affect credit decision or portfolio quality;
- Managing the optimal risk and return ratio of credit products, managing liquidity risk, currency risk and maturity risk premium;

- Improving and optimizing credit portfolio quality and structure;
- Ensuring the adequate level of LLP;
- Ensuring compliance of the credit process with Georgian legislation and regulations of the National Bank of Georgia.

In all cases of risk-taking, the creditworthiness of the customer is to be assessed and monitored during the lifetime of the credit exposure according to the Credit Policy.

Portfolio quality reports are regularly prepared by the Credit Analysis and Loan Administration Department and presented to the Board of Directors.

The capital requirement for credit risk is calculated by the Bank under Basel II requirements, using the standardized approach. For the expected losses, the Bank calculates provisions and classifies assets based on IFRS.

Although the Bank considers credit risk as the most material and most important risk type, currently, due to the lack of data, using advanced methodologies for calculation of the credit risk capital requirement would be an excessive exercise for the Bank.

The Bank uses internal and external rating providers for credit risk assessment, such as Moody's, Fitch, and S&P.

Foreign Exchange Induced Credit Risk

Foreign Exchange Induced Credit Risk is the risk arising from the movements of foreign currency exchange rates that would deteriorate the creditworthiness of the customer.

Individual assessment of customers is carried out according to the Credit Policy. Furthermore, the limits outlined by the regulator are applied and a sensitivity analysis is conducted.

Exposures in foreign currency have to be assigned to a special segment under the Basel II credit risk capital calculation, based on CAR.

In addition to the capital requirement calculated under Basel II, the Bank calculates the effect of exceptional but possible movement on the FX rates to the credit portfolio by using scenario analysis.

The capital requirement for FX-induced credit risk equals the Pillar 1 calculation + the result of the scenario analysis.

Operational risk

Operational risk is defined as the Bank's exposure to potential losses that may impact its profitability and capital position. Operational risk may derive from inadequate internal processes or systems, external events, inadequate employee performance or from breach of, or non-compliance with, statutory provisions, contracts and internal regulations. Operational risk includes legal risk, but excludes reputational and strategic risk.

Operational risk is associated with human error, system failures and inadequate procedures and controls. It is the risk of loss arising from an inadequate information system, technology failures, breaches in internal controls, fraud, unforeseen catastrophes, or other operational problems that may result in unexpected losses. Operational risk exists in all products and business activities of the Bank.

The objective of operational risk management is to find the extent of the Bank's operational risk exposure, understand its drivers, allocate capital and identify trends internally and externally that would help in predicting it. It is vital for the Bank to try to prevent fraud, maintain the integrity of internal control, and reduce errors in transactions.

Internal control is usually embedded in the Bank's day-to-day activities and is designed to ensure, to the extent possible, that the Bank's activities are efficient and effective, information is reliable, timely and complete and the Bank is compliant with the applicable laws and regulations. Failure to understand and manage operational risk may increase the likelihood that some risks will go unrecognized and uncontrolled.

The Bank conducts adequate operational risk assessment procedures before it launches any new product, activity, process or system, as well as before it outsources core banking- and IT system-related activities. The aim of operational risk management is to identify, assess, monitor, control and mitigate operational risks and to support effective reporting of risks and emerging risk issues.

The Bank mitigates operational risks by defining, documenting and updating the relevant business processes. Furthermore, the Bank mitigates operational risks by following strict rules for the assignment of duties and responsibilities among and within the functions, and a system of internal control and supervision.

The Bank has in place an Operational Risk Management Policy, Operational Risk Management Procedure 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.

Capital requirement under ICAAP is calculated using the Basic Indicator Approach which is also used for the calculation of Pillar 1 capital.

Market risk

Market risk is the current or prospective risk of losses on on-balance sheet and off-balance sheet positions arising from adverse movements in market prices.

The Bank considers only the risk position of the trading book portfolio.

The market risk management framework was developed based on Group-wide methodologies.

According to the Georgian regulations, no capital charge has to be calculated for the trading book positions of the Bank. Under the ICAAP framework, the Bank needs to assess its exposures

to market risk and calculate capital requirement accordingly.

Market risk - Foreign exchange risk

Foreign exchange risk arises from open or imperfectly hedged positions in a particular currency as a result of unexpected movements in the level of exchange rates.

The FX position is continuously calculated during the day using transactions having an effect on the FX positions. The Bank manages FX positions within the approved internal and regulatory limits.

According to the Georgian Regulatory Setting, Calculating and Maintaining Overall Open Foreign Exchange Position Limit of Commercial Banks, FX risk has to be managed by limit systems, not by the capital.

Under the Pillar 2 capital calculation, the Bank decided to calculate the capital requirement for FX positions based on Value at Risk (VaR) methodology, using a 99.9% confidence level, 10 days holding period and multiplier based on Basel II.

Interest rate risk of the banking book

Interest rate risk means the risk of financial losses (damages) resulting from adverse movement of interest rates. The market risk management framework was originally developed based on the methodologies applied by the Group.

The interest rate risk of the banking book is assessed on a monthly basis. The interest rate risk reports positions and gaps by repricing periods for each relevant currency. A limit system is defined by ALCO for the gaps of each repricing period. Furthermore, the duration gap method is used for sensitivity analysis and for the calculation of capital requirement under ICAAP. Under Pillar 1, CAR does not require the Bank to calculate capital requirement to cover the interest rate risk of the banking book. Under the Pillar 2, the Bank decided to use the approach described in the Basel II framework. This method builds on the duration gap approach and quantifies the effect of a 200 basis points parallel shift of the interest rate curve on the net interest income of the Bank. The appropriateness of 200 basis points is back-tested on a regular basis. When the shock on the interest rate risk shows a potential decrease of the Bank's economic value in excess of 20% of its solvency capital, the Bank covers the limit breach with capital.

Business risk

Business risk is defined as the risk linked to a potential drop in profits or capital due to changes in the operating environment or erroneous corporate decisions, inadequate implementation of decisions or poor reaction to changes in the competitive environment.

The Bank considers strategic planning and budgeting processes as a crucial part of risk management. The Bank has developed detailed processes and regulation on the budgeting processes which ensures meticulous budgeting according to the business strategy of the Bank and also describes the processes to regularly monitor and review the budget.

For business risk, a regulatory capital requirement is not calculated. As the risk is defined to be material, the Bank calculates capital requirements to cover business risk under ICAAP. As the Bank has limited historical data to go by, a simplified methodology measuring the deviations from the budget has been developed.

Credit concentration risk

The concentration of credit risks is interpreted as a distribution of exposures to customers and trading partners where potential default by a relatively small group of counterparties or large individual counterparties is driven by a common underlying cause and may jeopardize the "business-as-usual" operation of the Bank.

The Bank controls concentration risk via a limit system. The total amount of loans and other exposures with direct and indirect exposures (e.g. via guarantees) is reduced by way of credit risk mitigation techniques based on credit risk capital calculation rules.

The Bank regularly monitors the concentration of the portfolio by calculating the HHI index for the whole portfolio of the Bank, using gross exposures.

The creation of capital reserves for concentration risk is not required under Pillar 1 calculations. Under Pillar 2 calculations, the Bank quantifies the impact of two different stress scenarios that include credit quality worsening of certain top customers. Capital requirement is estimated in line with a more severe scenario.

Residual risk

Residual risk is the risk of the large-scale devaluation or limited enforceability of collaterals behind credit exposures.

The CAR enables the Bank to use risk mitigation techniques to reduce the capital requirement of credit risks. While institutions mitigate these risks by way of collaterals, these collaterals can pose risks in and of themselves (legal, documentation and liquidity risks). The Bank has established processes to ensure the enforceability and proper valuation of the collaterals used during the lending process. The Credit Policy and Collateral Management Procedure contain requirements which are in line with the rules of CAR.

Residual risk is managed by processes; no capital allocation method is defined by the Bank.

Settlement risk

Settlement risk is the risk that a transaction executed is not settled as expected through a settlement system. Settlement risk comprises credit risk and liquidity risk elements.

The credit institution bears the risk that while it fulfills its contractual obligations (payment or delivery), the counterparty fails or defaults to do so. Finally, it may lead to the non-performance in further securities transactions of that party.

In order to minimize potential losses due to settlement risk, the Bank aims to settle transactions via central counterparties, based on delivery versus payment principles. The exposure to this risk is also limited through internal FI limits.

Based on Georgian regulations, (CAR) Pillar 1 capital is not calculated to cover settlement risk. Under Pillar 2, due to the low number of transactions exposed to settlement risk, no capital charge is calculated.

Liquidity risk

Liquidity risk is defined as the risk of inability of the Bank to honor its financial obligations. Liquidity risk comprises both funding liquidity and market liquidity risk:

- Funding liquidity risk appears when the Bank cannot fulfill its obligations because of inability to obtain new funding.
- Market liquidity risk appears when the Bank is not able to sell its assets easily at the market price without avoiding losses because of an illiquid market.

Measuring liquidity risk:

The major tools for measuring liquidity risk are identification of liquidity positions and stress testing;

Liquidity positions are identified on a monthly basis via standardized reporting packages for the regulator, ALCO and Risk Management Committee.

Stress testing is based on the Bank's cash inflows and cash outflows during the 6-month survival horizon. The target liquidity requirement is then estimated by applying the stress scenario on the expected cash inflows and outflows and the liquidity buffer.

The stress testing scenarios are based on assumptions such as:

- Rapid deterioration of the economic environment, causing disruptions in the expected cash inflows from the Bank's loan portfolio;
- Inaccessibility of the funding market for new funding transactions and termination of all callable funding transactions;
- Adverse changes in foreign exchange rates.

Managing liquidity risk:

The presence of liquidity risk in short-time intervals is considered to be more dangerous for the Bank's operations, because the shorter a term is, the less time the Bank has to make management decisions to adjust to the situation. The longer the time interval, the more controllable liquidity is considered to be, because the Bank has more time to take corrective measures. Therefore, the limits on short-term cumulative liquidity gaps are usually more conservative than those for longer terms.

The ever-changing financial markets have a direct impact on the availability of funding sources for the Bank. Therefore, even with constant monitoring of liquidity and funding sources, the Bank recognizes that unforeseen events (for example, changing economic or market conditions, deteriorating loan portfolio quality, or any other situation beyond the control of the Bank) may potentially lead to a short- or long-term crisis situation. Despite the low probability of a significant liquidity crisis, the Bank assesses the potential risk and prepares a clear action plan for liquidity crises.

To mitigate the funding liquidity risk, the Bank establishes a high-quality liquidity buffer, which may be used to meet payment obligations while continuing normal banking activities, without obtaining new funding. The Bank additionally ensures that its funding is diversified and that the maturity profile does not create significant gaps.

The liquidity limits are critical in the maintenance of adequate levels of liquidity and cushioning of high-quality liquid assets. These limits allow the withstanding of a range of stress events, including those involving loss of funding sources- the types of limits imposed by the regulator and approved by the governing bodies of the Bank.

The market liquidity risk is mitigated by having a liquidity buffer consisting of high-quality financial assets that, under stressed market conditions, maintain their market value. The Bank has access to NBG refinancing facilities to maintain its liquidity in GEL.

The Bank developed sound practices to manage liquidity risks which are laid down in the Liquidity Management Policy and Liquidity Management Procedure.

Liquidity reports are regularly introduced to ALCO.

Strategic risk

Strategic risks are those that arise from the fundamental decisions that executives make concerning the Bank's objectives. Essentially, strategic risks are the risks of failing to achieve these business objectives.

Strategic risk is managed by operating the proper internal governance system. In order to minimize potential losses due to strategic risk, the Bank established a framework for its internal governance system.

Strategic risk is only managed by processes; no capital is allocated.

Reputational risk

Reputational risk is the current or prospective indirect risk to earnings and capital arising from adverse perception of the image of the Bank on the part of customers, counterparties, shareholders, investors, regulators and other stakeholders. It manifests if the external opinion of the Bank is less favorable than desired.

Reputational risk is managed by respective processes and organizational units of the Bank.

Reputational risk is only managed by processes; no capital is allocated.

Group risk

Group risk is defined as possible losses due to the fact that the Bank is operating as a member of a group, as a subsidiary company or as a mother company. The Bank has no subsidiary, therefore only the risk of operating as a member of a financial group needs to be assessed. The main assessment factor is to identify those dependencies where a change in the level of parent company support might cause problems for the Bank. This assessment is based on expert judgment, and its result is manifested in the areas where the risk is managed.

The Bank has identified two major sources of group risk, which are managed with proper processes defined by the parent company and negotiated with the Bank:

- Group governance risk: the parent company operates a holding-level governance system which ensures that the Bank receives methodological support from the mother company;
- Own funds supply: planning of own funds and analysis of the possible ways of capital increase are part of the budgeting process, including own funds supply from parent company. As the risk currently is not material, no capital is allocated.

Macroeconomic risk

Macroeconomic risk is the current or prospective risk of losses on on-balance sheet and off-balance sheet positions arising from adverse movements in macroeconomic conditions, such as a fall in GDP growth rates, decline in real estate prices, etc.

Management of the risk (processes)

As macroeconomic risks are external risks that are beyond the Bank's control, the only tool for its management is stress tests based capital and liquidity planning. The Bank performs macroeconomic risks-related stress tests based on a methodological guideline (the Guideline) communicated to the Bank by the regulator.

For the purposes of internal capital assessment, the Bank applies transaction-level stress tests assessing the effect of FX, concentration and interest induced credit risks. Enterprise-level macroeconomic stress testing is used for capital planning purposes.

Regulatory risk

Regulatory risk is defined as risk stemming from the changing regulatory environment. It incorporates either the amendment of an existing or the enactment of a new national or international law/regulation.

In order to mitigate regulatory risk, the Bank permanently monitors not only the legislation but also prospective changes. A crucial point of the process is that the respective departments, managers and employees affected by the changing legislation are informed by the Legal Department. Senior management regularly receives executive summaries about recent regulatory modifications.

The Bank makes sure that existing and even significant prospective (if they are likely to be enacted) regulations are reflected in its strategy. To prepare for those significant legislative changes, the Bank applies several techniques: impact study, scenario analysis, action plans or even the modification of the business plan.

The Bank conducts regular revision of its internal regulations and ensures that they are compatible with the external regulatory environment.

Regulatory risk is only managed by processes; no capital is allocated.

Risk mitigation strategy

Techniques to mitigate risk are largely dependent on the type of risk that needs to be reduced. Among others, the Bank uses the following types of mitigation techniques:

- Audits - Regular audits from the Internal Audit department may identify problems such as accounting errors or security vulnerabilities before they become larger problems;
- Segregation of duties: responsibilities are strictly divided between the relevant positions;
- The four-eye principle and the principle of prevention of conflict of interests are adhered to at all levels of the business processes;
- Operating with a robust and professional risk management approach and control environment as a basis of solid risk-taking and proper risk management;
- Backup – the Bank backs up business information in multiple secure physical locations;
- Business Continuity Plan – the Bank has developed a plan to continue with normal operations in the face of extraordinary events such as natural disasters or security incidents;
- Control - control risk through internal processes or actions that reduce the likelihood of undesirable events;

- Diversification - the process of allocating capital and resources in diverse areas to reduce risk and volatility;
- Due Diligence - the process of investigation before committing to something such as a contract or strategy. Basic due diligence, such as checking the financial, environmental, corporate social responsibility and management practices of a potential partner, is a basic step in risk management;
- Communication – regularly communicating a risk factor to line managers serves to reduce it;
- Performance Management - Setting risk reduction goals as part of performance management;
- Policies - Policies designed to reduce the risk of misconduct;
- Standards - Establishing standards to guide business practices and decision-making;
- Training - Training for employees, designed to increase professionalism and skills.

Risk reporting

In order to ensure the timing, quality and informative value of the decision-making process, the Bank's risk management function reports to the Risk Management Committee of the Supervisory Board on a monthly basis. Reports include the loan portfolio report, corporate investment portfolio report, trading book report, related party transactions, off-balance sheet portfolio, collateral portfolio, non-performing loans and write-off report, credit concentrations, deposit portfolio report, FI exposures, liquidity and maturity analysis, market risk analysis, operational risk analysis, incident management, capital adequacy report, etc. On a quarterly basis, the Risk Management Committee reports to the Supervisory Board on the Bank's risk management activities and the way the committee had discharged its duties and responsibilities.

The risk management function reports to the Board of Directors on a regular basis. These reports include reviews of Credit Committee activities, internal loss data base reports, etc.

Stress Tests and Scenario Analysis

Scenario analysis is an exercise that uses the expert opinions of business and risk managers to identify plausible enterprise loss scenarios to estimate unexpected losses. Generally speaking, scenarios are a forward-looking assessment of key risks or "potential future events" that attempt to derive a reasoned assessment of likelihood, in terms of frequency and severity of plausible losses.

Stress test framework aims to assess the impact of extraordinary but possible events on the own capital or liquidity of the Bank. The Bank elaborated its ICAAP framework in a way which already contains a sensitivity analysis and scenario analysis to measure the exposure to the risks defined to be relevant.

The Bank performs macroeconomic risks-related stress tests based on a methodological guideline (the Guideline) communicated to the Bank by NBG. According to the Guideline, stress tests must be performed on the overall Bank level (enterprise-level stress) and transaction level (enterprise-level stress).

The transaction level tests assess the creditworthiness of the Bank's borrowers in the case of the changing external factors. The following risks are managed via stress testing on the enterprise risk level:

- Foreign exchange induced credit risk;
- Interest rate risk of the banking book;
- Foreign exchange rate risk;
- Concentration risk;
- Interest rate risk;
- Regulatory risk;
- Systematic risk.

Enterprise-level stress tests are used by the Bank in the course of its capital and liquidity planning by assessing the effect of various macroeconomic scenarios on the Bank's overall financial performance indicators, such as profitability, asset quality, funding base and liquidity.

COMPLIANCE DEPARTMENT

We are committed to adhering to the relevant laws, regulations and self-regulatory organizational standards. We constantly develop and enhance our capabilities of detecting Financial Crimes related to money laundering and financing terrorism. Our policies, methodologies and procedures are regularly reviewed and updated to reflect regulatory changes.

As part of our effort to fight against Financial Crime, we regularly deliver trainings for all our employees to enhance their knowledge. We have introduced a Compliance Reporting system through which the Bank's management is more informed on compliance issues or risks identified.

The Bank's Board of Directors and the Supervisory Board are informed regarding compliance issues and risks, identified through the Compliance Report. In 2017, the Compliance Report was discussed twice by the Supervisory Board and three times in Board of Directors meetings.

CSR, CHARITY AND SPONSORSHIP ACTIVITIES

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

Throughout 2017, PASHA Bank focused on supporting environmental projects and, at the launch of the year's CSR activities, the Bank planted 2,017 Georgian Pine Trees on behalf of its partners and employees. The trees were planted in area near Borjomi, where 260 hectares of forest were burnt in August 2008. Within the same year, PASHA Bank financed the planting of an additional 500 trees in this area as support to the forest rehabilitation project "Aghadgine". The planting of another 2,018 trees in this region was financed as part of a 2018 New Year gift for our clients and partners.

In September 2017, the Bank initiated a paper recycling project among corporates, in cooperation with TissuePaper, a paper recycling and manufacturing outfit, and the Business Information Agency: In return for each collected kilogram of used office paper, GEL 0,13 was donated to "Aghadgine" as a contribution to the forest rehabilitation process. By the year end, over 100 companies had joined the campaign and over 14 tons of paper had been collected.

In April, the Bank planted 1,000 Georgian Oak (Quercus Iberica) and Imeretian Oak (Quercus Imeretina) trees, the latter being on the Red List of threatened plant species. Children from local schools participated in the planting process, aiming at raising awareness about environmental issues.

In cooperation with Georgia Today Group, the Bank donated 100 Georgian Pine trees to 10 schools in Tbilisi on International Children's Day. In this case, too, the pupils of the schools participated in the planting process of the trees in their school yards, so that they can take care of the plants and see them grow throughout their study years.

The eco-friendly approach is also followed when it comes to employees. The Bank provided special boxes for collecting used paper for recycling; it gave small Caucasian Pine trees as a New Year gift to every employee; it stopped using plastic bottles for water - instead glass bottles are used and then recycled. These and other seemingly minor projects lead to raising awareness of environmental issues on one hand, and developing socially responsible habits on another.

In terms of sponsorship activities, 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, with two more sponsors coming on board in 2017. The project facilitates experience-sharing between top managers of various organizations. Throughout 2017, six Business Café meetings were held.

In March 2017, PASHA Bank partnered the largest HR event in Caucasus - HR Reborn. The event was organized by HR hub, which unites about 400 HR professionals from the private and public sector. This two-day event attracted HR managers, marketers and other professionals interested in this field. Master classes were conducted by coaches from different countries.

Later the same month, PASHA Bank partnered BIA Forum 'Georgian Economy - Prospects and Challenges,' which brought together more than 300 top executives from the business community, representatives of various government bodies and international organizations. The forum provided a communication platform for foreign investors and local companies. Shop Fest and B2B meetings were held in parallel with the forum, enabling participant companies to showcase their products/services and attract new partners.

In April 2017, PASHA Bank partnered the Golden Brand Awards for the third consecutive year. Organized by Global Idea and The FINANCIAL, Golden Brand has been considered the most prestigious and influential annual business awards since 2006, with awards given to companies that achieved special success during the previous year. As per traditional, the ceremony was attended by the top managers of leading companies, the representatives of government, diplomatic corps and the media.

On May 22-23rd, the International Business Forum took place in Batumi. The event was organized by consultancy company "IBF" and supported by PASHA Bank. The main topic of discussion was Leadership; therefore, a distinguished leadership record was the main criterion while choosing the speakers for the event. Each of the six presenters was a leading authority in the field they represent:

- Pierluigi Collina – Six times FIFA's "Best Referee of the Year" and member of the UEFA Referees Committee;
- Marshall Goldsmith - An American leadership coach, the author of several management-related books, one of the world's most-influential business thinkers for the past ten years by Thinkers50;
- Kevin Gaskell - Former CEO at Porsche and Lamborghini;
- Sean Fitzpatrick - Rugby legend, former captain of the New Zealand national rugby union team All Blacks, founder and CEO at Front Row Leadership;
- Dananjaya Hettiarachchi - The 2014 World Champion of Public Speaking, HR expert and trainer;
- John King – The co-author of #1 New York Times bestseller "Tribal Leadership", motivational speaker.

Up to 800 delegates from 14 countries attended the event; among them representatives of small, medium and large enterprises, startups, government and media.

On September 29th, the Caspian European Club and Caspian American Club hosted the first CEO Lunch Tbilisi under the auspices of the official ceremony marking the resumption of activities of Caspian Energy Georgia. The event served as the first get-together in a series of meetings for CEOs of Georgian and Azerbaijani companies and was supported by PASHA Bank.

Prime Minister of Georgia, Giorgi Kvirikashvili; First Vice Prime Minister, then Minister of Finance of Georgia, Dimitry Kumsishvili; Minister of Economy and Sustainable Development of Georgia, Giorgi Gakharia; and Ambassador Extraordinary and Plenipotentiary of the Republic of Azerbaijan to Georgia, Dursun Hasanov attended the CEO Lunch as honorary guests.

On November 30th, 2017, the International Chamber of Commerce (ICC-Georgia), in cooperation with ICC China, held the Silk Road Regional Trade Finance Forum. PASHA Bank, being the sponsor of the event, was represented on the trade finance panel discussion and presented the services it offers in this business segment.

In 2017, PASHA Bank held two business conferences under the auspices of MEETING ROOM – a project initiated by the Bank in 2016. The project implies a cycle of business conferences that aim 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. On December 6 the same year, the Bank hosted its second business conference on the topic of "Sustainable Energy Development in Georgia - The Case for Hydro Power Plants." In 2017, the themes of the conferences were: "Healthcare Sector Development in Georgia" and "Capital Raising Alternatives for Agricultural Projects".

Helping the development of various business sectors, and the Georgian economy in general, is an indirect continuation of what we see as our mission: contributing to the growth of large and medium-sized enterprises by providing them with competitive corporate and investment banking services. Thus, the organization and support of events aimed at professional growth through sharing experience and knowledge represents our main criterion while evaluating sponsorship projects. We believe that by supporting such initiatives, we contribute to the development of the business climate and the economy as a whole.

INFORMATION TECHNOLOGIES

The IT and Banking Systems Development of PASHA Bank Georgia is responsible for developing and implementing an overall information technology policy.

One of the key accomplishments of the last two years is an 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. Document flow of Legal and Project Management Departments will be also added in future.

In 2017, the Bank embarked on a path of developing the second phase of its ERP system. The second phase implies addition of functionalities such as recruitment, performance appraisal and learning development modules in HR soft.

The same year, the Business Continuity Planning (BCP) was completed successfully, and systems for the prevention of and recovery from potential threats to the Bank were put in place. BCP ensures the overall coordination of the Bank's response to a crisis/ disaster, in an effective, timely manner, with the goal of avoiding or minimizing damage to the Bank's employees, profitability, reputation, and/or ability to operate. BCP includes Business impact Assessment, Disaster Recovery Plan, Crisis Management Plan and Business Recovery Plans.

Many potential disruptive threats could occur at any time and could affect the Bank's business operations. A wide range of potential threats taking place at the primary datacenter will lead to the activation of these plans.

An Outsourced Centralized Archive was deployed successfully to ensure safe and instant access to all vital contracts/ documentation.

HUMAN RESOURCES

Our People

The most important strategic resource for us is our people.

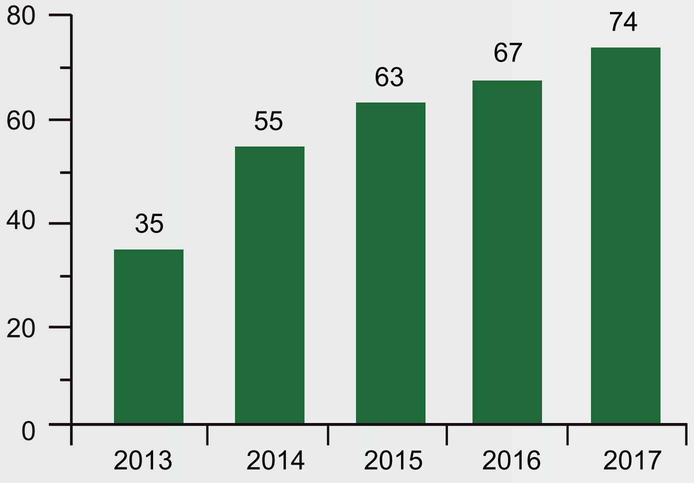
We take pride in having talented professionals eager to make a difference and we believe investment in people is the best allocation of our resources. Supporting our people in professional development, encouraging innovations and ensuring they feel valued, challenged and motivated is top of our agenda.

We take pride in having an established culture of mutual respect, transparent relations and cooperation.

Our HR strategy for the period 2013-2017 was focused on supporting sustainable growth of the Bank by attracting top talent.

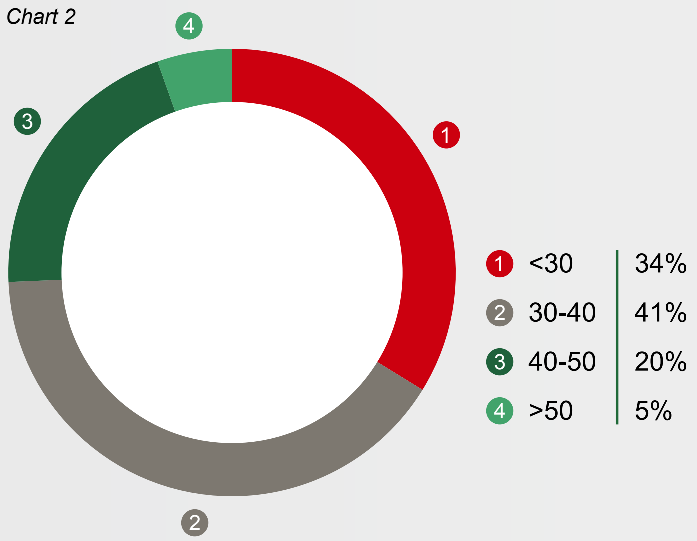
Number of Employees (2013-2017)

Chart 1



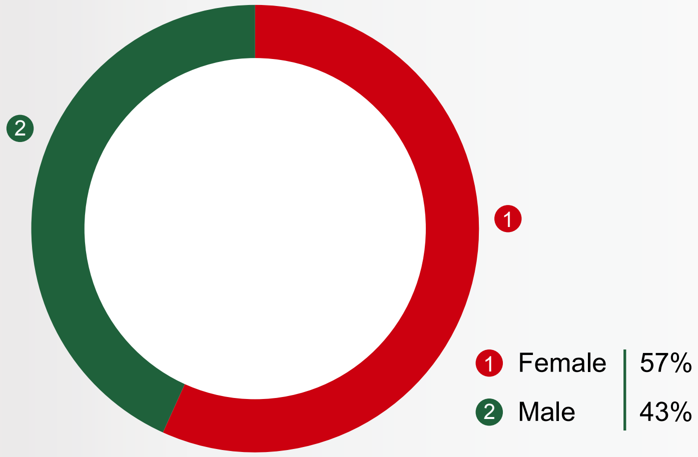
Age Composition

Chart 2



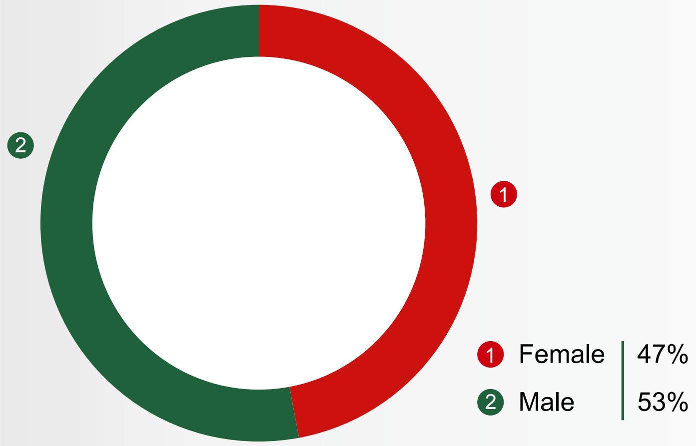
Gender Balance

Chart 3



Gender Balance in Middle Management

Chart 4



Learning and Development

We create an environment that enables professional growth and continuous learning. The Bank offers different opportunities to gain knowledge and skills: professional trainings both 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 spent on employee training and development in 2017 is 3.2% of the overall employee cost.

Number of people trained (2017)	51
% of people trained abroad	25%
Total training hours of employees for 2017	1760
Average training hours for 2017	25

Table 4

For those employees who we regard to have high potential to develop further and become future leaders, a special Talent Program has been put in place. Employees involved in the program are offered additional trainings customized to their particular needs.

We also launched the Internship Program for young talents, which has been successfully running for three years already. We have hired thirteen interns during this period; nine of whom were offered full-time employment 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.

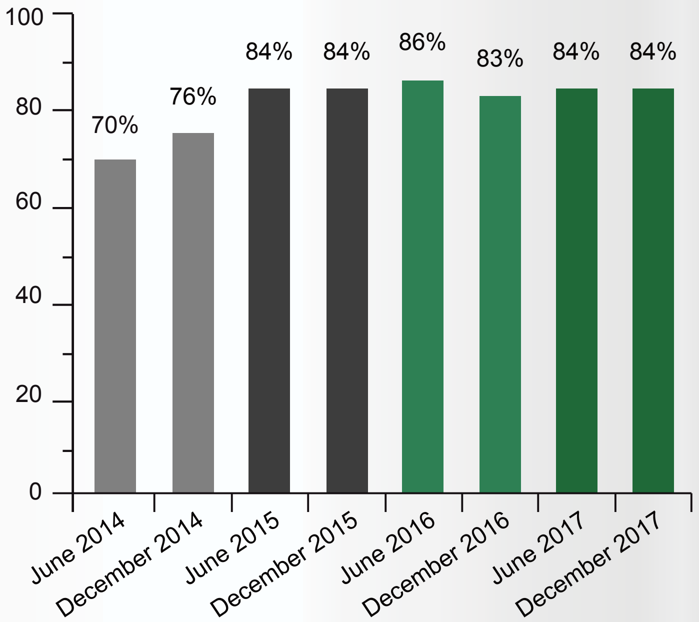
Employee engagement and satisfaction

We strive to ensure that our employees are happy in their jobs. To better understand their needs and attitudes, we conduct an internal satisfaction survey twice a year. The survey covers different topics, including the team, the management, loyalty, stress, development opportunities, etc.

The chart below shows how our employees' internal satisfaction indicator has evolved over time:

Satisfaction %

Chart 5



In addition, in 2017, a Health Index Study was conducted by the McKinsey team. The study measures a company's ability to create strong strategic alignment, ensure high quality execution and constant renewal. In response to the study results, we have planned five projects for 2018.

Remuneration of key management personnel

The remuneration policy of PASHA Bank ensures a fair approach and competitive compensation for key management personnel and all employees of the Bank. PASHA Bank defines key management personnel as members of the Supervisory Board and the Board of Directors.

The Supervisory Board consists of five members. Biographies of the Supervisory Board members are provided on page 23.

The Board of Directors consists of three members – the Chairman of the Board of Directors, Chief Commercial Officer and Chief Financial Officer. Biographies of the Board of Directors members are provided on page 35.

The HR and Remuneration Committee of the Supervisory Board is vested with the responsibility to recommend the remuneration for the key management personnel. More information regarding this Committee is provided on page 30.

According to Article 6, Section 6.11, Subsection 6.11.7 of PASHA Bank's Charter: the General Meeting of Shareholders reviews and makes resolutions on the following issues: election and dismissal of members of the Supervisory Board, the remuneration of its members, and conclusion of contracts with them.

According to Article 7, Section 7.9, Subsection 7.9.1 of PASHA Bank's Charter: the objectives and competence of the Supervisory Board include the following: appointment and dismissal of members of the Board of Directors, concluding agreements with members of the Board of Directors and determining their remuneration and working conditions.

Supervisory Board members, apart from the Chairman of the Supervisory Board, are not remunerated. Remuneration of the Chairman of the Supervisory Board consists of a monthly fixed payment only.

Remuneration of members of the Board of Directors consists of two components – fixed pay (salary) and variable pay (bonus). The variable pay is mainly based on the results of the Board of Directors' performance as a team, although it also includes individual assessment factors. Compensation consists of only a monetary component.

The remuneration system for the members of the Board of Directors is set by the Supervisory Board based on the principles of fairness and transparency. The risks associated with management remuneration affect every aspect of the Bank's business, including financial performance, culture, operations, reputation, and governance. To mitigate these risks, the Supervisory Board is committed to maintaining the management remuneration system that ensures the strategy alignment is based on a clear performance matrix and is appropriately governed.

Remuneration of employees

Remuneration of the Bank's employees consists of competitive salaries and variable pay. The latter is linked to the individual performance of employees. Our compensations consist of only a monetary component.
Salaries are determined internally on the basis of the job role, individual experience, performance, and market tendencies. Salaries are defined based on the salary scale to ensure fair treatment of everyone at any job level. Salary scale is developed internally and approved by the Board of Directors. It is linked to the job role level – job grade. Every job is analyzed according to the level of financial, informational, customer service, etc., responsibilities by the grading panel, the latter being selected and approved by the Chairman of the Board of Directors. Members of the grading panel are vested with the responsibility to analyze the job. Job specifics, current market trends and a skill-set required for a particular position are considered when determining compensations. To be aware of the market trends and stay competitive, we participate in the Georgian banking sector annual compensation survey conducted by independent company – "HR Expert". Every position in PASHA Bank is eligible for variable pay. The purpose of the variable component is to align the interest of the employees with that of the shareholders and other stakeholders of the Bank. Performance assessment is conducted annually. Individual performance is evaluated by the immediate supervisor, who is responsible for providing continuous feedback on the job and training of the subordinates. Performance is assessed according to internal methodology which is approved by the Board of Directors.

The remuneration policy and incentive schemes for the Board of Directors are reviewed by the HR and Remuneration Committee. The HR and Remuneration Committee suggests a target pool for the annual bonuses of the Board of Directors and support staff. Bonus methodologies for the Board of Directors, support function and front office, are reviewed and approved by the Supervisory Board.

Bonuses for middle management and support function employees are linked to individual, functional and behavioral performance and are calculated and distributed annually. Corporate banking and treasury functions receive quarterly bonuses based on their KPIs.

CORPORATE GOVERNANCE

COMMITMENT TO CORPORATE GOVERNANCE

PASHA Bank 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 a 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 the 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, as well as 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, to comply with ethical standards of business conduct as defined by the Bank's Code of Ethics.

GENERAL GOVERNANCE STRUCTURE

JSC PASHA Bank has the following governance structure:

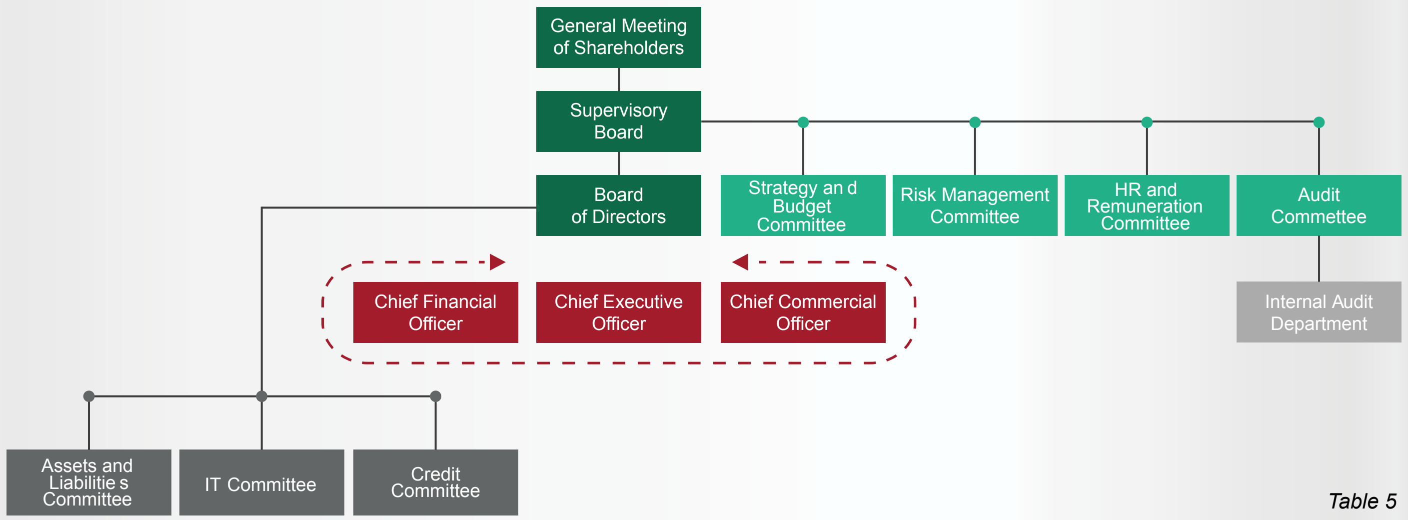


Table 5

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.

Shareholder Structure

The total authorized share capital of PASHA Bank amounts to GEL 103,000,000 (one hundred and three million Georgian Lari). 100% of the Bank shares are solely owned by OJSC PASHA Bank.

The ultimate beneficial owners of the company are Mrs. Leyla Aliyeva 45%, Mrs. Arzu Aliyeva 45% and Mr. Arif Pashayev 10%.

During the reporting period, there were no changes in the Bank's capital, Charter or the shareholder structure.

The Ownership Structure is as follows:

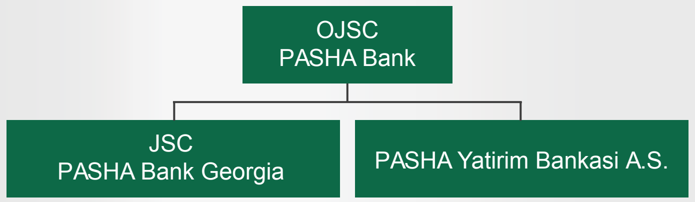


Table 6

General Meeting of Shareholders

The supreme governing body of the Bank is the General Meeting of Shareholders. The Bank holds Annual General Meetings within two months following the signing of the annual audited financial statements. Other general meetings are called if the interests of the Bank require so or if it is required by the Bank's Charter. The General Meetings are called by the Board of Directors, the Supervisory Board or the shareholder(s).

The General Meeting is called within a term of 20 calendar days after the Directors have sent notification to shareholders.

The Bank ensures that all valid proxy appointments received for the General Meetings are properly recorded.

The voting results and other relevant materials are distributed to the shareholders and to the ultimate shareholders.

The Supervisory Board ensures that the Supervisory Board members and all directors are made aware of their major shareholders' views, issues and concerns.

Issues Requiring Approval of the General Meeting of Shareholders

The General Meeting reviews and makes resolutions on the following issues:

a) approval and amendment of the Bank's Charter;

b) approval of the Bank's annual audited financial statements;

c) reorganization of the Bank, which includes mergers, divisions, transformations (change of organizational-legal form) and liquidation of the Bank, full or partial cancellation of pre-emptive rights during the increase of the share capital of the Bank;

d) issuance of new shares, sale of shares by the existing shareholder(s) or other securities convertible into shares;

e) accepting or rejecting proposals of the Supervisory Board or the Board of Directors concerning the utilization (including distribution) of profit or to make decisions concerning the utilization of the net profit, if the said bodies fail to make an agreed proposal;

f) approval of reports by the Board of Directors and the Supervisory Board;

g) election and dismissal of members of the Supervisory Board, determining the question of the remuneration of its members and conclusion of contracts with them;

h) approval of the first composition of the Board of Directors of the Bank;

i) approval of the first composition of the Audit Committee of the Bank;

j) making decisions on the participation in court proceedings against Board of Directors or Supervisory Board members;

k) adopting resolutions on issuance and sale of shares and other securities in accordance with the Bank's Charter and Georgian legislation;

l) making decisions on the acquisition, sale, transfer, exchange (or other transactions to similar effect) or encumbrance of the Bank's properties, the value of which is more than 25% of the book value of the Bank;

m) deciding on other matters pursuant to effective Georgian legislation.

Annual General Meeting of Shareholders of 2017

In 2017, the shareholders of the Bank were represented at the Annual General Meeting of Shareholders by Mr. Mir Jamal Pashayev, under duly notarized and legalized power of attorney (proxy).

The Annual General Meeting of Shareholders for the year 2017 was held on May 17, 2017.

Agenda of the Annual Meeting of Shareholders

1. Independent Auditors' Report

The General Meeting of Shareholders approved the annual audited financial statements together with the independent auditor's report.

2. Resolution on the net profit of the year 2016

The General Meeting of Shareholders decided not to distribute as dividends the net profit of the year 2016 in the amount of GEL 7,364,377.54 (as per NBG).

3. Election of the Supervisory Board Chairman

The General Meeting of Shareholders discussed and approved Mr. Mir Jamal Pashayev's intention to step down from the position of Supervisory Board Chairman and appointed him as Member of the Supervisory Board. The decision became effective from June 1, 2017.

4. Approval of the new composition of the Supervisory Board

The General Meeting of Shareholders approved the appointment of Mr. Farid Mammadov to the position of Supervisory Board Chairman. The decision became effective from June 1, 2017.

The shareholders did not make any request for the inclusion of any item to the agenda of the General Meeting.

Shareholder Rights

The rights and responsibilities of the shareholders are determined by the Charter of PASHA Bank, by the Law of Georgia on Entrepreneurs (as amended from time to time), the Law of Georgia on the Activities of Commercial Banks (as amended from time to time) and all other relevant laws and regulations, including the regulations issued by the National Bank of Georgia.

The Charter is available on PASHA Bank's website at www.pashabank.ge

The Bank's shareholders have the rights to:

a) attend or be represented at the General Meeting and take part in the voting;

b) be elected to the Supervisory Board;

c) participate in the distribution of profit and receive a pro rata share of dividends;

d) dispose of their shares in accordance with the Georgian legislation and the Bank's Charter;

e) in case of liquidation of the Bank, receive a pro rata share of the net assets remaining after the payment of the claims to the creditors;

f) have access to information concerning the economic activities of the Bank;

g) request the directors of the Bank to specify issues in the agenda of the General Meeting, request an extraordinary General Meeting or add issues for consideration to the agenda of a scheduled General Meeting;

h) request a special audit of the Bank's economic activities and annual balance sheet if they believe in their reasonable judgment that material irregularities have taken place;

i) enjoy a pre-emptive right to subscribe for newly issued or existing shares of the Bank on a pro-rata basis in accor dance with the terms and conditions of the Bank's Charter;

j) refer to the local court or, at the agreement of the parties, private arbitration for the solution of a conflict between themselves and the Bank;

k) other rights as stipulated by Georgian legislation and the Bank's Charter.

SUPERVISORY BOARD

The Supervisory Board is responsible for the 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. It advises the Board of Directors and is involved in decision-making on all fundamental matters affecting the Bank. It 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 the 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, take into consideration the interests of other stakeholders as well.

According to Article 7, Section 7.10, of the Bank's Charter the following activities are performed only by the Supervisory Board:

- Strategic supervision and control of the Bank;
- Reviewing and approving corporate strategy and strategic objectives;
- Reviewing and approving the annual budget and business plan;
- Initiation of new banking/commercial activities and termination or suspension of existing activities;
- Establishment and liquidation of new enterprises, branches;
- Acquisition and disposal of shares in other companies;
- Approval of the organizational structure;
- Approval of the Code of Ethics and whistleblowing procedures;
- Rendering resolutions for implementation of the decision of the General Meeting on admission of the Bank's shares and other securities to the stock market;
- Submitting proposals for profit distribution to the General Meeting of Shareholders;
- Redemption of shares by the Bank as provided under Georgian legislation;
- Performing strategic supervision of risk management activities;
- Approval of the risk appetite statement, conducting annual reviews;
- Approval of the business continuity plan;
- Authorization for conflicts or possible conflicts of interest and related party transactions within the limits established by the Bank;
- Approval of policies, standards and procedures in respect to conflicts of interest and related party transactions;
- Approval of structure, size and composition of the Board of Directors, including appointments and dismissal of its members;
- Determining the rights and obligations of members of the Board of Directors, monitoring and supervising their activities, requesting reports from the Board of Directors;
- Approval of succession policy and succession planning for members of the Board of Directors;
- Concluding the labor agreements and determining remuneration packages for members of the Board of Directors;
- 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;
- Approval of structure, size and composition of the Supervisory Board committees, including appointments and removals of Supervisory Board committee members; reviewing reports of the Supervisory Board committees;
- Election of external auditors;
- Appointment and dismissal of trade representatives (procurators);
- Appointment and dismissal of the Corporate Secretary;
- Approval of transactions including, but not limited to, attraction of borrowings, granting lending and trade finance products, approval of loan restructurings, loan write-offs, approval of acquisition and disposal of fixed assets and intangible assets, administrative expenses, cash limits, implementation of equity investments in public and private companies in case the transaction is above the decision-making and signatory authority limits of the Board of Directors;
- Approval of the decision-making and authority limits of the Board of Directors;

- 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;
- Approval of issuance of bonds;
- Approval and amendment of the Bank's statute, framework and policy type of documents;
- Determining and approving the amount of minimum and maximum interest rates to be used with regard to credit resources and deposits;
- Determining and approving the terms and conditions to be used with regard to credit resources and deposits to the Bank's employees;
- Convening General Meetings, if deemed necessary for the interests of the Bank;
- Supervision and representation of the Bank in case of conflict between members of the Board of Directors;
- Based on the decision of the General Meeting, handling 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;
- Supervising implementation of measures in accordance with results of examinations carried out by External and Internal Audits, as well as the National Bank of Georgia;
- Making a decision on such issues that are beyond the scope of the Board of Directors' powers;
- Performing any other duties as required by the General Meeting.

The Charter of the Bank did not change in 2017. The duties and responsibilities listed in Article 7, Section 7.10 were not delegated.

The Bank's Corporate Governance Policy sets the supervisory board membership criteria according to which the Supervisory Board seeks members with extensive experience and expertise and a reputation for integrity. Members of the Supervisory Board should have experience in positions with a high degree of responsibility, be leaders in the companies or institutions with which they are affiliated, and be selected based upon the contributions they can make to the Supervisory Board and their ability to represent the interests of shareholders. The Supervisory Board will also take into account the diversity of a candidate's perspectives, background and other pertinent factors. The Supervisory Board membership criteria and appointment process are regulated by the Bank's Standard on Appointment of Administrators. The latter is developed in compliance with the Regulation on Fit and Proper Criteria for Administrators of Commercial Banks and sets the requirements a candidate for the Supervisory Board Membership must comply with. In assessing the collective suitability of the board, the following should be taken into account:

- A member of the Supervisory Board should have a university education in one of the following fields: economics, finance, banking, business administration, audit, accounting or jurisprudence;
- A member of the Supervisory Board should not be an administrator of another commercial bank registered in Georgia, except in the case he/she holds an administrator's position in a bank which is the subsidiary or parent of the Bank;
- A member of the Supervisory Board should not be a member of the Supervisory Board or the Board of Directors in more than 7 enterprises registered in Georgia;
- A member of the Supervisory Board should not be the I or II rank relative of a member of the Board of Directors or the Supervisory Board of the Bank;
- A member of the Supervisory Board should have the appropriate qualification and professional experience- the composition of the Supervisory Board should ensure a variety of mix of skills, knowledge and experience which corresponds to the scale and complexity of the Bank's activities.

According to the Corporate Governance Policy, factors considered by the HR and Remuneration Committee and the Supervisory Board in its review of potential candidates include:

- Prominence in business, institutions or professions;
- Integrity, honesty and the ability to generate public confidence;
- Demonstrated sound and independent business judgment;
- Financial literacy and experience with financial institutions;
- Risk management experience;
- The professional experience required to contribute to the Supervisory Board committees;

- The ability to devote sufficient time to the Supervisory Board and committee work;
- Residency in and familiarity with the geographic regions where the Bank carries out business;
- The competencies and skills that the Supervisory Board considers each existing member should possess.

The Corporate Governance Policy of PASHA Bank is available on the Bank's website www.pashabank.ge

Board Effectiveness Review: Evaluation of Supervisory Board Members. The Supervisory Board conducts an annual effectiveness review in order to evaluate the performance of the Supervisory Board as a whole, Supervisory Board committees and of its individual members. The Board periodically reviews its structure, size and composition as well as committees' structures and coordination. Annual evaluations are internally facilitated. The performance evaluation process takes the form of a detailed questionnaire supplemented by individual interviews with members of the Supervisory Board and Supervisory Board committees. The Chairman holds private meetings with members of the Supervisory Board to discuss the evaluation results and individual performance. Chairmen of Supervisory Board committees are responsible for the evaluation of their committees.

At least once annually, the Supervisory Board reviews the Bank's corporate governance assessment report prepared by the Corporate Secretary and, either separately or as part of these assessments, reviews the effectiveness of its own governance practices and procedures, determining where improvements are needed and making any necessary changes.

The Board engaged the Institute of Corporate Secretaries and Administrators, The Governance Institute (ICSA), to conduct an externally facilitated corporate governance review for 2017. ICSA was asked to assess the extent to which PASHA Bank complies with the corporate governance provisions of the UK Corporate Governance Code (the "Code"). In performing this task, ICSA reviewed the comments and information provided by the Corporate Secretary. In order to understand the context for the Code, it provided some further background and explanation, summarized what it considered to be the main findings in the report, explained the scope and limitations of the report and provided conclusions from the exercise. It was revealed that the Bank complies with largely procedural or structural provisions of the code which are of true relevance to the Bank. However, they argued that having one or more truly 'independent' non-executive directors could be of considerable value in terms of diversity of opinions and constructive debate. The Supervisory Board will consider and decide (given its own particular stakeholders, requirements and constraints) which of the model provisions of the Code is of value for adoption.

The Schedule of Matters Reserved for the Supervisory Board Decision can be found on page 58.

The Supervisory Board of PASHA Bank consists entirely of non-executive directors and includes:

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

Each member of the Supervisory Board is elected by the General Meeting of Shareholders for a term of four years, but the authority is prolonged until the calling of the next General Meeting. The General Meeting may at any time re-elect a Supervisory Board member before the expiry of the above term. At the same time, any member may resign at any time.

At the Annual General Meeting held on May 17, 2017, Mr. Mir Jamal Pashayev resigned from the position of Chairman of the Supervisory Board and was elected as Member of the Supervisory Board. At the same meeting, Mr. Farid Mammadov was elected as the member and the Chairman of the Supervisory Board, effective from June 1, 2017.

The Supervisory Board held 27 board meetings throughout 2017.

Supervisory Board
Members on 31 December 2017

Name - Surname	Position	Date of Election	Date of Reelection	Other positions	Meetings attended/ eligible to attend	
Farid Mammadov	Board Chairman	01.06.17		Risk Management Committee Member	13/15	87%
Mir Jamal Pashayev	Board Member	22.10.12	01.06.17	HR and Remuneration Committee Chairman	17/27	63%
Jalal Gasimov	Board Member	19.10.15		Strategy and Budget Committee Chairman Risk Management Committee Chairman HR and Remuneration Committee Member	24/26	92%
Cenk Eynehan	Board Member	17.09.15			26/27	96%
Taleh Kazimov	Board Member	17.09.15			21/27	78%

Table 7

** Mr. Farid Mammadov was elected to the Supervisory Board from June 01, 2017. Some members were not eligible to attend some Board meetings as per the Bank's rules on managing conflict of interests.*

Agenda of Supervisory Board Meetings of PASHA Bank in 2017

Corporate governance-related items

1. Corporate Governance Self-Assessment Results;
2. Election of the new Chairman of the Supervisory Board;
3. New composition of the Audit Committee;
4. New composition of the Risk Management Committee;
5. New composition of the Board of Directors;
6. Corporate Governance Policy; Information Disclosure Policy; Standard on Appointment of Administrators; the Bank Related Party Standard; Whistleblowing Procedure; Statute of Risk Management Committee; Statutes of ALCO, IT Committee and Credit Committee; Statutes of the Bank's Departments; Human Resources Policy; Fraud Management Policy; Document Retention Policy; Environmental Policy and PR and Marketing Policy;
7. Decision-making authority with regard to the sale of the credit asset;
8. Appointment of the Head of the Internal Audit Department;
9. Appointment of the Corporate Secretary;
10. IFRS interim condensed financial results;
11. Recommend for approval by the General Meeting of Shareholders the annual audited financial statements together with independent auditor's report;
12. Submit proposals for dividend distribution to the General Meeting of Shareholders;
13. Related party transactions;
14. Bonus Calculation Methodology, Strategic KPIs, Template of Ranges for Calculating KPIs Achievement Level and Ranges of Calculating KPIs Achievement Level for the Board of Directors for the year 2017;
15. Bonus Pool for the Board of Directors and the Support Function;
16. Review of Whistleblowing Concerns Registry;
17. Review of quarterly financial and other activities reports;
18. Review of quarterly Supervisory Board committee reports;
19. Review of quarterly reports on critical and high-risk audit findings;
20. Review of the Compliance Reports.

Risk management related items

1. Risk Appetite Statement;
2. Internal Currency Position Calculation Methodology;
3. NBG Loan Loss Provisioning Methodology;
4. Financial Institution Rating and Internal Assessment Limit Setting;
5. Ratios and Terms Glossary;
6. Loan Loss Provisioning Methodology;
7. IFRS Accounting Policy;
8. Credit Standard;
9. Financial Instrument Structuring Standard;
10. Internal Capital Assessment Framework;
11. FI exposure limit structure;
12. Market Risk Management Policy;
13. IT Strategy;
14. Other risk, IT and compliance related policies;
15. Approval of the proposal of implementation of selected Disaster Recovery Architecture Concept, adoption of IT Disaster Recovery Site and standalone Staff Recovery Site, IT Equipment and Support Services provider;
16. Crisis Management Plan;
17. Disaster Recovery Plan;
18. Review of the BCP Test Report.

Strategic Planning and Budget

1. Macroeconomic and Market Assumptions of Georgia for 2018;
2. 2018 Budget for PASHA Bank;
3. Review proposal for support in Phase II of strategy development project;
4. Strategy 2018-2020 with competitive strategy, executive summary, financial model for the strategy; and other operational matters, such as approval of credit facilities.

BIOGRAPHIES OF THE SUPERVISORY BOARD MEMBERS

Farid Mammadov
Chairman of the Supervisory Board

Farid Mammadov completed his undergraduate education in Political Science at the Baku Social Management and Political Science Institute and earned a master's degree in Political Science from the Academy of Public Administration under the President of the Republic of Azerbaijan.

Having started his banking career in 1999 as credit officer at the United Credit Bank CB, Mammadov served as the Director of the Credits Department at the Bank of Baku OJSC from 2001 to 2010 and subsequently as the Deputy CEO. He started in 2012 to work as the Risk Director within PASHA Holding and served as a Member of the Board of Directors at PASHA Bank OJSC until June 2013, while maintaining his current duties. From this date until February 2017, he served as the First Deputy CEO at the Kapital Bank OJSC. Since February 2017, he has been serving as the Deputy CEO of PASHA Holding LLC and the Director of Business Group. His experience in banking and business management counts 18 years.

Farid Mammadov is the Chairman of the PASHA Bank Supervisory Board effective June 01, 2017.

Mir Jamal Pashayev
Member 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 a 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. He is also Chairman of the HR and Remuneration Committee of PASHA Bank Georgia.

Jalal Gasimov
Member of the Supervisory Board

Jalal Gasimov 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. He joined PASHA Holding as the Head of the Banking Group and Deputy CEO in 2015, where he was 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.

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 was then promoted to the position of the Bank's Treasury Director in 2009.

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

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

H. Cenk Eynehan
Member of the Supervisory Board

Hikmet Cenk Eynehan earned a two-year degree in economics from Erasmus University in the Netherlands, a Bachelor's degree in management from Monroe College in the United States of America, and completed an 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 (Netherlands) N.V., until 2001. He continued his professional career in the non-financial sector 2002-2004 and 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 was named 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 Supervisory Board has established the following committees under it - the Audit Committee, the Strategy and Budget Committee, the HR and Remuneration committee, and the Risk Management committee.

The Audit Committee

The Audit Committee of PASHA Bank was established by and is accountable to the Supervisory Board. The committee is a governing body that establishes and controls the internal audit function and monitors the Bank's activities according to the applicable legislation. The committee has the overall responsibility of overseeing the Bank's systems of internal control by establishing the internal audit function. The committee also communicates with the Bank's external auditor, reviews and comments on Audited Annual IFRS Financial Statements and Interim Condensed Financial Statements.

By bringing a systematic approach to the evaluation and improvement of risk management, internal control and governance processes, the committee monitors whether structural units and employees of the Bank follow the requirements of acting legislation.

The committee assists the Supervisory Board and the Board of Directors in ensuring the availability and adequacy of an effective internal control system in the Bank.

The members are appointed for a term of maximum four years, with their re-election unrestricted.

Committee meetings are to be held at least once every three months (quarterly) and may be held more often if required. During 2017, the committee held 11 meetings.

The decisions of the committee are made by a simple majority of votes of the members present at the meeting. Each member has one vote. If the votes are evenly split, the vote of the Chairman is considered decisive. Heads of the departments, external auditors or other persons may be invited to the committee meetings, if necessary.

Members on 31 December 2017

Name - Surname	Position	Date of Reelection	Meetings attended/ eligible to attend	
Parvin Ahadzade	Committee Chairman, former committee member	08.06.15	11/11	100%
Jamil Mammadov	Committee Member	17.10.14	10/11	91%
Ramil Heydarov	Committee Member	13.01.17	10/11	91%

Table 8

The Risk Management Committee

The Risk Management Committee of PASHA Bank 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 address 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, the risk appetite and tolerance statement, the Business Contingency Plan, and evaluates the effectiveness of mitigating strategies to address the material risks to the Bank. It reports to the Supervisory Board on any material change to the risk profile of the Bank.

The Risk Management Committee held 6 meetings in 2017, reviewing and submitting for approval to the Supervisory Board the Risk Management Committee Statute, the Risk Appetite Statement, Business Impact Assessment, Crisis Management Plan, Disaster Recovery Plan, Loan Loss Provisioning Methodology, Ratios and Terms Glossary, Risk Reports, Penetration Test, Risk Maturity Diagnostic Model, FI exposures, and Internal Capital Assessment Framework.

Members as of 31 December 2017

Name - Surname	Position	Date of Reelection	Meetings attended/ eligible to attend	
Jalal Gasimov	Committee Chairman	08.02.16	6/6	100%
Hayala Naghiyeva	Committee Member	08.02.16	4/6	67%
Kamala Nuriyeva	Committee Member	08.02.16	6/6	100%
Elman Eminov	Committee Member	08.02.16	6/6	100%
Farid Mammadov	Committee Member	02.10.17	0/1	0%

Table 9

The Strategy and Budget Committee

The Strategy and Budget Committee of PASHA Bank 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.

The Strategy and Budget Committee held 6 meetings in 2017. It reviewed reports on the status of the Bank's key/strategic projects, analyzed the key challenges of the current strategic period and future prospects, reviewed financial performance, peer group analysis, KPIs and Budget Execution Reports, the committee reports to the Supervisory Board, Macroeconomic and Market Assumptions of Georgia for 2018, and the Budget for 2018.

Members as of 31 December 2017

Name - Surname	Position	Date of Reelection	Meetings attended/ eligible to attend	
Jalal Gasimov	Committee Chairman	08.02.16	6/6	100%
Hayala Naghiyeva	Committee Member	08.02.16	5/6	83%
Sarkan Aliyev	Committee Member	08.02.16	5/6	83%
Murad Ahmadov	Committee Member	08.02.16	6/6	100%
Turkhan Mahmudov	Committee Member	08.02.16	4/6	67%

Table 10

The HR and Remuneration Committee

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.

The HR and Remuneration Committee held 5 meetings in 2017, reviewing HR activities reports, the analysis of Emotional and Social Competency Inventory, Bonus Pool for the Bank's Board of Directors and the Support Function, HR Policy, and Strategic KPIs (2018-2020) for the Board of Directors.

Members as of 31 December 2017

Name - Surname	Position	Date of Reelection	Meetings attended/ eligible to attend	
Mir Jamal Pashayev	Committee Chairman	08.02.16	5/5	100%
Jalal Gasimov	Committee Member	08.02.16	3/5	60%
Ayten Abbasli	Committee Member	08.02.16	5/5	100%

Table 11

BOARD OF DIRECTORS

The day-to-day operational management of the Bank is carried out by full-time executives, members of the Board of Directors. The Bank's Board of Directors is made up of three directors – the Chief Executive Officer, Chief Commercial Officer and Chief Financial Officer. The directors are appointed by the Supervisory Board for a fixed term, typically for four years, which may be renewed at the end of each four-year period. The position and scope of activity of each member of the Board of Directors is determined upon appointment of the respective member.

According to the Bank's Charter and the Board of Directors Statute, the following activities are to be performed by the Board of Directors:

- Carry out the Bank's day-to-day business operations;
- Take all reasonable measures to have up-to-date information on the financial standing of the Bank and make informed decisions on any matter concerning the operations of the Bank; in co-operation with the other functional units of the Bank, the Board of Directors shall ensure maintenance of the Bank's solvency and liquidity and shall also ensure that all measures required for this purpose are undertaken;
- Develop the corporate strategy, strategic objectives, business plan, annual budget and submit it to the Supervisory Board for approval;
- Present to the Supervisory Board and to the General Meeting of Shareholders, audited financial statements together with the Independent Auditors Report;
- Submit to the Supervisory Board for approval transactions that go beyond the scope of corporate strategy and strategic objectives, business plan and the budget (non-standard transactions);
- Report on delivery of performance against the corporate strategy and strategic objectives, business plan and budget to the Supervisory Board;
- Approve day-to-day operational banking activities, including attraction of borrowings, granting lending and trade finance products, approval of loan restructuring, approval of acquisition and disposal of fixed assets and intangible assets, administrative expenses, cash limits, equity investments in public companies and sign respective agreements within its decision-making and signatory authority limits, as approved by the Supervisory Board in the Decision-Making and Signatory Authority Matrix;
- Approve all kinds of technical assistance, service and purchase agreements and know-how;
- Supervise units and/or departments of the Bank, ensuring that the Bank provides proper service to its customers;
- Solve issues of collateral seizure and take other appropriate measures to protect the Bank against losses;
- Ensure the existence of a proper system of risk control in the Bank, in accordance with requirements of Georgian legislation;
- Prepare complete and accurate annual, semiannual, quarterly reports and other financial information;
- Prepare and submit proposals and draft resolutions, reports and any other information or documentation requested by or to be presented to the Supervisory Board or the General Meeting of Shareholders;
- Review information provided by internal or external auditors of the Bank, the Audit Committee, as well as any expert and/or advisor engaged by the Bank, as well as reports submitted by the managers of the Bank and make the appropriate decisions;
- Approve and amend internal regulatory documents of the Bank except those related to privileges of the Supervisory Board;
- Develop internal regulatory documents of the Bank and submit them for approval to the Supervisory Board;
- Develop and submit for approval to the Supervisory Board the Code of Ethics, including whistleblowing procedures;
- Develop and submit the organizational structure of the Bank for approval to the Supervisory Board;
- Approval of structure, size and composition of committees of the Board of Directors, including appointments and removals of committee members; reviewing reports of the committees;
- Approve job descriptions for managerial positions, work schedules, collective labor agreements;
- Decide on the appointment, dismissal and remuneration of the employees of the Bank, except of members of the Board of Directors, determine any other matter related to the employees of the Bank;
- Recommend and submit for approval to the Supervisory Board the bonus pool for employees of the Bank, except a bonus amount to be disbursed to front-office function;
- Approve the disbursement of a bonus amount to front-office function;

- Monitor compliance with the legislation, internal normative documentation and implementation of resolutions of the General Meeting of Shareholders and the Supervisory Board;
- Execute and implement resolutions rendered by the Supervisory Board and the General Meeting of Shareholders;
- Perform any other duties imposed by the Supervisory Board and the General Meeting of Shareholders.

The Board of Directors is led by the Chairman of the Board of Directors, who at the same time serves as the CEO of PASHA Bank.

The decisions of the Board of Directors are adopted by a simple majority of votes.

Nomination Process

The Supervisory Board is responsible to develop and present for approval to the General Meeting of Shareholders, a formal, rigorous and transparent procedure for the appointment of directors. The search for new members of the Board of Directors is conducted by the HR and Remuneration Committee of the Supervisory Board. The Chairman of the Supervisory Board and members of the HR and Remuneration Committee interview the candidates before their appointments are recommended to the Supervisory Board for approval. The HR and Remuneration Committee is responsible for considering succession planning for the directors and conducting an annual review of succession planning, and for proposing changes to the process as necessary.

The Board of Directors membership criteria and appointment process are regulated by the Bank's Standard on Appointment of Administrators. The Bank's directors appointment process is in compliance with banking regulations and contains similar criteria and limitations for membership of the Board of Directors.

Committees of the Board of Directors

According to the Board of Directors Statute, the Board of Directors may establish standing and/or ad hoc committees, which shall have the obligation of fulfilling the duties determined by the latter. The Board of Directors approves committee statutes, committee size and composition, including appointments and dismissals of committee members.

The Board of Directors is collectively responsible for decisions made and activities implemented by the committees.

The committee shall only exercise such powers that are explicitly attributed or delegated to it, and its actions as a whole should not exceed the powers of the Board of Directors.

Periodically, the Board of Directors should receive a report from each committee of its deliberations and findings.

There are currently three committees supporting the Board of Directors:

The Credit Committee

This committee was established to assist the Board of Directors in discharging its duties and responsibilities in specific areas of business activities. The committee monitors credit risk related issues, approves individual or group credits or other credit products within the delegated authorities, issues recommendations regarding individual or group credit exposures, issues recommendations regarding credit risk management, monitors loan portfolios, trade finance portfolios, investment portfolios and collateral portfolios, manages problem loans and ensures the adequacy of loan loss allowances.

The committee has a statute regulating its activities which contains provisions regarding its scope of authority, competencies, composition, working procedures, and its rights and responsibilities.

The committee is composed of five members and includes all executive directors of the Bank.

The IT Committee

This committee was established to assist the Board of Directors in discharging its duties and responsibilities in specific areas of business activity. The committee develops the Bank's strategic development plan in terms of the development of information technologies, defines the appropriateness of IT projects, discusses the impact of business decisions on those projects and monitors their implementation, discusses global problems of IT-based banking activities, discusses periodically the problems that arise in an IT service business environment, the impact of IT-based initiatives put forward by the structural units and the application of new IT initiatives, monitors information systems and other advanced automation in order to ensure their continuous operation, ensures and monitors IT systems fail-safety and data security in the Bank, ensures the development of the Bank's IT and information security policies, guidelines, rules and procedures, and periodically reviews the Bank's IT strategy and its tactical plans.

The committee has a statute regulating its activities and containing provisions on its scope of authority, competencies, composition, working procedures, and its rights and responsibilities.

The committee is composed of seven members and includes the Chief Executive Officer of the Bank.

The Assets and Liabilities Committee

This committee was established to assist the Board of Directors in discharging its duties and responsibilities in specific areas of business activity. It works to implement the practices of managing the Bank's assets and liabilities in terms of interest rate risks, liquidity risks and market risks. The assets and liabilities management of the Bank is based on policies, providing guidelines on risk appetite, revenue targets and rates of return, as well as risk management. The areas covered include capital ratios, liquidity, asset mix, rate settings for loans and deposits, and investment guidelines for the treasury portfolio. The key objectives of the committee include maintaining liquidity positions, capital ratios at the planned minimum, and ensuring the safety of the deposit base, maintaining asset and liability mix, generating a satisfactory revenue stream to satisfy profitability targets.

The committee has a statute regulating its activities and containing provisions on its scope of authority, competencies, composition, working procedures, and its rights and responsibilities.

The committee is composed of five members and includes all executive directors of 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 an 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. In 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.

The reporting line to the members of the Board of Directors is shown on the chart below.

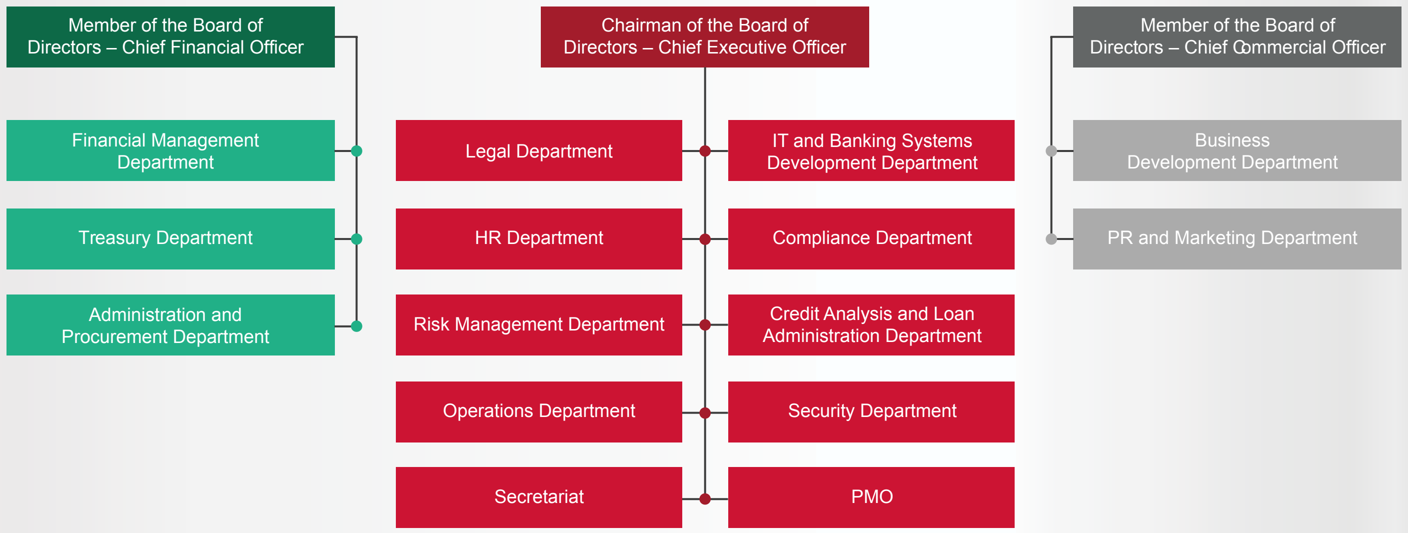


Table 12

INTERNAL AUDIT DEPARTMENT

The Internal Audit Department of PASHA Bank Georgia is responsible for providing a regular, independent, objective audit of the Bank's risk management, internal control and corporate governance processes. The main objective of the Department is to add value and ensure improvement of the Bank operations.

The Internal Audit Department is independent of the Bank's management and reports directly to the Audit Committee.

The Internal Audit Department Statute, revised and approved on 13 October 2017, describes matters related to the Department's purpose, rights and duties, scope of activities, reporting and independence.

The Internal Audit Policies and Procedures Manual approved by the Audit Committee on 26 September 2014 defines a set of comprehensive policies, methodology, procedures and guidance for performing risk-based and value-added audits.

The Annual Audit Plan that is based on a documented risk assessment is reviewed and approved by the Audit Committee.

Audit findings are communicated to the Audit Committee on a monthly basis.

The department budget and compensation is determined by the Supervisory Board based on the proposal of the Audit Committee.

The Head of the Internal Audit Department is appointed by the Bank's Supervisory Board based on the nomination and consent of the Audit Committee. All other employees are appointed by the Head of the Department which is agreed with the Audit Committee.

SCHEDULE OF MATTERS RESERVED FOR THE BOARD DECISION

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
29.	Granting lending and trade finance products (by amount; by maturity);	simple majority
30.	Sale of credit asset, irrespective of its amount, if: It is a collective sale (sale of more than one credit asset at once) of credit assets; The Bank incurs loss from the sale of credit asset and the sale is above the decision making limits of the Board of Directors;	simple majority

	Duties and Responsibilities	Quorum Required
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.	Approval 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, handling 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.	Performing any other duties as required by the General Meeting.	simple majority

FINANCIAL STATEMENTS

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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 2017, 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 2017 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
28 February 2018

STATEMENT OF FINANCIAL POSITION

As at 31 December 2017

(Amounts in tables are in thousands of Georgian Lari)

	Notes	2017	2016
Assets			
Cash and cash equivalents	5	**43,908**	7,599
Amounts due from credit institutions	6	**51,445**	83,261
Loans to customers	7	**111,679**	95,090
Investment securities	8	**62,033**	91,880
Property and equipment	9	**906**	1,108
Intangible assets	10	**2,122**	2,060
Deferred income tax assets	14	**–**	924
Other assets	11	**711**	563
Total assets		**272,804**	**282,485**
Liabilities			
Amounts due to credit institutions	12	**106,402**	131,681
Amounts due to customers	13	**58,181**	46,024
Provisions for guarantees and letters of credit		**135**	85
Other liabilities	11	**1,279**	1,411
Total liabilities		**165,997**	**179,201**
Equity			
Share capital	15	**103,000**	103,000
Retained earnings		**3,807**	354
Other reserves		**–**	(70)
Total equity		**106,807**	**103,284**
Total equity and liabilities		**272,804**	**282,485**

Signed on behalf of the Board of Directors of the Bank on 28 February 2018:

Arda Yusuf Arkun — Chairman of the Board of Directors

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

The accompanying selected explanatory notes on pages 68 to 99 are an integral part of these financial statements

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2017

(Amounts in tables are in thousands of Georgian Lari)

	Notes	2017	2016
Interest income			
Loans to customers		11,765	**12,785**
Investment securities		5,292	**8,382**
Amounts due from credit institutions		2,385	**2,153**
		19,442	**23,320**
Interest expense			
Amounts due to credit institutions		(3,099)	**(5,949)**
Amounts due to customers		(869)	**(784)**
		(3,968)	**(6,733)**
Net interest income		**15,474**	**16,587**
Provision for impairment losses on interest bearing assets	7, 8	(1,023)	**(1,010)**
Net interest income after impairment losses		**14,451**	**15,577**
Net gains/(losses) from foreign currencies:			
- dealing		1,190	**1,146**
- translation differences		402	**(199)**
Net fee and commission income	17	255	**244**
Other operating income		230	**387**
Non-interest income		**2,077**	**1,578**
Personnel expenses	18	(5,420)	**(5,183)**
General and administrative expenses	18	(5,302)	**(4,309)**
Depreciation and amortisation	9, 10	(1,351)	**(2,098)**
Provision for impairment losses on guarantees and letters of credit	16	(50)	**(85)**
Other operating expenses		(28)	**–**
Non-interest expenses		**(12,151)**	**(11,675)**
Profit before income tax benefit		**4,377**	**5,480**
Income tax expense	14	(924)	**(599)**
Net profit for the period		**3,453**	**4,881**
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods:			
Net unrealized gain on investments securities available for sale		70	**221**
Income tax effect on net gain on investments available for sale	14	–	**1**
Total comprehensive profit for the year		**3,523**	**5,103**

The accompanying selected explanatory notes on pages 68 to 99 are an integral part of these financial statements

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2017
(Amounts in tables are in thousands of Georgian Lari)

	Share capital	Retained earnings/ (accumulated deficit)	Other Reserves	Total Equity
1 January 2016	**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**
Profit for the year	–	3,453	–	3,453
Other comprehensive income for the year	–	–	70	70
Total comprehensive income for the year	**–**	**3,453**	**70**	**3,523**
31 December 2017	**103,000**	**3,807**	**-**	**106,807**

The accompanying selected explanatory notes on pages 68 to 99 are an integral part of these financial statements

STATEMENT OF CASH FLOWS

For the year ended 31 December 2017
(Amounts in tables are in thousands of Georgian Lari)

	Notes	2017	2016
Cash flows from operating activities			
Interest received		**19,832**	21,074
Interest paid		**(3,919)**	(6,522)
Fees and commissions received		**214**	591
Fees and commissions paid		**(411)**	(342)
Realised gains less losses from dealing in foreign currencies		**1,190**	1,146
Personnel expenses paid		**(5,459)**	(4,813)
General and administrative expenses paid		**(5,557)**	(4,205)
Other income received		**230**	387
Cash flows from operating activities before changes in operating assets and liabilities		**6,120**	**7,316**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		**30,971**	(49,840)
Loans to customers		**(16,021)**	16,233
Net increase/(decrease) in operating liabilities			
Amounts due to credit institutions		**(24,414)**	(46,506)
Amounts due to customers		**12,539**	22,243
Net cash from/(used in) operating activities		**9,195**	**(50,554)**
Cash flows from investing activities			
Purchase of investment securities		**(47,941)**	(40,151)
Proceeds from redemption of investment securities		**77,027**	74,994
Purchase of property and equipment		**(803)**	(118)
Proceeds from sale of property and equipment		**61**	-
Purchase of intangible assets		**(339)**	(308)
Net cash from investing activities		**28,005**	**34,417**
Effect of exchange rates changes on cash and cash equivalents		**(891)**	1,454
Net increase/(decrease) in cash and cash equivalents		**36,309**	(14,683)
Cash and cash equivalents, beginning	**5**	**7,599**	22,282
Cash and cash equivalents, ending	**5**	**43,908**	**7,599**

The accompanying selected explanatory notes on pages 68 to 99 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 shareholders of the Bank have approved a new strategy of the Bank for the next three year strategic period, based on which, several initiatives will be implemented by the Bank's management during 2018 and in the subsequent years to enter into MSME and retail markets.

The Bank has one service office in Georgia as of 31 December 2017. The Bank's registered legal address is 15 Rustaveli Avenue, Tbilisi, 0108, Georgia.

As at 31 December 2017 and 2016, 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 applied for the first time certain amendments to the standards, which are effective for annual periods beginning on or after 1 January 2017. The Bank has not early adopted any standards, interpretations or amendments that have been issued but are not yet effective. The nature and the impact of each amendment is described below:

Amendments to IAS 7 Statement of Cash Flows: Disclosure Initiative

The amendments require entities to provide disclosure of changes in their liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses). Due to the fact that the Bank does not have financing cash flows in 2017 or in 2016, the disclosure was not applicable in these financial statements.

Amendments to IAS 12 Income Taxes: Recognition of Deferred Tax Assets for Unrealised Losses

The amendments clarify that an entity needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of deductible temporary difference related to unrealised losses. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than their carrying amount. Application of the amendments has no effect on the Bank's financial position and performance as the Bank's current accounting policy is consistent with 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 advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Bank. 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. 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

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

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 observable;
- Level 3 – valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are 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.

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.

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.

3. Summary of accounting policies (continued)
Changes in accounting policies (continued)

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. 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.

3. Summary of accounting policies (continued)
Impairment of financial assets (continued)

Derecognition of financial assets and liabilities

Financial assets

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

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

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

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

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, 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

(Amounts in tables are in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

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.

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

3. Summary of accounting policies (continued)

Intangible assets (continued)

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 2017 and 2016 were 2.5922 GEL and 2.6468 GEL to 1 USD, respectively, 3.1044 GEL and 2.7940 GEL to 1 EUR, respectively and 1.5249 GEL and 1.4678 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.

IFRS 9 Financial Instruments

In July 2014, the IASB issued IFRS 9 Financial Instruments that replaces IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 addresses classification and measurement, impairment and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018. Except for hedge accounting, retrospective application is required but restating comparative information is not compulsory.

The Bank plans to adopt the new standard by recognizing the cumulative transition effect in opening retained earnings on 1 January 2018 and will not restate comparative information.

The Bank is in the process of quantifying the effect of adoption of IFRS 9, however no reasonable estimate of this effect is yet available.

(a) Classification and measurement

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

- Instruments that are managed on a "hold to collect" basis are measured at amortized cost;
- Instruments that are managed on a "hold to collect and for sale" basis are measured at fair value through other comprehensive income (FVOCI);

3. Summary of accounting policies (continued)

Intangible assets (continued)

- Instruments that are managed on other basis, including trading financial assets, will be measured at FVPL.

Equity financial assets are required to be classified at initial recognition as FVPL unless an irrevocable designation is made to classify the instrument as FVOCI. For equity investments classified as FVOCI, all realized and unrealized gains and losses, except for dividend income, are recognized in other comprehensive income with no subsequent reclassification to profit and loss. The classification and measurement of financial liabilities remain largely unchanged from the current IAS 39 requirements. Derivatives will continue to be measured at FVPL.
The Bank expects to continue measuring financial assets currently classified as loans and receivables at amortised cost as vast majority of the instruments satisfied the SPPI criterion. The Bank does not expect any non-derivative financial assets to be measured at FVPL.

(b) Impairment

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

The Bank has established a methodology for assigning rating to customer in following segments of portfolio: Corporate customers, SME customers, Financial Institutions and Retail/Individual customers. Assigned rating is returning PD on "customer by customer" base.

The Bank has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition. The Bank groups its loans into Stage 1, Stage 2, Stage 3 and POCI. The Bank calculates ECLs based on a three probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the EIR. In its ECL models, the Bank relies on a broad range of forward looking information as economic inputs, integrated in estimates of credit risk components (PD, LGD and EAD). Impairment losses and releases are accounted for and disclosed separately from modification losses or gains that are accounted for as an adjustment of the financial asset's gross carrying value.

The Bank considers that there has been a significant increase in credit risk when the credit rating has deteriorated significantly since initial recognition. Level of significant deterioration differs from segment to segment and varies from 2 to 3 notches or defined score threshold. The Bank also applies a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as moving a customer/facility to the watch list, or the account becoming forborne. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

The Bank considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations when the borrower becomes 90 days past due on its contractual payments depending on segment. The Bank considers treasury and interbank balances defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements. As a part of a qualitative assessment of whether a customer is in default, the Bank also considers a variety of instances that may indicate unlikeliness to pay.

The Bank calculates ECLs on an individual basis for POCI assets, significant assets with factors of credit impairment and certain assets with factors of significant increase of credit risk. The Bank calculates ECL on a collective basis for all other classes of assets which it groups into homogeneous borrowers.

IFRS 15 Revenue from Contracts with Customers

IFRS 15, issued in May 2014, and amended in April 2016, will supersede all current revenue recognition requirements under IFRS. Either a full retrospective application or a modified retrospective application is required for annual periods beginning on or after 1 January 2018. The Bank plans to adopt the new standard using the modified retrospective method by recognizing the cumulative transition effect in opening retained earnings on 1 January 2018, without restating comparative information.

IFRS 15 establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. However, interest and fee income integral to financial instruments and leases will fall outside the scope of IFRS 15 and will be regulated by the other applicable standards (IFRS 9 and IFRS 16 Leases). As a result, the majority of the Bank's income will not be impacted by the adoption of this standard.

The Bank currently does not expect a material effect from initial application of IFRS 15.

IFRS 16 Leases

IFRS 16 was issued in January 2016 and it replaces IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases-Incentives and SIC-27

3. Summary of accounting policies (continued)

Intangible assets (continued)

Evaluating the Substance of Transactions Involving the Legal Form of a Lease. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

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

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

IFRS 16 also requires lessees and lessors to make more extensive disclosures than under IAS 17.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted, but not before an entity applies IFRS 15. A lessee can choose to apply the standard using either a full retrospective or a modified retrospective approach. The standard's transition provisions permit certain reliefs. In 2018, the Bank will continue to assess the potential effect of IFRS 16 on its financial statements.

Annual Improvements 2014-2016 Cycle (issued in December 2016) include:

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration

The Interpretation clarifies that, in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the advance consideration. The Interpretation is effective for annual periods beginning on or after 1 January 2018. Since the Bank's current practice is in line with the Interpretation, the Bank does not expect any effect on its financial statements.

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

(Amounts in tables are in thousands of Georgian Lari)

4. Significant accounting judgments and estimates (continued)

Estimation uncertainty (continued)

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:

	2017	2016
Cash on hand	**673**	656
Current accounts with the NBG	**714**	665
Current accounts with other credit institutions	**13,253**	3,778
Time deposits with credit institutions up to 90 days	**29,268**	2,500
Cash and cash equivalents	**43,908**	**7,599**

As at 31 December 2017, current accounts and time deposit accounts with credit institutions denominated in GEL and USD represent 40.68% and 54.12% of total current and time deposit accounts respectively (31 December 2016: GEL 46.03%, USD 14.31%).

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2017	2016
Mandatory reserve with the NBG	**28,803**	52,576
Time deposits for more than 90 days	**22,642**	30,685
Amounts due from credit institutions	**51,445**	**83,261**

In 2017 and 2016 the 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 and non-resident financial institutions by a credit institution for the appropriate two-week period in GEL and foreign currencies, respectively.

Time deposits comprise of deposits in USD and GEL placed with resident commercial banks with maturities ranging from January 2018 to June 2018 (31 December 2016: deposits in USD and GEL placed with resident and non-resident commercial banks with maturities ranging from February 2017 to December 2017).

7. Loans to customers

Loans to customers comprise:

	2017	2016
Private entities	77,831	66,767
Foreign state controlled entities	36,302	30,129
Individuals	644	314
Loans to customers	**114,777**	**97,210**
Less – allowance for impairment	(3,098)	(2,120)
Loans to customers	**111,679**	**95,090**

7. Loans to customers (continued)

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

	2017		
	Legal entities	Individuals	Total
At 1 January 2017	**2,049**	**71**	**2,120**
Charge for the year	968	10	978
At 31 December 2017	**3,017**	**81**	**3,098**
Collective impairment	1,301	5	1,306
Individual impairment	1,716	76	1,792
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	9,500	76	9,576

	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

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.

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 2017, the Bank had a concentration of loans due from three major group of borrowers in the total exposure of GEL 61,621 thousand that represented 53.69% of the total gross loan portfolio (31 December 2016: loans from three major groups of GEL 53,847 thousand with 55.39% of the gross loan portfolio). An allowance of GEL 1,957 thousand (31 December 2016: GEL 1,121 thousand) was recognised against these loans. Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2017, comprised GEL 1,716 thousand, (2016: GEL 845 thousand).

(Amounts in tables are in thousands of Georgian Lari)

7. Loans to customers (continued)

Loans are made in the following industry sectors:

	2017	2016
Energy	54,902	30,129
Non-banking credit organizations	21,921	20,664
Trade and services	16,110	18,752
Construction	12,593	8,778
Mining	4,611	3,644
Utility	3,996	14,929
Individuals	644	314
	114,777	**97,210**

8. Investment securities

As at 31 December 2017, investment securities comprised of debt securities of the Ministry of Finance of Georgia and debt securities of companies and commercial banks registered in Georgia.

Investment securities comprise:

	2017	2016
Investment securities:		
Certificates of deposit of financial institutions	26,849	26,543
Bonds of financial institutions	22,079	21,541
Corporate bonds	12,177	12,969
Treasury bonds of the Ministry of Finance of Georgia	1,174	31,028
Investment securities:	**62,279**	**92,081**
Less: allowance for impairment (a)	(246)	(201)
Total investment securities:	**62,033**	**91,880**

(a) The allowance for impairment relates to the collectively impaired exposures of corporate bonds. The charge for 2017 is GEL 45 thousand (2016: GEL 201 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 2016	**1,840**	**2,390**	**247**	**459**	**1,912**	**6,848**
Additions	3	37	66	27	–	133
Disposals	–	(15)	–	–	–	(15)
31 December 2016	**1,843**	**2,412**	**313**	**486**	**1,912**	**6,966**
Additions	9	607	135	11	4	766
Disposals and write-offs	–	(6)	(68)	–	–	(74)
31 December 2016	**1,852**	**3,013**	**380**	**497**	**1,916**	**7,658**
Accumulated depreciation						
1 January 2016	**(1,173)**	**(1,447)**	**(108)**	**(232)**	**(1,199)**	**(4,159)**
Depreciation charge	(461)	(616)	(77)	(95)	(461)	(1,710)
Disposals and write-offs	–	11	–	–	–	11
31 December 2016	**(1,634)**	**(2,052)**	**(185)**	**(327)**	**(1,660)**	**(5,858)**
Depreciation charge	(193)	(348)	(72)	(98)	(252)	(963)
Disposal charge	–	1	68	–	–	69
31 December 2017	**(1,827)**	**(2,399)**	**(189)**	**(425)**	**(1,912)**	**(6,752)**
Net book value						
1 January 2016	**667**	**943**	**139**	**227**	**713**	**2,689**
31 December 2016	**209**	**360**	**128**	**159**	**252**	**1,108**
31 December 2017	**25**	**614**	**191**	**72**	**4**	**906**

(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 2016	**488**	**1,829**	**2,317**
Additions	425	90	515
Disposals and write offs	(16)	(90)	(106)
31 December 2016	**897**	**1,829**	**2,726**
Additions	284	166	450
Write offs	(192)	(2)	(194)
31 December 2017	**989**	**1,993**	**2,982**
Accumulated amortization			
1 January 2016	**(108)**	**(185)**	**(293)**
Amortization charge	(214)	(174)	(388)
Disposals and write offs	14	1	15
31 December 2016	**(308)**	**(358)**	**(666)**
Amortisation charge	(204)	(184)	(388)
Write offs	192	2	194
31 December 2017	**(320)**	**(540)**	**(860)**
Net book value			
1 January 2016	**380**	**1,644**	**2,024**
31 December 2016	**589**	**1,471**	**2,060**
31 December 2017	**669**	**1,453**	**2,122**

11. Other assets and liabilities

Other assets comprise:

	2017	2016
Other non-financial assets		
Prepaid expenses	399	365
Prepayments for operating lease	218	170
Prepaid taxes other than income tax	10	16
Prepayments for acquisition of intangible assets	4	4
Other	18	8
	649	**563**
Other financial assets		
Derivative financial assets	**62**	**–**
	62	–
Total other assets	**711**	**563**

The table below shows the fair values of derivative financial instruments, recorded as assets, together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying asset or liability and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are not indicative of the credit risk.

	2017	
	National amount	Fair Value asset
Foreign exchange contracts		
Forward – domestic	2,592	62
Total derivative assets	**2,592**	**62**

Other liabilities comprise:

	2017	2016
Other financial liabilities		
Other financial liabilities	131	223
	131	**223**
Other non-financial liabilities		
Payable to employees	1,111	1,150
Deferred income	36	38
Taxes other than income tax	1	–
	1,148	**1,188**
Other liabilities	**1,279**	**1,411**

(Amounts in tables are in thousands of Georgian Lari)

12. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	2017	2016
Time deposits of the Parent	52,069	37,617
Time deposits of non-resident commercial banks	27,122	39,956
Time deposits of resident commercial banks	22,688	14,478
Short-term loan from the NBG	3,002	28,030
Current accounts of the Parent	1,511	8,597
Overdraft from the Parent	10	3,003
Amounts due to credit institutions	**106,402**	**131,681**

As at 31 December 2017 the time deposits of non-resident commercial banks are comprised of USD and EUR denominated deposits of an entity under common control and other non-resident bank (2016: USD denominated deposits of an entity under common control). As at 31 December 2017 time deposits placed by three resident commercial banks were denominated in GEL and EUR and matured in January and February 2018 (2016: time deposits placed by four resident commercial banks denominated in GEL and USD, matured in January 2017).

13. Amounts due to customers

The amounts due to customers include the following:

	2017	2016
Time deposits	38,948	33,492
Current accounts	19,233	12,532
Amounts due to customers	**58,181**	**46,024**
Held as security against guarantees issued (Note 16)	4,342	757

As at 31 December 2017, amounts due to customers included balances with three major customers of GEL 28,726 thousand that constituted 49.37% of the total of customer accounts (31 December 2016: 27,561 thousand that constituted 59.88% of the total of customer accounts).

An analysis of customer accounts by economic sector follows:

	2017	2016
Trade and services	27,724	24,279
Individuals	11,016	13,356
Insurance	6,360	4,491
Energy	5,204	256
Construction	4,816	2,052
Non-banking credit organizations	3,050	37
Transportation and telecommunication	11	1,239
Pharmacy	–	314
Amounts due to customers	**58,181**	**46,024**

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 2017.

The corporate income tax expense for the year ended 31 December 2017 comprises of deferred tax expense of GEL 924 thousand (31 December 2016: GEL 599 thousand).

In 2017 and 2016 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:

	2017	2016
Profit before income tax	**4,377**	**5,480**
Statutory tax rate	15%	15%
Theoretical income tax expense at the statutory rate	**(657)**	**(822)**
Tax exempt income	131	243
Non-deductible expenses	(3)	(20)
Effect from change in tax legislation	61	–
Tax losses utilized during the year	(456)	–
Income tax expense	**(924)**	**(599)**

(Amounts in tables are in thousands of Georgian Lari)

14. Taxation (continued)

Deferred tax assets and liabilities as at 31 December 2017 and 31 December 2016 and their movements for the respective period:

	2015	Through statement of profit and loss	Through statement of OCI	2016	Through statement of profit and loss	2017
Tax effect of deductible temporary differences						
Tax losses carried forward	1,818	(1,014)	–	804	(804)	–
Other liabilities	68	67	–	135	(135)	–
Deferred tax asset	**1,886**	**(947)**	**–**	**939**	**(939)**	**–**
Tax effect of taxable temporary differences						
Property and equipment	73	153	–	226	226	–
Intangible assets	(49)	(3)	–	(52)	52	–
Loans to customers	(394)	217	–	(177)	177	–
Investment securities	6	(19)	(1)	(12)	12	–
Deferred tax liability	**(364)**	**348**	**(1)**	**(15)**	**15**	**–**
Deferred tax asset/(liability)	**1,522**	**(599)**	**(1)**	**924**	**(924)**	**–**

The Bank's accumulated tax losses at 31 December 2017 equal GEL 7,140 thousand which expire by 1 January 2019. The management evaluated the probability of recovery of deferred tax assets on past tax losses and also probability of reversal of temporary taxable and deductible differences in year 2018 and concluded that the deferred tax asset should be fully derecognized as at 31 December 2017.

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 2017 and 2016, 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 2017 (2016: 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 has been fully transferred to profit and loss by 31 December 2017 as all of the financial instruments reclassified have matured by this date.

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 2017 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 2017 and 2016, the Bank's commitments and contingencies comprised the following:

	2017	2016
Credit related commitments		
Unused credit lines	23,341	13,026
Guarantees issued	22,566	5,230
Letters of credit	1,478	318
	47,385	**18,574**
Operating lease commitments		
Not later than 1 year	1,831	1,723
More than 1 year but less than 5 years	6,553	8,016
Contingency over 5 years	–	868
	8,384	**10,607**
Less: provisions for guarantees and letters of credit	(135)	(85)
Commitments and contingencies (before deducting collateral)	**55,634**	**29,096**
Less: deposits held as security against guarantees issued (Note 13)	(4,342)	(757)
Commitments and contingencies	**51,292**	**28,339**

17. Net fee and commission income

Net fee and commission income comprises:

	2017	2016
Guarantees and letters of credits issued	397	285
Settlement operations	127	126
Brokerage operations	48	152
Cash operations	17	21
Plastic cards	5	–
Currency conversion operations	4	2
Other commission income	71	–
Fee and commission income	**669**	**586**
Settlement operations	(189)	(161)
Plastic cards	(108)	(82)
Guarantees and letters of credits issued	(111)	(82)
Cash operations	(5)	(16)
Brokerage operations	(1)	(1)
Fee and commission expense	**(414)**	**(342)**
Net fee and commission income	**255**	**244**

18. Personnel, general and administrative expenses

Personnel, general and administrative expenses comprise:

	2017	2016
Salaries	3,870	3,658
Bonuses and other employee benefits	1,550	1,525
Personnel expenses	**5,420**	**5,183**
Operating leases	1,679	1,479
Professional services	2,065	1,214
Advertising costs	469	587
Personnel training	191	253
Corporate hospitality and entertainment	169	146
Transportation and business trip expenses	123	84
Utilities	119	112
Deposit insurance fee	100	–
Insurance	71	77
Security expenses	58	58
Maintenance and exploitation	49	37
Membership fees	38	35
Charity costs	29	11
Taxes other than income tax	10	19
Communication	5	3
Other	127	194
General and administrative expenses	**5,302**	**4,309**

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, the Bank distinguishes between expected and unexpected losses. Expected losses are typically reserved for as described in credit risk policy. For unexpected losses the 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)

	Notes	High grade 2017	Standard grade 2017	Individually impaired	Total 2017
		Neither past due nor impaired			
Amounts due from credit institutions	6	51,445	–	–	**51,445**
Loans to customers	7	105,201	–	9,576	**114,777**
Investment securities	8	62,279	–	–	**62,279**
Total		**218,925**	**–**	**9,576**	**228,501**

	Notes	High grade 2016	Standard grade 2016	Individually impaired	Total 2016
		Neither past due nor impaired			
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**

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:

	2017				2016			
	Georgia	OECD	Other Non-OECD	Total	Georgia	OECD	Other Non-OECD	Total
Assets								
Cash and cash equivalents	35,380	6,474	2,054	**43,908**	5,164	–	2,435	**7,599**
Amounts due from credit institutions	51,445	–	–	**51,445**	78,236	5,025	–	**83,261**
Loans to customers	111,679	–	–	**111,679**	95,090	–	–	**95,090**
Investment securities	62,033	–	–	**62,033**	88,860	–	3,020	**91,880**
Other assets	62	–	–	**62**	–	–	–	**–**
	260,599	**6,474**	**2,054**	**269,127**	**267,350**	**5,025**	**5,455**	**277,830**
Liabilities								
Amounts due to credit institutions	25,690	–	80,712	**106,402**	3,500	–	128,181	**131,681**
Amounts due to customers	41,081	–	17,100	**58,181**	27,677	–	18,347	**46,024**
Other liabilities	131	–	–	**131**	223	–	–	**223**
	66,902	**–**	**97,812**	**164,714**	**31,400**	**–**	**146,528**	**177,928**
Net assets/(liabilities)	**193,697**	**6,474**	**(95,758)**	**104,413**	**235,950**	**5,025**	**(141,073)**	**99,902**

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:

	2017, %	2016, %
LK "Average Liquidity Ratio" (Average volume of liquid assets / Average volume of liabilities)	47.41	39.05

(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 2017	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Financial liabilities					
Amounts due to credit institutions	67,309	40,420	–	–	107,729
Amounts due to customers	37,674	16,212	4,682	–	58,568
Other financial liabilities	131	–	–	–	131
Total undiscounted financial liabilities	**105,114**	**56,632**	**4,682**	**–**	**166,428**

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**

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
2017	47,385	–	–	–	**47,385**

	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
2016	18,256	–	318	–	**18,574**

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 2017	Effect on profit before tax 2017	change in currency rate 2016	Effect on profit before tax 2016
USD	15%/(15%)	261/(261)	15%/(15%)	1,070/(1,070)
EUR	15%/(15%)	19/(19)	15%/(15%)	75/(75)

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
2017	1,208
2016	1,159

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 2017.

Currency	Increase/(decrease) in basis points 2017	Sensitivity of net interest income 2017
GEL	100/(100)	115/(115)

Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but 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 2017	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets for which fair values are disclosed				
Cash and cash equivalents	43,908	–	–	**43,908**
Amounts due from credit institutions	–	–	51,445	**51,445**
Loans to customers	–	–	111,679	**111,679**
Investment securities	–	–	62,033	**62,033**
Assets measured at fair value				
Other assets - derivative financial assets	–	62	–	**62**

	Fair value measurement using			
As at 31 December 2017	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets for which fair values are disclosed				
Amounts due to credit institutions	–	–	106,402	**106,402**
Amounts due to customers	–	–	58,181	**58,181**

	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**
Liabilities for which fair values are disclosed				
Amounts due to credit institutions	–	–	131,681	**131,681**
Amounts due to customers	–	–	46,024	**46,024**

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 2017	Fair value 2017	Unrecognised gain/(loss) 2017	Carrying value 2016	Fair value 2016	Unrecognised gain/(loss) 2016
Financial assets						
Cash and cash equivalents	43,908	43,908	–	7,599	7,599	–
Amounts due from credit institutions	51,445	51,445	–	83,261	83,261	–
Loans to customers	111,679	111,679	–	95,090	95,090	–
Investment securities	62,033	63,071	1,038	91,880	94,704	2,824
Other financial assets	62	62	–	–	–	–
Financial liabilities						
Amounts due to credit institutions	106,402	106,402	–	131,681	131,681	–
Amounts due to customers	58,181	58,181	–	46,024	46,024	–
Total unrecognised change in fair value			**1,038**			**2,824**

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 2017 at market interest rates, while the contractual interest rates of those loans issued in 2016 approximate market interest rates as at 31 December 2017. Hence their carrying value approximates their fair value.

Forward foreign exchange contracts are derivatives valued using a valuation technique with market observable inputs. The applied valuation technique for such derivatives includes forward pricing models using present value calculations.

Investment securities

As at 31 December 2017 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.

	2017			2016		
	Within one year	**More than one year**	**Total**	**Within one year**	**More than one year**	**Total**
Cash and cash equivalents	43,908	–	**43,908**	7,599	–	**7,599**
Amounts due from credit institutions	51,445	–	**51,445**	83,261	–	**83,261**
Loans to customers	83,719	27,960	**111,679**	50,747	44,343	**95,090**
Investment securities	21,105	40,928	**62,033**	63,163	28,717	**91,880**
Property and equipment	–	906	**906**	–	1,108	**1,108**
Intangible assets	–	2,122	**2,122**	–	2,060	**2,060**
Deferred income tax assets	–	–	**–**	–	924	**924**
Other assets	495	216	**711**	384	179	**563**
Total	**200,672**	**72,132**	**272,804**	**205,154**	**77,331**	**282,485**
Amounts due to credit institutions	106,402	–	106,402	131,681	–	**131,681**
Amounts due to customers	53,682	4,499	58,181	44,404	1,620	**46,024**
Provisions for guarantees and letters of credit	135	–	135	85	–	**85**
Other liabilities	1,279	–	1,279	1,411	–	**1,411**
Total	**161,498**	**4,499**	**165,997**	**177,581**	**1,620**	**179,201**
Net	**39,174**	**67,633**	**106,807**	**27,573**	**75,711**	**103,284**

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:

	2017			2016		
	The Parent	**Key management personel**	**Entities under common control**	**The Parent**	**Key management personel**	**Entities under common control**
Cash and cash equivalents	2,053	–	5,018	2,435	–	–
Property plant and equipment	–	–	–	21	–	–
Loans to customers	–	166	–	–	–	–
Amounts due from credit Institutions	–	–	–	–	–	5,025
Amounts due to credit institutions	(53,589)	–	(24,530)	(49,218)	–	(39,956)
Amounts due to customers	–	(6,579)	(28,140)	–	(2,293)	(23,027)
Other liabilities	(12)	–	–	(2)	–	–

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

	2017			2016		
	The Parent	**Key management personel**	**Entities under common control**	**The Parent**	**Key management personel**	**Entities under common control**
Fee and commission income	–	–	1	50	–	–
Fee and commission expense	171	–	–	84	–	–
Interest income on loans to customers	–	16	–	–	–	–
Interest income on amounts due from credit institutions	(2)	–	360	–	–	72
Interest expense on amounts due to credit institutions	1,643	–	362	1,911	–	277
Interest expense on amounts due to customers	–	175	449	–	105	396
Professional fees	79	–	–	–	–	–

Compensation of key management personnel was comprised of the following:

	2017	**2016**
Salaries and other short-term benefits	1,548	1,029

Key management personnel as at 31 December 2017 comprised of 5 members of the Supervisory Board (31 December 2016: 4 members) and 3 members of the Board of Directors of the Bank (31 December 2016: 3 members).

(Amounts in tables are in thousands of Georgian Lari)

23. Capital adequacy

The Bank maintains an actively managed capital base to cover risks inherent in the business.
The adequacy of the Bank's capital is monitored using, among other measures, the ratios established by the NBG in supervising the Bank.

The primary objectives of the Bank's capital management are (i) to ensure that the Bank complies with externally imposed capital requirements set by the NBG (capital adequacy ratio of at least 9.6% (2016: 10.8%)) and (ii) to safeguard the Bank's ability to continue as a going concern. 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 9.6% (2016: 10.8%). of risk-weighted assets and Tier 1 Capital adequacy ratio of 6.4%. (2016: 7.2%). As at 31 December 2017 and as at 31 December 2016, the Bank's capital adequacy ratios on this basis were as follows:

	Notes	31 December 2017	Adjustments	31 December 2017 Per the NBG
Share capital	15	103,000	–	103,000
Prior years accumulated deficit		354	(2,149)	(1,795)
Less: Intangible assets, net	10	(2,122)	–	(2,122)
Other adjustments		–	(3,888)	(3,888)
Main capital		**101,232**	**(6,037)**	**95,195**
Current year income		3,453	554	4,007
General reserves		3,479	(523)	2,956
Additional capital		**6,932**	**31**	**6,963**
Less: deductions from capital		–	–	–
Total capital		**108,164**	**(6,006)**	**102,158**
Risk weighted assets				**261,848**
Capital adequacy ratio				39.01%
Tier 1 Capital adequacy ratio				36.36%

	Notes	31 December 2016	Adjustments	31 December 2016 Per the NBG
Share capital	15	103,000	–	103,000
Prior years accumulated deficit	10	(4,527)	(4,632)	(9,159)
Less: Intangible assets, net		(2,060)	–	(2,060)
Main capital		**96,413**	**(4,632)**	**91,781**
Current year income		4,881	2,483	7,364
General reserves	7	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				46.39%
Tier 1 Capital adequacy ratio				42.08%

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.

In December 2017, the NBG adopted amendments to the regulations relating to capital adequacy requirements, including amendments to the regulation on capital adequacy requirements for commercial banks, and introduced new requirements on the determination of the countercyclical buffer rate, on the identification of systematically important banks, on determining systemic buffer requirements and on additional capital buffer requirements for commercial banks within Pillar 2.

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 2017 and 31 December 2016, the Bank's capital adequacy ratios on the Basel II basis were as follows:

	Notes	31 December 2017	Adjustments	31 December 2017 Per the NBG
Additional tier 1 capital	15	103,000	–	103,000
Prior years accumulated deficit		354	(2,149)	(1,795)
Less: Intangible assets, net	10	(2,122)	–	(2,122)
Other adjustments		–	(3,888)	(3,888)
Current year income		3,453	554	4,007
Core Tier 1 capital		**104,685**	**(5,483)**	**99,202**
Tier 1 capital		**104,685**	**(5,483)**	**99,202**
Supplementary capital		3,479	(523)	2,956
Total regulatory capital		**108,164**	**(6,006)**	**102,158**
Risk weighted assets				**283,322**
Capital adequacy ratio				36.06%
Core Tier 1 capital/Tier 1 capital adequacy ratio				35.01%

	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%

24. Subsequent events

On 1 February 2018, Mr. Arda Arkun replaced Mr. Shahin Mammadov at the position of the Chairman of the Board of Directors of the Bank.

On 31 January 2018 the Bank used the cash cover provided by the Parent to write off one individually impaired loan with a net book value of GEL 7,784 thousand as at 31 December 2017.

CAPITAL ADEQUACY

Below is the reconciliation of the capital adequacy ratio of the Bank to show the effect of the regulatory requirements applicable at 31 December 2017 on the Bank's regulatory capital and risk weighted assets reported at 31 December 2016:

	Notes	31 December 2017	Adjustments	31 December 2017 Per the NBG
Additional tier 1 capital	15	103,000	–	103,000
Prior years accumulated deficit		354	(2,149)	(1,795)
Less: Intangible assets, net	10	(2,122)	–	(2,122)
Other adjustments		–	(3,888)	(3,888)
Current year income		3,453	554	4,007
Core Tier 1 capital		**104,685**	**(5,483)**	**99,202**
Tier 1 capital		**104,685**	**(5,483)**	**99,202**
Supplementary capital		3,479	(523)	2,956
Total regulatory capital		**108,164**	**(6,006)**	**102,158**
Risk weighted assets				**283,322**
Capital adequacy ratio				36.06%
Core Tier 1 capital/Tier 1 capital adequacy ratio				35.01%

	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 assessed in compliance with regulatory requirements in effect at 31 December 2017				**275,051**
Capital adequacy ratio				36.79%
Core Tier 1 capital/Tier 1 capital adequacy ratio				36.05%

AUDITOR'S REMUNERATION DISCLOSURE

Remuneration of the Bank's auditor for the years ended 31 December 2017 and 2016 comprises (net of VAT):

	2017	2016
Fees for the audit of the Bank's annual financial statements for the year ended 31 December	127,495	125,941
Expenditures for other professional services	1,188	7,163
Total fees and expenditures	**128,683**	**133,104**

Fees and expenditures payable to other auditors and audit firms in respect of other professional services comprised GEL 721 thousand (2016: GEL 95 thousand).

ABBREVIATIONS

ACCA - Association of Chartered Certified Accountants
ALCO - Assets and Liabilities Committee
AML - Anti-Money-Laundering
AZN - Azerbaijani Manat, the national currency of Azerbaijan
B2B - Business-to-Business
BCP - Business Continuity Planning
BIA - Business Information Agency
BOG - Bank of Georgia
c.a. - circa, meaning approximately
CAR - Capital Adequacy Ratio
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
ERP - Enterprise Resource Planing
EUR - Euro, the official currency of the Eurozone
EY - Ernst & Young
FI - Financial Institution
FIFA - Fédération Internationale de Football Association
FX - Forex, the market in which currencies are traded
GDP -Gross Domestic Product
GEL - Georgian Lari or Lari, national currency of Georgia
GEOSTAT - National Statistics Office of Georgia
HR - Human Resources
IFRS - International Financial Reporting Standards
IPD - Investments and Projects Department
ICC - International Chamber of Commerce
ICAAP - Internal Capital Adequacy Assessment Process
ICSA - Institute of Corporate Secretaries and Administrators
IT - Information Technology
JSC - Joint Stock Company
KPI - Key Performance Indicator
LLA - Loan-Loss Allowance
LLC - Limited Liability Company
LLP - Loan-Loss Provisions
LTD - Limited
MBA - Master of Business Administration
MIS - Management Information Systems
mln - Million
M&A - Mergers and Acquisitions
NBG - National Bank of Georgia
NPL - Non-Performing Loan
OJSC - Open Joint Stock Company
PBG - PASHA Bank Georgia
P&L - Profit & Loss
Ph.D. - Doctor of Philosophy
Q1 - Quarter 1
RAS - Risk Appetite Statement
RM - Risk Management
ROA - Return on Assets
ROAE - Return on Average Equity
SME - Small and Medium Enterprise
UFA - Union of European Football Associations
UK - United Kingdom
USD - The US Dollar, national currency of the United States of America
VaR - Value at Risk
vs - Versus

10.07.2018

PASHA Bank

New heights. Together.

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