# “UNIBANK COMMERCIAL BANK” OPEN JOINT STOCK COMPANY

**The International Financial Reporting Standards Consolidated Financial Statements and Independent Auditors’ Report**
For the Year Ended December 31, 2020

# "UNIBANK COMMERCIAL BANK" OPEN JOINT STOCK COMPANY

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## STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2020

The following statement is made with a view to distinguishing respective responsibilities of the management and those of the independent auditors in relation to the consolidated financial statements of "Unibank Commercial Bank" OJSC (the "Bank") and its subsidiaries (the "Group").

Management is responsible for the preparation of the consolidated financial statements that present fairly the consolidated financial position of the Group as at December 31, 2020, the consolidated results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the consolidated financial statements, management is responsible for:

- Selecting suitable accounting principles and applying them consistently;
- Making judgements and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the consolidated financial statements; and
- Preparing the consolidated financial statements on a going concern basis, unless it is inappropriate to presume that the Group will continue in business for the foreseeable future.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Group;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the consolidated financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- Maintaining statutory accounting records in compliance with legislation and accounting standards of the Republic of Azerbaijan;
- Taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- Detecting and preventing fraud, errors and other irregularities.

The consolidated financial statements for the year ended December 31, 2020 were authorized for issue on May 31, 2021 by the Management Board of the Group.

**On behalf of the Executive Board:**

**Mr. Faig Huseynov**

Chairman of the Executive Board
Baku, the Republic of Azerbaijan

May 31, 2021

**Mr. Igor Okayev**

Chief Financial Officer
Baku, the Republic of Azerbaijan

May 31, 2021

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## INDEPENDENT AUDITORS' REPORT

To the Shareholders and Executive Board of "Unibank Commercial Bank" Open Joint Stock Company.

### *Opinion*

We have audited the consolidated financial statements of "Unibank Commercial Bank" Open Joint Stock Company (the "Bank") and its subsidiary (the "Group"), which comprise the consolidated statement of financial position as at December 31, 2020, the consolidated statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at December 31, 2020, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

### *Basis for Opinion*

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group 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 Consolidated Financial Statements*

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

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

The Audit Committee is responsible for overseeing the Group's financial reporting process.

ASSURANCE ADVISORY TAX LEGAL

Baker Tilly Audit Azerbaijan CJSC trading as Baker Tilly is a member of the global network of Baker Tilly International Ltd., the members of which are separate and independent legal entities.

***Auditors' Responsibilities for the Audit of the Consolidated Financial Statements***

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated 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 consolidated 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 Group'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 Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern;
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated 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.

Baker Tilly Azerbaijan

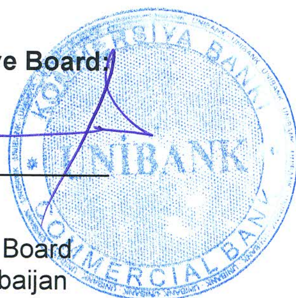
May 31, 2021
Baku, the Republic of Azerbaijan

## "UNIBANK COMMERCIAL BANK" OPEN JOINT STOCK COMPANY

### CONSOLIDATED STATEMENT OF FINANCIAL POSITION
### AS AT DECEMBER 31, 2020
*(in thousands of Azerbaijan Manats)*

| | Notes | December 31, 2020 | December 31, 2019 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and cash equivalents | 7 | 106,494 | 143,749 |
| Mandatory cash balances with the Central Bank of the Republic of Azerbaijan | | 3,163 | 3,642 |
| Due from other banks | 8 | 6,082 | 14,211 |
| Loans and advances to customers | 9, 32 | 501,281 | 454,558 |
| Investment securities | 10, 32 | 52,866 | 84,736 |
| Deferred income tax asset | 26 | 4,414 | 6,351 |
| Premises and equipment | 11 | 72,103 | 64,155 |
| Intangible assets | 11 | 15,313 | 14,534 |
| Other financial assets | 12 | 24,964 | 20,539 |
| Other assets | 13 | 20,226 | 16,811 |
| **TOTAL ASSETS** | | **806,906** | **823,286** |
| **LIABILITIES AND EQUITY** | | | |
| LIABILITIES: | | | |
| Due to banks and other financial institutions | 14 | 19,907 | 30,139 |
| Customer accounts | 15, 32 | 548,653 | 550,217 |
| Term borrowings | 16, 32 | 97,028 | 77,553 |
| Subordinated debt | 19, 32 | 16,036 | 17,029 |
| Lease liability | 17 | 4,157 | 3,830 |
| Other liabilities | 18 | 7,310 | 8,934 |
| **TOTAL LIABILITIES** | | **693,091** | **687,702** |
| EQUITY: | | | |
| Equity attributable to owners of the Bank: | | | |
| Share capital | 20 | 125,686 | 125,686 |
| Share premium | 20 | 484 | 484 |
| Other reserves | | 243 | 154 |
| (Accumulated deficit)/retained earnings | | (12,598) | 9,260 |
| **TOTAL EQUITY** | | **113,815** | **135,584** |
| **TOTAL LIABILITIES AND EQUITY** | | **806,906** | **823,286** |

**On behalf of the Executive Board:**




**Mr. Faig Huseynov**

Chairman of the Executive Board
Baku, the Republic of Azerbaijan

May 31, 2021

**Mr. Igor Okayev**

Chief Financial Officer
Baku, the Republic of Azerbaijan

May 31, 2021

The notes on pages 9-91 form an integral part of these consolidated financial statements.

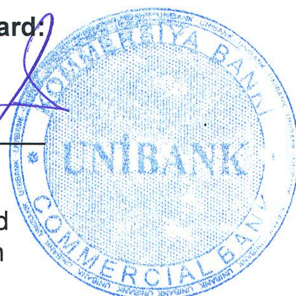
# "UNIBANK COMMERCIAL BANK" OPEN JOINT STOCK COMPANY

## CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED DECEMBER 31, 2020

*(in thousands of Azerbaijan Manats, unless otherwise indicated)*

| | Notes | Year ended December 31, 2020 | Year ended December 31, 2019 |
|---|---|---|---|
| Interest income | 21, 32 | 94,113 | 84,666 |
| Interest expense | 21, 32 | (29,513) | (33,254) |
| **Net interest income before expected credit losses** | 21 | **64,600** | **51,412** |
| (Charge)/recovery of expected credit losses | 22, 32 | (34,569) | 60,362 |
| **Net interest income** | | **30,031** | **111,774** |
| Fee and commission income | 23, 32 | 21,067 | 17,073 |
| Fee and commission expense | 23 | (14,046) | (10,658) |
| Net gain from foreign currencies | 24 | 2,518 | 3,623 |
| Impairment loss on other assets | 13 | (1,646) | (1,543) |
| Recovery/(charge) of expected credit losses for guarantees and credit related commitments | 22 | 4,774 | (435) |
| Administrative and other operating expenses | 25, 32 | (57,738) | (53,099) |
| Fair value gain on loans to customers and term borrowings at initial measurement | 9, 16 | 1,396 | 13,118 |
| Other operating income, net | | 1,008 | 1,035 |
| **(Loss)/profit before income tax** | | **(12,636)** | **80,888** |
| Income tax expense | 26 | (4,139) | (1,488) |
| **Net (loss)/profit for the year** | | **(16,775)** | **79,400** |
| **OTHER COMPREHENSIVE INCOME** | | | |
| **Items that will be reclassified subsequently to profit or loss** | | | |
| Fair value gain on debt investment securities | 10 | 111 | 193 |
| Income tax recorded directly in other comprehensive income | 26 | (22) | (39) |
| **Other comprehensive income for the year** | | **89** | **154** |
| **TOTAL COMPREHENSIVE (LOSS)/INCOME FOR THE YEAR** | | **(16,686)** | **79,554** |
| (Loss)/earnings per share basic and diluted (AZN) | 27 | **(0.36)** | **1.72** |

**On behalf of the Executive Board:**



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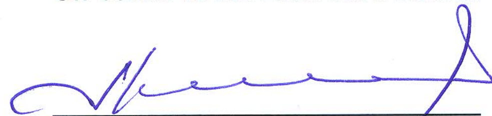
## "UNIBANK COMMERCIAL BANK" OPEN JOINT STOCK COMPANY

### CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
### FOR THE YEAR ENDED DECEMBER 31, 2020
*(in thousands of Azerbaijan Manats)*

| | Share capital | Share premium | Other reserves | Retained earnings/ (accumulated deficit) | Total equity |
|---|---|---|---|---|---|
| **January 1, 2019** | **125,686** | **484** | **-** | **(70,140)** | **56,030** |
| Net profit for the year | - | - | - | 79,400 | 79,400 |
| Other comprehensive income for the year | - | - | 154 | - | 154 |
| **December 31, 2019** | **125,686** | **484** | | **9,260** | **135,584** |
| Net loss for the year | - | - | - | (16,775) | (16,775) |
| Other comprehensive income for the year | - | - | 89 | - | 89 |
| Dividends declared | - | - | - | (5,083) | (5,083) |
| **December 31, 2020** | **125,686** | **484** | **243** | **(12,598)** | **113,815** |

**On behalf of the Executive Board:**



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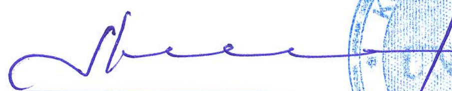
# "UNIBANK COMMERCIAL BANK" OPEN JOINT STOCK COMPANY

## CONSOLIDATED STATEMENT OF CASH FLOWS
## FOR THE YEAR ENDED DECEMBER 31, 2020
*(in thousands of Azerbaijan Manats)*

| | Notes | Year ended December 31, 2020 | Year ended December 31, 2019 |
|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | | |
| Interest received | | 88,836 | 81,054 |
| Interest paid | | (27,479) | (31,561) |
| Fees and commissions received | | 21,067 | 17,071 |
| Fees and commissions paid | | (13,974) | (10,866) |
| Net gain from foreign currencies | | 2,491 | 3,536 |
| Other operating income received, net | | 537 | 241 |
| Administrative and other operating expenses paid | | (49,204) | (46,389) |
| Income tax paid | | (1,600) | (100) |
| **Cash flows from operating activities before changes in operating assets and liabilities** | | **20,674** | **12,986** |
| (Increase)/decrease in operating assets: | | | |
| Mandatory cash balances with the CBAR | | 479 | (514) |
| Due from other banks | | 909 | 78,152 |
| Loans and advances to customers | | (68,981) | 927 |
| Other financial assets | | (4,425) | (12,788) |
| Other assets | | (3,599) | (28) |
| Increase/(decrease) in operating liabilities: | | | |
| Due to banks and other financial institutions | | (10,368) | 13,917 |
| Customer accounts | | (517) | 83,519 |
| Other liabilities | | 1,066 | 389 |
| **Net cash (used in)/provided from operating activities** | | **(64,762)** | **176,560** |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | | |
| Proceeds from/(purchase of) investment securities, net | | 31,891 | (77,191) |
| Acquisition of premises, equipment and intangible assets | | (15,989) | (17,732) |
| Proceeds on disposal of premises and equipment | | 243 | 331 |
| **Net cash provided from/(used in) investing activities** | | **16,145** | **(94,592)** |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | | |
| Proceeds from term borrowings | 16 | 22,323 | 38,334 |
| Repayment of term borrowings | 16 | (3,790) | (84,162) |
| Repayment of subordinated debt | 19 | (1,003) | (1,700) |
| Repayment of principal portion of lease liabilities | 17 | (1,048) | (1,016) |
| Dividends paid | | (5,083) | - |
| **Net cash provided from/(used in) financing activities** | | **11,399** | **(48,544)** |
| Effect of exchange rate changes on cash and cash equivalents | | (37) | 337 |
| Net (decrease)/increase in cash and cash equivalents | | (37,255) | 33,761 |
| Cash and cash equivalents at the beginning of the year | 7 | 143,749 | 109,988 |
| **Cash and cash equivalents at the end of the year** | 7 | **106,494** | **143,749** |

**On behalf of the Executive Board:**



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Baku, the Republic of Azerbaijan

May 31, 2021

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Chief Financial Officer
Baku, the Republic of Azerbaijan

May 31, 2021

The notes on pages 9-91 form an integral part of these consolidated financial statements.

## 1. ORGANIZATION

These consolidated financial statements of the "Unibank Commercial Bank" OJSC (the "Bank") and its subsidiaries (together referred to as the "Group") for the year ended December 31, 2020, have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The Bank was incorporated and is domiciled in the Republic of Azerbaijan. The Bank is a joint stock company limited by shares and was set up in accordance with Azerbaijani regulations. As at December 31, 2020 the Bank is ultimately controlled by Mr. Eldar Garibov (December 31, 2019: Mr. Eldar Garibov). See Note 20.

On January 23, 2008, the Bank registered its fully owned subsidiary, Unicapital Open Joint Stock Company ("Unicapital"), with the Ministry of Justice of the Republic of Azerbaijan. Unicapital commenced its operations in February 2008. Major activities of Unicapital are trust management of stock portfolios and dealing in the stock market of the Republic of Azerbaijan.

***Principal activity of the Bank.*** The principal business activity of the Bank is commercial and retail banking operations within the Republic of Azerbaijan. The Bank has been operating under a full banking license issued by the Central Bank of the Republic of Azerbaijan (the "CBAR") since 1992.

The Bank participates in the state deposit insurance scheme, which was introduced by the "Law on Deposit Insurance" dated December 29, 2006. The Azerbaijan Deposit Insurance Fund guarantees repayment of 100% of individual deposits meeting the following criteria:

According to the Law of the Republic of Azerbaijan on "Deposit Insurance", insured deposit is the part of a protected deposit that will be compensated by the Deposit Insurance Fund in case of an insurance incident that occurred in the participant bank where a depositor is serviced. Starting from June 1, 2020, the maximum annual interest rate on protected deposits in the national currency is set at 12%, and in foreign currency - 2.5%. According to another law on "Full Deposit Insurance" dated January 19, 2016 and last amended on December 18, 2020, all protected deposits within the annual interest rate set by the Board of Trustees of the Deposit Insurance Fund are fully insured until April 5, 2021 regardless of their amounts. Starting from April 5, 2021 in case of an insurance incident each depositor is entitled to receive compensation from the Deposit Insurance Fund for the full amount of deposit agreement, but not exceeding AZN 100 thousand.

As at December 31, 2020 the Bank has 32 branches (December 31, 2019: 32 branches) within the Republic of Azerbaijan.

The Bank's registered address is 79 Rashid Behbudov Street, AZ1014, Baku, the Republic of Azerbaijan

### Business environment

The Group's operations are conducted in the Republic of Azerbaijan. There were a number of significant changes in the operating and economic environment during the year 2020, which had an impact on the Group's business activities.

In March 2020 the World Health Organization (WHO) announced that the spread of the COVID-19 virus across the globe was a pandemic. Significant restrictions on travel and movement of individuals and the closure of non-essential businesses have either been imposed in most countries or have happened as a result of the pandemic. This has led to significant declines in GDP in most if not all large economically strong countries in which the Republic of Azerbaijan is in a trade relationship. The global economy was negatively impacted by the coronavirus pandemic (COVID-19) spread in the first half of 2020. Starting from June 2020 many countries including the Republic of Azerbaijan demonstrated improvement in the signs of pandemic and certain restrictions were lifted subsequently. As a result, recovery in global financial and commodity markets observed. However, subsequently the number of reported cases significantly increased in the Republic of Azerbaijan, and the government introduced new restrictions from mid-December 2020.

The restrictive lock-down measures to combat COVID-19 in the country significantly reduced economic activity and aggregate spending levels. Certain segments of the economy, such as hotels, transport, travel, entertainment and many other businesses also international trade much affected by these measures.

Oil prices have decreased significantly due to the substantial reduction in oil consumption in the pandemic environment but demonstrated stable growth during the second quarter of 2020. The government introduced support packages in the form of subsidized lending tools, payments to unemployed individuals and other subsidies to the entrepreneurs during the year to compensate for the economic slowdown caused by the pandemic.

On April 24, 2020, the Central Bank of Azerbaijan approved a package of additional measures "Procedure for the Temporary Regulation of Credit Institutions in the Context of the Coronavirus Pandemic". This procedure is designed to reduce the possible negative impact of the COVID-19 pandemic on the banking sector of the Republic of Azerbaijan and determines the classification of loans and risk groups, capital adequacy ratio and its calculation in banks and non-bank credit organizations operating in the Republic of Azerbaijan. According to the rules, concessions should be considered during the classification of loans and credit restructuring cases that meet the criteria. In addition, the total capital adequacy ratio for banks which are having special importance for the banking system was set at a minimum of 11%, and for other banks at 9% until April 1, 2021. According to the rule, dividend payments based on the results of previous years should be postponed until July 1, 2021, in order to protect the capital position and financial stability of banks.

The Group's operations are conducted in the Republic of Azerbaijan. Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks. The future stability of the Azerbaijan's economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the Government as well as crude oil prices and stability of Azerbaijani Manat. Although the economy of the Republic of Azerbaijan is particularly sensitive to oil and gas prices, during recent years the Government of the Republic of Azerbaijan initiated major economic and social reforms to accelerate the transition to a more balanced economy and reduce dependence on the oil and gas sector. GDP in Azerbaijan was USD 42.6 billion during the year 2020, according to the State Statistical Committee of the Republic of Azerbaijan. In the long-term, the Azerbaijan GDP is projected to trend around USD 50 billion in 2021 and USD 51 Billion in 2022, according to our econometric models.

The government continued its monetary policy with respect to the stability of Azerbaijani Manat as well as allocated foreign currency resources which stabilized Azerbaijani Manat. This policy continued in 2020 with the aim of maintaining macroeconomic stability. The Central Bank of the Republic of Azerbaijan has changed the refinancing rate several times during the year and the range was between 7.25% - 6.25% with a steady decrease in rates.

The Group's management is monitoring changes in the macroeconomic environment and taking precautionary measures it considers necessary in order to support the sustainability and development of the Group's business in the foreseeable future.

International credit rating agencies regularly evaluate the credit rating of the Republic of Azerbaijan. Fitch and S&P evaluated the rating of the Republic of Azerbaijan as "BB+". Moody's Investors Service set "Ba2" credit rating for the country.

The future economic growth of the Republic of Azerbaijan is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory and political developments. The Management is unable to predict, all developments in the economic environment which would have an impact on the Group's operations and consequently what effect, if any, they could have on the consolidated financial position of the Group. The management is currently performing sensitivity analyses under different oil price scenarios and elaborating relevant action plans for maintaining the sustainability of the business.

In September 2020, the escalation of unresolved conflict in Karabakh region (located in the southwest, which is internationally recognized as part of the Republic of Azerbaijan) resulted in clashes between the Republic of Azerbaijan and Armenian forces in occupied territories. In response, both countries introduced a curfew and military mobilization. Although the military actions mainly occurred in the western part of the Republic of Azerbaijan, some businesses were affected by the curfew which covered all the territories of the Republic of Azerbaijan including the capital Baku, to a certain degree. A complete ceasefire and a cessation of all hostilities in the zone of the Karabakh conflict was achieved on November 10, 2020. The level of macroeconomic effects in which the state involvement in liberated regions is uncertain as of reporting date.

These events and conditions described above created a level of uncertainty and risk that companies have not encountered before. The above-mentioned events had a significant effect on the consolidated financial results of the Group during the year ended December 31, 2020 and in the subsequent period.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of preparation.** These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention, as modified by the initial recognition of financial instruments based on fair value, financial instruments categorized at fair value through profit or loss ("FVPL") and at fair value through other comprehensive income ("FVOCI"). These consolidated financial statements have been prepared assuming that the Group is a going concern and will continue in operation for the foreseeable future. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below.

The preparation of consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 3.

***Financial instruments - key measurement terms***. Depending on their classification, financial instruments are carried at fair value or amortized cost as described below.

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 best evidence of fair value is the price in an active market. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Fair value of financial instruments traded in an active market is measured as the product of the quoted price for the individual asset or liability and the number of instruments held by the entity. This is the case even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

Valuation techniques such as discounted cash flow models or models based on recent arm's length transactions or consideration of financial data of the investees are used to measure fair value of certain financial instruments for which external market pricing information is not available. Fair value measurements are analyzed by level in the fair value hierarchy as follows: (i) level one are measurements at quoted prices (unadjusted) in active markets for identical assets or liabilities, (ii) level two measurements are valuations techniques with all material inputs observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices), and (iii) level three measurements are valuations not based on solely observable market data (that is, the measurement requires significant unobservable inputs). Transfers between levels of the fair value hierarchy are deemed to have occurred at the end of the reporting period. Refer to Note 31.

*Transaction costs* are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Amortized cost is the amount at which the financial instrument was recognized at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment losses. Accrued interest includes amortization of transaction costs deferred at initial recognition and of any premium or discount to the maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortized discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of the related items in the statement of financial position.

The effective interest method is a method of allocating interest income or interest expense over the relevant period, so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date, except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortized over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

***Initial recognition of financial instruments***. Trading securities, derivatives and other financial instruments at fair value through profit or loss are initially recorded at fair value. All other financial instruments are initially recorded at fair value plus transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

All purchases and sales of financial assets that require delivery within the time frame established by regulation or market convention ("regular way" purchases and sales) are recorded at trade date, which is the date on which the Group commits to deliver a financial asset. All other purchases are recognized when the entity becomes a party to the contractual provisions of the instrument.

***Classification of financial instruments.*** A financial asset is classified as measured at: amortized cost, fair value through other comprehensive income ("FVOCI") or fair value through profit or loss ("FVPL").

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated at FVPL:

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- the contractual terms of the financial asset give right on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated at FVPL:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give right on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity investment that is not held for trading, the Group may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis.

All other financial assets are classified as measured at FVPL.

In addition, on initial recognition, the Group may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortized cost or at FVOCI at FVPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

***Business model assessment.*** The Group makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio management as well as compliance with those policies and practice. In particular, whether management's strategy focuses on earning contractual interest income, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Group's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated - e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Group's stated objective for managing the financial assets is achieved and how cash flows are realised.

***Assessment whether contractual cash flows are solely payments of principal and interest.*** For the purposes of this assessment, "principal" is defined as the fair value of the financial asset on initial recognition. "Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Group considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition.

In making the assessment, the Group considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Group's claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
- features that modify consideration of the time value of money - e.g. periodical reset of interest rates, which is not consistent with the interest payment period.

***Reclassification of financial assets.*** Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Group changes its business model for managing financial assets. The reclassification has a prospective effect.

***Financial assets impairment – credit loss allowance for ECL.*** The Group assesses, on a forward-looking basis, the ECL for debt instruments measured at AC and FVOCI and for the exposures arising from loan commitments and financial guarantee contracts. The Group measures ECL and recognises credit loss allowance at each reporting date. The measurement of ECL reflects:

(i) an unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes, (ii) time value of money and (iii) all reasonable and supportable information that is available without undue cost and effort at the end of each reporting period about past events, current conditions and forecasts of future conditions.

Debt instruments measured at AC are presented in the consolidated statement of financial position net of the allowance for ECL. For loan commitments and financial guarantees, a separate provision for ECL is recognized as a liability in the consolidated statement of financial position. For debt instruments at FVOCI, changes in amortized cost, net of allowance for ECL, are recognized in profit or loss and other changes in carrying value are recognized in OCI as gains less losses on debt instruments at FVOCI.

The Group applies a three-stage model for impairment, based on changes in credit quality since initial recognition. A financial instrument that is not credit-impaired on initial recognition is classified in Stage 1. Financial assets in Stage 1 have their ECL measured at an amount equal to the portion of lifetime ECL that results from default events possible within the next 12 months or until contractual maturity, if shorter (“12 months ECL”). If the Bank identifies SICR since initial recognition, the asset is transferred to Stage 2 and its ECL is measured based on ECL on a lifetime basis, that is, up until contractual maturity but considering expected prepayments, if any (“Lifetime ECL”). Refer to Note 29 for a description of how the Group determines when a SICR has occurred. If the Group determines that a financial asset is credit-impaired, the asset is transferred to Stage 3 and its ECL is measured as a Lifetime ECL. The Group’s definition of credit impaired assets and definition of default is explained in Note 29. For financial assets that are purchased or originated credit-impaired (“POCI Assets”), the ECL is always measured as a Lifetime ECL. POCI assets are financial assets that are credit-impaired upon initial recognition, such as impaired loans acquired. Note 29 provides information about inputs, assumptions and estimation techniques used in measuring ECL, including an explanation of how the Group incorporates forward-looking information in the ECL models.

***Presentation of allowance for ECL in the consolidated statement of financial position.*** Loss allowances for ECL are presented in the consolidated statement of financial position as follows:

- financial assets measured at amortized cost: as a deduction from the gross carrying amount of the assets;
- loan commitments and financial guarantee contracts: generally, as a provision;
- where a financial instrument includes both a drawn and an undrawn component, and the Group cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Group presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision; and
- debt instruments measured at FVOCI: no loss allowance is recognized in the consolidated statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is recognized as part of fair value reserve.

***Financial assets – write-off.*** Financial assets are written-off, in whole or in part, when the Group exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery. The write-off represents a dercognition event. The Group may write-off financial assets that are still subject to enforcement activity when the Group seeks to recover amounts that are contractually due, however, there is no reasonable expectation of recovery.

***Derecognition of financial assets.*** The Group derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (b) the Group has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership, but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose restrictions on the sale.

***Derivative financial instruments.*** In the normal course of business, the Group enters into various derivative financial instruments including foreign currency forwards and cross currency swaps (back-to-back loans) in the foreign exchange and capital markets. The counterparties are mostly local banks. The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the statement of profit or loss within net gain/(losses) from foreign currencies.

***Cash and cash equivalents.*** Cash and cash equivalents consist of cash on hand, unrestricted balances on corresponded and term deposits with the Central Bank of the Republic of Azerbaijan (the "CBAR") with original maturity of less or equal to 90 days, notes issued by the Central Bank of the Republic of Azerbaijan (the "CBAR") up to 90 days and amounts due from credit institutions with original maturity of less or equal to 90 days and are free from contractual encumbrances. Funds restricted for a period of more than 1 business day on origination are excluded from cash and cash equivalents, both in the consolidated statement of financial position and for the purposes of the consolidated statement of cash flows. Cash and cash equivalents are carried at amortized cost because: (i) they are held for collection of contractual cash flows and those cash flows represent SPPI, and (ii) they are not designated at FVPL.

***Mandatory cash balances with the Central Bank of the Republic of Azerbaijan.*** Mandatory cash balances with the Central Bank of the Republic of Azerbaijan represent the amount of obligatory reserves deposited with the Central Bank of the Republic of Azerbaijan in accordance with requirements established by the Central Bank of the Republic of Azerbaijan, which subject to restrictions on their availability. In view of the above, the amount of the minimum reserve deposit required by the Central Bank of the Republic of Azerbaijan is not included as a cash equivalent in the consolidated statement of cash flows.

***Due from other banks***. Amounts due from banks are recorded when the Group advances money to counterparty banks. Amounts due from other banks are carried at AC when: (i) they are held for the purposes of collecting contractual cash flows and those cash flows represent SPPI, and (ii) they are not designated at FVTPL.

***Loans and advances to customers.*** Loans and advances to customers are recorded when the Group advances money to purchase or originate a loan due from a customer. Based on the business model and the cash flow characteristics, the Group classifies loans and advances to customers into one of the following measurement categories:

(i) AC: loans that are held for collection of contractual cash flows and those cash flows represent SPPI and loans that are not voluntarily designated at FVTPL, and

(ii) FVTPL: loans that do not meet the SPPI test or other criteria for AC or FVOCI are measured at FVTPL.

Impairment allowances are determined based on the forward-looking ECL models. Note 29 provides information about inputs, assumptions and estimation techniques used in measuring ECL, including an explanation of how the Group incorporates forward-looking information in the ECL models.

***Credit related commitments.*** Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and others on behalf of customers to secure loans, overdrafts and other banking facilities.

Financial guarantee contracts are initially measured at fair value and subsequently measured at the higher of:

- The amount of the loss allowance; and
- The premium received on initial recognition less income recognized in accordance with the principles of IFRS 15.

Loan commitments provided by the Group are measured as the amount of the loss allowance. The Group has not provided any commitment to provide loans at a below-market interest rate, or that can be settled net in cash or by delivering or issuing another financial instrument.

For loan commitments and financial guarantee contracts, the loss allowance is recognized as a provision. However, for contracts that include both a loan and an undrawn commitment and the Group cannot separately identify the expected credit losses on the undrawn commitment component from those on the loan component, the expected credit losses on the undrawn commitment are recognized together with the loss allowance for the loan. To the extent that the combined expected credit losses exceed the gross carrying amount of the loan, the expected credit losses are recognized as a provision.

***Equity instruments at FVOCI***. On initial recognition of an equity investment that is not held for trading, the Group may irrevocably elect to present subsequent changes in fair value in other comprehensive income. Such classification is determined on an instrument-by-instrument basis.

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

***Investments in debt securities.*** Based on the business model and the cash flow characteristics, the Group classifies investments in debt securities as carried at AC, FVOCI or FVTPL. Debt securities are carried at AC if they are held for collection of contractual cash flows and where those cash flows represent SPPI, and if they are not voluntarily designated at FVTPL in order to significantly reduce an accounting mismatch.

Debt securities are carried at FVOCI if they are held for collection of contractual cash flows and for selling, where those cash flows represent SPPI, and if they are not designated at FVTPL. Interest income from these assets is calculated using the effective interest method and recognized in profit or loss. An impairment allowance estimated using the expected credit loss model is recognized in profit or loss for the year. All other changes in the carrying value are recognized in OCI. When the debt security is derecognized, the cumulative gain or loss previously recognized in OCI is reclassified from OCI to profit or loss.

Investments in debt securities are carried at FVTPL if they do not meet the criteria for AC or FVOCI. The Group may also irrevocably designate investments in debt securities at FVTPL on initial recognition if applying this option significantly reduces an accounting mismatch between financial assets and liabilities being recognized or measured on different accounting bases.

***Premises and equipment.*** Premises and equipment are stated at cost less accumulated depreciation and provision for impairment, where required. Costs of minor repairs and maintenance are expensed when incurred. Costs of replacing major parts or components of premises and equipment items are capitalized and the replaced part is retired.

***Depreciation.*** Land and construction in progress are not depreciated. Depreciation on other items of premises and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives.

| 2020 and 2019 | Residual values | Useful lives in years |
|---|---|---|
| Buildings | 40% | 50 years |
| Office and computer equipment | 20% | 5 - 6 years |
| Furniture, fixtures and other equipment | 30% | 5 - 8 years |
| Leasehold improvements | - | over the term of the underlying lease |
| Right to use | - | over the term of the underlying lease |

Construction in progress is carried at cost, less any recognized impairment loss. Cost includes professional fees. Such construction in progress is classified to the appropriate categories of property and equipment when completed and ready for intended use.

Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

The residual value of an asset is the estimated amount that the Group would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

Gains and losses on disposals determined by comparing proceeds with carrying amount are recognized in profit or loss for the year (within other operating income or expenses).

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in profit or loss.

***Investment property.*** Investment property is property held by the Group to earn rental income or for capital appreciation, or both and which is not occupied by the Group. Investment property includes building for future use as property and equipment.

Investment property is stated at cost less accumulated depreciation and provision for impairment, where required.

Subsequent expenditure is capitalized only when it is probable that future economic benefits associated with it will flow to the Group and the cost can be measured reliably. All other repairs and maintenance costs are expensed when incurred. If an investment property becomes owner-occupied, it is reclassified to premises and equipment. Depreciation on items of investment property is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives. Estimated useful lives of investment property are 50 years. At each end of each reporting period management assesses whether there is any indication of impairment of investment properties. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. However, since it is not possible to measure fair value less costs to sell because there is no basis for making reliable estimate of the price at which an orderly transaction to sell the asset would take place between market participants at the measurement date under current market conditions, the entity uses the asset's value in use as its recoverable amount. The carrying amount is reduced to the recoverable amount and the impairment loss is recognized in profit or loss for the year. An impairment loss recognized for an asset in prior years is reversed where appropriate if there has been a change in the estimates used to determine the asset's value in use.

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are recognized in profit or loss for the year.

***Intangible assets***

***Intangible assets acquired separately.*** Intangible assets with finite useful lives that are acquired separately are carried at cost less accumulated amortization and accumulated impairment losses. Amortization is recognized on a straight-line basis over their estimated useful lives. The estimated useful lives of intangible assets are 10 years. The estimated useful life and amortization method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

***Derecognition of intangible assets.*** An intangible asset is derecognized on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognized in profit or loss when the asset is derecognized.

***Repossessed collateral.*** The Group obtains collateral in respect of customer liabilities where this is considered appropriate. The collateral normally takes the form of a lien over the customer's assets and gives the Group a claim on these assets for both existing and future customer liabilities.

In certain circumstances, assets are repossessed following the foreclosure on loans that are in default. Repossessed collateral is initially recognized at an amount equal to the carrying amount of a loan for which it was pledged. Repossessed assets are measured at the lower of carrying amount and fair value less costs to sell.

***Impairment of tangible and intangible assets.*** At the end of each reporting period, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). When it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. When a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

When an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

***Lease.*** The Group assesses at contract inception whether a contract is, or contains, a lease. That is, if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

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

***Right-of-use assets.*** The Group recognizes right-of-use assets at the commencement date of the lease (i.e., the date the underlying asset is available for use). Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any re-measurement of lease liabilities. The cost of right-of-use assets includes the amount of lease liabilities recognized, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received. Right-of-use assets are depreciated on a straight-line basis over the shorter of the lease term.

If the ownership of the leased asset transfers to the Group at the end of the lease term or the cost reflects the exercise of a purchase option, depreciation is calculated using the estimated useful life of the asset. The right-of-use assets are also subject to impairment.

***Lease liabilities.*** At the commencement date of the lease, the Group recognizes lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments (including in-substance fixed payments) less any lease incentives receivable, variable lease payments that depend on an index or a rate, and amounts expected to be paid under residual value guarantees. The lease payments also include the exercise price of a purchase option reasonably certain to be exercised by the Group and payments of penalties for terminating the lease, if the lease term reflects the Group exercising the option to terminate.

Variable lease payments that do not depend on an index or a rate are recognized as expenses (unless they are incurred to produce inventories) in the period in which the event or condition that triggers the payment occurs.

In calculating the present value of lease payments, the Group uses its incremental borrowing rate at the lease commencement date because the interest rate implicit in the lease is not readily determinable. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made. In addition, the carrying amount of lease liabilities is re-measured if there is a modification, a change in the lease term, a change in the lease payments (e.g. changes to future payments resulting from a change in an index or rate used to determine such lease payments) or a change in the assessment of an option to purchase the underlying asset.

***Due to banks***. Amounts due to banks are recorded when money or other assets are advanced to the Group by counterparty banks. The non-derivative liability is carried at amortized cost. If the Group purchases its own debt, the liability is removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is included in gains or losses arising from retirement of debt.

***Customer accounts***. Customer accounts are non-derivative liabilities to individuals, state or corporate customers and are carried at amortized cost.

***Derecognition of financial liabilities.*** The Group derecognizes financial liabilities when, and only when, the Group’s obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit and loss accounts.

***Offset of financial assets and liabilities.*** Financial assets and liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognized amounts, and there is an intention to either settle on a net basis, or to realize the asset and settle the liability simultaneously. Such a right of set off (a) must not be contingent on a future event and (b) must be legally enforceable in all of the following circumstances: (i) in the normal course of business, (ii) the event of default and (iii) the event of insolvency or bankruptcy.

***Income taxes***. Income taxes have been provided for in the consolidated financial statements in accordance with legislation enacted or substantively enacted by the end of the reporting period. The income tax charge/credit comprises current tax and deferred tax and is recognized in profit or loss for the year, except if it is recognized in other comprehensive income or directly in equity because it relates to transactions that are also recognized, in the same or a different period, in other comprehensive income or directly in equity.

Current tax is the amount expected to be paid to, or recovered from, the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxable profits or losses are based on estimates if the consolidated financial statements are authorised prior to filing relevant tax returns. Taxes other than on income are recorded within administrative and other operating expenses.

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realized, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities

***Share capital***. Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recorded as share premium in equity.

***Equity reserves.*** The reserves recorded in equity (other comprehensive income) on the Group’s consolidated statement of financial position include “other reserve” which comprises changes in fair value of investment securities at FVOCI.

***Income and expense recognition.*** Interest income and expense are recorded for debt instruments measured at amortized cost or at FVOCI on an accrual basis using the effective interest method. This method defers, as part of interest income or expense, all fees paid or received between the parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Fees integral to the effective interest rate include origination fees received or paid by the entity relating to the creation or acquisition of a financial asset or issuance of a financial liability, for example fees for evaluating creditworthiness, evaluating and recording guarantees or collateral, negotiating the terms of the instrument and for processing transaction documents. Commitment fees received by the Group to originate loans at market interest rates are integral to the effective interest rate if it is probable that the Group will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination. The Group does not designate loan commitments as financial liabilities at FVPL.

For financial assets that are originated or purchased credit-impaired, the effective interest rate is the rate that discounts the expected cash flows (including the initial expected credit losses) to the fair value on initial recognition (normally represented by the purchase price). As a result, the effective interest is credit-adjusted.

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for:

- Financial assets that have become credit-impaired (Stage 3), for which interest revenue is calculated by applying the effective interest rate to their amortized cost (net of the expected credit loss (“ECL”) provision); and
- Financial assets that are purchased or originated credit-impaired, for which the original credit-adjusted effective interest rate is applied to the amortized cost.

***Fee and commission income and expense.*** All other fees, commissions and other income and expense items are generally recorded on an accrual basis over the period in which the services are rendered as the customer simultaneously receives and consumes the benefits as the Group performs, usually on a straight-line basis.

Commissions and fees arising from negotiating, or participating in the negotiation of a transaction for a third party, such as the acquisition of loans, shares or other securities or the purchase or sale of businesses, and which are earned when the Group satisfies the performance obligation are recorded upon the completion of the transaction. Portfolio and other management advisory and service fees are recognized based on the applicable service contracts, over the period in which the services are rendered as the customer simultaneously receives and consumes the benefits as the Group performs, usually on a straight-line basis. Asset management fees relating to investment funds are recognized over the period in which services are rendered as the customer simultaneously receives and consumes the benefits as the Group performs, usually on a straight-line basis. The same principle is applied for wealth management, financial planning and custody services that are continually provided over an extended period of time.

***Foreign currency translation***. The functional currency of the Group is the currency of the primary economic environment in which the Group operates. The functional and the presentation currency of the Group, is the national currency of the Republic of Azerbaijan, Azerbaijani Manats ("AZN").

Monetary assets and liabilities are translated into the Group's functional currency at the official exchange rate of the CBAR at the end of the respective reporting period. Foreign exchange gains and losses resulting from the settlement of transactions and from the translation of monetary assets and liabilities into the Group's functional currency at year-end official exchange rates of the CBAR, are recognized in profit or loss for the year (as foreign exchange translation gains less losses). Translation at year-end rates does not apply to non-monetary items that are measured at historical cost. Non-monetary items measured at fair value in a foreign currency, including equity investments, are translated using the exchange rates at the date when the fair value was determined.

Effects of exchange rate changes on non-monetary items measured at fair value in a foreign currency are recorded as part of the fair value gain or loss.

The exchange rates used by the Group in the preparation of the consolidated financial statements as at year-end are as follows:

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| AZN/US Dollar 1 | 1.7000 | 1.7000 |
| AZN/Euro 1 | 2.0890 | 1.9035 |

***Offsetting***. Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position only when there is a legally enforceable right to offset the recognized amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously. Such a right of set off (a) must not be contingent on a future event and (b) must be legally enforceable in all of the following circumstances: (i) in the normal course of business, (ii) the event of default and (iii) the event of insolvency or bankruptcy.

***Earnings per share***. Earnings per share are determined by dividing the profit or loss attributable to owners of the Group by the weighted average number of participating shares outstanding during the reporting year.

***Staff costs and related contributions***. Wages, salaries, contributions to the Republic of Azerbaijan state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits are accrued in the year in which the associated services are rendered by the employees of the Group. The Group has no legal or constructive obligation to make pension or similar benefit payments beyond the payments to the statutory defined contribution scheme.

## 3. CRITICAL ACCOUNTING ESTIMATES, AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

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

***Measurement of ECL allowance.*** Measurement of ECLs is a significant estimate that involves determination of methodology, models and data inputs. Details of ECL measurement methodology are disclosed in Note 29. The following components have a major impact on credit loss allowance: definition of default, SICR, probability of default ("PD"), exposure at default ("EAD"), and loss given default ("LGD"), as well as models of macro-economic scenarios. The Group regularly reviews and validates the models and inputs to the models to reduce any differences between expected credit loss estimates and actual credit loss experience. For details of ECL measurement including incorporation of forward-looking information refer to Note 29.

***Credit exposure on revolving credit facilities (e.g. credit cards, overdrafts)***. For certain loan facilities, the Group's exposure to credit losses may extend beyond the maximum contractual period of the facility. This exception applies to certain revolving credit facilities, which include both a loan and an undrawn commitment component and where the Group's contractual ability to demand repayment and cancel the undrawn component in practice does not limit its exposure to credit losses.

For such facilities, the Group measures ECLs over the period that the Group is exposed to credit risk and ECLs are not mitigated by credit risk management actions. Application of this exception requires judgement. Management applied its judgement in identifying the facilities, both retail and commercial, to which this exception applies. The Group applied this exception to facilities with the following characteristics: (a) there is no fixed term or repayment structure, (b) the contractual ability to cancel the contract is not in practice enforced as a result of day-to-day management of the credit exposure and the contract may only be cancelled when the Group becomes aware of an increase in credit risk at the level of an individual facility, and (c) the exposures are managed on a collective basis. Further, the Group applied judgement in determining a period for measuring the ECL, including the starting point and the expected end point of the exposures.

The Group considered historical information and experience about: (a) the period over which the Group is exposed to credit risk on similar facilities, including when the last significant modification of the facility occurred and that therefore determines the starting point for assessing SICR, (b) the length of time for related defaults to occur on similar financial instruments following a SICR and (c) the credit risk management actions (eg. the reduction or removal of undrawn limits), prepayment rates and other factors that drive expected maturity. In applying these factors, the Group segments the portfolios of revolving facilities into sub-groups and applies the factors that are most relevant based on historical data and experience as well as forward-looking information.

***Significant increase in credit risk ("SICR")***. In order to determine whether there has been a significant increase in credit risk, the Group compares the risk of a default occurring over the life of a financial instrument at the end of the reporting date with the risk of default at the date of initial recognition. The assessment considers relative increase in credit risk rather than achieving a specific level of credit risk at the end of the reporting period. The Group considers all reasonable and supportable forward looking information available without undue cost and effort, which includes a range of factors, including behavioral aspects of particular customer portfolios. The Group identifies behavioral indicators of increases in credit risk prior to delinquency and incorporated appropriate forward looking information into the credit risk assessment, either at an individual instrument, or on a portfolio level. Refer to Note 29.

***Business model assessment***. The business model drives classification of financial assets. Management applied judgement in determining the level of aggregation and portfolios of financial instruments when performing the business model assessment. When assessing sales transactions, the Group considers their historical frequency, timing and value, reasons for the sales and expectations about future sales activity. Sales transactions aimed at minimizing potential losses due to credit deterioration are considered consistent with the “hold to collect” business model. Other sales before maturity, not related to credit risk management activities, are also consistent with the “hold to collect” business model, provided that they are infrequent or insignificant in value, both individually and in aggregate. The Group assesses significance of sales transactions by comparing the value of the sales to the value of the portfolio subject to the business model assessment over the average life of the portfolio. In addition, sales of financial asset expected only in stress case scenario, or in response to an isolated event that is beyond the Group’s control, is not recurring and could not have been anticipated by the Group, are regarded as incidental to the business model objective and do not impact the classification of the respective financial assets.

The “hold to collect and sell” business model means that assets are held to collect the cash flows, but selling is also integral to achieving the business model’s objective, such as, managing liquidity needs, achieving a particular yield, or matching the duration of the financial assets to the duration of the liabilities that fund those assets.

The residual category includes those portfolios of financial assets, which are managed with the objective of realizing cash flows primarily through sale, such as where a pattern of trading exists. Collecting contractual cash flow is often incidental for this business model.

***Assessment whether cash flows are solely payments of principal and interest (“SPPI”)***. Determining whether a financial asset’s cash flows are solely payments of principal and interest required judgement. The time value of money element may be modified, for example, if a contractual interest rate is periodically reset but the frequency of that reset does not match the tenor of the debt instrument’s underlying base interest rate, for example a loan pays three months interbank rate but the rate is reset every month. The effect of the modified time value of money was assessed by comparing relevant instrument’s cash flows against a benchmark debt instrument with SPPI cash flows, in each period and cumulatively over the life of the instrument. The assessment was done for all reasonably possible scenarios, including reasonably possible financial stress situation that can occur in financial markets. In case of a scenario with cash flows that significantly differ from the benchmark, the assessed instrument’s cash flows are not SPPI and the instrument is then carried at FVTPL.

The Group identified and considered contractual terms that change the timing or amount of contractual cash flows. The SPPI criterion is met if a loan allows early settlement and the prepayment amount substantially represents principal and accrued interest, plus a reasonable additional compensation for the early termination of the contract. The asset’s principal is the fair value at initial recognition less subsequent principal repayments, ie instalments net of interest determined using the effective interest method. As an exception to this principle, the standard also allows instruments with prepayment features that meet the following condition to meet SPPI: (i) the asset is originated at a premium or discount, (ii) the prepayment amount represents contractual paramount and accrued interest and a reasonable additional compensation for the early termination of the contract, and (ii) the fair value of the prepayment feature is immaterial at initial recognition.

The Group’s loan agreements allow adjusting interest rates in response to certain macro-economic or regulatory changes. Management applied judgement and assessed that competition in the banking sector and the practical ability of the borrowers to refinance the loans would prevent it from resetting the interest rates at an above-market level and hence cash flows were assessed as being SPPI.

***Modification of financial assets***. When financial assets are contractually modified (e.g. renegotiated), the Group assesses whether the modification is substantial and should result in derecognition of the original asset and recognition of a new asset at fair value. This assessment is based primarily on qualitative factors, described in the relevant accounting policy and it requires significant judgment. In particular, the Group applies judgment in deciding whether credit impaired renegotiated loans should be derecognized and whether the new recognized loans should be considered as credit impaired on initial recognition. The derecognition assessment depends on whether the risks and rewards, that is, the variability of expected (rather than contractual) cash flows, change as a result of such modifications. Management determined that risks and rewards did not change as a result of modifying such loans and therefore in substantially all such modifications, the loans were neither derecognized nor reclassified out of the credit-impaired stage.

***Fair value of restructured loans to customers and borrowing from CBAR under below market rate originated under the Decree.*** As disclosed in Note 16 to the consolidated financial statements, the Group obtained borrowings from CBAR in the cumulative amount of AZN 34,725 thousand as at December 31, 2020 (2019: AZN 28,012 thousand) with 0.1% annual interest rate and restructured the loans to the costumers in the amount of AZN 37,305 thousand with interest rate of 1% under the Decree. Terms and conditions for both borrowings and loans originated under this Decree did not match the normal market conditions as at the initial recognition therefore the Group recognized these financial instruments at fair value utilizing the market rate for similar financial instruments. The market rate used for discounting the similar loans was 22-24% and 7.5% for borrowings received from CBAR, respectively.

***Initial recognition of related party transactions.*** In the normal course of business, the Group enters into transactions with its related parties. IFRS 9 requires initial recognition of financial instruments based on their fair values. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis. Terms and conditions of related party balances are disclosed in Note 32.

***Useful life of premises and equipment.*** The Group assesses the remaining useful lives of items of property and equipment at least at each financial year-end. If expectations differ from previous estimates, the changes are accounted for as a change in an accounting estimate in accordance with IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors". These estimates may have a material impact on the amount of the carrying values of property and equipment and on depreciation recognized in profit or loss.

***Valuation of lease liabilities and right of use assets.*** The application of IFRS 16 requires to make judgements of right of use assets and lease liabilities. In determining the lease term, the Group considers all facts and circumstances that create an economic incentive to exercise renewal options (or not to exercise termination options). Assessing whether a contract includes a lease also requires judgement. Estimates are required to determine the appropriate discount rate used to measure lease liabilities.

## 4. ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS

In the current year, the Group has adopted all of the applicable new and revised Standards and Interpretations issued by the IASB and the IFRIC of the IASB that are relevant to its operations and effective for annual reporting periods ending in December 31, 2020.

IASB has published **"Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)"** as a first reaction to the potential effects the IBOR reform could have on financial reporting. A hedging relationship is affected if the reform gives rise to uncertainty about the timing and/or amount of benchmark-based cash flows of the hedged item or the hedging instrument. These amendments have no impact on the consolidated financial statements of the Group as it does not have any interest rate hedge relationships.

**IFRS 3 Business Combinations. Amendment of the definition of "Business"** – The amendments will help companies determine whether an acquisition made is of a business or a group of assets.

The amended definition emphasizes that the output of a business is to provide goods and services to customers, whereas the previous definition focused on returns in the form of dividends, lower costs or other economic benefits to investors and others. Distinguishing between a business and a group of assets is important because an acquirer recognizes goodwill only when acquiring a business.

According to the amendment new definition a "business" is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.

**New definition of "Material"** – The IASB has issued amendments to its definition of material to make it easier for companies to make materiality judgements. The updated definition amends IAS 1 Presentation of Financial Statements and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

The amendments clarify the definition of material and how it should be applied by including in the definition guidance that until now has featured elsewhere in IFRS Standards. According to the new definition, information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

On May 15, 2020 IASB has published **"COVID-19-Related Rent Concessions (Amendment to IFRS 16)"** amending the standard to provide lessees with an exemption from assessing whether a COVID-19-related rent concession is a lease modification.

The changes in COVID-19-Related Rent Concessions (Amendment to IFRS 16) amend IFRS 16 to:

- provide lessees with an exemption from assessing whether a COVID-19-related rent concession is a lease modification;
- require lessees that apply the exemption to account for COVID-19-related rent concessions as if they were not lease modifications;
- require lessees that apply the exemption to disclose that fact; and
- require lessees to apply the exemption retrospectively in accordance with IAS 8, but not require them to restate prior period figures.

The amendment is effective for annual reporting periods beginning on or after June 1, 2020. Earlier application is permitted. The impact of the adoption of this standard had no effect on the consolidated financial statements.

Unless otherwise disclosed, the new standards are not expected to have a material effect on the consolidated financial statements of the Group.

## 5. STANDARD AND INTERPRETATIONS ISSUED BUT NOT YET ADOPTED

At the date of authorization of these consolidated financial statements, other than the Standards and Interpretations adopted by the Group in advance of their effective dates, the following Interpretations were in issue but not yet effective.

**IFRS 17 "Insurance contracts"** was issued in May 2017 and replaced IFRS 4 "Insurance contracts". The new standard establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard. An entity shall apply IFRS 17 "Insurance Contracts" to insurance contracts, including reinsurance contracts, it issues; reinsurance contracts it holds; and investment contracts with discretionary participation features it issues, provided the entity also issues insurance contracts.

IFRS 17 is effective for annual reporting periods beginning on or after January 1, 2023. Earlier application is permitted if both IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments have also been applied.

**Amendments to IAS 1 to clarify the classification of liabilities** – In January 2020 the IASB has issued **“Classification of Liabilities as Current or Non-Current (Amendments to IAS 1)”** providing a more general approach to the classification of liabilities under IAS 1 based on the contractual arrangements in place at the reporting date. The amendments in Classification of Liabilities as Current or Non-Current (Amendments to IAS 1) affect only the presentation of liabilities in the statement of financial position — not the amount or timing of recognition of any asset, liability income or expenses, or the information that entities disclose about those items.

The amendments are effective for annual reporting periods beginning on or after January 1, 2023 and are to be applied retrospectively. Earlier application is permitted.

**Reference to the Conceptual Framework – Amendments to IFRS 3 – In May 2020, the IASB issued Amendments to IFRS 3 “Business Combinations” – Reference to the Conceptual Framework**. The amendments are intended to replace a reference to the Framework for the Preparation and Presentation of Financial Statements, issued in 1989, with a reference to the Conceptual Framework for Financial Reporting issued in March 2018 without significantly changing its requirements. The Board also added an exception to the recognition principle of IFRS 3 to avoid the issue of potential ‘day 2’ gains or losses arising for liabilities and contingent liabilities that would be within the scope of IAS 37 or IFRIC 21 Levies, if incurred separately. At the same time, the Board decided to clarify existing guidance in IFRS 3 for contingent assets that would not be affected by replacing the reference to the Framework for the Preparation and Presentation of Financial Statements. The amendments are effective for annual reporting periods beginning on or after January 1, 2022 and apply prospectively.

**Property, Plant and Equipment: Proceeds before Intended Use – Amendments to IAS 16** – In May 2020, the IASB issued Property, Plant and Equipment – Proceeds before Intended Use, which prohibits entities deducting from the cost of an item of property, plant and equipment, any proceeds from selling items produced while bringing that asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Instead, an entity recognizes the proceeds from selling such items, and the costs of producing those items, in profit or loss. The amendment is effective for annual reporting periods beginning on or after January 1, 2022 and must be applied retrospectively to items of property, plant and equipment made available for use on or after the beginning of the earliest period presented when the entity first applies the amendment.

**Onerous Contracts – Costs of Fulfilling a Contract – Amendments to IAS 37** – In May 2020, the IASB issued amendments to IAS 37 to specify which costs an entity needs to include when assessing whether a contract is onerous or loss-making. The amendments apply a “directly related cost approach”. The costs that relate directly to a contract to provide goods or services include both incremental costs and an allocation of costs directly related to contract activities. General and administrative costs do not relate directly to a contract and are excluded unless they are explicitly chargeable to the counterparty under the contract. The amendments are effective for annual reporting periods beginning on or after January 1, 2022.

**IFRS 1 “First-time Adoption of International Financial Reporting Standards”** – Subsidiary as a first-time adopter. As part of its 2018-2020 annual improvements to IFRS standards process, the IASB issued an amendment to IFRS 1 “First-time Adoption of International Financial Reporting Standards”. The amendment permits a subsidiary that elects to apply paragraph D16(a) of IFRS 1 to measure cumulative translation differences using the amounts reported by the parent, based on the parent’s date of transition to IFRS. This amendment is also applied to an associate or joint venture that elects to apply paragraph D16 (a) of IFRS 1. The amendment is effective for annual reporting periods beginning on or after January 1, 2022 with earlier adoption permitted.

**IFRS 9 Financial Instruments – Fees in the “10 per cent” test for derecognition of financial liabilities.** As part of its 2018-2020 annual improvements to IFRS standards process the IASB issued amendment to IFRS 9. The amendment clarifies the fees that an entity includes when assessing whether the terms of a new or modified financial liability are substantially different from the terms of the original financial liability. These fees include only those paid or received between the borrower and the lender, including fees paid or received by either the borrower or lender on the other’s behalf. An entity applies the amendment to financial liabilities that are modified or exchanged on or after the beginning of the annual reporting period in which the entity first applies the amendment. The amendment is effective for annual reporting periods beginning on or after January 1, 2022 with earlier adoption permitted. The Group will apply the amendments to financial liabilities that are modified or exchanged on or after the beginning of the annual reporting period in which the entity first applies the amendment.

**“IAS 41 Agriculture” – Taxation in fair value measurements** – As part of its 2018-2020 annual improvements to IFRS standards process the IASB issued amendment to IAS 41 Agriculture. The amendment removes the requirement in paragraph 22 of IAS 41 that entities exclude cash flows for taxation when measuring the fair value of assets within the scope of IAS 41. An entity applies the amendment prospectively to fair value measurements on or after the beginning of the first annual reporting period beginning on or after January 1, 2022 with earlier adoption permitted.

**IFRS 10 “Consolidated Financial Statements” and IAS 28 (amendments) Sale or Contribution of Assets between an Investor and its Associate or Joint Venture** – The amendments to IFRS 10 and IAS 28 deal with situations where there is a sale or contribution of assets between an investor and its associate or joint venture. Specifically, the amendments state that gains or losses resulting from the loss of control of a subsidiary that does not contain a business in a transaction with an associate or a joint venture that is accounted for using the equity method, are recognized in the parent’s profit or loss only to the extent of the unrelated investors’ interests in that associate or joint venture.

Similarly, gains and losses resulting from the re-measurement of investments retained in any former subsidiary (that has become an associate or a joint venture that is accounted for using the equity method) to fair value are recognized in the former parent’s profit or loss only to the extent of the unrelated investors’ interests in the new associate or joint venture. The effective date of the amendments has yet to be set by the IASB; however, earlier application of the amendments is permitted.

Unless otherwise disclosed, the new standards are not expected to have material effect on the consolidated financial statements of the Group.

## 6. MANAGEMENT OF CAPITAL

The objectives of management when managing the Bank’s and Group’s capital are (i) to comply with the capital requirements set by the CBAR and (ii) to safeguard the Group’s ability to continue as a going concern.

Under the current prudential capital requirements set by the CBAR banks have to: (a) hold the minimum level of total statutory capital of AZN 50,000 thousand (December 31, 2019: AZN 50,000 thousand); (b) maintain a ratio of regulatory capital to risk weighted assets (“statutory capital ratio”) at or above a prescribed minimum of 9% (December 31, 2019: 10%) and (c) maintain a ratio of Tier-1 capital to the risk-weighted assets (the ‘Tier-1 capital ratio’) at or above the prescribed minimum of 5% (December 31, 2019: 5%).

Management considers that the Bank was in compliance with the statutory capital ratio as at December 31, 2020 and 2019. The calculation of capital adequacy based on the prudential reports prepared by the Bank in accordance with the prudential regulations set by the CBAR was as follows:

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| Total capital | 82,906 | 80,202 |
| Risk-weighted assets | 583,661 | 552,230 |
| **Capital adequacy ratio (%)** | **14.20%** | **14.52%** |

The table below provides an overview of the differences in composition of the net assets as at December 31, 2020 presented in the Group's consolidated financial statements prepared under IFRS and total statutory capital determined under the rules and regulations of the CBAR.

| | December 31, 2020 (unaudited) | December 31, 2019 (unaudited) |
|---|---|---|
| **Total statutory capital** | **82,906** | **80,202** |
| Differences between statutory capital and IFRS equity: | | |
| - retained earnings/(accumulated losses) | 22,182 | 49,203 |
| - loan loss allowance | 17,399 | 54,303 |
| - provision for potential losses | (486) | (5,260) |
| - income tax | 669 | 1,648 |
| - others | 4,600 | (1,488) |
| - differences on deduction | 20,665 | 20,212 |
| - intangible assets | 15,299 | 14,518 |
| - deferred tax assets | 4,367 | 4,703 |
| - investments | 999 | 991 |
| - general allowances | (6,852) | (4,968) |
| - other capital | (6,800) | (10,200) |
| **IFRS equity of the Bank** | **112,101** | **134,449** |
| **IFRS equity of subsidiaries** | **1,714** | **1,135** |
| **Total equity attributable to owners of the Bank** | **113,815** | **135,584** |

## 7. CASH AND CASH EQUIVALENTS

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| Cash on hand | 55,700 | 56,653 |
| Cash balances with the CBAR (other than mandatory cash balances) | 42,799 | 35,442 |
| Notes issued by CBAR with original maturity up to 90 days | 1,916 | 5,958 |
| Correspondent accounts with other banks: | | |
| - rated A- to A+ (Fitch Ratings) | 88 | 31,277 |
| - rated BBB- to BBB+ (Fitch Ratings) | 4,711 | 13,165 |
| - rated below BBB- (Fitch Ratings) | 415 | 369 |
| - not rated | 865 | 885 |
| **Total correspondent accounts with other banks** | 6,079 | 45,696 |
| **Total cash and cash equivalents** | **106,494** | **143,749** |

As at December 31, 2020 the Group had one bank (December 31, 2019: two banks), with balances exceeding 10% of total cash and cash equivalents. The gross value of these balances as at December 31, 2020 was AZN 44,715 thousand (December 31, 2019: was AZN 57,278 thousand).

The most recently published international rating for the Republic of Azerbaijan is BB+ (Fitch Ratings) (2019: BB+/Fitch Ratings).

For the purpose of ECL measurement cash and cash equivalents balances are included in Stage 1. The ECL for these balances represents an insignificant amount, therefore the Group did not recognize any credit loss allowance for cash and cash equivalents.

## 8. DUE FROM OTHER BANKS

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| Term placements with resident banks | 36,127 | 36,125 |
| Term placements with non-resident banks | 6,082 | 6,986 |
| | **42,209** | **43,111** |
| Less: Allowance for expected credit loss | (36,127) | (28,900) |
| **Net due from other banks** | **6,082** | **14,211** |

As at December 31, 2020 term placements with local banks included term placements with five local banks with principal balance amounting to the equivalent of AZN 36,127 thousand and bearing 3% annual interest rate (December 31, 2019: placements with five local banks amounting to the equivalent of AZN 36,125 thousand and bearing 3% annual interest rate). As at December 31, 2020 the Group recognized credit loss allowance in the amount of AZN 36,127 thousand against due from other banks that were pledged as collateral against the loans to "Direkt Kredi" LLC (previously "Unileasing" CJSC) (December 31, 2019: AZN 28,900 thousand).

As at December 31, 2020, accrued interest income included in due from other banks amounted to AZN 13 thousand (December 31, 2019: nil).

Amounts due from other banks are not collateralized. An analysis by credit quality of amounts due from other banks is as follows:

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| Current and not impaired | | |
| - Central Bank of the Republic of Azerbaijan | - | - |
| >BBB (Fitch Ratings) | 5,842 | 6,565 |
| <BBB (Fitch Ratings) | - | 4,760 |
| - not rated | 240 | 2,886 |
| **Total due from other banks** | **6,082** | **14,211** |

As at December 31, 2020 the Group has seven banks (December 31, 2019: four banks) with an outstanding balance exceeding 10% of total due from other banks. The gross value of these balances as at December 31, 2020 is AZN 41,969 thousand (December 31, 2019: AZN 33,765 thousand).

An analysis of changes in gross carrying value and corresponding ECL allowance on amounts due from banks and other financial institutions during the year ended December 31, 2020 is as follows:

| | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **Gross carrying value as at January 1, 2020** | **6,986** | - | **36,125** | **43,111** |
| Net change in carrying value | (904) | - | 2 | (902) |
| Transfers to Stage 1 | - | - | - | - |
| Transfers to Stage 2 | - | - | - | - |
| Transfers to Stage 3 | - | - | - | - |
| Foreign exchange and other movements | - | - | - | - |
| **As at December 31, 2020** | **6,082** | - | **36,127** | **42,209** |

| | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **ECL allowance as at January 1, 2020** | - | - | **(28,900)** | **(28,900)** |
| Net change in ECL value | - | - | (7,227) | (7,227) |
| Transfers to Stage 1 | - | - | - | - |
| Transfers to Stage 2 | - | - | - | - |
| Transfers to Stage 3 | - | - | - | - |
| **As at December 31, 2020** | - | - | **(36,127)** | **(36,127)** |

An analysis of changes in gross carrying value and corresponding ECL allowance on amounts due from banks and other financial institutions during the year ended December 31, 2019 is as follows:

| | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **Gross carrying value as at January 1, 2019** | **85,274** | - | **36,125** | **121,399** |
| Net change in carrying value | (78,288) | - | - | (78,288) |
| Transfers to Stage 1 | - | - | - | - |
| Transfers to Stage 2 | - | - | - | - |
| Transfers to Stage 3 | - | - | - | - |
| Foreign exchange and other movements | - | - | - | - |
| **As at December 31, 2019** | **6,986** | - | **36,125** | **43,111** |

| | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **ECL allowance as at January 1, 2019** | **(1,853)** | - | **(28,941)** | **(30,794)** |
| Net change in ECL value | 1,853 | - | 41 | 1,894 |
| Transfers to Stage 1 | - | - | - | - |
| Transfers to Stage 2 | - | - | - | - |
| Transfers to Stage 3 | - | - | - | - |
| **As at December 31, 2019** | - | - | **(28,900)** | **(28,900)** |

## 9. LOANS AND ADVANCES TO CUSTOMERS

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| Business loans | 180,332 | 173,723 |
| Cash consumer loans | 183,221 | 154,104 |
| Credit cards | 99,421 | 83,316 |
| Purchase of apartments and mortgages | 51,489 | 49,092 |
| Micro loans | 50,395 | 48,264 |
| Purchase of motor vehicles | 644 | 869 |
| Gross loans and advances to customers | **565,502** | **509,368** |
| Less: Allowance for expected credit loss | (64,221) | (54,810) |
| **Net loans and advances to customers** | **501,281** | **454,558** |

The Group received compensation from the government in the amount of AZN 48,524 thousand for the problematic loans under the Decree during the year ended December 31, 2019. Additionally, the Group restructured loans in amount of AZN 37,305 thousand under the Decree with 1% of interest and 5 years of maturity. Before restructuring these loans were either written off or presented in Stage 3. The restructured loans were also granted with 1 year of grace period for payment of principal amount as stipulated in the Decree. As the modification of terms of these loans were substantially different from their original conditions, the Group applied derecognition approach regarding these loans. These loans were recognized as new loans at initial recognition with fair value of AZN 9,870 thousand taking into account prevailing market rates of 22-24% and classified as POCI. The Group recognized gain in the amount of AZN 6,847 thousand from modification at initial recognition of these loans.

The carrying value of these loans as at December 31, 2020 amounted to AZN 9,813 thousand.

During the year ended December 31, 2020 the Group restructured loans in the amount of AZN 10,980 thousand under the COVID-19 restructuring program.

Economic sector risk concentrations within the customer loan portfolio are as follows:

| | December 31, 2020 | | December 31, 2019 | |
|---|---|---|---|---|
| | Amount | % | Amount | % |
| ***Retail loans*** | | | | |
| Cash consumer loans | 183,221 | 32.4 | 154,104 | 30.3 |
| Credit cards | 99,421 | 17.6 | 83,316 | 16.4 |
| Purchase of apartments and mortgages | 51,489 | 9.1 | 49,092 | 9.6 |
| Micro loans | 50,395 | 8.9 | 48,264 | 9.5 |
| Purchase of motor vehicles | 644 | 0.1 | 869 | 0.1 |
| **Total retail loans** | **385,170** | **68.1** | **335,645** | **65.9** |
| ***Business loans*** | | | | |
| Trade and services | 124,892 | 22.1 | 120,672 | 23.7 |
| Manufacturing | 29,718 | 5.3 | 28,419 | 5.6 |
| Agriculture | 12,067 | 2.1 | 10,866 | 2.1 |
| Construction | 11,325 | 2.0 | 10,739 | 2.1 |
| Other | 2,330 | 0.4 | 3,027 | 0.6 |
| **Total business loans** | **180,332** | **31.9** | **173,723** | **34.1** |
| **Gross loans and advances to customers** | **565,502** | **100.0** | **509,368** | **100.0** |

As at December 31, 2020 the Group had 33 borrowers (December 31, 2019: 34 borrowers) with the outstanding loan amount above AZN 1,000 thousand. The aggregate balance of these borrowers was AZN 105,867 thousand (December 31, 2019: AZN 92,455 thousand) or 19% (December 31, 2019: 18%) of the gross loan portfolio.

As at December 31, 2020 mortgage loans included AZN 50,644 thousand (December 31, 2019: AZN 43,272 thousand) under the program covered by the borrowing agreement with the Azerbaijan Mortgage Fund. In addition, a further AZN 2,039 thousand (December 31, 2019: AZN 1,756 thousand) of these loans are awaiting the approval of the Azerbaijan Mortgage Fund to be included as part of this program and therefore for further funding under the borrowing agreement to be provided to the Group.

As at December 31, 2020, accrued interest income included in loans and advances to customers amounted to AZN 17,550 thousand (December 31, 2019: AZN 12,660 thousand).

The following tables show the summary of reconciliations from the opening to the closing balances of gross loans and the loss allowance of loans to customers for the year ended December 31, 2020:

| | | | 2020 | | |
|---|---|---|---|---|---|
| **Gross carrying value** | **Stage 1** | **Stage 2** | **Stage 3** | **POCI** | **Total** |
| **As at January 1, 2020** | **363,518** | **38,924** | **97,056** | **9,870** | **509,368** |
| Transfer to Stage 1 | 456 | (456) | - | - | - |
| Transfer to Stage 2 | (14,887) | 15,243 | (356) | - | - |
| Transfer to Stage 3 | (8,520) | (3,752) | 12,272 | - | - |
| New assets originated or purchased | 370,432 | 22,772 | 19,589 | - | 412,793 |
| Loans repaid | (301,382) | (22,924) | (12,449) | (1,888) | (338,643) |
| Recovery of loans written off | - | - | 5,167 | - | 5,167 |
| Amounts written off | - | - | (25,859) | - | (25,859) |
| Foreign exchange and other movements | 59 | 678 | 108 | 1,831 | 2,676 |
| **At December 31, 2020** | **409,676** | **50,485** | **95,528** | **9,813** | **565,502** |

| | | | 2020 | | |
|---|---|---|---|---|---|
| **Allowance for ECL of loans to customers** | **Stage 1** | **Stage 2** | **Stage 3** | **POCI** | **Total** |
| **At January 1, 2020** | **(4,442)** | **(3,005)** | **(47,363)** | - | **(54,810)** |
| Transfer to Stage 1 | (8) | 8 | - | - | - |
| Transfer to Stage 2 | 230 | (369) | 139 | - | - |
| Transfer to Stage 3 | 186 | 250 | (436) | - | - |
| Net remeasurement | 191 | (2,432) | (18,927) | - | (21,168) |
| New assets originated or purchased | (1,810) | (1,371) | (3,438) | - | (6,619) |
| Recovery of loans written off | - | - | (5,167) | - | (5,167) |
| Amounts written off | - | - | 25,859 | - | 25,859 |
| Unwinding of discount | - | - | (2,316) | - | (2,316) |
| **At December 31, 2020** | **(5,653)** | **(6,919)** | **(51,649)** | - | **(64,221)** |

The following tables show the summary of reconciliations from the opening to the closing balances of gross loans and the loss allowance of loans to customers for the year ended December 31, 2019:

| | | | 2019 | | |
|---|---|---|---|---|---|
| **Gross carrying value** | **Stage 1** | **Stage 2** | **Stage 3** | **POCI** | **Total** |
| **As at January 1, 2019** | **311,618** | **39,259** | **116,571** | - | **467,448** |
| Transfer to Stage 1 | 1,236 | (900) | (336) | - | - |
| Transfer to Stage 2 | (15,096) | 17,390 | (2,294) | - | - |
| Transfer to Stage 3 | (3,129) | (8,847) | 11,976 | - | - |
| New assets originated or purchased | 356,811 | 6,088 | 3,732 | 9,870 | 376,501 |
| Loans repaid | (287,757) | (14,052) | (67,604) | - | (369,413) |
| Recovery of loans written off | - | - | 39,699 | - | 39,699 |
| Amounts written off | - | - | (4,678) | - | (4,678) |
| Foreign exchange and other movements | (165) | (14) | (10) | - | (189) |
| **At December 31, 2019** | **363,518** | **38,924** | **97,056** | **9,870** | **509,368** |

| | | | 2019 | | |
|---|---|---|---|---|---|
| **Allowance for ECL of loans to customers** | **Stage 1** | **Stage 2** | **Stage 3** | **POCI** | **Total** |
| **At January 1, 2019** | **(4,742)** | **(3,516)** | **(70,369)** | - | **(78,627)** |
| Transfer to Stage 1 | (47) | 33 | 14 | - | - |
| Transfer to Stage 2 | 425 | (1,705) | 1,280 | - | - |
| Transfer to Stage 3 | 30 | 1,304 | (1,334) | - | - |
| Net remeasurement | 3,429 | 1,423 | 59,209 | - | 64,061 |
| New assets originated or purchased | (3,537) | (544) | (1,142) | - | (5,223) |
| Recovery of loans written off | - | - | (39,699) | - | (39,699) |
| Amounts written off | - | - | 4,678 | - | 4,678 |
| **At December 31, 2019** | **(4,442)** | **(3,005)** | **(47,363)** | - | **(54,810)** |

An analysis of changes in the gross carrying value and corresponding ECL in relation to business loans during the year ended December 31, 2020 is as follows:

| | | 2020 | | |
|---|---|---|---|---|
| **Gross carrying value** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **As at January 1, 2020** | **83,408** | **25,509** | **64,806** | **173,723** |
| Transfer to Stage 1 | - | - | - | - |
| Transfer to Stage 2 | (4,459) | 4,459 | - | - |
| Transfer to Stage 3 | (3,332) | (1,685) | 5,017 | - |
| New assets originated or purchased | 129,011 | 2,220 | 6,840 | 138,071 |
| Loans repaid | (106,860) | (16,142) | (5,161) | (128,163) |
| Recovery of loans written off | - | - | 131 | 131 |
| Amounts written off | - | - | (4,268) | (4,268) |
| Foreign exchange and other movements | 58 | 678 | 102 | 838 |
| **At December 31, 2020** | **97,826** | **15,039** | **67,467** | **180,332** |

| | | 2020 | | |
|---|---|---|---|---|
| **Allowance for ECL of loans to customers** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **At January 1, 2020** | **(2,640)** | **(2,016)** | **(26,600)** | **(31,256)** |
| Transfer to Stage 1 | - | - | - | - |
| Transfer to Stage 2 | 1 | (1) | - | - |
| Transfer to Stage 3 | 143 | 35 | (178) | - |
| Net remeasurement | 1,720 | 1,587 | (10,183) | (6,876) |
| New assets originated or purchased | (784) | (39) | (507) | (1,330) |
| Recovery of loans written off | - | - | (131) | (131) |
| Amounts written off | - | - | 4,268 | 4,268 |
| Unwinding of discount | - | - | (309) | (309) |
| **At December 31, 2020** | **(1,560)** | **(434)** | **(33,640)** | **(35,634)** |

An analysis of changes in the gross carrying value and corresponding ECL in relation to business loans during the year ended December 31, 2019 is as follows:

| | 2019 | | | |
|---|---|---|---|---|
| **Gross carrying value** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **As at January 1, 2019** | **71,081** | **18,657** | **65,121** | **154,859** |
| Transfer to Stage 1 | 13 | (13) | - | - |
| Transfer to Stage 2 | (12,322) | 12,322 | - | - |
| Transfer to Stage 3 | (300) | (5,128) | 5,428 | - |
| New assets originated or purchased | 91,394 | 2,468 | 361 | 94,223 |
| Loans repaid | (66,293) | (2,783) | (6,211) | (75,287) |
| Recovery of loans written off | - | - | 117 | 117 |
| Amounts written off | - | - | - | - |
| Foreign exchange and other movements | (165) | (14) | (10) | (189) |
| **At December 31, 2019** | **83,408** | **25,509** | **64,806** | **173,723** |

| | 2019 | | | |
|---|---|---|---|---|
| **Allowance for ECL of loans to customers** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **At January 1, 2019** | **(2,810)** | **(1,979)** | **(30,277)** | **(35,066)** |
| Transfer to Stage 1 | - | - | - | - |
| Transfer to Stage 2 | 402 | (402) | - | - |
| Transfer to Stage 3 | 6 | 880 | (886) | - |
| Net remeasurement | 1,969 | (445) | 4,765 | 6,289 |
| New assets originated or purchased | (2,207) | (70) | (85) | (2,362) |
| Recovery of loans written off | - | - | (117) | (117) |
| Amounts written off | - | - | - | - |
| **At December 31, 2019** | **(2,640)** | **(2,016)** | **(26,600)** | **(31,256)** |

An analysis of changes in the gross carrying value and corresponding ECL in relation to cash consumer loans during the year ended December 31, 2020 is as follows:

| | 2020 | | | | |
|---|---|---|---|---|---|
| **Gross carrying value** | **Stage 1** | **Stage 2** | **Stage 3** | **POCI** | **Total** |
| **As at January 1, 2020** | **116,475** | **8,659** | **19,100** | **9,870** | **154,104** |
| Transfer to Stage 1 | 115 | (115) | - | - | - |
| Transfer to Stage 2 | (4,588) | 4,826 | (238) | - | - |
| Transfer to Stage 3 | (2,012) | (1,565) | 3,577 | - | - |
| New assets originated or purchased | 129,433 | 16,356 | 11,252 | - | 157,041 |
| Loans repaid | (106,515) | (5,976) | (6,404) | (1,888) | (120,783) |
| Recovery of loans written off | - | - | 3,283 | - | 3,283 |
| Amounts written off | - | - | (12,259) | - | (12,259) |
| Foreign exchange and other movements | 1 | - | 3 | 1,831 | 1,835 |
| **At December 31, 2020** | **132,909** | **22,185** | **18,314** | **9,813** | **183,221** |

| | 2020 | | | | |
|---|---|---|---|---|---|
| **Allowance for ECL of loans to customers** | **Stage 1** | **Stage 2** | **Stage 3** | **POCI** | **Total** |
| **At January 1, 2020** | **(947)** | **(810)** | **(11,707)** | - | **(13,464)** |
| Transfer to Stage 1 | (1) | 1 | - | - | - |
| Transfer to Stage 2 | 122 | (245) | 123 | - | - |
| Transfer to Stage 3 | 24 | 192 | (216) | - | - |
| Net remeasurement | (1,077) | (3,173) | (6,369) | - | (10,619) |
| New assets originated or purchased | (359) | (365) | (1,741) | - | (2,465) |
| Recovery of loans written off | - | - | (3,283) | - | (3,283) |
| Amounts written off | - | - | 12,259 | - | 12,259 |
| Unwinding of discount | - | - | (1,350) | - | (1,350) |
| **At December 31, 2020** | **(2,238)** | **(4,400)** | **(12,284)** | - | **(18,922)** |

An analysis of changes in the gross carrying value and corresponding ECL in relation to cash consumer loans during the year ended December 31, 2019 is as follows:

| | | | 2019 | | |
|---|---|---|---|---|---|
| **Gross carrying value** | **Stage 1** | **Stage 2** | **Stage 3** | **POCI** | **Total** |
| **As at January 1, 2019** | **98,117** | **16,330** | **25,712** | - | **140,159** |
| Transfer to Stage 1 | 652 | (372) | (280) | - | - |
| Transfer to Stage 2 | (692) | 2,630 | (1,938) | - | - |
| Transfer to Stage 3 | (1,234) | (3,206) | 4,440 | - | - |
| New assets originated or purchased | 147,966 | 2,641 | 3,123 | 9,870 | 163,600 |
| Loans repaid | (128,334) | (9,364) | (44,962) | - | (182,660) |
| Recovery of loans written off | - | - | 35,753 | - | 35,753 |
| Amounts written off | - | - | (2,748) | - | (2,748) |
| **At December 31, 2019** | **116,475** | **8,659** | **19,100** | **9,870** | **154,104** |

| | | | 2019 | | |
|---|---|---|---|---|---|
| **Allowance for ECL of loans to customers** | **Stage 1** | **Stage 2** | **Stage 3** | **POCI** | **Total** |
| **At January 1, 2019** | **(554)** | **(1,374)** | **(18,843)** | - | **(20,771)** |
| Transfer to Stage 1 | (42) | 28 | 14 | - | - |
| Transfer to Stage 2 | 5 | (1,139) | 1,134 | - | - |
| Transfer to Stage 3 | 8 | 392 | (400) | - | - |
| Net remeasurement | 472 | 1,648 | 40,313 | - | 42,433 |
| New assets originated or purchased | (836) | (365) | (920) | - | (2,121) |
| Recovery of loans written off | - | - | (35,753) | - | (35,753) |
| Amounts written off | - | - | 2,748 | - | 2,748 |
| **At December 31, 2019** | **(947)** | **(810)** | **(11,707)** | - | **(13,464)** |

An analysis of changes in the gross carrying value and corresponding ECL in relation to credit cards loans during the year ended December 31, 2020 is as follows:

| | | 2020 | | |
|---|---|---|---|---|
| **Gross carrying value** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **As at January 1, 2020** | **75,507** | **2,991** | **4,818** | **83,316** |
| Transfer to Stage 1 | 231 | (231) | - | - |
| Transfer to Stage 2 | (4,789) | 4,834 | (45) | - |
| Transfer to Stage 3 | (1,208) | (156) | 1,364 | - |
| New assets originated or purchased | 54,179 | 3,285 | 569 | 58,033 |
| Loans repaid | (37,862) | (342) | 78 | (38,126) |
| Recovery of loans written off | - | - | 656 | 656 |
| Amounts written off | - | - | (4,461) | (4,461) |
| Foreign exchange and other movements | - | - | 3 | 3 |
| **At December 31, 2020** | **86,058** | **10,381** | **2,982** | **99,421** |

| | | 2020 | | |
|---|---|---|---|---|
| **Allowance for ECL of loans to customers** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **At January 1, 2020** | **(686)** | **(127)** | **(3,463)** | **(4,276)** |
| Transfer to Stage 1 | (5) | 5 | - | - |
| Transfer to Stage 2 | 104 | (119) | 15 | - |
| Transfer to Stage 3 | 12 | 8 | (20) | - |
| Net remeasurement | (385) | (848) | (1,456) | (2,689) |
| New assets originated or purchased | (613) | (918) | (446) | (1,977) |
| Recovery of loans written off | - | - | (656) | (656) |
| Amounts written off | - | - | 4,461 | 4,461 |
| Unwinding of discount | - | - | (448) | (448) |
| **At December 31, 2020** | **(1,573)** | **(1,999)** | **(2,013)** | **(5,585)** |

An analysis of changes in the gross carrying value and corresponding ECL in relation to credit cards loans during the year ended December 31, 2019 is as follows:

| | 2019 | | | |
|---|---|---|---|---|
| **Gross carrying value** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **As at January 1, 2019** | **63,289** | **2,555** | **9,612** | **75,456** |
| Transfer to Stage 1 | 137 | (136) | (1) | - |
| Transfer to Stage 2 | (1,482) | 1,736 | (254) | - |
| Transfer to Stage 3 | (847) | (229) | 1,076 | - |
| New assets originated or purchased | 57,426 | 547 | 160 | 58,133 |
| Loans repaid | (43,016) | (1,482) | (6,564) | (51,062) |
| Recovery of loans written off | - | - | 1,541 | 1,541 |
| Amounts written off | - | - | (752) | (752) |
| **At December 31, 2019** | **75,507** | **2,991** | **4,818** | **83,316** |

| | 2019 | | | |
|---|---|---|---|---|
| **Allowance for ECL of loans to customers** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **At January 1, 2019** | **(524)** | **(109)** | **(7,991)** | **(8,624)** |
| Transfer to Stage 1 | (4) | 4 | - | - |
| Transfer to Stage 2 | 13 | (144) | 131 | - |
| Transfer to Stage 3 | 8 | 9 | (17) | - |
| Net remeasurement | 163 | 180 | 5,307 | 5,650 |
| New assets originated or purchased | (342) | (67) | (104) | (513) |
| Recovery of loans written off | - | - | (1,541) | (1,541) |
| Amounts written off | - | - | 752 | 752 |
| **At December 31, 2019** | **(686)** | **(127)** | **(3,463)** | **(4,276)** |

An analysis of changes in the gross carrying value and corresponding ECL in relation to purchase of apartments and mortgages loans during the year ended December 31, 2020 is as follows:

| | 2020 | | | |
|---|---|---|---|---|
| **Gross carrying value** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **As at January 1, 2020** | **45,260** | **1,625** | **2,207** | **49,092** |
| Transfer to Stage 1 | 105 | (105) | - | - |
| Transfer to Stage 2 | (366) | 436 | (70) | - |
| Transfer to Stage 3 | (497) | (316) | 813 | - |
| New assets originated or purchased | 7,165 | 185 | - | 7,350 |
| Loans repaid | (4,050) | (209) | (729) | (4,988) |
| Recovery of loans written off | - | - | 169 | 169 |
| Amounts written off | - | - | (134) | (134) |
| **At December 31, 2020** | **47,617** | **1,616** | **2,256** | **51,489** |

| | 2020 | | | |
|---|---|---|---|---|
| **Allowance for ECL of loans to customers** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **At January 1, 2020** | **(3)** | **(48)** | **(460)** | **(511)** |
| Transfer to Stage 1 | (2) | 2 | - | - |
| Transfer to Stage 2 | - | - | - | - |
| Transfer to Stage 3 | 1 | 12 | (13) | - |
| Net remeasurement | 4 | 22 | 241 | 267 |
| New assets originated or purchased | - | (24) | (62) | (86) |
| Recovery of loans written off | - | - | (169) | (169) |
| Amounts written off | - | - | 134 | 134 |
| **At December 31, 2020** | **-** | **(36)** | **(329)** | **(365)** |

An analysis of changes in the gross carrying value and corresponding ECL in relation to purchase of apartments and mortgages loans during the year ended December 31, 2019 is as follows:

| | 2019 | | | |
|---|---|---|---|---|
| **Gross carrying value** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **As at January 1, 2019** | **50,907** | **1,513** | **1,756** | **54,176** |
| Transfer to Stage 1 | 431 | (376) | (55) | - |
| Transfer to Stage 2 | (495) | 584 | (89) | - |
| Transfer to Stage 3 | (676) | (231) | 907 | - |
| New assets originated or purchased | 3,063 | 414 | 74 | 3,551 |
| Loans repaid | (7,970) | (279) | (406) | (8,655) |
| Recovery of loans written off | - | - | 20 | 20 |
| Amounts written off | - | - | - | - |
| Foreign exchange and other movements | - | - | - | - |
| **At December 31, 2019** | **45,260** | **1,625** | **2,207** | **49,092** |

| | 2019 | | | |
|---|---|---|---|---|
| **Allowance for ECL of loans to customers** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **At January 1, 2019** | **(2)** | **(19)** | **(392)** | **(413)** |
| Transfer to Stage 1 | - | - | - | - |
| Transfer to Stage 2 | - | (9) | 9 | - |
| Transfer to Stage 3 | 3 | 14 | (17) | - |
| Net remeasurement | (2) | 8 | (15) | (9) |
| New assets originated or purchased | (2) | (42) | (25) | (69) |
| Recovery of loans written off | - | - | (20) | (20) |
| Amounts written off | - | - | - | - |
| **At December 31, 2019** | **(3)** | **(48)** | **(460)** | **(511)** |

An analysis of changes in the gross carrying value and corresponding ECL in relation to micro loans during the year ended December 31, 2020 is as follows:

| | 2020 | | | |
|---|---|---|---|---|
| **Gross carrying value** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **As at January 1, 2020** | **42,823** | **86** | **5,355** | **48,264** |
| Transfer to Stage 1 | 5 | (5) | - | - |
| Transfer to Stage 2 | (685) | 688 | (3) | - |
| Transfer to Stage 3 | (1,471) | (30) | 1,501 | - |
| New assets originated or purchased | 50,644 | 726 | 928 | 52,298 |
| Loans repaid | (46,069) | (201) | (176) | (46,446) |
| Recovery of loans written off | - | - | 835 | 835 |
| Amounts written off | - | - | (4,556) | (4,556) |
| **At December 31, 2020** | **45,247** | **1,264** | **3,884** | **50,395** |

| | 2020 | | | |
|---|---|---|---|---|
| **Allowance for ECL of loans to customers** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **At January 1, 2020** | **(166)** | **(4)** | **(4,716)** | **(4,886)** |
| Transfer to Stage 1 | - | - | - | - |
| Transfer to Stage 2 | 3 | (4) | 1 | - |
| Transfer to Stage 3 | 6 | 3 | (9) | - |
| Net remeasurement | (71) | (20) | (951) | (1,042) |
| New assets originated or purchased | (54) | (25) | (682) | (761) |
| Recovery of loans written off | - | - | (835) | (835) |
| Amounts written off | - | - | 4,556 | 4,556 |
| Unwinding of discount | - | - | (209) | (209) |
| **At December 31, 2020** | **(282)** | **(50)** | **(2,845)** | **(3,177)** |

An analysis of changes in the gross carrying value and corresponding ECL in relation to micro loans during the year ended December 31, 2019 is as follows:

| | 2019 | | | |
|---|---|---|---|---|
| **Gross carrying value** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **As at January 1, 2019** | **28,103** | **158** | **13,398** | **41,659** |
| Transfer to Stage 1 | 3 | (3) | - | - |
| Transfer to Stage 2 | (68) | 77 | (9) | - |
| Transfer to Stage 3 | (72) | (37) | 109 | - |
| New assets originated or purchased | 56,962 | 18 | 14 | 56,994 |
| Loans repaid | (42,105) | (127) | (8,565) | (50,797) |
| Recovery of loans written off | - | - | 1,586 | 1,586 |
| Amounts written off | - | - | (1,178) | (1,178) |
| **At December 31, 2019** | **42,823** | **86** | **5,355** | **48,264** |

| | 2019 | | | |
|---|---|---|---|---|
| **Allowance for ECL of loans to customers** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **At January 1, 2019** | **(852)** | **(35)** | **(12,336)** | **(13,223)** |
| Transfer to Stage 1 | (1) | 1 | - | - |
| Transfer to Stage 2 | 5 | (11) | 6 | - |
| Transfer to Stage 3 | 5 | 9 | (14) | - |
| Net remeasurement | 827 | 32 | 8,044 | 8,903 |
| New assets originated or purchased | (150) | - | (8) | (158) |
| Recovery of loans written off | - | - | (1,586) | (1,586) |
| Amounts written off | - | - | 1,178 | 1,178 |
| **At December 31, 2019** | **(166)** | **(4)** | **(4,716)** | **(4,886)** |

An analysis of changes in the gross carrying value and corresponding ECL in relation to purchase of motor vehicles loans during the year ended December 31, 2020 is as follows:

| | 2020 | | | |
|---|---|---|---|---|
| **Gross carrying value** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **As at January 1, 2020** | **45** | **54** | **770** | **869** |
| Transfer to Stage 1 | - | - | - | - |
| Transfer to Stage 2 | - | - | - | - |
| Transfer to Stage 3 | - | - | - | - |
| New assets originated or purchased | - | - | - | - |
| Loans repaid | (26) | (54) | (57) | (137) |
| Recovery of loans written off | - | - | 93 | 93 |
| Amounts written off | - | - | (181) | (181) |
| **At December 31, 2020** | **19** | **-** | **625** | **644** |

| | 2020 | | | |
|---|---|---|---|---|
| **Allowance for ECL of loans to customers** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **At January 1, 2020** | - | - | **(417)** | **(417)** |
| Transfer to Stage 1 | - | - | - | - |
| Transfer to Stage 2 | - | - | - | - |
| Transfer to Stage 3 | - | - | - | - |
| Net remeasurement | - | - | (209) | (209) |
| New assets originated or purchased | - | - | - | - |
| Recovery of loans written off | - | - | (93) | (93) |
| Amounts written off | - | - | 181 | 181 |
| **At December 31, 2020** | - | - | **(538)** | **(538)** |

An analysis of changes in the gross carrying value and corresponding ECL in relation to purchase of motor vehicles loans during the year ended December 31, 2019 is as follows:

| | | 2019 | | |
|---|---|---|---|---|
| **Gross carrying value** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **As at January 1, 2019** | **121** | **46** | **972** | **1,139** |
| Transfer to Stage 1 | - | - | - | - |
| Transfer to Stage 2 | (37) | 41 | (4) | - |
| Transfer to Stage 3 | - | (16) | 16 | - |
| New assets originated or purchased | - | - | - | - |
| Loans repaid | (39) | (17) | (896) | (952) |
| Recovery of loans written off | - | - | 682 | 682 |
| Amounts written off | - | - | - | - |
| Foreign exchange and other movements | - | - | - | - |
| **At December 31, 2019** | **45** | **54** | **770** | **869** |

| | | 2019 | | |
|---|---|---|---|---|
| **Allowance for ECL of loans to customers** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **At January 1, 2019** | - | - | **(530)** | **(530)** |
| Transfer to Stage 1 | - | - | - | - |
| Transfer to Stage 2 | - | - | - | - |
| Transfer to Stage 3 | - | - | - | - |
| Net remeasurement | - | - | 795 | 795 |
| New assets originated or purchased | - | - | - | - |
| Recovery of loans written off | - | - | (682) | (682) |
| Amounts written off | - | - | - | - |
| **At December 31, 2019** | - | - | **(417)** | **(417)** |

Analysis by credit quality of loans and advances to customers outstanding as at December 31, 2020 is as follows:

| | Business loans | Cash consumer loans | Credit cards | Purchase of apartments and mortgages | Micro loans | Purchase of motor vehicles | Total |
|---|---|---|---|---|---|---|---|
| Stage 1 (12-months ECL) | 97,826 | 132,909 | 86,058 | 47,617 | 45,247 | 19 | 409,676 |
| Stage 2 (lifetime ECL) | 15,039 | 22,185 | 10,381 | 1,616 | 1,264 | - | 50,485 |
| - not past due | 9,960 | 16,735 | 6,391 | 964 | 294 | - | 34,344 |
| - less than 30 days overdue | 1,062 | 3,822 | 2,777 | 158 | 708 | - | 8,527 |
| - 30 to 90 days overdue | 4,017 | 1,628 | 1,213 | 494 | 262 | - | 7,614 |
| Stage 3 (lifetime ECL): | 67,467 | 18,314 | 2,982 | 2,256 | 3,884 | 625 | 95,528 |
| - not past due | 16,549 | 3,883 | 280 | 304 | 41 | - | 21,057 |
| - less than 30 days overdue | 12 | 2,333 | 87 | 65 | 10 | - | 2,507 |
| - 30 to 90 days overdue | 2,260 | 4,773 | 1,258 | 728 | 962 | - | 9,981 |
| - over 90 days overdue | 48,646 | 7,325 | 1,357 | 1,159 | 2,871 | 625 | 61,983 |
| POCI | - | 9,813 | - | - | - | - | 9,813 |
| **Total gross loans and advances to customers** | **180,332** | **183,221** | **99,421** | **51,489** | **50,395** | **644** | **565,502** |
| Less: Credit loss allowance | (35,634) | (18,922) | (5,585) | (365) | (3,177) | (538) | (64,221) |
| **Total net loans and advances to customers** | **144,698** | **164,299** | **93,836** | **51,124** | **47,218** | **106** | **501,281** |

Analysis by credit quality of loans outstanding as at December 31, 2019 is as follows:

| | Business loans | Cash consumer loans | Credit cards | Purchase of apartments and mortgages | Micro loans | Purchase of motor vehicles | Total |
|---|---|---|---|---|---|---|---|
| Stage 1 (12-months ECL) | 83,408 | 116,475 | 75,507 | 45,260 | 42,823 | 45 | 363,518 |
| Stage 2 (lifetime ECL) | 25,509 | 8,659 | 2,991 | 1,625 | 86 | 54 | 38,924 |
| - not past due | 11,739 | 7,262 | 1,183 | 1,259 | 22 | 8 | 21,473 |
| - less than 30 days overdue | 13,693 | 1,377 | 1,782 | 366 | 64 | - | 17,282 |
| - 30 to 90 days overdue | 77 | 20 | 26 | - | - | 46 | 169 |
| Stage 3 (lifetime ECL): | 64,806 | 19,100 | 4,818 | 2,207 | 5,355 | 770 | 97,056 |
| - not past due | 11,652 | 3,152 | 435 | 760 | 18 | - | 16,017 |
| - less than 30 days overdue | 148 | 1,360 | 107 | 96 | 8 | - | 1,719 |
| - 30 to 90 days overdue | 5,015 | 1,554 | 428 | 170 | 22 | 11 | 7,200 |
| - over 90 days overdue | 47,991 | 13,034 | 3,848 | 1,181 | 5,307 | 759 | 72,120 |
| POCI | - | 9,870 | - | - | - | - | 9,870 |
| **Total gross loans and advances to customers** | **173,723** | **154,104** | **83,316** | **49,092** | **48,264** | **869** | **509,368** |
| Less: Credit loss allowance | (31,256) | (13,464) | (4,276) | (511) | (4,886) | (417) | (54,810) |
| **Total net loans and advances to customers** | **142,467** | **140,640** | **79,040** | **48,581** | **43,378** | **452** | **454,558** |

The fair value of collateral in respect of Stage 3 loans and advances to customers at December 31, 2020 was as follows:

| | Business loans | Cash consumer loans | Purchase of apartments and mortgages | Credit cards | Micro loans | Purchase of motor vehicles | Total |
|---|---|---|---|---|---|---|---|
| - real estate | 35,409 | 574 | 2,022 | - | 496 | - | 38,501 |
| - personal transport | 158 | 130 | - | - | - | 508 | 796 |
| - moveable property | 155 | - | - | - | 1,625 | - | 1,780 |
| - bank deposits | - | 266 | - | 59 | - | - | 325 |
| - other assets | 249 | - | - | - | 1 | - | 250 |
| **Total** | **35,971** | **970** | **2,022** | **59** | **2,122** | **508** | **41,652** |

The Group considers fair value of realized collaterals for loss given default rate determination during collective impairment assessment of loan portfolio.

Fair value of collateral in respect of Stage 3 loans and advances to customers at December 31, 2019 was as follows:

| | Business loans | Cash consumer loans | Purchase of apartments and mortgages | Credit cards | Micro loans | Purchase of motor vehicles | Total |
|---|---|---|---|---|---|---|---|
| - real estate | 39,099 | 687 | 1,681 | - | 154 | - | 41,621 |
| - personal transport | 143 | - | - | - | - | 547 | 690 |
| - moveable property | 154 | 44 | - | - | 4,487 | - | 4,685 |
| - bank deposits | - | 317 | - | 61 | - | - | 378 |
| - other assets | 193 | - | - | - | 7 | - | 200 |
| **Total** | **39,589** | **1,048** | **1,681** | **61** | **4,648** | **547** | **47,574** |

Currency, interest rate, geographical and liquidity analysis of loans and advances to customers are disclosed in Note 29. Refer to Note 31 for the estimated fair value of each class of amounts of loans and advances to customers. Information on related party balances is disclosed in Note 32.

## 10. INVESTMENT SECURITIES

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| Notes issued by the Ministry of Finance of the Republic of Azerbaijan | 33,997 | 45,065 |
| Corporate debt securities | 18,209 | 7,849 |
| Corporate shares – unquoted | 750 | 750 |
| Government securities of other countries | - | 31,607 |
| Less: Allowance for expected credit loss | (90) | (535) |
| **Total investment securities** | **52,866** | **84,736** |

As at December 31, 2020, accrued interest income included in investment securities amounted to AZN 644 thousand (December 31, 2019: AZN 1,179 thousand).

Details of corporate unquoted shares designated as FVOCI are:

| Name | Nature of business | Country of registration | % of ownership | December 31, 2020 | December 31, 2019 |
|---|---|---|---|---|---|
| "Milli Kart" LLC | Card processing | The Republic of Azerbaijan | 8.0 | 400 | 400 |
| Azerbaijan Credit Bureau | Data processing | The Republic of Azerbaijan | 12.5 | 250 | 250 |
| Baku Stock Exchange | Stock exchange | The Republic of Azerbaijan | 6.0 | 60 | 60 |
| S.W.I.F.T SCRL | Telecommunication | The Republic of Azerbaijan | 0.5 | 43 | 40 |
| **Total investment securities** | | | | **753** | **750** |

An analysis of changes in gross carrying value and corresponding ECL allowance on investment securities during the year ended December 31, 2020 is as follows:

| | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **Gross carrying value as at January 1, 2020** | **84,521** | - | - | **84,521** |
| Net change in carrying value | (32,315) | - | - | (32,315) |
| **As at December 31, 2020** | **52,206** | - | - | **52,206** |

| | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **ECL allowance as at January 1, 2020** | **(535)** | - | - | **(535)** |
| Net change in ECL value | 445 | - | - | 445 |
| **As at December 31, 2020** | **(90)** | - | - | **(90)** |

An analysis of changes in gross carrying value and corresponding ECL allowance on investment securities during the year ended December 31, 2019 is as follows:

| | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **Gross carrying value as at January 1, 2019** | **6,055** | - | - | **6,055** |
| Net change in carrying value | 78,466 | - | - | 78,466 |
| **As at December 31, 2019** | **84,521** | - | - | **84,521** |

| | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **ECL allowance as at January 1, 2019** | **(165)** | **-** | **-** | **(165)** |
| Net change in ECL value | (370) | - | - | (370) |
| **As at December 31, 2019** | **(535)** | - | - | **(535)** |

There were no transfers between stages in gross carrying values and ECL allowance on investment securities during the years ended December 31, 2020 and 2019.

The Group recognized gain on fair value change of debt investment securities in the amount of AZN 137 thousand during the year ended December 31, 2020 (2019: 193 thousand).

## 11. PREMISES, EQUIPMENT AND INTANGIBLE ASSETS

| | Land and buildings | Office and computer equipment | Furniture, fixture and other equipment | Construction in progress | Leasehold improvements | Total premises and equipment | Intangible assets | Total |
|---|---|---|---|---|---|---|---|---|
| **Net book value as at January 1, 2019** | **39,983** | **5,266** | **6,578** | **405** | **2,551** | **54,783** | **12,548** | **67,331** |
| Additions | 4,720 | 1,676 | 4,895 | 2,683 | 464 | 14,438 | 3,914 | 18,352 |
| Transfers in/(out) | 2,372 | - | - | (2,372) | - | - | - | - |
| Disposals | - | (2,430) | (2,844) | (163) | (121) | (5,558) | (1,023) | (6,581) |
| Accumulated depreciation of disposals | - | 2,226 | 2,059 | - | 102 | 4,387 | 1,007 | 5,394 |
| Depreciation and amortization charge | (1,689) | (849) | (855) | - | (502) | (3,895) | (1,912) | (5,807) |
| Cost as at December 31, 2019 | 53,758 | 12,136 | 18,876 | 553 | 6,477 | 91,800 | 21,096 | 112,896 |
| Accumulated depreciation/amortization as at December 31, 2019 | (8,372) | (6,247) | (9,043) | - | (3,983) | (27,645) | (6,562) | (34,207) |
| **Net book value as at December 31, 2019** | **45,386** | **5,889** | **9,833** | **553** | **2,494** | **64,155** | **14,534** | **78,689** |
| Additions | 1,581 | 4,185 | 2,245 | 2,228 | 2,706 | 12,945 | 2,936 | 15,881 |
| Transfers in/(out) | 2,205 | - | - | (2,205) | - | - | - | - |
| Disposals | (382) | (15) | (689) | (2) | (517) | (1,605) | - | (1,605) |
| Accumulated depreciation of disposals | 53 | 13 | 475 | - | 517 | 1,058 | - | 1,058 |
| Depreciation and amortization charge | (1,754) | (1,108) | (1,033) | - | (555) | (4,450) | (2,157) | (6,607) |
| Cost as at December 31, 2020 | 57,162 | 16,306 | 20,432 | 574 | 8,666 | 103,140 | 24,032 | 127,172 |
| Accumulated depreciation/amortization as at December 31, 2020 | (10,073) | (7,342) | (9,601) | - | (4,021) | (31,037) | (8,719) | (39,756) |
| **Net book value as at December 31, 2020** | **47,089** | **8,964** | **10,831** | **574** | **4,645** | **72,103** | **15,313** | **87,416** |

Construction in progress consists of construction and refurbishment of branch premises. Upon completion, assets are transferred to land and buildings.

Intangible assets include software and licenses. Additions to intangible assets during the year ended December 31, 2020 included security software, corporate internet banking software, bank accounting software modules and other licenses in the amount of AZN 2,936 thousand (2019: security software, corporate internet banking software, bank accounting software modules and other licenses in the amount of AZN 3,914 thousand).

As at December 31, 2020 included in the closing balance of premises and equipment were fully depreciated assets still in use with the total initial cost of AZN 1,777 thousand (December 31, 2019: AZN 1,526 thousand).

Included in the carrying amount of the land and buildings category of premises and equipment the amount of AZN 3,880 thousand is the right-of-use assets for 21 branches area as at December 31, 2020 (December 31, 2019: AZN 3,666 thousand).

## 12. OTHER FINANCIAL ASSETS

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| Receivables from online payments | 19,366 | 11,001 |
| Receivables for credit and debit card transactions | 2,731 | 2,148 |
| Brokerage operations | 2,142 | 4,867 |
| Settlements on money transfer operations | 225 | 1,841 |
| Others | 500 | 682 |
| | **24,964** | **20,539** |

Receivables for credit and debit card transactions represent net funds receivable from other local banks for cash withdrawn from the Bank's ATMs by customers of other banks.

## 13. OTHER ASSETS

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| Repossessed collaterals | 15,206 | 14,876 |
| Investment property | 3,924 | 1,265 |
| Prepayment for equipment | 3,507 | 1,829 |
| Prepaid expenses | 1,113 | 1,496 |
| Others | 873 | 586 |
| | **24,623** | **20,052** |
| Less: Provision for impairment of repossessed collaterals | (4,397) | (3,241) |
| **Total other assets** | **20,226** | **16,811** |

Movements in provision for impairment of repossessed collaterals during the years ended December 31, 2020 and 2019 are as follows:

| | 2020 | 2019 |
|---|---|---|
| Balance at January 1 | 3,241 | 1,784 |
| Increase in provision for impairment losses | 1,646 | 1,543 |
| Derecognized as a result of sale of assets | (490) | (86) |
| **Balance at December 31** | **4,397** | **3,241** |

As at December 31, 2020 and 2019 repossessed collaterals mainly represent immovable properties confiscated by the Group for loans and lease receivables determined to be credit impaired. During the year ended December 31, 2020 the Group recognized impairment loss on repossessed collaterals in the amount of AZN 1,646 thousand (2019: AZN 1,543 thousand).

The following table provides the reconciliation between the carrying amounts of investment property at the beginning and end of the period:

| | **Investment property** |
|---|---|
| **Cost** | |
| Balance at January 1, 2019 | 1,285 |
| **Balance at December 31, 2019** | **1,285** |
| | |
| **Depreciation** | |
| Balance at January 1, 2019 | - |
| Depreciation charge | (20) |
| **Balance at December 31, 2019** | **(20)** |
| **Carrying amount** | |
| **At December 31, 2019** | **1,265** |
| | |
| **Cost** | |
| Balance at January 1, 2020 | 1,285 |
| Additions | 2,677 |
| **Balance at December 31, 2020** | **3,962** |
| | |
| **Depreciation** | |
| Balance at January 1, 2020 | (20) |
| Depreciation charge | (18) |
| **Balance at December 31, 2020** | **(38)** |
| **Carrying amount** | |
| **At December 31, 2020** | **3,924** |

As at December 31, 2020, investment property was carried at cost. Management believes that the fair value of investment property as at December 31, 2020 approximated its carrying amount. The fair value of the Group's investment property is categorized into level 3 of the fair value hierarchy.

## 14. DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

| | **December 31, 2020** | **December 31, 2019** |
|---|---|---|
| Short-term placements of other banks and financial institutions | 19,761 | 29,521 |
| Correspondent accounts and overnight placement of other banks | 146 | 618 |
| **Total due to other banks** | **19,907** | **30,139** |

As at December 31, 2020 short-term placements of other banks and financial institutions included placement of one resident bank, bearing interest rates of 8% per annum with maturity to December 2021 (December 31, 2019: several placements of one resident bank, bearing interest rates of 7.9-9% per annum with maturities from February to December 2020).

As at December 31, 2020, accrued interest expenses included in amounts due to banks and other financial institutions amounted to AZN 157 thousand (December 31, 2019: AZN 21 thousand).

As at December 31, 2020 the Group has one bank (December 31, 2019: one bank) with outstanding balance exceeding 10% of total due to banks and other financial institutions. The gross value of this balance as at December 31, 2020 is AZN 10,041 thousand (December 31, 2019: AZN 29,521 thousand).

## 15. CUSTOMER ACCOUNTS

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| **Individuals** | | |
| - Term deposits | 337,937 | 341,877 |
| - Current/demand accounts | 110,531 | 90,490 |
| **Other legal entities** | | |
| - Term deposits | 9,969 | 12,457 |
| - Current/settlement accounts | 88,023 | 103,636 |
| **State and public organizations** | | |
| - Current/settlement accounts | 2,193 | 1,757 |
| **Total customer accounts** | **548,653** | **550,217** |

Economic sector concentrations within customer accounts are as follows:

| | December 31, 2020 | | December 31, 2019 | |
|---|---|---|---|---|
| | Amount | % | Amount | % |
| Individuals | 448,468 | 81.7 | 432,367 | 78.6 |
| Trade and services | 77,404 | 14.1 | 82,395 | 15.0 |
| Finance | 12,049 | 2.2 | 12,479 | 2.3 |
| Manufacturing | 4,927 | 0.9 | 4,892 | 0.9 |
| Agriculture | 1,305 | 0.2 | 1,749 | 0.3 |
| Construction | 1,113 | 0.2 | 1,217 | 0.2 |
| Energy and mining | 932 | 0.2 | 3,058 | 0.6 |
| Communication and transport | 926 | 0.2 | 10,488 | 1.9 |
| Other | 1,529 | 0.3 | 1,572 | 0.3 |
| **Total customer accounts** | **548,653** | **100.0** | **550,217** | **100.0** |

As at December 31, 2020 the Group had 41 customers (December 31, 2019: 39 customers) with balances above AZN 1,000 thousand. The aggregate balance of these customers was AZN 132,302 thousand (December 31, 2019: AZN 129,020 thousand) or 24% (December 31, 2019: 23%) of total customer accounts.

Included in customer accounts in the amount of AZN 5,255 thousand and AZN 5,603 thousand as at December 31, 2020 and 2019, respectively is accrued interest payable.

Included in customer accounts in the amount of AZN 19,094 thousand and AZN 29,020 thousand as at December 31, 2020 and 2019, respectively are deposits blocked as collateral for loans issued.

Included in customer accounts in the amount of AZN 388,619 thousand and AZN 421,462 thousand as at December 31, 2020 and 2019, respectively are deposits secured by the Azerbaijan Deposit Insurance Fund.

## 16. TERM BORROWINGS

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| Funds borrowed from resident banks and government organizations | 97,028 | 77,553 |
| **Total term borrowings** | **97,028** | **77,553** |

In February 2020 the Group received borrowings from CBAR in the amount of AZN 6,713 thousand with annual interest rate of 0.1% per annum for 5 years under the Decree. Previously in 2019 the Group received AZN 28,012 thousand for the same purposes. The interest rate of borrowings received in 2020 and 2019 from CBAR for the purpose of financing the restructured loans were of below market rate as at the date of origination, therefore the Group recognized gain in the amount of AZN 1,296 thousand at initial recognition of these borrowings (2019: AZN 6,271 thousand). The fair value of these borrowings at initial recognition was AZN 5,303 thousand (2019: AZN 27,741 thousand). As at December 31, 2020 total outstanding amount of borrowings from CBAR under the Decree was AZN 27,160 thousand. The Group also applied for obtaining additional borrowings from CBAR in the amount of AZN 2,579 thousand under the same conditions. The management of the Group expects to receive these borrowings during 2021.

As at December 31, 2020, accrued interest payable included in term borrowings amounted to AZN 2,422 thousand (December 31, 2019: AZN 185 thousand).

A reconciliation of the opening and closing amounts of term borrowings with relevant cash and non-cash changes from financing activities is stated below:

| | 2020 | 2019 |
|---|---|---|
| **January 1** | **77,553** | **129,689** |
| **Cash flows** | | |
| Proceeds | 22,323 | 38,334 |
| Repayment | (3,790) | (84,162) |
| Interest paid | (698) | (3,866) |
| **Non-cash changes** | | |
| Interest expense | 2,936 | 3,829 |
| Fair value adjustment at initial recognition | (1,296) | (6,271) |
| **December 31** | **97,028** | **77,553** |

## 17. LEASE LIABILITY

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| Lease liabilities (current) | 1,086 | 972 |
| Lease liabilities (non-current) | 3,071 | 2,858 |
| **Total lease liabilities** | **4,157** | **3,830** |

Future minimum lease payments as at December 31, 2020 were as follows:

| | Minimum lease payments due | | |
|---|---|---|---|
| | **Within one year** | **One to ten years** | **Total** |
| Lease payments | 1,361 | 3,534 | 4,895 |
| Finance charges | (275) | (463) | (738) |
| **Net present value as at December 31, 2020** | **1,086** | **3,071** | **4,157** |

Future minimum lease payments as at December 31, 2019 were as follows:

| | Minimum lease payments due | | |
|---|---|---|---|
| | **Within one year** | **One to ten years** | **Total** |
| Lease payments | 1,225 | 3,296 | 4,521 |
| Finance charges | (253) | (438) | (691) |
| **Net present value as at December 31, 2019** | **972** | **2,858** | **3,830** |

A reconciliation of the opening and closing amounts of lease liabilities with relevant cash and non-cash changes from financing activities is stated below:

| | **2020** | **2019** |
|---|---|---|
| **Balance at January 1** | **3,830** | **4,846** |
| **Changes from financing cash flows** | | |
| Repayment of principal portion of lease liability | (1,048) | (1,016) |
| **Other changes** | | |
| Interest expense | 355 | 329 |
| Interest paid | (355) | (329) |
| New leases | 574 | - |
| Modification | 994 | - |
| Derecognition | (193) | - |
| **Balance at December 31** | **4,157** | **3,830** |

## 18. OTHER LIABILITIES

| | **December 31, 2020** | **December 31, 2019** |
|---|---|---|
| **Other financial liabilities:** | | |
| Items in course of settlement | 896 | - |
| Others | 1,711 | 1,318 |
| **Total other financial liabilities** | **2,607** | **1,318** |
| **Other non-financial liabilities:** | | |
| Payables to employees | 2,683 | 1,222 |
| Current income tax liability | 624 | - |
| Provision for guarantees and similar commitments | 486 | 5,260 |
| Others | 910 | 1,134 |
| **Total other liabilities** | **7,310** | **8,934** |

An analysis of changes in ECL allowance on guarantees and similar commitments during the year ended December 31, 2020 is as follows:

| | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
|---|---|---|---|---|
| **ECL allowance as at January 1, 2020** | **(753)** | **-** | **(4,507)** | **(5,260)** |
| Recovery of expected credit losses and derecognition | 267 | - | 4,507 | 4,774 |
| **As at December 31, 2020** | **(486)** | **-** | **-** | **(486)** |

An analysis of changes in ECL allowance on guarantees and similar commitments during the year ended December 31, 2019 is as follows:

| | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **ECL allowance as at January 1, 2019** | **(628)** | - | **(4,197)** | **(4,825)** |
| Charge of expected credit losses | (125) | - | (310) | (435) |
| **As at December 31, 2019** | **(753)** | - | **(4,507)** | **(5,260)** |

## 19. SUBORDINATED DEBT

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| Subordinated debt securities issued | 16,036 | 17,029 |
| **Total subordinated debt** | **16,036** | **17,029** |

On December 28, 2017, the Group issued subordinated debt securities in the amount of USD 10,000 thousand. The debt bears an annual interest rate of 6% and matures on December 28, 2023.

As at December 31, 2020, accrued interest payable included in subordinated debt amounted to AZN 39 thousand (December 31, 2019: AZN 29 thousand).

The repayment of Group's subordinated debt ranks after all other creditors in case of liquidation of the Group.

A reconciliation of the opening and closing amounts of subordinated debt with relevant cash and non-cash changes from financing activities is stated below:

| | 2020 | 2019 |
|---|---|---|
| **January 1,** | **17,029** | **18,725** |
| **Cash flows** | | |
| Repurchase/repayment | (1,003) | (1,700) |
| Interest paid | (1,018) | (1,019) |
| **Non-cash changes** | | |
| Interest expense | 1,028 | 1,023 |
| **December 31,** | **16,036** | **17,029** |

## 20. SHARE CAPITAL

| | Number of outstanding ordinary shares | Ordinary shares | Share premium | Total |
|---|---|---|---|---|
| **As at December 31, 2019** | **46,208,219** | **125,686** | **484** | **126,170** |
| **As at December 31, 2020** | **46,208,219** | **125,686** | **484** | **126,170** |

The nominal value of the registered amount of the Bank's issued share capital as at December 31, 2020 is AZN 125,686 thousand (December 31, 2019: AZN 125,686 thousand).

The shareholders of the Bank as at December 31, 2020 and 2019 were as follows:

| No | Shareholders | December 31, 2020, % (rounded up to one hundred decimal) | December 31, 2019, % (rounded up to one hundred decimal) |
|---|---|---|---|
| 1 | Mr. Eldar Garibov | 86.39 | 77.39 |
| 2 | Other minor legal shareholders | 7.60 | 7.60 |
| 3 | Other minor individual shareholders | 6.01 | 6.01 |
| 4 | European Bank for Reconstruction and Development | - | 9.00 |

Share premium represents the excess of contributions received over the nominal value of shares issued.

On June 11, 2020, Mr. Eldar Garibov purchased 4,159 thousand shares in the amount of AZN 11,312 thousand from European Bank of Reconstruction and Development. Mr. Eldar Garibov remains to be ultimate controlling party of the Group.

As at December 31, 2020 and 2019 share capital amount of the Bank did not change.

As at December 31, 2020 all ordinary shares have a nominal value of AZN 2.72 per share (December 31, 2019: AZN 2.72 per share) and rank equally. Each share carries one vote. During the year ended December 31, 2020, AZN 5,083 thousand dividends were declared and paid (December 31, 2019: nil).

Dividends payable are restricted to the maximum retained earnings of the Group, which are determined according to legislation of the Azerbaijan Republic. Banks are not allowed to pay dividends if net assets are less than share capital. As disclosed in Note 1, CBAR put restrictions on distribution of dividends until July 1, 2021 as a part of measures to protect financial stability of banks in the context of coronavirus pandemic. Despite of such restriction, the dividends in the amount of AZN 5,083 thousand were declared and paid by the Group during 2020 (2019: nil). As the distribution of dividends has not negatively affected the financial stability of the Group, the Management believes that CBAR will not impose any administrative sanction due to this incompliance.

## 21. INTEREST INCOME AND EXPENSE

| | Year ended December 31, 2020 | Year ended December 31, 2019 |
|---|---|---|
| **Interest income on financial assets recorded at amortized cost comprises:** | | |
| - Loans and advances to customers | 89,657 | 78,431 |
| - Investment securities | 2,894 | 3,629 |
| - Due from other banks and correspondent accounts | 1,560 | 2,597 |
| - Finance leases | 2 | 9 |
| **Total interest income** | **94,113** | **84,666** |
| **Interest expense on financial liabilities recorded at amortized cost comprises:** | | |
| - Term deposits of individuals | (20,577) | (24,494) |
| - Term borrowings, due to banks and other financial institutions | (6,403) | (6,798) |
| - Subordinated debt | (1,028) | (1,023) |
| - Term deposits of legal entities | (1,150) | (610) |
| - Lease liability | (355) | (329) |
| **Total interest expense** | **(29,513)** | **(33,254)** |
| **Net interest income** | **64,600** | **51,412** |

## 22. (CHARGE)/RECOVERY OF EXPECTED CREDIT LOSSES

The table below shows the ECL (charge)/recovery on financial instruments recorded in the statement of profit or loss and other comprehensive income for the year ended December 31, 2020:

| | Note | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|---|
| - Due from banks and other financial institutions | 8 | - | - | (7,227) | (7,227) |
| - Loans and advances to customers | 9 | (1,619) | (3,803) | (22,365) | (27,787) |
| - Investment securities | 10 | 445 | - | - | 445 |
| **Charge of credit loss allowance on financial assets** | | **(1,174)** | **(3,803)** | **(29,592)** | **(34,569)** |
| - Unused credit lines and guarantees | 30 | 267 | - | 4,507 | 4,774 |
| **Total credit loss allowance charge** | | **(907)** | **(3,803)** | **(25,085)** | **(29,795)** |

The table below shows the ECL (charge)/recovery on financial instruments recorded in the statement of profit or loss and other comprehensive income for the year ended December 31, 2019:

| | Note | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|---|
| - Due from banks and other financial institutions | 8 | 1,853 | - | 41 | 1,894 |
| - Loans and advances to customers | 9 | (108) | 879 | 58,067 | 58,838 |
| - Investment securities | 10 | (370) | - | - | (370) |
| **Recovery of credit loss allowance on financial assets** | | **1,375** | **879** | **58,108** | **60,362** |
| - Unused credit lines and guarantees | 30 | (125) | - | (310) | (435) |
| **Total credit loss allowance recovery** | | **1,250** | **879** | **57,798** | **59,927** |

## 23. FEE AND COMMISSION INCOME AND EXPENSE

| | Year ended December 31, 2020 | Year ended December 31, 2019 |
|---|---|---|
| **Fee and commission income:** | | |
| Plastic cards operations | 11,539 | 8,547 |
| Settlement transactions | 3,742 | 3,137 |
| Cash transactions | 2,320 | 2,305 |
| Brokerage operations | 1,770 | 1,131 |
| Guarantees and letters of credit issued | 175 | 240 |
| Others | 1,521 | 1,713 |
| **Total fee and commission income** | **21,067** | **17,073** |

| | | |
|---|---|---|
| **Fee and commission expense:** | | |
| Plastic cards operations | (9,717) | (7,209) |
| Cash transactions | (3,223) | (1,958) |
| Centralized credit registry | (523) | (604) |
| Settlement transactions | (450) | (558) |
| Guarantees and letters of credit | (34) | (32) |
| Others | (99) | (297) |
| **Total fee and commission expense** | **(14,046)** | **(10,658)** |
| **Net fee and commission income** | **7,021** | **6,415** |

## 24. NET GAIN FROM FOREGN CURRENCIES

| | Year ended December 31, 2020 | Year ended December 31, 2019 |
|---|---|---|
| Gains less losses from trading in foreign currencies | 4,042 | 4,483 |
| Foreign exchange translation gains, net | 27 | 87 |
| Net result from foreign currency derivatives | (1,551) | (947) |
| **Total net gain from foreign currencies** | **2,518** | **3,623** |

## 25. ADMINISTRATIVE AND OTHER OPERATING EXPENSES

| | Year ended December 31, 2020 | Year ended December 31, 2019 |
|---|---|---|
| Staff costs | (33,891) | (28,873) |
| Depreciation expenses | (4,468) | (3,915) |
| Professional fees | (2,502) | (3,013) |
| Amortization expenses | (2,157) | (1,912) |
| Computer software costs | (2,113) | (1,609) |
| Insurance of customer deposits | (1,947) | (1,852) |
| Advertising expenses | (1,921) | (1,867) |
| Communication expenses | (1,505) | (1,453) |
| Security expenses | (1,137) | (1,017) |
| Utility expenses (included AZN 34 thousand COVID-19 related expenses) | (1,109) | (1,368) |
| Repair and maintenance expenses | (864) | (1,108) |
| Taxes other than income tax | (721) | (659) |
| Rent expenses | (689) | (775) |
| Other insurance expenses | (429) | (421) |
| Publishing and stationary | (244) | (344) |
| Representation expenses | (220) | (463) |
| Payments to the Financial Markets Supervisory Authority | (156) | (500) |
| Purchase of plastic cards | (6) | (466) |
| Other expenses (included AZN 220 thousand COVID-19 related expenses) | (1,659) | (1,484) |
| **Total administrative and other operating expenses** | **(57,738)** | **(53,099)** |

Included in staff costs for the year ended December 31, 2020 are obligatory payments to the State Social Protection Fund of the Republic of Azerbaijan in the amount of AZN 4,072 thousand (2019: AZN 3,568 thousand).

## 26. INCOME TAXES

### *(a) Components of income tax expense*

Income tax expense comprises the following:

| | Year ended December 31, 2020 | Year ended December 31, 2019 |
|---|---|---|
| Current income tax | (2,224) | (100) |
| Deferred income tax | (1,915) | (1,388) |
| **Income tax expense for the year** | **(4,139)** | **(1,488)** |

### *(b) Reconciliation between the tax expense and profit or loss multiplied by applicable tax rate*

The income tax rate applicable to the majority of the Group's income is 20%. A reconciliation between the expected and the actual taxation charge is provided below.

| | Year ended December 31, 2020 | Year ended December 31, 2019 |
|---|---|---|
| **(Loss)/profit before income tax** | **(12,636)** | **80,888** |
| Theoretical tax benefit at statutory rate (20%) | 2,527 | (16,178) |
| Revision of prior year income tax estimation | (590) | (1,044) |
| Change in unrecognized deferred income tax asset | (6,076) | 15,734 |
| **Income tax expense for the year** | **(4,139)** | **(1,488)** |

### *(c) Deferred taxes analyzed by type of temporary difference*

Differences between IFRS and Azerbaijan statutory taxation regulations give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases.

The tax effect of the movements in these temporary differences is detailed below and is recorded at the rate of 20%.

| | January 1, 2020 | Charged to profit or loss | Charged to other comprehensive income | December 31, 2020 |
|---|---|---|---|---|
| **Tax effect of deductible/(taxable) temporary differences** | | | | |
| Customer accounts | 118 | (118) | - | - |
| Other liabilities | 1,294 | (545) | - | 749 |
| Due from other banks | 7,437 | 1,355 | - | 8,792 |
| Lease liability | 33 | 23 | - | 56 |
| Loans and advances to customers | (14,246) | 6,833 | - | (7,413) |
| Premises, equipment and intangible assets | (1,822) | (539) | - | (2,361) |
| Other assets | (1,449) | (252) | - | (1,701) |
| Investment securities | 56 | - | (22) | 34 |
| Due to banks and other financial institutions | (7) | - | - | (7) |
| Other temporary differences | - | (86) | - | (86) |
| Tax loss carried forward | 14,937 | (2,510) | - | 12,427 |
| Deferred income tax asset before valuation allowance | 6,351 | 4,161 | (22) | 10,490 |
| Deferred tax asset not recognized | - | (6,076) | - | (6,076) |
| **Net deferred income tax asset** | **6,351** | **(1,915)** | **(22)** | **4,414** |

| | January 1, 2019 | Charged to profit or loss | Charged to other comprehensive income | December 31, 2019 |
|---|---|---|---|---|
| **Tax effect of deductible/(taxable) temporary differences** | | | | |
| Customer accounts | 448 | (330) | - | 118 |
| Other liabilities | 971 | 323 | - | 1,294 |
| Due from other banks | 6,137 | 1,300 | - | 7,437 |
| Lease liability | - | 33 | - | 33 |
| Loans and advances to customers | (6,784) | (7,462) | - | (14,246) |
| Premises, equipment and intangible assets | (1,203) | (619) | - | (1,822) |
| Other assets | (473) | (976) | - | (1,449) |
| Investment securities | - | 95 | (39) | 56 |
| Due to banks and other financial institutions | - | (7) | - | (7) |
| Other temporary differences | 1,546 | (1,546) | - | - |
| Tax loss carried forward | 22,870 | (7,933) | - | 14,937 |
| Deferred income tax asset before valuation allowance | 23,512 | (17,122) | (39) | 6,351 |
| Deferred tax asset not recognized | (15,734) | 15,734 | - | - |
| **Net deferred income tax asset** | **7,778** | **(1,388)** | **(39)** | **6,351** |

In the context of the Group's current structure and Azerbaijan tax legislation, tax losses and current tax assets of different group companies may not be offset against current tax liabilities and taxable profits of other group companies and, accordingly, taxes may accrue even where there is a tax loss. Therefore, deferred tax assets and liabilities are offset only when they relate to the same taxable entity and the same taxation authority.

The composition of the total net deferred tax asset of the Group after offsetting within the individual entities comprising the Group is, as follows:

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| Deferred income tax asset | 4,414 | 6,351 |
| **Total net deferred income tax asset** | **4,414** | **6,351** |

Movement in valuation allowance of deferred income tax asset is as follows:

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| Opening balance as at January 1 | - | (15,734) |
| Charged to profit or loss | (6,076) | 15,734 |
| **Total deferred income tax asset not recognized** | **(6,076)** | **-** |

## 27. (LOSS)/EARNINGS PER SHARE

Basic (loss)/earnings per share are calculated by dividing the (loss)/profit attributable to equity holders of the Group by the weighted average number of ordinary shares in issue during the period, excluding treasury shares.

The Group has no dilutive potential ordinary shares, therefore, the diluted (loss)/earnings per share equal the basic (loss)/earnings per share.

| | Note | Year ended December 31, 2020 | Year ended December 31, 2019 |
|---|---|---|---|
| (Loss)/profit for the year attributable to ordinary shareholders | | (16,775) | 79,400 |
| Weighted average number of ordinary shares in issue (thousands) | 20 | 46,208 | 46,208 |
| **Basic and diluted (loss)/earnings per ordinary share (expressed in AZN per share)** | | **(0.36)** | **1.72** |

## 28. SEGMENT ANALYSIS

Operating segments are components that engage in business activities that may earn revenues or incur expenses, whose operating results are regularly reviewed by the chief operating decision maker (CODM) and for which discrete financial information is available. The CODM is the person or group of persons who allocates resources and assesses the performance for the entity. The functions of CODM are performed by the Board of Directors of the Group.

### *(a) Description of products and services from which each reportable segment derives its revenue*

The Group is organized on the basis of main business segments:

- Retail banking – representing private banking services, private customer current accounts, savings, deposits, investment savings products, custody, credit and debit cards, consumer loans and mortgages.
- Corporate banking – representing direct debit facilities, current accounts, deposits, overdrafts, loan and other credit facilities, foreign currency and derivative products.

### *(b) Factors that management used to identify the reportable segments*

The Group's segments are strategic business units that focus on different customers. They are managed separately because each business unit requires different marketing strategies and service level.

Segment financial information reviewed by the CODM includes the results and the statement of financial position of the Group's subsidiaries. Ongoing review of these subsidiary entities is delegated to the local management teams, but the CODM performs regular review on a consolidated basis. The CODM obtains financial statements of the Group's subsidiaries. Such financial information overlaps with segment analysis provided internally to the CODM.

Management therefore applied the core principle of IFRS 8, *Operating Segments*, in determining which of the overlapping financial information sets should form the basis of operating segments. Management considered that information on subsidiary entities is available when required in concluding that segments include details of the subsidiaries.

### *(c) Measurement of operating segment profit or loss, assets and liabilities*

The CODM reviews financial information prepared based on Azerbaijani accounting standards adjusted to meet the requirements of internal reporting. Such financial information differs in certain aspects from International Financial Reporting Standards:

(i) funds are not reallocated between segments;
(ii) income taxes are not allocated to segments;

The CODM evaluates performance of each segment based on profit before tax.

### *(d) Information about reportable segment profit or loss, assets and liabilities*

Segment information for the main reportable business segments of the Group for the years ended December 31, 2020 and 2019 is set out below:

| | Retail banking | Corporate banking | Investment banking | Eliminations | Total Group |
|---|---|---|---|---|---|
| **Year ended December 31, 2020** | | | | | |
| Interest income | 77,811 | 11,808 | 4,454 | 40 | 94,113 |
| Fee and commission income | 13,755 | 5,162 | 507 | 1,643 | 21,067 |
| Total revenues | 91,566 | 16,970 | 4,961 | 1,683 | 115,180 |
| Interest expense | (18,086) | (8,428) | (2,959) | (40) | (29,513) |
| Fee and commission expense | (10,019) | (2,015) | (369) | (1,643) | (14,046) |
| Impairment loss on repossessed collateral | - | (1,646) | - | - | (1,646) |
| Fair value gain | 1,396 | - | - | - | 1,396 |
| Charge of expected credit loss | (17,782) | (10,005) | (6,782) | - | (34,569) |
| Recovery of expected credit losses for guarantees and credit related commitments | - | 4,774 | - | - | 4,774 |
| Foreign exchange translation gains/(losses), net | 17 | 8 | 2 | - | 27 |
| Administrative and other operating expenses | (40,130) | (10,115) | (758) | - | (51,003) |
| **Segment results** | **6,962** | **(10,457)** | **(5,905)** | **-** | **(9,400)** |
| **Year ended December 31, 2019** | | | | | |
| Interest income | 68,083 | 10,332 | 6,226 | 25 | 84,666 |
| Fee and commission income | 11,412 | 4,283 | 421 | 957 | 17,073 |
| Total revenues | 79,495 | 14,615 | 6,647 | 982 | 101,739 |
| Interest expense | (19,500) | (10,067) | (3,662) | (25) | (33,254) |
| Fee and commission expense | (7,629) | (1,791) | (281) | (957) | (10,658) |
| Impairment loss on repossessed collateral | - | (1,543) | - | - | (1,543) |
| Fair value gain | 13,118 | - | - | - | 13,118 |
| Recovery of expected credit losses | 46,177 | 12,661 | 1,524 | - | 60,362 |
| Charge of expected credit losses for guarantees and credit related commitments | - | (435) | - | - | (435) |
| Foreign exchange translation gains/(losses), net | 51 | 26 | 10 | - | 87 |
| Administrative and other operating expenses | (37,182) | (9,383) | (705) | - | (47,270) |
| **Segment results** | **74,530** | **4,083** | **3,533** | **-** | **82,146** |

Total reportable segment assets and liabilities as at December 31, 2020 and 2019 are presented in the following table:

| | Retail banking | Corporate banking | Investment banking | Eliminations | Total Group as at December 31, 2020 |
|---|---|---|---|---|---|
| Total reportable segment assets | 404,906 | 189,573 | 66,271 | 9,136 | 669,886 |
| Total reportable segment liabilities | (411,786) | (192,794) | (67,398) | (9,646) | (681,624) |
| Capital expenditure paid | 11,298 | 4,545 | - | - | 15,843 |

| | Retail banking | Corporate banking | Investment banking | Eliminations | Total Group as at December 31, 2019 |
|---|---|---|---|---|---|
| Total reportable segment assets | 410,444 | 212,438 | 77,089 | 925 | 700,896 |
| Total reportable segment liabilities | (393,201) | (203,513) | (73,850) | (4,374) | (674,938) |
| Capital expenditure paid | 12,351 | 5,381 | - | - | 17,732 |

### *(e) Reconciliation of reportable segment revenues, profit or loss, assets and liabilities*

A reconciliation of adjusted profit before tax to total profit before income tax is provided as follows:

| | 2020 | 2019 |
|---|---|---|
| **Adjusted (loss)/profit before income tax for reportable segments** | **(9,400)** | **82,146** |
| Gain from foreign currencies | 2,491 | 3,536 |
| Other operating income, net | 1,008 | 1,035 |
| Depreciation of premises and equipment and investment property | (4,468) | (3,995) |
| Amortization of intangible assets | (2,157) | (1,912) |
| Penalties for unpaid taxes for prior years | (110) | (2) |
| **(Loss)/profit before income tax** | **(12,636)** | **80,888** |

The adjustments are attributable to the following:

- Gains/(losses) arising from trading in foreign currencies are not allocated to the segments.
- The Group does not allocate depreciation and amortization to the segments.
- The Group does not allocate other operating loss and other non-operating income to segments.
- The Group does not allocate penalties for unpaid taxes for prior years.

Reportable segments' assets are reconciled to total assets as follows:

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| **Total reportable segment assets** | **669,886** | **700,896** |
| Deferred income tax asset | 4,414 | 6,351 |
| Premises, equipment and intangible assets | 87,416 | 78,689 |
| Other financial assets | 24,964 | 20,539 |
| Other assets | 20,226 | 16,811 |
| **Total consolidated assets** | **806,906** | **823,286** |

The adjustments are attributable to the following:

- Income taxes, other assets and other financial assets are not allocated between the reporting segments for internal management reporting.
- Premises, equipment and intangible assets are not allocated between the reporting segments for internal management reporting.

Reportable segments’ liabilities are reconciled to total liabilities as follows:

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| **Total reportable segment liabilities** | **681,624** | **674,938** |
| Other financial liabilities | 2,607 | 1,318 |
| Other non-financial liabilities | 4,079 | 7,616 |
| Lease liability | 4,157 | 3,830 |
| Current income tax liability | 624 | - |
| **Total consolidated liabilities** | **693,091** | **687,702** |

The adjustments are attributable to the following:

- Current income tax liability, other financial liabilities and other liabilities are not allocated between the reportable segments for internal management reporting.
- Deferred income tax liability is not calculated for the purpose of internal management reporting.

The Group does not report the geographical segment based on the fact that the substantially all of its operating are carries out in the Republic of Azerbaijan.

### *(f) Analysis of revenues by products and services*

The Group’s revenues are analyzed by products and services in Note 21 (interest income) and Note 23 (fee and commission income).

## 29. FINANCIAL RISK MANAGEMENT

The risk management function within the Group is carried out in respect of financial risks, operational risks and legal risks. Financial risk comprises market risk (including currency risk, interest rate risk and other price risk), credit risk and liquidity risk. The primary objectives of the financial risk management function are to establish risk limits, and then ensure that exposure to risks stays within these limits. The operational and legal risk management functions are intended to ensure proper functioning of internal policies and procedures to minimize operational and legal risks.

The Group has exposure to financial risks which include credit, liquidity, market and operational risks. The taking of risk is integral to the Group’s business.

The Group’s risk management function’s aim is to achieve an appropriate balance between risk and return and to minimize potential adverse effects on the Group’s financial performance.

### *Risk management framework*

The risk management function is an integral part of the Group’s internal control system and is centralized. The Group’s risk management policies and approaches aim to identify, analyze, mitigate and manage the risks faced by the Group. This is accomplished through setting appropriate risk limits and controls, continuously monitoring risk levels and the adherence to limits and procedures and ensuring that business processes are correctly formulated and maintained.

Risk Management policies and procedures are reviewed regularly to reflect changes in market conditions, products and services offered and to ensure that “best practices” are implemented. The Group, as part of its risk culture, emphasizes integrity, management and employee standards in order to maintain and continuously improve upon a conservative control environment.

***Risk management bodies and governance***

Risk management policy, assessment, approval, monitoring and controls are conducted by a number of specialized bodies within the Group. The Group has established executive bodies, committees and departments which conform to Azerbaijani law, the Central Bank of the Republic of Azerbaijan regulations and the best industry practices.

The Supervisory Board of the Group has overall responsibility for the oversight of the risk management framework, overseeing the management of key risks and reviewing and approving risk management policies as well as several key risk limit approval authorities, including significantly large exposures, economic and product sector limits. It also delegates certain authority levels to the Executive Board and the Credit Committee.

Established by, appointed by and reporting directly to the Supervisory Board are the Executive Board, the Executive Committee, the Risk Management Committee ("RMC"), the Audit Committee ("AC"), the Internal Audit Department and the Credit Committee.

The Executive Board is responsible for the implementation and monitoring of risk mitigation measures and ensuring that the Group operates within the established risk parameters. The Member of the Executive Board responsible for risk management along with the Risk Management Department which reports to him are responsible for the overall risk management functions, ensuring the implementation of common principles and methods for identifying, measuring, mitigating, managing and reporting both financial and non-financial risks.

The Risk Management Committee is chaired by the Member of the Executive Board responsible for risk management. This Committee is responsible for establishing risk management methodologies and ensuring that the risk appetite of the Group is correctly reflected in the strategic and business plans of the Group. It is the main forum for discussing and recommending changes in all risk approaches and procedures to the Executive and Supervisory Boards. It ensures that the Risk Management Department, the Credit Committee, as well as the Executive Board, address all potential risks facing the Group and report on these issues to the Supervisory Board.

The Audit Committee is responsible for overseeing and monitoring the internal control framework of the Group and for assessing the adequacy of risk management policies and procedures, as an integral part of the internal control system of the Group. The Chairman of the AC, an independent professional auditor, and the other two Committee members are representatives of two of the shareholders. The AC members cannot be employees or part of the management structure of the Group. They provide recommendations to the Executive Board, the Risk Management Committee and the Supervisory Board on development of the framework, as well as their views on, the quality of risk management and compliance with established policies, procedures and limits. The AC supervises the work of the Internal Audit, which reports directly to the AC. The Internal Audit's working plans, schedule of audits and its reports, including non-planned audits, are closely reviewed and approved by the AC.

Implementation plans based on Internal Audit's and the AC's recommendations, including status reports, are approved by the Executive Board and reported to the Executive Board, the Supervisory Board and the General Meeting of the Shareholders.

The Credit Committee consists of five members. They are nominated by the Risk Management Committee and the Executive Board and elected by the Supervisory Board. The Credit Committee manages and approves, or recommends for approval counterparty credit risk exposures within its credit approval authority for corporate, retail and financial sector entities. It also continuously reviews and makes recommendations as to analysis methodology and portfolio quality, including overall structure, diversification and pricing. The Credit Committee is one of the bodies which ensures adherence to all approval and authority limits and high standards for risk analysis and assessments.

RMC is responsible for the management and optimization of the Group's asset and liability structure. It is an integral part of the risk management process that focuses on various market risks, including liquidity, foreign currency and interest rate risks. RMC's functions include making recommendations for approval of strategies, policies and limits associated with the aforementioned risks. It is responsible for providing timely and reliable information and reports regarding these risk areas. RMC assists in setting pricing policies and funding strategies. It is also responsible, along with other risk management and controlling units of the Group, for ensuring that Treasury and other relevant units work with the parameters set by RMC, the Executive Board and the Supervisory Board.

***Credit risk***

Credit risk is the risk of financial loss to the Group if a customer or counterparty fails to meet its contractual obligations when due. The major portion of credit risk arises from the Group's loans and advances to customers and banks and other on and off balance sheet credit exposures. For risk reporting purposes, the Group considers and consolidates all elements of credit risk exposures such as individual customer and counterparty default risk and industry risk.

The general credit risk approval structure, for corporate legal entities, private individuals and financial organizations, is as follows:

*For secured business loans:*

- The Supervisory Board reviews and approves limits up to a maximum limit of 25% of the Tier1 capital and meets on a regular basis;
- The Chairman of the Supervisory Board together with The Credit Committee reviews and approves limits up to a maximum limit of 15% of Tier1 capital and meets on a regular basis;
- The Credit Committee reviews and approves limits up to a maximum limit of AZN 4,000 thousand and meets on a regular basis;
- The Junior Credit Committee reviews and approves up to a maximum limit of AZN 800 thousand and meets on a regular basis;
- The Risk Management, Director of the Corporate Banking Services Department, Director of the Micro business Department and Director of the Problem Business Loans Management Department reviews and approves limits up to a maximum limit of AZN 150 thousand.

*For secured retail loans:*

- The Supervisory Board reviews and approves up to a maximum limit of 25% of the Tier1 capital and meets on a regular basis;
- The Chairman of the Supervisory Board reviews and approves limits up to a maximum limit of 15% of the Tier1 capital and meets on a regular basis;
- The Credit Committee reviews and approves limits up to a maximum limit of AZN 4,000 thousand and meets on a regular basis;
- The Junior Credit Committee reviews and approves limits up to a maximum limit of AZN 800 thousand and meets on a regular basis;
- The Risk Management, Retail Banking Services Department and the Problem Retail Loans Management Department reviews and approves limits up to a maximum limit of AZN 150 thousand.

*For unsecured business loans:*

- The Supervisory Board reviews and approves limits up to a maximum limit of 10% of the Tier1 capital and meets on a regular basis;
- The Chairman of the Supervisory Board together with The Credit Committee reviews and approves limits up to a maximum limit of 6% of Tier1 capital and meets on a regular basis;

- The Credit Committee reviews and approves limits up to a maximum limit of AZN 800 thousand and meets on a regular basis;
- The Junior Credit Committee reviews and approves up to a maximum limit of AZN 400 thousand and meets on a regular basis;
- The Risk Management, Director of the Corporate Banking Services Department, Director of the Micro business Department and Director of the Problem Business Loans Management Department reviews and approves limits up to a maximum limit of AZN 20 thousand.

*For unsecured retail loans:*

- The Supervisory Board reviews and approves up to a maximum limit of 10% of the Tier1 capital and meets on a regular basis;
- The Chairman of the Supervisory Board together with The Credit Committee reviews and approves limits up to a maximum limit of 6% of Tier1 capital and meets on a regular basis;
- The Credit Committee reviews and approves limits up to a maximum limit of AZN 800 thousand and meets on a regular basis;
- The Junior Credit Committee reviews and approves limits up to a maximum limit of AZN 400 thousand and meets on a regular basis;
- The Risk Management, Retail Banking Services Department and the Problem Retail Loans Management Department reviews and approves limits up to a maximum limit of AZN 20 thousand.

The Supervisory Board also approves general limits so as to control and manage risk diversification:

- Portfolio limits: corporate loans, retail loans and interbank exposures as percentages of the total portfolio;
- Portfolio limits: secured facilities and unsecured facilities as percentages of the total portfolios and as a percentage of the retail portfolio; and
- Economic sector and product exposures: as a percentage of the corporate and retail portfolios.

The Executive Board also approves limits and authority levels for exposures, as follows:

- By branch;
- By collateral type and loan to value ratios;
- By individual authority.

As at December 31, 2020 and 2019 the breakdown of the loan portfolio by economic and product sectors is provided in Note 9.

***Credit risk management***

Credit risk policy is developed by the Risk Management Committee and Executive Board in line with the risk profile and strategic plans of the Group. It is approved by the Supervisory Board.

This policy establishes:

- Procedures for generating, analyzing, reviewing and approving counterparty risk exposures;
- The methodology for the credit assessment of counterparties;
- The methodology for the credit rating of counterparties;
- The methodology for the evaluation and control of collateral;
- Credit documentation requirements;
- Loan administration procedures;
- Procedures for the ongoing monitoring of credit exposures;
- Environmental policy; and
- Loan loss provisioning policy.

Loan/credit requests are originated and generated by client managers and credit inspectors. Credit applications within approved authority limits are approved by the relevant business generating units. The copies of the approved requests are submitted to the Risk Management Department for prior -control, including being assigned a rating and input into a monitoring schedule. Risk exposure requests above these limits are sent to the Credit Group of the Risk Management Department. The Credit Group performs a secondary analysis and issues a report, rating and opinion. If the credit request is below a certain authorized limit and receives a positive opinion from Risk Management, and is signed off by the appropriate individuals, then the request is considered approved. If the opinion of risk management is negative then the request is sent to the Credit Committee for adjudication. If approved and the transaction is in an amount higher than the competence of the Credit Committee then it is sent to the Executive Board for approval. Large transactions, as defined above, have to be submitted to the Supervisory Board for approval.

Consumer lending is built based on the scoring model. The model is empirical, which is created according to the statistic information. The model consists of 7 score groups, where the first level is the lowest value of PD, and the last level is the highest one. Depending on the level, the credit amount and the interest rates are provided for the consumer lending.

Credit risk for off-balance sheet financial instruments is defined as the possibility of sustaining a loss as a result of a party to a financial instrument failing to perform in accordance with the terms of the contract. The Group uses the same credit policies in entering into conditional obligations as it does for on-balance sheet financial instruments through established credit approvals, risk control limits and monitoring procedures.

Credit assessments are done on a portfolio basis concentrating on amount and term limits, approval procedures, target groups, types of product, default statistics, loan/value ratios (if applicable), and pricing.

***Expected credit loss (ECL) measurement – definitions***

ECL is a probability-weighted estimate of the present value of future cash shortfalls (i.e., the weighted average of credit losses, with the respective risks of default occurring in a given time period used as weights). An ECL measurement is unbiased and determined by evaluating a range of possible outcomes.

Discount Rate – a tool to discount an expected loss to the present value at the reporting date. The discount rate represents the effective interest rate (EIR) for the financial instrument or an approximation thereof.

Lifetime period – the maximum period over which ECL should be measured. For loans with fixed maturity, the lifetime period is equal to the remaining contractual period. For loan commitments and financial guarantee contracts, this is the maximum contractual period over which an entity has a present contractual obligation to extend credit. For credit cards issued to individuals, it is the period that is based on internal statistics, and it is equal to 3 years.

Lifetime ECL – losses that result from all possible default events over the remaining lifetime period of the financial instrument.

12-month ECL – the portion of lifetime ECLs that represent the ECLs resulting from default events on a financial instrument that are possible within 12 months after the reporting date that are limited by the remaining contractual life of the financial instrument.
Forward looking information – the information that includes the key macroeconomic variables impacting credit risk and expected credit losses for each portfolio segment. A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward-looking information.

Credit Conversion Factor (CCF) – a coefficient that shows that the probability of conversion of an off-balance sheet amounts to exposure on the balance within a defined period. It can be calculated for a 12-month or lifetime period. Based on the analysis performed, the Group considers that 12-month and lifetime CCFs are the same.

Purchased or originated credit impaired (POCI) financial assets – financial assets that are credit-impaired upon initial recognition.

Low credit risk financial assets – assets that have an investment grade defined by external rating agencies or corresponding internal rating, debt instruments issued by Azerbaijan Republic and nominated in AZN, loans to companies owned by Azerbaijan Republic and nominated in AZN. The presumption, being that there have been significant increases in credit risk since initial recognition when financial assets are more than 30 days past due, has not been rebutted.

Default and credit-impaired asset – a loan is in default, meaning fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

- the borrower is more than 90 days past due on its contractual payments;
- the loan is restructured less than 6 months ago and is 31-90 days past due on its contractual payments;
- the borrower has the external rating below Caa2;
- the Group consider to sell the borrower's debt with significant losses (more than 5% of the debt principal balance and accrued interest);
- other information available on borrower bankruptcy or default.

The Credit Committee decides on recognition of the borrower as credit-impaired one based on the unlikeliness-to-pay criteria listed below:

- the borrower is insolvent;
- it is becoming likely that the borrower will enter bankruptcy;
- Other criteria reflecting difficulties with successful fulfilling of obligations by the borrower.

An instrument is considered to no longer be in default (i.e. to have cured) when it no longer meets any of the default criteria for a consecutive period of six months.

Significant increase in credit risk (SICR) – the SICR assessment is performed on an individual basis and on a portfolio basis. For loans issued to legal entities and individuals, interbank loans and debt securities accounted for at AC or at FVOCI, SICR is assessed on an individual basis by monitoring the triggers stated below. The criteria used to identify a SICR are monitored and reviewed periodically for appropriateness by the Group's Risk Management Committee.

The Group considers a financial instrument to have experienced a SICR when one or more of the following quantitative, qualitative or backstop criteria have been met.

For loans issued to legal entities and bonds issued by the legal entities, interbank operations and bonds issued by the banks:

- 31-90 days past due;
- Restructured and 6-30 days past due;
- Monitoring suggests borrower has financial difficulties.

For loans to individuals:

- 31-60 days past due;
- Restructured and 6-30 days past due;

If there is evidence that the SICR criteria are no longer met and this has lasted at least 6 month, the instrument will be transferred back to Stage 1. If an exposure has been transferred to Stage 2 Based on a qualitative indicator, the Group monitors whether that indicator continues to exist or has changed.

***ECL measurement – description of estimation techniques***

General principle

For non-POCI financial assets, ECLs are generally measured based on the risk of default over one of two different time periods, depending on whether the credit risk of the borrower has increased significantly since initial recognition. This approach can be summarized in a three-stage model for ECL measurement:

Stage 1: a financial instrument that is not credit-impaired on initial recognition and its credit risk has not increased significantly since initial recognition; loss allowance is based on 12-month ECLs.
Stage 2: if a SICR since initial recognition is identified, the financial instrument is moved to Stage 2 but not yet deemed to be credit-impaired; loss allowance is based on lifetime ECLs.
Stage 3: if the financial instrument is credit-impaired, the financial instrument is then moved to Stage 3 and loss allowance is based on lifetime ECLs.

ECL for POCI financial assets is always measured on a lifetime basis (Stage 3), so at the reporting date, the Bank only recognizes the cumulative changes in lifetime expected credit losses.

The Group can carry out three separate approaches for ECL measurement:

- assessment on an individual basis;
- assessment on a portfolio basis;
- assessment based on external ratings.

The Group performs an assessment on an individual basis for the following types of loans issued to legal entities: loans with unique credit risk characteristics, individually significant loans and credit-impaired loans.

The Group performs an assessment on a portfolio basis for the following types of assets: loans and credit-related commitments issued to legal entities (standard lending, specialized lending, loans to leasing companies, etc.), interbank loans, retail loans and loans issued to SMEs. This approach incorporates aggregating the portfolio into homogeneous segments based on borrower-specific information.

The Group performs assessments on external ratings for the following types of loans: interbank loans, debt securities issued by the banks, legal entities and sovereigns, loans issued to sovereigns.

Principles of assessment on individual basis – ECL assessments on an individual basis are done by weighting the estimates of credit losses for different possible outcomes against the probabilities of each outcome. The Group defines at least two possible outcomes for each loan, one of which leads to credit loss in spite of the probability of such a scenario. Individual assessment is mainly based on the expert judgement of the Problem Loans Collection Department. Expert judgements are regularly tested in order to decrease the difference between estimates and actual losses.

Principles of assessment on portfolio basis – to assess the staging of exposure and to measure a loss allowance on a collective basis, the Group combines its exposures into segments on the basis of shared credit risk characteristics, such as that exposures to risk within a group are homogeneous.

Examples of shared characteristics include: type of customer (such as income producing real estate or leasing companies), product type (such as credit cards or cash loans), credit risk rating and date of initial recognition.

The different segments reflect differences in credit risk parameters such as PD and LGD. The appropriateness of groupings is monitored and reviewed on a periodic basis by the Risk Management Committee.

In general, ECL is the multiplication of the following credit risk parameters: EAD, PD and LGD (definitions of the parameters are provided above). The general approach used for ECL calculation is stated below. It could be applied for products assessed on a portfolio basis and for products for which the bank has credit risk ratings assessment based on borrower-specific information.

The ECL is determined by predicting credit risk parameters (EAD, PD and LGD) for the next 12 months or instrument lifetime. These three components are multiplied together and adjusted for the likelihood of survival (i.e. the exposure has been repaid or defaulted in an earlier period).

The brief principles of calculating the credit risk parameters are as following.

The EADs are determined based on the expected payment profile, which varies by product type:

- for amortizing products and bullet repayment loans, EAD is based on the contractual repayments owed by the borrower over a 12-month or lifetime basis.
- for revolving products, the EAD is predicted by taking the current drawn balance and adding a credit conversion factor that accounts for the expected drawdown of the remaining limit by the time of default.

Two types of PDs are used for calculating ECLs: 12-month and lifetime PD:

- 12-month PDs – the estimated probability of a default occurring within the next 12 months (or over the remaining life of the financial instrument if less than 12 months). This parameter is used to calculate 12- month ECLs. An assessment of a 12-month PD is based on the latest available historic default data and adjusted for forward-looking information when appropriate.
- Lifetime PDs – the estimated probability of a default occurring over the remaining life of the financial instrument. This parameter is used to calculate lifetime ECLs for Stage 2 exposures. An assessment of a Lifetime PD is based on the latest available historic default data and adjusted for forward looking information when appropriate.

To calculate Lifetime PD, the Group uses different statistical approaches depending on the segment and product type, such as the extrapolation of 12-month PDs based on migration matrixes and developing lifetime PD curves based on the historical default data. For lifetime PD calculations, the Group uses historical default data and the extrapolation of trends for longer periods during which default data was not available.

LGD represents the Group's expectation of the extent of loss on a defaulted exposure. LGD varies by the product, overdue days and the availability of collateral or other credit support.

The 12-month and lifetime LGDs are determined based on the factors that impact the expected recoveries after a default event.

The approach to LGD measurement can be divided into three possible approaches:

- measurement of LGD based on the specific characteristics of the collateral;
- calculation of LGD on a portfolio basis based on recovery statistics;
- individually defined LGD depending on different factors and scenarios.

For loans secured by real estate the Group calculates LGD based on specific characteristics of the collateral, such as projected collateral values, historical discounts on sales and other factors.

For particular segments of the corporate, retail, interbank loan portfolio and corporate bonds LGD is calculated on a collective basis based on the latest available recovery statistics.

**ECL measurement for off-balance sheet financial instruments**

CCF for undrawn credit lines of legal entities, credit cards issued to individuals and financial guarantees is defined based on statistical analysis of exposure at default.

CCF for overdrafts is defined as 100% since the limits can be used by the clients at any time.

Principles of assessment based on external ratings – the principles of ECL calculations based on external ratings are the same as for their assessment on a portfolio basis. Since the clients have defined the external credit rating, credit risk parameters (PD) could be taken from the default and recovery statistics published by international rating agencies.

Forward-looking information incorporated in the ECL models. The assessment of the SICR and the calculation of ECLs both incorporate forward-looking information. The Group has performed historical analyses and identified the key economic variables impacting credit risk and ECLs for each portfolio.

These economic variables and their associated impact on the PD vary by financial instrument. These economic variables, such as consumer price index changes, nominal and real GDP growth, nominal and real effective exchange rates, USD exchange rate changes, changes in the budget expenditures have been tested by performing statistical regression analysis to understand the impact of changes in these variables has historically had on default rates.

Based on them the Group's Risk Management Committee makes the forecast of future macroeconomic conditions, which is considered by the management of the Group to define the next coming stage of economic cycle using not only statistical approach but also expert judgement of the management.

The assessment of SICR is performed using the Lifetime PD for retail borrowers and 12-month PD for other financial assets, along with qualitative and backstop indicators. This determines whether the whole financial instrument is in Stage 1, Stage 2, or Stage 3 and hence whether a 12-month or lifetime ECL should be recorded. Following this assessment, the Bank measures ECL as either a probability-weighted 12 month ECL (Stage 1), or a probability weighted lifetime ECL (Stages 2 and 3). These probability-weighted ECLs are determined by running the relevant ECL model.

As with any economic forecast, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty, and therefore the actual outcomes may be significantly different to those projected. The Group considers these forecasts to represent its best estimate of the possible outcomes and has analyzed the nonlinearities and asymmetries within the Group's different portfolios to establish that the chosen scenarios are appropriately representative of the range of possible scenarios.

**Validation**

The Group regularly reviews its methodology and assumptions to reduce any difference between the estimates and the actual loss of credit. Such validation is performed at least once a year. The results of validation the ECL measurement methodology are communicated to the Group management and further steps for tuning models and assumptions are defined after discussions between authorized persons.

**Assessment of loss allowance for credit related commitments**

Assessment of loss allowance for credit related commitments is performed on a similar basis with balance sheet exposures by application of credit conversion factor (CCF) if the counterparty has current balance sheet exposure. Statistical information and Basel Committee values are used for calculation of CCF. If the counterparty does not have balance sheet exposure the assessment of expected credit loss allowance is performed on an individual or collective basis depending on the amount of exposure by applying CCF.

***Collateral and other credit enhancements***

Exposure to credit risk is also assessed and managed, in part, by obtaining, controlling and monitoring collateral in the form of mortgage interests over property, pledge of assets and securities and other collateral including deposits, corporate and personal guarantees.

While collateral is an important mitigating factor in assessing the credit risk, it is the Group's policy to establish that loans are within the customer's capacity to repay rather to rely solely on security. Collateral is considered as a secondary source of repayment. In limited cases, depending on the customer's standing or on the type of product or amounts, the facilities may be unsecured. The Group has in place various limits on the unsecured portions of its risk portfolio.

The principal types of collateral accepted by the Group are as follows:

- Commercial real estate;
- Residential real estate;
- Corporate capital assets;

- Corporate liquid assets;
- Transport vehicles;
- Term deposits;
- Other, including precious metals.

Strict appraisal, documentation and, where applicable, registration procedures are in place for all forms of collaterals. Loan to values ratios are approved by the Executive Board and controlled by the Risk Management Department. The loan to value limits as of December 31, 2020 and December 31, 2019 are as follows:

| Type of collateral | Ratio of loan amount to liquid value of collateral |
|---|---|
| Real estate | up to 70% |
| Precious metals | up to 80% |
| Machinery, equipment | up to 50% |
| Inventory | up to 60% |
| Vehicles, transport | up to 70% |
| Term deposit | up to 90% |

As supplement collateral the Bank may accept personal guarantees.

An exclusion from the collateral guidelines requires high level authorization of the Executive Board.

The Monitoring Group is responsible for establishing a schedule of monitoring events, fulfilling this plan and notifying the appropriate parties if the monitoring results are unsatisfactory and recommending a plan of action. The Monitoring Group physically monitors all transactions above an established amount plus does selected checks of transactions below this amount. All transactions above a certain amount are first monitored either before or at least within one month of disbursement. Following this, risk exposures are monitored according to a schedule.

The Statistical Group of the Risk Management Department is charged with compiling and reporting on all counterparty credit risk issues, including compliance with all limits, risk concentrations, portfolio trends, past due and default statistics, loan loss reserves and collateral statistics. Besides regular monthly reporting, they also compile reports on adherence to selected credit procedures.

***Related party lending***

The Central Bank of the Republic of Azerbaijan has strict definitions regarding the category of "related parties". Mainly, these are corporate entities owned/controlled by the shareholders or the private individuals themselves or immediate family members. Also included are individuals with senior management/authority positions in the Group. The largest loan per related party private individual may not be more than 3% of the consolidated capital of the Group. Per related corporate entity, the limit is 10%. The overall limit for related party risk exposure is 20%. Pricing and other terms and conditions must be done on an arms-length basis.

***Past due, non-performing loans***

The Group has in place procedures for reporting and dealing with past-due and non-performing loans from the first day past-due. Unsecured retail loans over 10 days past-due are automatically transferred to the Problematic Loans Department. The department classifies loans under following categories based on their characteristics:

**SOFT10 status** - Represents loans with, depending on the loan type, 10-20 days overdue and which have never had 60 days overdue during the loan period.

**HARD status** - Represents loans with, depending on the loan type, 21-59 days overdue and which have never had 60 days overdue during the loan period.

**PROBLEM status** - Represents loans which at least once have had 60 days overdue and more than 1 day overdue loans during the loan period.

Corporate loans over 60-days past-due are also transferred to this department. If the Problematic Loans Department is unsuccessful in collecting on these obligations, then legal proceedings are initiated. When a loan is deemed uncollectible, recommendations to write-off these amounts are presented to the Credit Committee and the Executive Board. Final decisions regarding write-offs are taken by the Supervisory Board.

All past-due statistics are reported to the Credit Committee on at least a monthly basis. All corporate loan past-due issues are individually reported to the Credit Committee.

***Allowance for loan losses – provisioning policy***

The Group establishes an allowance for loan losses that represents its estimate of losses incurred in its risk exposures.

In its IFRS reporting, the Group utilizes the methodology which complies with IFRS 9.

***Maximum exposure to credit risk***

The Group's maximum exposure to on balance sheet credit risk is generally reflected in the carrying amounts of financial assets on the consolidated statement of financial position. The impact of possible netting-off of assets and liabilities to reduce potential credit exposure is not significant.

The maximum credit risk for off-balance items, mainly letters of credit and guarantees, represents the gross amount of the commitment. The Group's maximum exposure to off-balance credit risk is disclosed in Note 30.

Credit risk for off-balance sheet financial instruments is defined as the possibility of sustaining a loss as a result of another party to a financial instrument failing to perform in accordance with the terms of the contract. The Group uses the same credit policies in making conditional obligations as it does for on-balance sheet financial instruments through established credit approvals, risk control limits and monitoring procedures.

***Maximum exposure of credit risk***

The Groups maximum exposure to credit risk varies significantly and is dependent on both individual risks and general market economy risks.

For financial assets in the balance sheet, the maximum exposure is equal to the carrying amount of those assets prior to any offset or collateral. The Group's maximum exposure to credit risk under contingent liabilities and commitments to extend credit, in the event of non-performance by the other party where all counterclaims, collateral or security prove valueless, is represented by the contractual amounts of those instruments.

**Currency risk**

The Group is exposed to effects of fluctuation in the prevailing local/foreign currency exchange rates on its financial position. Currency risk is the risk that movements in foreign exchange rates will affect the Group's income or the value of its portfolios of financial instruments.

The main element in the Group's risk policy regarding foreign currency risk is that there is no conscious effort to take a trading position in any currency. Limited open positions occur as a natural consequence of business operations only. The Group uses every effort to match its assets and liabilities by currency.

Exposure to foreign exchange risk faced by the Bank is also limited by the Central Bank of the Republic of Azerbaijan statutory requirements.

The foreign exchange exposures are managed by the Risk Management Department, who issue daily reports, reviewed and controlled by the Treasury Department. The table below summarizes the Group's exposure to foreign currency exchange rate risk at the end of the reporting period:

| | December 31, 2020 | | | | |
|---|---|---|---|---|---|
| | Monetary assets | Monetary liabilities | Forward contracts | SWAP agreements | Net position |
| AZN | 561,670 | (529,692) | (9,079) | (34,000) | (11,101) |
| USD | 112,097 | (139,851) | 8,500 | 34,000 | 14,746 |
| EUR | 19,390 | (17,787) | - | - | 1,603 |
| Other | 1,693 | (1,058) | - | - | 635 |
| **Total** | **694,850** | **(688,388)** | **(579)** | **-** | **5,883** |

| | December 31, 2019 | | | | |
|---|---|---|---|---|---|
| | Monetary assets | Monetary liabilities | Forward contracts | SWAP agreements | Net position |
| AZN | 494,646 | (453,220) | - | (11,900) | 29,526 |
| USD | 196,744 | (202,227) | 1,096 | 11,900 | 7,513 |
| EUR | 27,453 | (28,777) | - | - | (1,324) |
| Other | 2,591 | (1,122) | (1,107) | - | 362 |
| **Total** | **721,434** | **(685,346)** | **(11)** | **-** | **36,077** |

The above analysis includes only monetary assets and liabilities. Investments in equities and non-monetary assets are not considered to give rise to any material currency risk.

The Group has extended loans and advances denominated in foreign currencies. Depending on the revenue stream and cost structure of the borrower, the possible appreciation of the currencies in which loans and advances have been extended against the Azerbaijani Manat may adversely affect the borrower's repayment ability and therefore increase the potential of future loan losses.

The following table presents sensitivities of profit and loss to reasonably possible changes in exchange rates applied at the end of the reporting period, with all other variables held constant:

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| US Dollars strengthening by 50% (2019: 50%) | 7,373 | 3,757 |
| US Dollars weakening by 50% (2019: 50%) | (7,373) | (3,757) |
| Euro strengthening by 50% (2019: 50%) | 802 | (662) |
| Euro weakening by 50% (2019: 50%) | (802) | 662 |
| Other currency strengthening by 50% (2019: 50%) | 318 | 181 |
| Other currency weakening by 50% (2019: 50%) | (318) | (181) |

Other than as a result of any impact on the Group's profit or loss, there is no other impact on the Group's equity as a result of such changes in exchange rates.

The exposure was calculated only for monetary balances denominated in currencies other than the functional currency of the respective entity of the Group.

The Group's exposure to currency risk at the end of the reporting period is not representative of the typical exposure during the year. The following table presents sensitivities of profit and loss and equity to reasonably possible changes in exchange rates applied to average exposure to currency risk during the year, with all other variables held constant:

| | Average exposure during 2020 | Average exposure during 2019 |
|---|---|---|
| US Dollars strengthening by 50% (2019: 50%) | 5,565 | 1,024 |
| US Dollars weakening by 50% (2019: 50%) | (5,565) | (1,024) |
| Euro strengthening by 50% (2019: 50%) | 70 | (679) |
| Euro weakening by 50% (2019: 50%) | (70) | 679 |
| Other currency strengthening by 50% (2019: 50%) | 249 | 451 |
| Other currency weakening by 50% (2019: 50%) | (249) | (451) |

Other than as a result of any impact on the Group's profit or loss, there is no other impact on the Group's equity as a result of such changes in exchange rates.

***Interest rate risk***

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Group is exposed to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes, but may also reduce or create losses in the event that unexpected movements occur.

***Interest rate gap analysis***

Interest rate risk is managed principally through monitoring interest rate gaps. A summary of the interest gap position for major financial instruments is as follows:

| | Less than 1 month | 1-6 months | 6-12 months | Over 1 year | Non-interest bearing | Carrying amount |
|---|---|---|---|---|---|---|
| **December 31, 2020** | | | | | | |
| **ASSETS** | | | | | | |
| Cash and cash equivalents | 1,916 | - | - | - | 104,578 | 106,494 |
| Mandatory cash balances with the CBAR | - | - | - | - | 3,163 | 3,163 |
| Due from other banks | 1,207 | - | - | - | 4,875 | 6,082 |
| Loans and advances to customers | 3,500 | 67,174 | 79,663 | 333,395 | 17,549 | 501,281 |
| Investment securities | 11,245 | 3,483 | 15,582 | 22,073 | 483 | 52,866 |
| Other financial assets | - | - | - | - | 24,964 | 24,964 |
| **Total financial assets** | **17,868** | **70,657** | **95,245** | **355,468** | **155,612** | **694,850** |
| **LIABILITIES** | | | | | | |
| Due to banks and other financial institutions | (4,579) | (5,025) | (10,000) | - | (303) | (19,907) |
| Customer accounts | (15,683) | (100,688) | (192,946) | (33,342) | (205,994) | (548,653) |
| Term borrowings | (241) | (1,890) | (9,138) | (82,590) | (3,169) | (97,028) |
| Subordinated debt | - | - | - | (15,997) | (39) | (16,036) |
| Lease liability | (90) | (453) | (543) | (3,071) | - | (4,157) |
| Other financial liabilities | - | - | - | - | (2,607) | (2,607) |
| **Total financial liabilities:** | **(20,593)** | **(108,056)** | **(212,627)** | **(135,000)** | **(212,112)** | **(688,388)** |
| **Net liquidity gap:** | **(2,725)** | **(37,399)** | **(117,382)** | **220,468** | **(56,500)** | **6,462** |

| | Less than 1 month | 1-6 months | 6-12 months | Over 1 year | Non-interest bearing | Carrying amount |
|---|---|---|---|---|---|---|
| **December 31, 2019** | | | | | | |
| **ASSETS** | | | | | | |
| Cash and cash equivalents | 5,958 | - | - | - | 137,791 | 143,749 |
| Mandatory cash balances with the CBAR | - | - | - | - | 3,642 | 3,642 |
| Due from other banks | - | - | 1,360 | 5,865 | 6,986 | 14,211 |
| Loans and advances to customers | 8,037 | 62,839 | 66,361 | 304,801 | 12,520 | 454,558 |
| Investment securities | 500 | 34,759 | 14,110 | 33,566 | 1,801 | 84,736 |
| Other financial assets | - | - | - | - | 20,539 | 20,539 |
| **Total financial assets** | **14,495** | **97,598** | **81,831** | **344,232** | **183,279** | **721,435** |
| **LIABILITIES** | | | | | | |
| Due to banks and other financial institutions | - | (19,500) | (10,000) | - | (639) | (30,139) |
| Customer accounts | (21,726) | (161,800) | (113,087) | (52,148) | (201,456) | (550,217) |
| Term borrowings | (564) | (1,348) | (179) | (75,277) | (185) | (77,553) |
| Subordinated debt | - | - | - | (17,000) | (29) | (17,029) |
| Lease liability | (88) | (409) | (475) | (2,858) | - | (3,830) |
| Other financial liabilities | - | - | - | - | (1,318) | (1,318) |
| **Total financial liabilities:** | **(22,378)** | **(183,057)** | **(123,741)** | **(147,283)** | **(203,627)** | **(680,086)** |
| **Net liquidity gap:** | **(7,883)** | **(85,459)** | **(41,910)** | **196,949** | **(20,348)** | **41,349** |

The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. Management monitors on a daily basis and sets limits on the level of mismatch of interest rate repricing that may be undertaken.

At present, the Group manages its interest rate risk by matching, where possible, its maturity and/or repricing positions. In addition, the Group's monthly interest margins are continually reviewed in order to reprice its assets when deemed appropriate. Operational procedures set the acceptable interest rate margin at a minimum of 10%. The Risk Management Department constantly monitors the maintenance of this margin. RMC is also responsible for presenting interest rate movement reports and forecasts. At present, through the Group's matching policies and high interest rate margins, potential interest rate risk is not considered to be significant.

RMC and Treasury are responsible for managing interest rate risk, the Risk Management Department for controlling and the Executive Board must approve all guidelines and asset/liability repricing.

The Group monitors interest rates for its financial instruments. The table below summarizes interest rates based on reports reviewed by key management personnel:

| | December 31, 2020 | | | | December 31, 2019 | | | |
|---|---|---|---|---|---|---|---|---|
| | USD | AZN | EUR | Other | USD | AZN | EUR | Other |
| **Assets** | | | | | | | | |
| Cash and cash equivalents | 0.4 | 0.8 | - | 0.4 | 0.8 | 0.8 | 0.1 | 0.2 |
| Due from other banks | 2.0 | - | - | - | 3.0 | - | - | - |
| Loans and advances to customers | 7.5 | 20.5 | 3.2 | - | 9.6 | 20.3 | 5.2 | 28.0 |
| Investment securities | 4.2 | 7.6 | 1.8 | - | 2.6 | 7.3 | 1.8 | - |
| **Liabilities** | | | | | | | | |
| Due to other banks and financial institutions | - | 7.1 | 1.0 | - | - | 8.6 | - | - |
| Customer accounts | 1.2 | 9.4 | 0.1 | - | 1.8 | 10.2 | 0.2 | - |
| Term borrowings | - | 2.7 | - | - | - | 2.7 | - | - |
| Subordinated debt | 6.0 | - | - | - | 6.0 | - | - | - |
| Lease liability | - | 7.5 | - | - | - | 7.5 | - | - |

The sign "-" in the table above means that the Group does not have the respective assets or liabilities in corresponding currency.

***Geographical risk concentrations***

The geographical concentration of the Group's financial assets and liabilities at December 31, 2020 is set out below:

| | The Republic of Azerbaijan | OECD countries | Other non-OECD countries | Total |
|---|---|---|---|---|
| **FINANCIAL ASSETS:** | | | | |
| Cash and cash equivalents | 100,420 | 5,136 | 938 | 106,494 |
| Mandatory cash balances with the CBAR | 3,163 | - | - | 3,163 |
| Due from other banks | 184 | 5,898 | - | 6,082 |
| Loans and advances to customers | 501,281 | - | - | 501,281 |
| Investment securities | 46,840 | 6,026 | - | 52,866 |
| Other financial assets | 24,964 | - | - | 24,964 |
| **TOTAL FINANCIAL ASSETS** | **676,852** | **17,060** | **938** | **694,850** |
| **FINANCIAL LIABILITIES:** | | | | |
| Due to banks and other financial institutions | 18,340 | - | 1,567 | 19,907 |
| Customer accounts | 531,390 | 10,849 | 6,414 | 548,653 |
| Term borrowings | 97,028 | - | - | 97,028 |
| Subordinated debt | 16,036 | - | - | 16,036 |
| Lease liability | 4,157 | - | - | 4,157 |
| Other financial liabilities | 2,607 | - | - | 2,607 |
| **TOTAL FINANCIAL LIABILITIES** | **669,558** | **10,849** | **7,981** | **688,388** |
| **NET POSITION** | **7,294** | **6,211** | **(7,043)** | **6,462** |
| **CREDIT RELATED COMMITMENTS** | **94,387** | - | - | **94,387** |

Assets, liabilities and credit related commitments have generally been based on the country in which the counterparty is located. Balances with the Republic of Azerbaijan counterparties actually outstanding to/from off-shore companies of these the Republic of Azerbaijan counterparties are allocated to the caption "the Republic of Azerbaijan". Cash on hand and premises and equipment have been allocated based on the country in which they are physically held.

The geographical concentration of the Group's financial assets and liabilities at December 31, 2019 is set out below:

| | The Republic of Azerbaijan | OECD countries | Other non-OECD countries | Total |
|---|---|---|---|---|
| **FINANCIAL ASSETS:** | | | | |
| Cash and cash equivalents | 98,068 | 28,563 | 17,118 | 143,749 |
| Mandatory cash balances with the CBAR | 3,642 | - | - | 3,642 |
| Due from other banks | 7,646 | 6,565 | - | 14,211 |
| Loans and advances to customers | 454,558 | - | - | 454,558 |
| Investment securities | 47,813 | 35,220 | 1,703 | 84,736 |
| Other financial assets | 20,539 | - | - | 20,539 |
| **TOTAL FINANCIAL ASSETS** | **632,266** | **70,348** | **18,821** | **721,435** |
| **FINANCIAL LIABILITIES:** | | | | |
| Due to banks and other financial institutions | 30,139 | - | - | 30,139 |
| Customer accounts | 532,218 | 1,603 | 16,396 | 550,217 |
| Term borrowings | 77,553 | - | - | 77,553 |
| Subordinated debt | 7,153 | 9,876 | - | 17,029 |
| Leae liability | 3,830 | - | - | 3,830 |
| Other financial liabilities | 1,318 | - | - | 1,318 |
| **TOTAL FINANCIAL LIABILITIES** | **652,211** | **11,479** | **16,396** | **680,086** |
| **NET POSITION** | **(19,945)** | **58,869** | **2,425** | **41,349** |
| **CREDIT RELATED COMMITMENTS** | **78,205** | **-** | **-** | **78,205** |

### *Liquidity risk*

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations arising from its financial obligations. It refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments as they actually fall due. Liquidity risk exists when the maturities of assets and liabilities do not match. The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of financial institutions.

In order to manage liquidity risk, the Group performs daily monitoring of future expected cash flows on clients' and banking operations, which is part of the assets/liabilities management process. The Executive Board and Supervisory Board set limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals under both normal and stressed conditions. They also set parameters for the risk diversification of the liability base.

The Central Bank of the Republic of Azerbaijan has in place minimum levels of liquidity required. As of December 31, 2020 the Bank was in compliance with these covenants.

The Group's liquidity policy is comprised of the following:

- Projecting cash flows and maintaining the level of liquid assets necessary to ensure liquidity in various time-bands;
- Maintaining a funding plan commensurate with the Group's strategic goals;
- Maintaining a diverse range of funding sources thereby increasing the Group's borrowing capacity, domestically as well as from foreign sources;
- Maintaining highly liquid and high-quality assets;
- Adjusting its product base by time bands against available funding sources;
- Daily monitoring of liquidity ratios against regulatory requirements; and
- Constant monitoring of asset and liability structures by time-bands.

The treasury function within the Group is charged with the following responsibilities:

- Compliance with the liquidity requirements of the Central Bank of the Republic of Azerbaijan as well as with the liquidity requirement covenants contained in the agreements with foreign lending sources;
- Daily reports to management, including reporting to management on the forecast levels of cash flows in the main currencies (AZN, USD, EUR), cash positions, changes in the consolidated statement of financial position;
- Constantly controlling/monitoring the level of liquid assets;
- Monitoring of deposit and other liability concentrations; and
- Maintaining a plan for the instant increase of cash to provide liquidity under stressed conditions.

RMC is responsible for ensuring that Treasury properly manages the Group's liquidity position. The Risk Management Department is responsible for controlling these activities. Decisions on liquidity positions and management are made by the Executive Board. Funding plans are approved by the Supervisory Board.

The table below shows liabilities at December 31, 2020 by their remaining contractual maturity. The amounts disclosed in the maturity table are the contractual undiscounted cash flows, including gross loan commitments and financial guarantees. Such undiscounted cash flows differ from the amount included in the statement of financial position because the amount in the statement of financial position is based on discounted cash flows.

When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the end of the reporting period. Foreign currency payments are translated using the spot exchange rate at the end of the reporting period.

The undiscounted maturity analysis of financial assets and liabilities by contractual maturities at December 31, 2020 is as follows:

| | Demand and less than 1 month | From 1 to 6 months | From 6 to 12 months | From 12 months to 5 years | Over 5 years | No maturity | Total |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and cash equivalents | 106,494 | - | - | - | - | - | 106,494 |
| Mandatory cash balances with the CBAR | - | - | - | - | - | 3,163 | 3,163 |
| Due from other banks | 1,269 | 627 | 372 | 5,078 | - | 240 | 7,586 |
| Loans and advances to customers | 29,337 | 105,966 | 118,517 | 403,027 | 130,898 | - | 787,745 |
| Investment securities | 11,452 | 5,362 | 16,555 | 23,455 | - | 750 | 57,574 |
| Other financial assets | 24,964 | - | - | - | - | - | 24,964 |
| **Total financial assets** | **173,516** | **111,955** | **135,444** | **431,560** | **130,898** | **4,153** | **987,526** |

| | Demand and less than 1 month | From 1 to 6 months | From 6 to 12 months | From 12 months to 5 years | Over 5 years | No maturity | Total |
|---|---|---|---|---|---|---|---|
| **Liabilities** | | | | | | | |
| Due to banks and other financial institutions | (4,928) | (5,558) | (10,427) | - | - | - | (20,913) |
| Customer accounts | (171,853) | (109,161) | (206,004) | (38,173) | - | - | (525,191) |
| Term borrowings | (586) | (2,584) | (3,857) | (18,829) | (70,299) | - | (96,155) |
| Subordinated debt | - | (549) | (510) | (19,073) | - | - | (20,132) |
| Lease liability | (116) | (575) | (670) | (3,142) | (392) | - | (4,895) |
| Other financial liabilities | (2,607) | - | - | - | - | - | (2,607) |
| **Total financial liabilities** | **(180,090)** | **(118,427)** | **(221,468)** | **(79,217)** | **(70,691)** | **-** | **(669,893)** |
| **Net liquidity gap on recognized financial assets and liabilities** | **(6,574)** | **(6,472)** | **(86,024)** | **352,343** | **60,207** | **4,153** | **317,633** |
| **Cumulative liquidity gap on recognized financial assets and liabilities** | **(6,574)** | **(13,046)** | **(99,070)** | **253,273** | **313,480** | **317,633** | |
| **Credit related commitments** | **94,387** | **-** | **-** | **-** | **-** | **-** | **94,387** |

The undiscounted maturity analysis of financial assets and liabilities by contractual maturities at December 31, 2019 is as follows:

| | Demand and less than 1 month | From 1 to 6 months | From 6 to 12 months | From 12 months to 5 years | Over 5 years | No maturity | Total |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and cash equivalents | 143,749 | - | - | - | - | - | 143,749 |
| Mandatory cash balances with the CBAR | - | - | - | - | - | 3,642 | 3,642 |
| Due from other banks | 90 | 1,200 | 1,903 | 13,476 | - | 421 | 17,090 |
| Loans and advances to customers | 25,202 | 93,439 | 95,640 | 273,624 | 139,331 | - | 627,236 |
| Investment securities | 811 | 37,389 | 15,413 | 33,843 | - | 749 | 88,205 |
| Other financial assets | 20,539 | - | - | - | - | - | 20,539 |
| **Total financial assets** | **190,391** | **132,028** | **112,956** | **320,943** | **139,331** | **4,812** | **900,461** |

| | Demand and less than 1 month | From 1 to 6 months | From 6 to 12 months | From 12 months to 5 years | Over 5 years | No maturity | Total |
|---|---|---|---|---|---|---|---|
| **Liabilities** | | | | | | | |
| Due to banks and other financial institutions | (850) | (19,947) | (10,391) | - | - | - | (31,188) |
| Customer accounts | (220,935) | (173,399) | (120,381) | (57,237) | - | - | (571,952) |
| Term borrowings | (893) | (1,952) | (2,482) | (15,862) | (64,400) | - | (85,589) |
| Subordinated debt | - | (510) | (539) | (20,083) | - | - | (21,132) |
| Lease liability | (112) | (521) | (592) | (2,953) | (343) | - | (4,521) |
| Other financial liabilities | (1,318) | - | - | - | - | - | (1,318) |
| **Total financial liabilities** | **(224,108)** | **(196,329)** | **(134,385)** | **(96,135)** | **(64,743)** | **-** | **(715,700)** |
| **Net liquidity gap on recognized financial assets and liabilities** | **(33,717)** | **(64,301)** | **(21,429)** | **224,808** | **74,588** | **4,812** | **184,761** |
| **Cumulative liquidity gap on recognized financial assets and liabilities** | **(33,717)** | **(98,018)** | **(119,447)** | **105,361** | **179,949** | **184,761** | |
| **Credit related commitments** | **78,205** | **-** | **-** | **-** | **-** | **-** | **78,205** |

Customer accounts are classified in the above analysis based on contractual maturities. However, in accordance with Azerbaijan Civil Code, individuals have a right to withdraw their deposits prior to maturity if they forfeit their right to accrued interest.

The table presents an analysis of liquidity position of the Group's financial assets and liabilities by expected maturities as at December 31, 2020:

| | Demand and less than 1 month | From 1 to 6 months | From 6 to 12 months | Over 1 year | No maturity | Total |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and cash equivalents | 106,494 | - | - | - | - | 106,494 |
| Mandatory cash balances with the CBAR | - | - | - | - | 3,163 | 3,163 |
| Due from other banks | 1,207 | - | - | 4,635 | 240 | 6,082 |
| Loans and advances to customers | 21,049 | 67,174 | 79,663 | 333,395 | - | 501,281 |
| Investment securities | 31,936 | - | 6,284 | 13,896 | 750 | 52,866 |
| Other financial assets | 24,964 | - | - | - | - | 24,964 |
| **Total financial assets** | **185,650** | **67,174** | **85,947** | **351,926** | **4,153** | **694,850** |
| **Liabilities** | | | | | | |
| Due to banks and other financial institutions | (4,882) | (5,025) | (10,000) | - | - | (19,907) |
| Customer accounts | (6,866) | (1,606) | (5,289) | (534,892) | - | (548,653) |
| Term borrowings | (3,410) | (1,890) | (9,138) | (82,590) | - | (97,028) |
| Subordinated debt | (39) | - | - | (15,997) | - | (16,036) |
| Lease liability | (90) | (453) | (543) | (3,071) | - | (4,157) |
| Other financial liabilities | (2,607) | - | - | - | - | (2,607) |
| **Total financial liabilities** | **(17,894)** | **(8,974)** | **(24,970)** | **(636,550)** | **-** | **(688,388)** |
| **Net liquidity gap December 31, 2020** | **167,756** | **58,200** | **60,977** | **(284,624)** | **4,153** | **6,462** |
| **Cumulative liquidity gap December 31, 2020** | **167,756** | **225,956** | **286,933** | **2,309** | **6,462** | |

The table presents an analysis of liquidity position of the Group's financial assets and liabilities by expected maturities as at December 31, 2019:

| | Demand and less than 1 month | From 1 to 6 months | From 6 to 12 months | Over 1 year | No maturity | Total |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and cash equivalents | 143,749 | - | - | - | - | 143,749 |
| Mandatory cash balances with the CBAR | - | - | - | - | 3,642 | 3,642 |
| Due from other banks | - | - | 1,360 | 12,430 | 421 | 14,211 |
| Loans and advances to customers | 20,554 | 62,839 | 66,360 | 304,805 | - | 454,558 |
| Investment securities | 36,157 | 30,798 | 4,245 | 12,787 | 749 | 84,736 |
| Other financial assets | 20,539 | - | - | - | - | 20,539 |
| **Total financial assets** | **220,999** | **93,637** | **71,965** | **330,022** | **4,812** | **721,435** |
| **Liabilities** | | | | | | |
| Due to banks and other financial institutions | (639) | (19,500) | (10,000) | - | - | (30,139) |
| Customer accounts | (1,542) | (2,728) | (1,023) | (544,924) | - | (550,217) |
| Term borrowings | (749) | (1,348) | (179) | (75,277) | - | (77,553) |
| Subordinated debt | (29) | - | - | (17,000) | - | (17,029) |
| Lease liability | (88) | (409) | (475) | (2,858) | - | (3,830) |
| Other financial liabilities | (1,318) | - | - | - | - | (1,318) |
| **Total financial liabilities** | **(4,365)** | **(23,985)** | **(11,677)** | **(640,059)** | **-** | **(680,086)** |
| **Net liquidity gap December 31, 2019** | **216,634** | **69,652** | **60,288** | **(310,037)** | **4,812** | **41,349** |
| **Cumulative liquidity gap December 31, 2019** | **216,634** | **286,286** | **346,574** | **36,537** | **41,349** | |

The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group. An unmatched position potentially enhances profitability, but can also increase the risk of losses. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Group and its exposure to changes in interest and exchange rates.

Management believes that in spite of a substantial portion of customer accounts being on demand, diversification of these deposits by number and type of depositors, and the past experience of the Group would indicate that these customer accounts provide a long-term and stable source of funding for the Group.

Liquidity requirements to support calls under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Group does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded. Refer to Note 29 for liquidity mismatch of the Group.

### *Operational risk*

The Group is exposed to operational risk. Operational risk is defined as the risk of loss, whether direct or indirect, resulting from inadequate or failed internal processes, people or systems or due to external factors other than credit, market and liquidity risks. Inadequate or inappropriately designed business process systems, management failures, technology failures, faulty control structures, human error, fraud and non-conformance to generally accepted standards of corporate behavior can cause losses for an organization.

The Group's objective in managing operational risk is to balance the avoidance of financial losses and damage to the Group's reputation with overall operational efficiencies and cost effectiveness.

Operational risk arises in the unit that generates an operation, and so the primary responsibility for addressing operational risk lies within each business unit. This responsibility is supported by the development of overall standards within the general internal control system of the Group. The approach of the Group's internal control system covers the following areas:

- requirements for the appropriate segregation of duties, including avoidance of conflicts of interest, independent authorization of transactions and strict delineations of system access rights;
- requirements for the reconciliation and monitoring of transactions;
- compliance with regulatory and other legal requirements;
- documentation of controls, procedures and instructions and their approval across business and risk management lines;
- constant control and monitoring of adherence to controls, procedures and instructions, including a strong internal audit function;
- continuous evaluation of present and potential operational risks;
- continuous evaluation of the adequacy of controls and procedures in addressing the risks identified;
- development of contingency plans;
- continual evaluation of IT security issues;
- requirements for the reporting of operational errors and losses and proposed remedial actions;
- appropriate recruitment, training and professional development;
- ensuring adherence to the Group's out-sourcing policy;
- ethical and code of conduct standards; and
- implementation of risk mitigation measures, including insurance.

The Operational Risk Group of the Risk Management Department and Internal Audit have primary responsibility for monitoring, reporting and making recommendations to improve the Group's operational risk management.

## 30. CONTINGENCIES AND COMMITMENTS

***Legal proceedings*** – From time to time and in the normal course of business, claims against the Group are received from customers and counterparties. Management is of the opinion that no material unaccrued losses will be incurred and accordingly no provision has been made in this consolidated financial statements.

***Taxation*** – Commercial legislation of the Republic of Azerbaijan, including tax legislation, may allow more than one interpretation. In addition, there is a risk of tax authorities making arbitrary judgments of business activities. If a particular treatment, based on management's judgment of the Group's business activities, was to be challenged by the tax authorities, the Group may be assessed additional taxes, penalties and interest.

Such uncertainty may relate to the valuation of financial instruments, valuation of provision for impairment losses and the market pricing of deals. Additionally, such uncertainty may relate to the valuation of temporary differences on the provision and recovery of the provision for impairment losses on loans to customers and receivables, as an underestimation of the taxable profit. The management of the Group believes that it has accrued all tax amounts due and therefore no allowance has been made in the consolidated financial statements.

Generally, taxpayers are subject to tax audits with respect to three calendar years preceding the year of the audit. However, completed audits do not exclude the possibility of subsequent additional tax audits performed by upper-level tax inspectorates reviewing the results of tax audits of their subordinate tax inspectorates. In the case of criminal investigation statute of limitation may be extended up to seven years based on the court decision.

***Credit related commitments*** – The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. Documentary and commercial letters of credit, which are written undertakings by the Group on behalf of a customer authorizing a third party to draw drafts on the Group up to a stipulated amount under specific terms and conditions, are collateralized by the underlying shipments of goods, to which they relate, or cash deposits and, therefore, carry less risk than a direct borrowing.

Commitments to extend credit represent unused portions of authorizations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group monitors the term to maturity of credit related commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Outstanding amount of credit related commitments are, as follows:

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| Cancellable undrawn credit lines | 89,220 | 70,390 |
| Letters of guarantee and similar commitments | 5,653 | 13,075 |
| Less: Expected credit losses for credit related commitments | (486) | (5,260) |
| **Total credit related commitments** | **94,387** | **78,205** |

The total outstanding contractual amount of undrawn credit lines, letters of credit, and guarantees does not necessarily represent future cash requirements, as these financial instruments may expire or terminate without being funded. Credit related commitments are denominated in currencies as follows:

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| Azerbaijani Manats | 87,201 | 60,117 |
| US Dollars | 6,892 | 16,547 |
| Euro | 294 | 1,541 |
| **Total** | **94,387** | **78,205** |

Liquidity and currency analysis of contingencies and commitments are disclosed in Note 29. Information on related party balances is disclosed in Note 32.

## 31. FAIR VALUE OF FINANCIAL INSTRUMENTS

IFRS defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

### Fair value hierarchy

The Group measures fair values using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurements:

- **Level 1**: quoted market price (unadjusted) in an active market for an identical instrument.
- **Level 2**: inputs other than quotes prices included within Level 1 that are observable either directly (i.e., as prices) or indirectly (i.e., derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- **Level 3**: inputs that are unobservable. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

The table below analyses financial instruments measured at fair value at December 31, 2020 and 2019, by the level in the fair value hierarchy into which the fair value measurement is categorized. The amounts are based on the values recognized in the consolidated statement of financial position:

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| Investment securities at level 1 | 33,997 | 76,672 |
| Investment securities at level 3 | 18,869 | 8,064 |
| | **52,866** | **84,736** |

### Fair value of financial assets and financial liabilities that are not measured at fair value on a recurring basis (but fair value disclosures are required)

Except as detailed in the following table, the directors consider that the carrying amounts of financial assets and financial liabilities recognized in the consolidated financial statements approximate their fair values.

| | December 31, 2020 | | December 31, 2019 | |
|---|---|---|---|---|
| | Carrying value | Fair value | Carrying value | Fair value |
| Cash and cash equivalents | 106,494 | 106,494 | 143,749 | 143,749 |
| Mandatory cash balances with the CBAR | 3,163 | 3,163 | 3,642 | 3,642 |
| Due from other banks | 6,082 | 6,082 | 14,211 | 14,211 |
| Loans and advances to customers | 501,281 | 501,281 | 454,558 | 454,558 |
| Other financial assets | 24,964 | 24,964 | 20,539 | 20,539 |
| **Total financial assets:** | **641,984** | **641,984** | **636,699** | **636,699** |
| Due to other banks and financial institutions | 19,907 | 19,907 | 30,139 | 30,139 |
| Customer accounts | 548,653 | 548,653 | 550,217 | 550,217 |
| Term borrowings | 97,028 | 97,028 | 77,553 | 77,553 |
| Subordinated debt | 16,036 | 16,036 | 17,029 | 17,029 |
| Lease liability | 4,157 | 4,157 | 3,830 | 3,830 |
| Other financial liabilities | 2,607 | 2,607 | 1,318 | 1,318 |
| **Total financial liabilities:** | **688,388** | **688,388** | **680,086** | **680,086** |

The fair values of the financial assets and financial liabilities included in the Level 2 and Level 3 categories above have been determined in accordance with generally accepted pricing models based on a discounted cash flow analysis, with the most significant inputs being the discount rate that reflects the credit risk of counterparties.

## 32. RELATED PARTY TRANSACTIONS

Parties are generally considered to be related if the parties are under common control or one party has the ability to control the other party or can 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.

As at December 31, 2020 and 2019, the outstanding balances with related parties were as follows:

| | December 31, 2020 | | | | December 31, 2019 | | | |
|---|---|---|---|---|---|---|---|---|
| | Key management personnel | Ultimate controlling party | Other shareholders | Other related parties | Key management personnel | Ultimate controlling party | Other shareholders | Other related parties |
| Gross amount of loans and advances to customers (contractual interest rate: 2020:4% - 26% p.a.; 2019: 8% - 28% p.a.) | 179 | 59 | - | 61 | 140 | 96 | - | - |
| Allowance for expected credit losses | (1) | - | - | - | (1) | (1) | - | - |
| Investment securities | - | - | - | 400 | - | - | - | 400 |
| Current/settlements accounts | 370 | 515 | - | 370 | 126 | 94 | - | 76 |
| Term deposits (contractual interest rate: 2020: 0.5% - 10% p.a.; 2019: 2% - 8% p.a.) | 694 | - | - | - | 322 | - | - | 1,000 |
| Subordinated debt (contractual interest rate: 2020: 6% p.a.; 2019: 6% p.a.) | - | - | - | - | - | - | 9,876 | - |

As at December 31, 2020 and 2019 fair value of collaterals pledged in respect to loans issued to key management personnel amounted to AZN 412 thousand and AZN 222 thousand, respectively.

The income and expense items with related parties for the years ended December 31, 2020 and 2019 were as follows:

| | Year ended December 31, 2020 | | | | Year ended December 31, 2019 | | | |
|---|---|---|---|---|---|---|---|---|
| | Key management personnel | Ultimate controlling party | Other shareholders | Other related parties | Key management personnel | Ultimate controlling party | Other shareholders | Other related parties |
| Interest income | 12 | 6 | - | 17 | 20 | 18 | - | - |
| Interest expense | (26) | (1) | (154) | (34) | (3) | - | (362) | (276) |
| Provision for/(recovery of) expected credit loss | 1 | - | - | - | 2 | 4 | - | - |
| Fee and commission income | 3 | 14 | - | 19 | 3 | 28 | - | 22 |
| Other income | - | 9 | - | 13 | - | - | - | 5 |
| Administrative and other operating expense | 2,183 | 2,122 | - | 383 | 1,890 | 266 | - | 277 |

During the year ended December 31, 2020, the remuneration of key management personnel comprised salaries and bonuses totaling to AZN 4,304 thousand (December 31, 2019: AZN 2,156 thousand).

Other rights and obligations with related parties were as follows:

| | December 31, 2020 | | | | December 31, 2019 | | | |
|---|---|---|---|---|---|---|---|---|
| | Key management personnel | Ultimate controlling party | Other shareholders | Other related parties | Key management personnel | Ultimate controlling party | Other shareholders | Other related parties |
| Letters of guarantee | - | - | - | 169 | - | - | - | - |