Pillar 3 Annual Report / 2018

ბაზისბანკი
BASISBANK
Hualing Group Member

CONTENTS

EXECUTIVE SUMMARY

Pillar 3 disclosures of JSC Basisbank and the Group[1] are based on Disclosure Requirements under Pillar 3 by Basel Committee on Banking Supervision, the European Union directives N 575/2013 and in line with the framework of the "Regulation on Disclosure Requirements for Commercial Banks under Pillar 3" introduced by the National Bank of Georgia (NBG).

MANAGEMENT STATEMENT

The Management Board confirms that the information provided in the present Basisbank 2018 Pillar 3 Report is accurate and free of any misstatement.

The present report meets the requirements of the Decree №92/04 of the Governor of the National Bank of Georgia of April 2017 on Regulation on Disclosure Requirements for Commercial Banks under Pillar 3, along with other rules and regulations set by the NBG.

Unless otherwise stated, all data and information disclosed in the present report is presented according to the local reporting standards set by the NBG. The present regulation does not require to have Pillar 3 disclosures audited. The report is prepared in full observation of the internal control processes as agreed with the Supervisory Board.

ABOUT THE GROUP

Basisbank, together with the subsidiaried operating under its umbrella, (collectively to be referred to as "the Group") is a diversified financial institution. The activities of the Group is focused on the financial services area and includes commercial and retail banking services, insurance and leasing.

Basisbank is the 6th largest bank in the financial market, as at 31 December 2018 its assets exceeding GEL 1.4 billion and number of clients reaching 127000. The Group operates in almost all regions of Georgia, with 463 employees working at 22 branches serving the clients.

Basisbank unites three subsidiaries under its umbrella:

- BAMH Asset Management Holding Company LTD
- JSC Hualing Insurance
- JSC BHL Leasing

The group's strategy is oriented on to diversifying its business model and develop on the market by reinforcing our operational capacity and our competitive position, goal of our strategic measures is to make the Bank a stronger player on the market by gaining sizeable market share, through its increased presence across country, armed with strong client franchise and healthy capital structure.

[1] The group hereafter refers to JSC Basisbank and its subsidiaries consolidated

KEY FINANCIAL INDICTORS

Financial Statements under IFRS and local supervisory standards as at 31 December 2018.

TABLE 1 In Thousand GEL

	IFRS STATEMENTS (consolidated)	IFRS STATEMENTS (bank stand-alone)	FINANCIAL STATEMENTS local standards (bank stand-alone)
Cash and cash equivalents	132,500	130,272	131,602
Mandatory cash balances with the NBG	170,443	170,443	170,443
Investments in debt securities	175,690	175,690	175,877
Investments in equity securities	63	63	63
Investment in subsidiaries	-	10,096	6,300
Loans and advances to customers	900,803	900,803	884,876
Investment properties	1,572	1,037	-
Current income tax prepayment	5	-	-
other financial assets	5,066	809	1,001
Other assets	17,449	15,031	13,520
Intangible assets	1,382	1,364	1,364
Premises and equipment	26,457	26,421	26,637
Non-current assets held for sale	4,360	4,016	-
TOTAL ASSETS	1,435,790	1,436,045	1,411,682
Due to other banks	100,196	100,196	100,232
Customer accounts	727,421	734,262	733,110
Other borrowed funds	345,782	345,782	347,676
Insurance and other financial liabilities	6,353	1,822	4,153
Current income tax liability	1,647	1,374	1,374
Deferred income tax liability	1,671	1,664	2,288
Provisions for liabilities and charges	374	374	949
Other liabilities	2,812	2,410	2,966
TOTAL LIABILITIES	1,186,256	1,187,884	1,192,749
Share capital	16,057	16,057	16,138
Share premium	74,923	74,923	75,784
Retained earnings	147,931	146,559	117,359
Share based payment reserve	1,339	1,339	-
Revaluation reserve for premises	9,284	9,284	9,653
TOTAL EQUITY	249,534	248,161	218,933

KEY FINANCIAL RATIOS

TABLE 2

CAPITAL RATIOS	DEC-18	DEC-17
Common equity Tier 1 ratio>=8.926	16.93%	17.92%
Tier 1 ratio >=11.076	16.93%	17.92%
Total Regulatory Capital ratio >=16.767	18.08%	19.08%
INCOME		
Total Interest Income /Average Annual Assets	7.84%	7.49%
Total Interest Expense / Average Annual Assets	3.51%	3.20%
Earnings from Operations / Average Annual Assets	3.15%	3.33%
Net Interest Margin	4.33%	4.29%
Return on Average Assets (ROAA)	2.87%	1.91%
Return on Average Equity (ROAE)	17.64%	11.04%
ASSET QUALITY		
Non Performed Loans / Total Loans	3.76%	4.02%
LLR/Total Loans	3.76%	4.26%
FX Loans/Total Loans	63.05%	70.24%
FX Assets/Total Assets	57.23%	63.64%
Loan Growth-YTD	16.27%	42.20%
LIQUIDITY		
Liquid Assets/Total Assets	30.38%	33.06%
FX Liabilities/Total Liabilities	69.73%	77.70%
Current & Demand Deposits/Total Assets	26.60%	31.95%

SUPERVISORY REQUIREMENTS UNDER BASEL 3 FRAMEWORK

In 2013 the NBG Regulation on Capital Adequacy Requirements for Commercial Banks became effective. The principles of the regulation are based on the requirements of the capital adequacy framework, i.e. Basel 3, of the Basel Committee on Banking Supervision, and directives and regulations of European Union N 575/2013 approved on 26 June 2013.

The purpose of Basel 3 is strengthening of capitalization, liquidity, market and other risk-related requirements and ensuring of transparency. It sets:

- Capital adequacy requirements;
- Liquidity requirements;
- Requirements related to risk concentration;
- Requirements for leverage ratio;
- Requirements related to relevance of administrators and corporate governance;
- Requirements related to transparency and disclosure.

Under Basel 3, Capital Adequacy Requirements for Commercial Banks are based on three pillars: Pillar 1 sets minimum requirements for regulatory capital; Pillar 2 covers supervisory review and capital assessment process and Regulation on Additional Capital Buffers; Pillar 3 is about information disclosure by commercial banks.

Pillar 1 regulatory framework defines the value of the risk-weighted assets and sets minimum capital requirements for credit, market and operational risk exposures.

Pillar 2 includes a supervisory reviewing and assessment process, in which the National Bank examines the relevant risks management policies implemented by commercial banks, strategies, processes and mechanisms and their compliance with the Bank's risk positions; In addition to fulfilling minimum capital requirements, the Commercial Bank is obliged to comply with the requirements of the additional capital buffer for the risks that are not included in the Pillar 1 (including market risks that are not included in the Pillar 1. For example, the concentration risks, interest, liquidity, strategic and reputation risks and more).

Pillar 3 - Commercial Banks are obliged to provide a high level of transparency aimed at raising confidence towards the financial sector and protection of consumer and investor rights. This is regulated by the requirements of Pillar 3 and implies publishing quantitative and qualitative information by the Bank - disclosure of information on capital adequacy, corporate governance, risk concentrations and management standards, as well as disclosure of internal processes and other important information.

CAPITAL REQUIREMENTS

Within Pillar 1, the minimum capital requirements	
Common Equity Tier 1 (CET 1) ratio of RWAs	4.5%
Tier 1 Capital ratio of RWAs	6%
Total Regulatory Capital of RWAs	8%

Tier 1 - minimum capital requirement applicable is 4.5 %. It represents the primary source of the capital, i.e. the equity that includes common stock and additional reserves (additional funds originated as a result of issuing the common tier 1 capital instruments; as well as accumulated reserves /retained earnings) less supervisory adjustments.

Additional Tier 1 capital - (AT1) is unsecured, perpetual capital instruments that have no step-ups, are subordinated to depositors, unsecured creditors and subordinated debt of the commercial bank; and are not subject to legal or economic conditions that put the claim in the senior position vis-à-vis bank creditors, while the bank retains the discretion on suspension/payment of dividend/coupon. At least 6% of risk-weighted assets are required to be covered by Such Tier 1 capital (CET1 plus AT1), considering regulatory adjustments.

Supervisory Capital - Commercial Bank's capital adequacy is determined by its supervisory capital, composed of basic and additional premium capital elements and secondary, liquidation capital.

Tier 2 capital (liquidation) comprises certain subordinated instruments, unsecured securities, long-term liabilities, with the original term of more than 5 years, with no step-ups. These do not have the conditions that could promote the investor’s right to accelerate the future payments (coupon or principal), except for bankruptcy and liquidation cases.

ADDITIONAL SUPERVISORY REQUIREMENTS – CAPITAL BUFFERS

In addition to the minimum capital requirements under Pillar 1, NBG sets capital buffer requirements within pillar 1 and pillar 2 framework.

Under pillar 1 commercial banks are required to meet a combination of capital buffer requirements comprising three components:

- The capital conservation buffer is a standard buffer, defined as 2.5% of total risk-weighted risk exposures, and is designed to provide for risks originated as a result of stress events.
- The countercyclical buffer represents one of the main macro-prudential policy instruments, with the goal to limit excessive credit growth that leads to the build-up of systemic risks. In determining the countercyclical capital buffer, an analysis of a number of factors is taken into account, including the credit-to-GDP ratio and indicators describing its deviation from the long-run trend; trends in lending, along with other indicators and characteristics of the country's macro-financial environment.
- Systemic buffers are set additionally by the NBG for systemically important commercial banks.

SUPERVISORY REQUIREMENTS FOR JSC BASISBANK

The Supervisory Requirements of BasisBank include minimum supervisory requirements set within the framework of Pillar 1, plus capital conservation buffer and countercyclical buffer, which is currently defined by the National Bank at 0%. As for system buffers, Basisbank is not considered by the National Bank as a system-maker, so the systemic capital buffer rate for Basisbank is set at 0%.

The requirements introduced under Pillar 2 define the following buffers:

- Unhedged currency induced credit risk buffer;
- Credit portfolio concentration risk buffer, consisting of the name and sectoral concentration buffers;
- Net stress test buffer, set in accordance with supervisory stress tests;
- Net GRAPE buffer is set as part of the review of the risk categories and the bank's internal capital adequacy within the NBG's General Risk Assessment Program.

Capital buffers defined by Pillar 2 are individual for all banks and depend on the Bank's risk positions concentration. Individual GRAPE buffers also became active during 2018.

According to NBG's current capital requirements, the banks are obliged to maintain a ratio of regulatory capital to risk-weighted assets (capital ratio) at the minimum required limit.

By December 2018, the distribution of the concentration (name and sectoral) buffer and the net GRAPE buffer requirement for capital elements was carried out in the following percentage ratio:

Common Tier 1 Capital	15%
Tier 1 Capital	20%
Total Regulatory Capital	100%

RISK WEIGHTED RISK EXPOSURES

Risk weighted risk exposure is the sum of the credit risk, market risk and operational risk weighted risk exposures.

CREDIT RISK ANALYSIS

In accordance with the current regulation, the bank uses a standardized approach to calculate the credit risk weighted risk exposure.

Credit risk exposure consists of three components: balance elements, off-balance elements and counterparty-related credit risk weighted risk exposures.

The cost of the risk exposure for balance elements is interest, penalty, accounts receivable, and other claims against the party, reduced by special reserve and capital adjustment and added to the principal.

In the calculation of the credit risk exposure Basisbank uses the following permissible methods:

- Loans secured by residential real estate are weighted at the 35% risk weight;
- Credit risk mitigation;
- Use of ratings established by external credit rating agencies;

Using credit mitigation

The Bank stated that it would mitigate the risk exposure in case of the “funded collateral of the loan”, i.e. reduce it in consideration of the value of collateral/guarantee and credit evaluation weight. In case the debtor is at default, the bank has the right to sell and/or repossess the collateralized assets in a timely manner. For these purposes, it is permitted to subtract risk position only with the funds available on the client’s deposit account. Accordingly, the risk position, is considered as funded collateral when it is secured with deposit. The deposit can be owned as by the borrower client as well by the third party. Deposit taken as collateral (or its part used as collateral) must be free of other liabilities.

Note: As of December 2018 the credit mitigation is equal to GEL 98,142 thousand. See Appendix 1, Table 12.

Evaluation by Credit Rating Agencies

With the recommendation of the National Bank of Georgia, the assessments of the following agencies - Moody’s, Fitch, Standard&Poors, can be regarded as credit assessments by external credit rating agencies.

Evaluations of the specified agencies comply with the six-step scale, summarized in the table below:

he 6-Step Credit Quality Assessment Scale		
Fitch	Moody’s	S&P
AAA to AA-	Aaa to Aa3	AAA to AA-
A+ to A-	A1 to A3	A+ to A-
BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-
BB+ to BB-	Ba1 to Ba3	BB+ to BB-
B+ to B-	B1 to B3	B+ to B-
CCC+ and lower	Caa1 and lower	CCC+ and lower

The assessments for the short-term evaluation will be made in accordance with the following table:

The 6-Step Credit Quality Assessment Scale		
Fitch	Moody’s	S&P
F1+, F1	P-1	A-1+, A-1
F2	P-2	A-2
F3	P-3	A-3
lower than F3	NP	B-1, B-2, B-3, C

Note: starting from July, 2018, the NBG introduced the Regulation on Defining the Unhedged Borrowers. The borrower risk exposure can be attributed to the hedged category, if the repayment of their claims is considered by:

1. The versatile banks and those financial institutions, against whom the risk exposures are weighted at 0%.
2. Production of the standardized merchandise/proceeds from trade and products are traded (pricing) in the same currency as the loan.
3. Proceeds from export, sales price for the product is in the same currency as the loan.
4. Proceeds from the hotels; majority (>50%) of the hotel visitors are from foreign countries.
5. Proceeds from electric energy production sector; 50% of the risk exposure;
6. Borrowers that meet the below criteria:

   - Debt / EBITDA <=1.5
   - EBIT / Interest Expenses >=5.0
   - Equity / Assets >=75%

It is also important that the Regulation on Asset Classification and the Creation and Use of Loan Loss Reserves by Commercial Banks sets the minimum requirements for "Loan Services" (PTI) and Loan Security (LTV) ratios for the loans classified as standard and issued to individuals. The amendments double the risk weight for those unsecured consumer loans, which do not meet the requirements related to the loan service and security ratios. If the commercial banks breach the limits set under the revised regulation, they face the sharply increased regulatory burden in terms of capital adequacy requirements.

The cost of the risk exposure for off-balance elements is their value, reduced by special reserves, multiplied by the credit conversion factor. The effect of the credit conversion factor the credit risk conversion factor of the off-balance elements related to the credit risk weighting as of December 2018, is GEL 38,161 thousand GEL. Please refer to Appendix 1, Table 8.

Counterparty-related credit risk weighted risk exposures - The counterparty-related credit risk is the risk of counterparty's default before completion of the transaction. For these purposes, only the risks associated with the counterparty that are included in the interest rate and exchange rate derivative instruments (futures, forwards, swaps, options and other off-balance liabilities from similar agreements) are considered. If the term of the agreements on the interest rate and the exchange rate derivative instruments does not exceed 14 calendar days, it does not take into consideration for the risk weighting purposes.

As of December 31, 2018, the bank had no counterparty-related, exchange rate and interest rate-related contracts. Please refer to Appendix 1, table 15.

MARKET RISK WEIGHTED RISK EXPOSURES

Within Pillar-1, only currency risk is considered as part of market risk. Market risk weighted risk exposure equals to the overall open currency position defined under the Regulation on Limit defining, calculation and following of overall open currency position for Commercial Banks".

The currency risk arises at open and improperly hedged positions as a result of unexpected movements in certain currency (this causes the possible losses of market participant related to internal or settlement currency).

Currency positions are managed in compliance with Bank Management's foreign exchange policy. Foreign exchange management policy comprises limits for everyday positions and limit of overall open currency positions, which is 5% of supervisory capital, which is quite strict, compared with limits allowed by NBG (limit of 20% for the open net position).

OPERATIONAL RISK ANALYSIS

Within the framework of Pillar 1, the capital requirement is calculated using the Basic Indicator Approach (BIA). The operational capital requirement, according to BIA, should amount to 15% of the NBG-set indicator. It is defined as the average of the sum of net interest and net non-interest revenues for the last three years.

Note: As of December, 2018, the operational risk-weighted risk exposure amounts to GEL 100,987. Please refer to Appendix 2, table 23.

During the evaluation and management of operational risks, the bank also uses other qualitative and quantitative criteria, that provides a more comprehensive and effective management of operational risks. Operational risk activity is governed by Regulation on Operational Risk Management.

The following instruments are used:

- Data accumulation on losses and damages: obtaining of fixed losses with participation of business-units (collection of decentralized data);
- Self-assessment: evaluation of possible losses with participation of business-units; (assessment of frequency and severity of incurred losses)
- Definition of appropriate measures for risk mitigation - based on incurred losses and analysis obtained as a result of self-assessment.

Operational risk at BasisBank is managed at three levels (Business-unit/department level, operational risk management level, audit level), that provides constant control of operational risks.

Operational risks department assesses required capital defined using the BIA on an annual basis as well as the projected level of loss coverage resulting from an internal evaluation. If operational risk management considers that BIA has not sufficiently covered the potential losses, the additional capital is allocated based on the request of the operational risk management.

TABLE 3

In Thousand GEL

	2018	2017	2016
Total amount of losses	14,395	15,504	50,200
Total amount of losses, exceeding GEL 10,000	-	-	37,712
Number of events with losses exceeding GEL 10,000	-	-	2
Total amount of 5 biggest losses	6,577	10,779	42,528

JSC BASISBANK TIER 1 AND REGULATORY CAPITAL POSITION AS OF 2018

TABLE 4 In Thousand GEL

REGULATORY CAPITAL - PILLAR 1/2	DEC-18
Common shares that comply with the criteria for Common Equity Tier 1	16,138
Stock surplus (share premium) of common share that meets the criteria of Common Equity Tier 1	75,784
Other disclosed reserves	91,782
Retained earnings (loss)	35,230
Common Equity Tier 1 capital before regulatory adjustments	218,933
Regulatory Adjustments of Common Equity Tier 1 capital	(11,017)
Common Equity Tier 1	207,917
Additional tier 1 capital before regulatory adjustments	-
Tier 2 capital before regulatory adjustments	14,064
Regulatory capital	221,981
Risk-weighted assets (RWA) (Based on Basel III framework)	1,227,819
TIER 1 RATIO	16.93%
TOTAL REGULATORY CAPITAL RATIO	18.08%

Based on the data of 2018, supervisory components are adjusted by the following elements:

- With asset revaluation reserves 9,653 thousand GEL
- With intangible assets, 1,364 thousand GEL

The Bank has invested in three companies, which are accounted for by full consolidation.

1. Insurance Company Hulling Insurance. This significant investment in equity is subject to limited recognition. The value of the investment does not exceed the 10% significant investment threshold, so there is no reduction in capital by this element.

2. Asset Management Company Basis Asset Management Holding is recorded in equity as the component adjusting the common tier 1 capital.

3. JSC BHL Leasing. This investment in equity is subject to limited recognition. The value of the investment does not exceed the10% significant investment threshold, so there is no reduction in capital by this element.

TABLE 5 In Thousand GEL

RISK WEIGHTED RISK EXPOSURES	DEC-18	DEC-17
Credit-risk weighted risk exposures	1,125,113	903,929
Balance elements	1,032,467	849,790
Off-balance elements	92,646	54,139
Counterparty-related credit risk weighted risk exposures	-	-
Market risk weighted risk exposures	1,719	748
Operational risk weighted risk exposures	100,987	75,594
TOTAL RISK WEIGHTED RISK EXPOSURES	1,227,819	980,272

ADDITIONAL BASEL 3 REQUIREMENTS

LEVERAGE RATIO

The leverage ratio was introduced by the NBG in 2018 based on the recommendations by the Basel Committee of Banking Supervision, which is the capital risk based additional requirement.

To calculate the leverage ratio, the primary capital is divided to the total risk exposure and expressed as percentage. The total risk exposure is the sum of: balance risk exposure, derivatives, security-funded transactions and off-balance sheet elements.

On September 26, 2018, based on the Decree of the Governor of the National Bank of Georgia No. 214/04, the bank leverage should always exceed 5%.

Note: As of December 31, 2018, the Basisbank indicator is 14%. Please refer to Appendix I, TABLE 15.1.

LIQUIDITY RISK

In parallel with the capital standards based on Basel 3 framework, the NBG introduced LCR – Liquidity Coverage Ratio. The aim of the ratio is for the commercial banks to hold liquid assets sufficient for covering total net outflows in financial stress situations. For this purpose, the bank needs to maintain adequate level of liquidity, to allow it to cope with the expected difference between the inflow and outflow of liquid funds within a 30-day stress environment. Except for the LCR, the liquidity of commercial banks is regulated through the average liquidity ratio, which is the ratio of average liquid assets of the reporting month to the same month's average liabilities.

The table below shows the LCR for December as at 31 December 2018

In Thousand GEL

LIQUIDITY COVERAGE RATIO (LCR)	DEC-18
High quality liquid assets (total)	385,346
Net cash outflow (total)	225,044
LCR (%)	171%

Note: The National Bank intends to introduce long-term liquidity ratio starting from 2019 – Net Stable Funding Ratio (NSFR), to be in full compliance with Basel 3 standards. This ratio restricts dependence from short-term financing and stabilizes the risk of funding.

The NSFR is defined as the ratio of available stable funding to the need of stable funding. The compulsory requirement is the minimum of 100%. After the requirement is implemented, starting from 2020, the average liquidity requirement will be abolished.

GROUP STRUCTURE AND GOVERNANCE

Joint Stock Company “Basisbank” (hereinafter referred to as “Bank”) was established on August 16, 1993, registered by the National Bank of Georgia on November 04, 1993 according to the Law of Georgia on Entrepreneurs. In accordance with the Georgian legislation, Bank holds license for the banking activities issued by the National Bank of Georgia (November 4, 1993, license N173). The Bank’s registered address is: is: #1 Ketevan Tsamebuli Avenue, Tbilisi 0103, Georgia.

The Bank is a universal banking institution and the area of its business is banking and related activities in compliance with the active legislation.

SHAREHOLDER STRUCTURE

Xinjiang Hualing Industry & Trade (Group) Co Ltd, incorporated in People’s Republic of China, has been the Bank’s immediate parent company since 2012 and the Bank was ultimately controlled by Mr. Mi Enhua.

The list of BB’s Shareholders as at 31 December 2018:

List of shareholders holding 1% or more share of the authorized capital with indication of their shares	
"Xinjiang HuaLing Industry & Trade (Group) Co" Ltd	91.85%
Mi Zaiqi	6.93%
List of Beneficiaries of the Bank who hold, directly or indirectly, 5 or more percent of shares with indication of their shares	
Mi Enhua	91.76%
Mi Zaiqi	6.93%

MAIN SHAREHOLDER

Xinjiang Hualing Industry and Trade Group Co. (Hualing Group) is a Chinese private enterprise group with broadly diversified businesses including commercial real estate development, management, foreign trade, logistics, construction, tourism and financial industry. Founded in 1988, Hualing Group has built its diversified business around 30 affiliated subsidiary companies where 5000 employees are working. At the end of 2018, the Group recorded US$ 29 million of registered capital and US$ 1,004 billion of net worth. The founder and owner of the Group is Mr. Mi Enhua, who owns 99.904% of Hualing Group shares and 91.76% of Basisbank shares.

The rights and obligations of Basisbank shareholders is defined by the bank’s Charter. Shareholder of the ordinary shares is authorized to: receive full and timely information about the venue, date, and agenda of the General Meeting of Shareholders, along with the information on the agenda of the meeting; participate in the management of the Bank through taking part in the General Meeting of Shareholders; exercise the voting right at the General Meeting of Shareholders; receive dividends; purchase or sell his/her own shares in accordance with the active legislation; use the preferential right on new share acquisition in proportion to their share in the authorized capital.

BANK GROUP STRUCTURE – SUBSIDIARIES

Presently, Basisbank has three subsidiaries united under its umbrella: Basis Asset Management Holding Ltd, JSC Hualing Insurance, JSC BHL Leasing.

Name	Activity	2018	2017
Basis Asset Management Holding Ltd	Asset Management	100%	100%
JSC Hualing Insurance	Insurance	100%	100%
JSC BHL Leasing	Leasing	100%	100%

BASIS ASSET MANAGEMENT-HOLDING, LTD - The company is incorporated and operating in Georgia. This limited liability company is engaged in the transactions related to the management of immovable and movable property, holding and leasing of property.

Governing body: Levan Gardapkhadze, The Director

JSC HUALING INSURANCE - Founded in December 2017 and operating in Georgia. This joint stock company has limited shares and is incorporated in accordance with the Georgian legislation. The core business activity of the company is insurance business operations in Georgia. The Insurance State Supervision Service issued life and non-life insurance licenses to the company, active since December 27, 2017. Hualing Insurance offers life, property, car and travel, corporate and other insurance packages. Currently, the company is not engaged in health insurance.

Governing body: Chairman of Supervisory Board- Zaiqi Mi

Members of Supervisory Board: David Tsaava, Hui Li

General Director: David Kakabadze

Deputy General Directors: Lia Aslanikashvili, Nino Chedia, Shota Svanadze

JSC BHL LEASING - The Company is incorporated and operating in Georgia. This joint stock company was established in accordance with the Georgian regulations. The bank founded the subsidiary in December, 2017 and the company started operating in December 2018. Its main area of activity is offering financial leasing service and products, including:

- Vehicle leasing
- Leasing of fixed assets (equipment, machinery, gadgets, etc.)
- Concessional agri-leasing (APMA)
- Leasing within the framework of Produce in Georgia program
- Sales and leaseback

Governing body: Chairman of Supervisory Board- Zaiqi Mi

Members of Supervisory Board: David Tsaava, Hui Li

General Director: Konstantine Sulamanidze

Deputy General Directors: Lia Aslanikashvili, Malkhaz Kharchilava

THE BASIS OF CONSOLIDATION IN JSC BASISBANK'S FINANCIALS

TABLE 6

Name of Entity	Method of Accounting Consolidation	Method of Regulatory Consolidation			
		Full Consolidation	Proportional Consolidation	Neither consolidated nor deducted	Deducted
JSC "Hualing Insurance"	Full Consolidation			x	
"Basis Asset Management-Holding" LLC	Full Consolidation				x
BHL Leasing	Full Consolidation			x	

As of 2018, for the supervisory purposes, the bank's subsidiaries are not consolidated in the bank's financial statements, but are weighted in the risk-weighted assets at 250% risk weight.

GOVERNANCE BODIES

GOVERNANCE STRUCTURE

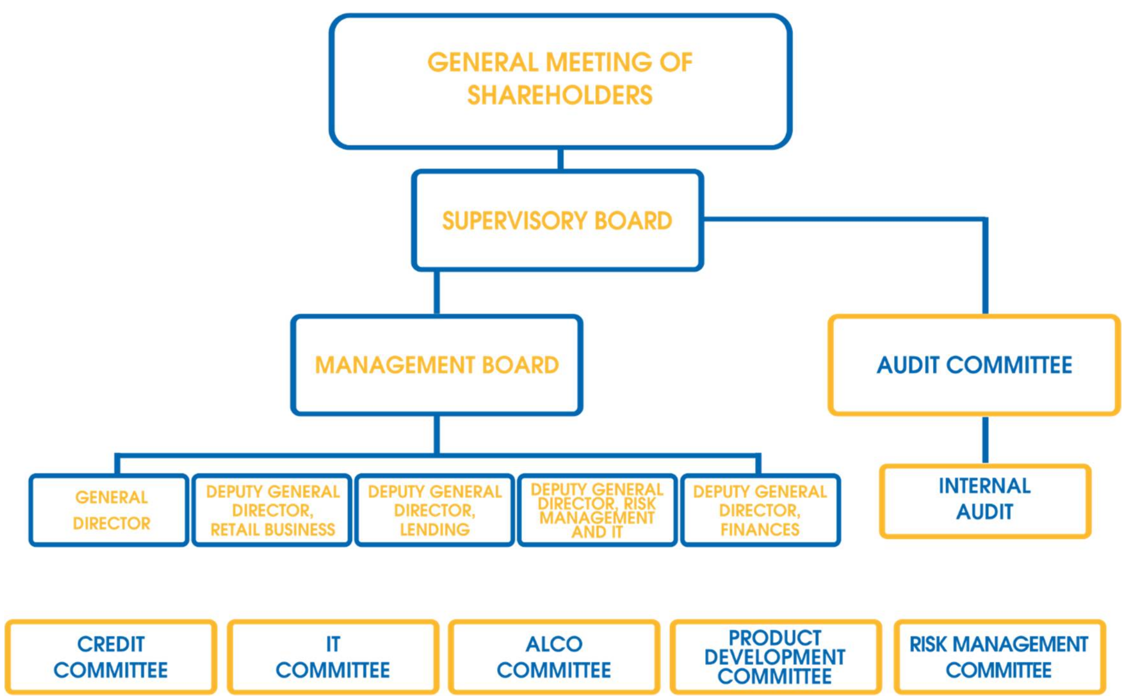
To ensure the stable functioning of the bank, the authorities of the supervisory and executive bodies are segregated. Their functions fully ensure the bank management.

The governance bodies are:

- General Meeting
- Supervisory Board and board-level committees;
- The Management Board and the board-level committees;

The Basisbank corporate governance is regulated through the following documents:

- Bank Charter;
- Regulation on Corporate Governance Principles;
- Regulation on Corporate Ethics;
- Internal Regulation;
- Regulation on the Supervisory Board;
- Regulation on the Management Board;
- Regulation on Audit Committee.



GENERAL MEETING OF SHAREHOLDERS

The General Meeting of Shareholders is the supreme governing body of the Bank. By participating in the Meeting, the shareholders exercise their rights of bank membership in compliance with the legislation of Georgia and the Bank Charter. Each ordinary share entitles the right to one vote to its holder at the General Meeting of Shareholders.

General Meeting of Shareholders takes decisions on the following:

- Amendments and additions to the Charter;
- Putting the bank shares or other securities on the securities market;
- Rules of selling and buying of the bank shares and other owned securities;
- Election of the Supervisory Board, approval of its (including the board committee(s) budget;
- Approval/amendment of the Supervisory Board regulation;
- On distribution and usage of the net profit of the Bank;
- On increasing/decreasing of the Bank's capital;

Each next scheduled General Meeting of Shareholders is convened once a year, no later than within two months after issuance of the audited financial statements of the previous year, which shall be prepared within the period of four months after the year-end.

The extraordinary General Meeting of Shareholders is convened at the request of the Chairman of the Supervisory Board, the Management Board or the shareholders who hold at least 5% of shares.

SUPERVISORY BOARD

The Supervisory Board is the supreme supervisory body of the bank. It is elected by the General Meeting of Shareholders and consists of five members. The composition of the board went through changes in 2018, to reflect the amendments in the Law of Georgia on the Activities of Commercial Banks. The directors who had executive functions, left their Supervisory Board positions and the board was replenished by Ms. Mia Mi and Mr. Zaza Robakidze.

Two Board members are considered to be independent from the influences of the bank and other external parties. When considering members as independent, the Bank was guided by the criteria set under the NBG regulations and the Supervisory Board Regulation, developed in accordance with the NBG regulations.

When electing the Board members, consideration is given to their education, work experience and skills. It is the balanced board that should ensure the discussion of underlying issues from various angles and making important strategic decisions.

The board is elected for the term of 4 (four) years. The authority of board members continues after the expiration of this period, before the next General Meeting of Shareholders is convened. Re-appointment of the Board members is unlimited. Dismissal of Supervisory Board member before the term is possible by the General meeting of shareholders at any time.

The Supervisory Board is headed by the Chairman, who is elected by the Board from its members by a simple majority of votes for the term of four years.

Supervisory Board has two Vice-Chairmen who are elected by the Board from its members by a simple majority of votes for the term of four years.

Meetings of the Board are held at least four times a year. Supervisory Board members can attend the meetings both in person and by using means of electronic communication.

Supervisory Board is authorized to:

- Implement the principles of strategic development, banking, risk management, and supervise their execution;
- Approve and update periodically such documents as: Bank Internal Regulation, Policies governing the bank management and banking activities;
- Approve Strategic Development Plan, review and approve the annual plan of the bank's activities submitted by the Management Board, annual budget, control their performance, review periodic financial reports submitted by the Management Board;
- Approve the organizational structure of the bank;
- In case of consent of the General Meeting of Shareholders, appoint the General Director, other members of the Management Board, determine the issues relating to fixed and variable pay of the Management Board members;
- Approve the Conflict of Interests policy, control the transactions containing potential risks and, above the limits set under the policy, discuss transactions planned with the bank-related persons;
- Appoint the external auditor of the bank and request direct reporting from them;
- Convene the General Meeting of Shareholders;
- Exercise internal control and oversight of risk management through the functions delegated to the board-level committees;
- Exercise other powers granted by the applicable legislation and the Bank's Charter.

The key functions of the Supervisory Board are supervision of the Basisbank Group's activities, Corporate Governance and Risk Management. Within the framework of these functions, the Board makes decisions on establishing the group's values, organizational structure and generally, ensuring that the group is governed in full compliance with the principles of fairness, competence, professionalism and ethics; establishes the group's strategy and oversees management's implementation of strategic objectives; ensures that the group is in compliance with all regulatory and supervisory requirements; establishes the risk appetite of the company along with Management Board and the CRO (Deputy General Director on risk and IT). The Board also oversees Management Board's activities and evaluates Management Board's decisions, ensuring independence and effectiveness of control functions, and conducts Management Board's performance evaluation. The Board is responsible to oversee transactions with related parties and ensure existence of effective procedures and policies within the group in line with the requirements of law and regulatory framework.

Composition of the Supervisory Board

Zhang Jun - Chairman of the Supervisory Board

Zhang Jun holds an MBA. 2010 to present: Deputy General Manager in finance and foreign investments at Xinjiang Hualing Trade and Industry (Group) Co., Ltd. 1998 to 2010: worked as Sales Department General Manager, Assistant to the Chairman of the Board, HR Director in Urumqi City Commercial Bank. 1992 to 1997: Deputy Director in Chengxin Credit Union of Urumqi. Mr. Zhang held senior managerial positions at Urumqi Branch of the People's Bank of China, Urumqi City Commercial Bank and other financial institutions for many years. He has extensive practical experience in the operation and management of commercial banks, hence the profound and clear view of the strategic development of small and medium-sized commercial banks.

Zhou Ning - Vice Chairman of the Supervisory Board, Independent Member

Zhou Ning holds an MBA from Fuqua School of Business in USA, MS in Engineering from Virginia Polytechnic Institute, and BS in Engineering from the University of Science and Technology of China. 2005 to present: Managing Director in Tuhong International Co. Having implemented a number of financial advisory projects at Urumqi City Commercial Bank, Bank of Deyang, Yantai Bank, Hang Seng Bank, Wing Lung Bank, Xiamen Bank, Hong Kong Fubon Bank and Bank of Tianjin, Mr. Zhou has an in-depth understanding of strategy and business development of domestic and foreign small and medium banks.

Mi Zaiqi - Vice Chairman of the Supervisory Board

Holds a BA from University of California. 2011 to present: Deputy Director of GM Office in Xinjiang Hualing Trade and Industry Group Co., Ltd and Director of GM Office in Georgia Branch Office of Xinjiang Hualing Trade and Industry Group Co., Ltd. 2010-2011: worked as an assistant to GM in Xinjiang Hualing Real Estate Development Co., Ltd. 2005 to 2006: worked as an assistant to GM at Xinjiang Hualing Grand Hotel Co., Ltd.

Zaza Robakidze - Independent Member of the Supervisory Board

Zaza Robakidze, a proficient banking expert with over 24 years of sector experience, accepted the position of the Member of Supervisory Board in late 2018. He has also been serving as Chairman of Basisbank's Audit Committee since 2012. Zaza Robakidze spent several years working at the National Bank of Georgia on various positions, from Economist to Head of Supervision Department. Zaza Robakidze holds a Master's Degree in Economics.

Mia Mi - Member of the Supervisory Board

Holds a Bachelor's Degree in Business Administration from University of Southern California, Los Angeles. Director of International Development at Hualing Group International Special Economic Zone in Georgia. Extensive experience in assisting Chairman of JSC Hualing International Special Economic Zone in 2 crucial actions: acquisition of Basisbank in 2012 and each year (2011-2015) organizing international construction materials fair, connecting buyers and sellers from across Central Asia. 2015-2017, Mia Mi held various positions in key departments at Basisbank, analyzing loan portfolio, communicating with Chinese corporate and retail clients as well as Banks shareholders, organizing major corporate events and assisting HR in recruiting talents.

Audit Committee

At the decision of the Supervisory Board, the Audit Committee is composed out of the Board. It consists of three members, majority of which are independent members. The Committee meetings are held at least once per quarter. The Committee is accountable to the Supervisory Board.

One of the main functions of the Audit Committee is the provision of an effective internal control system, which in turn involves assessment of the risk management framework, the adequacy and efficiency of risks management systems and processes. Besides, the Audit Committee reviews and evaluates the Bank's financial statements, monitors the bank's accounting policies and practices, approves the scale and frequency of internal audit. The functions of the Audit Committee also include the submission of recommendations on the candidates for external audit, their independence, remuneration and release, review of the opinions and recommendations prepared by the external audit and monitoring of their performance.

As of end-2018, the Audit Committee consisted of:

Zaza Robakidze	Chairman, Independent Member
Mi Zaiqi	Committee Member
Zhou Ning	Independent Member

MANAGEMENT BOARD

The Management Board consists of no less than 5 members. One of them is the General Director, who has a common leadership of the Management Board. The General Director is appointed / dismissed by the Supervisory Board with the consent of the General Meeting of Shareholders. The rest of the members of the Management Board shall be appointed by the supervisory board with the proposal of the General Director.

The Supervisory Board defines the structure and the function of the Management Board, their role and responsibilities in the governance. The accountability of the Management Board members, the holding of the session and decision making rules are set out by the Supervisory Board in the Regulation of the Management Board.

The main function of the Management Board is the daily management of the Bank and resolution of all the issues that, according to the legislation and the Charter, are not subject to the competence of the General Meeting of the Shareholders and the Supervisory Board. In addition, the Management Board discusses and makes preliminary decisions on the issues, which, according to the legislation and the charter, require the consent of the Supervisory Board.

The management recognizes the importance of good corporate governance and risk management culture as well as its role in these processes. The management runs operations of the Bank and is responsible for managing its activities in accordance with the Bank's objectives, in compliance with applicable laws/regulations as well as internal regulations. The Management Board works closely together with the Supervisory Board and reports to the Supervisory Board on all issues with relevance for the Bank concerning strategy, the intended business policy, planning, business development, risk situation, risk management, staff development, reputation and compliance, at least quarterly.

The primary function of the Management is to effectively run the group’s activity, ensure the uninterrupted growth and development of the bank and the group, and ensure sustainable positioning on the market in line with the objectives set by the Supervisory Board.

The management is responsible for delivering business objectives in line with the group’s strategy, ensuring the Bank’s capital and liquidity planning, and that management policies and procedures are communicated and implemented throughout the bank and are supported by sufficient authority and resources; the management is also responsible to ensure that the bank operates consistently with the processes and procedures set out in its internal and external regulations, resources allocations, planning, managing, accounting and reporting of financial and risk position, properly executing the management and control functions.

General Director:

- Allocates duties and responsibilities between the Management Board members, as a result of consultation with the Supervisory Board;
- Ensures proper functioning of the Management Board, making of collective decisions and compliance of decisions with the company's strategy;
- supervises and coordinates the implementation of the decisions of the Management Board;
- Represents the bank vis-a-vis the third parties.

Members of the Management Board:

- Supervise their respective structural entities, caring for their proper functioning and implementing policies developed in accordance with the Bank's strategy;
- represent the Bank vis-a-vis the third parties within their executive powers;

David Tsaava - General Director

Member of Management Board since 2008. Member of Supervisory Board from 2015. Holds PhD in Business administration. Mr. Tsaava has 14 years of experience in banking. David Tsaava worked in lending and led the Corporate Lending Division for years. In 2010 Mr. Tsaava has been working as General Director of the Bank. Since December 2017 David Tsaava has also been serving as Deputy Head of Supervisory Board at JSC BHL Leasing member of the Supervisory Board at JSC Hualing Insurance.

Lia Aslanikashvili - Deputy General Director, Finance

Ms. Aslanikashvili holds Master's degree in International Economic Relations from Tbilisi State University. With 19 years of experience in banking, she managed treasury and settlement departments for many years at Basisbank. Since December 2017 Ms. Aslanikashvili also serves as Deputy General Director at JSC BHL Leasing and JSC Hualing Insurance.

David Kakabadze - Deputy General Director, Risk Management and IT

Member of Management Board since 2008. Holds Master's degree in Finance from Caucasus Business School. With 16 years of experience in banking, David Kakabadze worked in Information Technologies and Risk Management. Since December 2017 Mr. Kakabadze has also been serving as General Director at JSC Hualing Insurance.

Hui Li - Deputy General Director, Lending

Member of the Management Board since 2012. Holds Bachelor’s Degree in Accounting. Ms. Li has been working in the financial sector since 1993, as successful accountant and a loan officer. She was in charge of loan approval in Credit Management Department of Urumqi City Commercial Bank. Then she held the position of Deputy Manager of Credit Department and Deputy Director in Urumqi Chengxin Credit Cooperatives. Ms. Li served on the Supervisory Board of Basisbank since 2015. She supervises the approval of large-scale loans at Basisbank. Ms. Li is the Deputy Chairman of the Supervisory Board at JSC BHL Leasing and a member of the Supervisory Board JSC Hualing Insurance.

Levan Gadrapkhadze - Deputy General Director, Retail Business

Member of Management Board and Deputy General Director, Retail Business. Holds a Master's Degree in Business Administration and has 16 years of experience in banking. He worked for the plastic cards and foreign exchange departments on various positions. Member of Management Board since 2008. Since December 2017Levan Gardapkhadze has also been serving as a Deputy General Director at JSC Hualing Insurance. Since October 2018 he is the Director of Basis Asset Management Holding, Ltd.

RISK GOVERNANCE AND STRATEGY

RISK STRATEGY

Holding adequate level of capital has to be ensured mandatorily over any time of the operation of the Bank, therefore setting up a risk strategy and planning the capital adequacy as part of the general strategic planning is crucial part for the governance of the financial institutions.

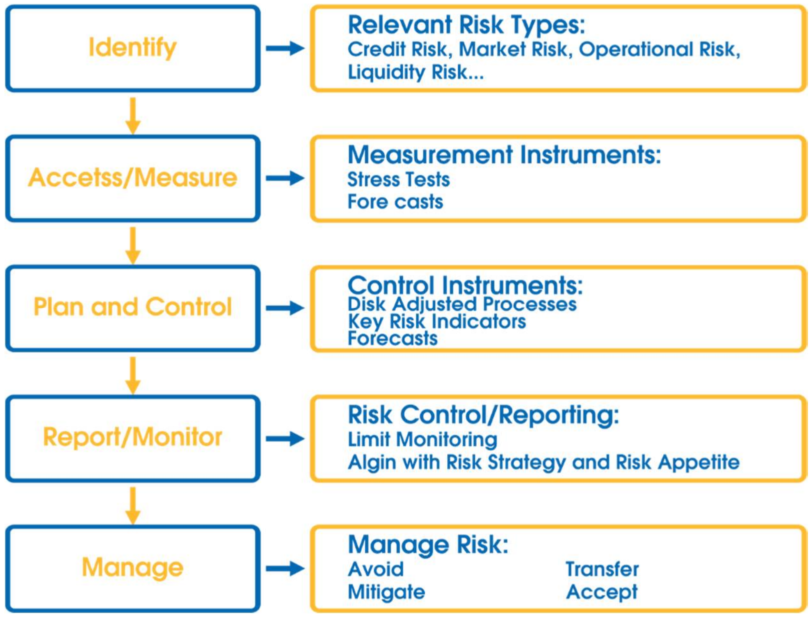
Risk strategy of the bank is derived from the business strategy and is based on the Group's Risk Appetite, strategic and capital plan with the goal to align risk, capital and performance targets.

Risk Strategy is approved by the Supervisory Board and is modified at any time when strategy is revised by the Bank, but at least annually. Risk Strategy should be available for the whole institution. Risk and capital are managed via a framework of principles formalized in policies and procedures, organizational structure with clearly delegated authority levels and measurement and monitoring processes that are closely aligned with the activities of the divisions and business units. This dedicated governance framework ensures that all inherent risks are controlled in a proper way within the everyday operation of the Bank. A comprehensive management reporting system is build up to serve as an effective tool for risk governance and create transparency and risk mitigation.

The Bank sets principles about risk taking and risk management which are reflected in the internal rules and policies, and applied consistently throughout the organization. These general principles are the following:

- Prudent risk-taking with comprehensive risk assessment and control environment,
- Proper quantification of risks using proper methodologies in line with the size and complexity of the Bank,
- Adopting and fulfilment of all the regulatory requirements and guidelines available and using best practices in compliance with the international standards,
- Maintaining proper risk control hierarchy, independent from business activities in order to avoid conflict of interest,
- Taking into consideration risk perspective upon the launch of new activities, business lines or products.

In pursuit of its objectives, risk management is segregated into five discrete processes: identify, assess, control, report and manage/challenge all material risk types, financial, as well as non-financial risks, including credit risk, market risk, operational risk, liquidity risk, regulatory risk and reputational risk, inherent in the Banking Business. Modelling and measurement approaches for quantifying risk and capital demand are implemented across all material risk types in the frame of Internal Capital Adequacy Assessment Process (ICAAP) of the Bank.

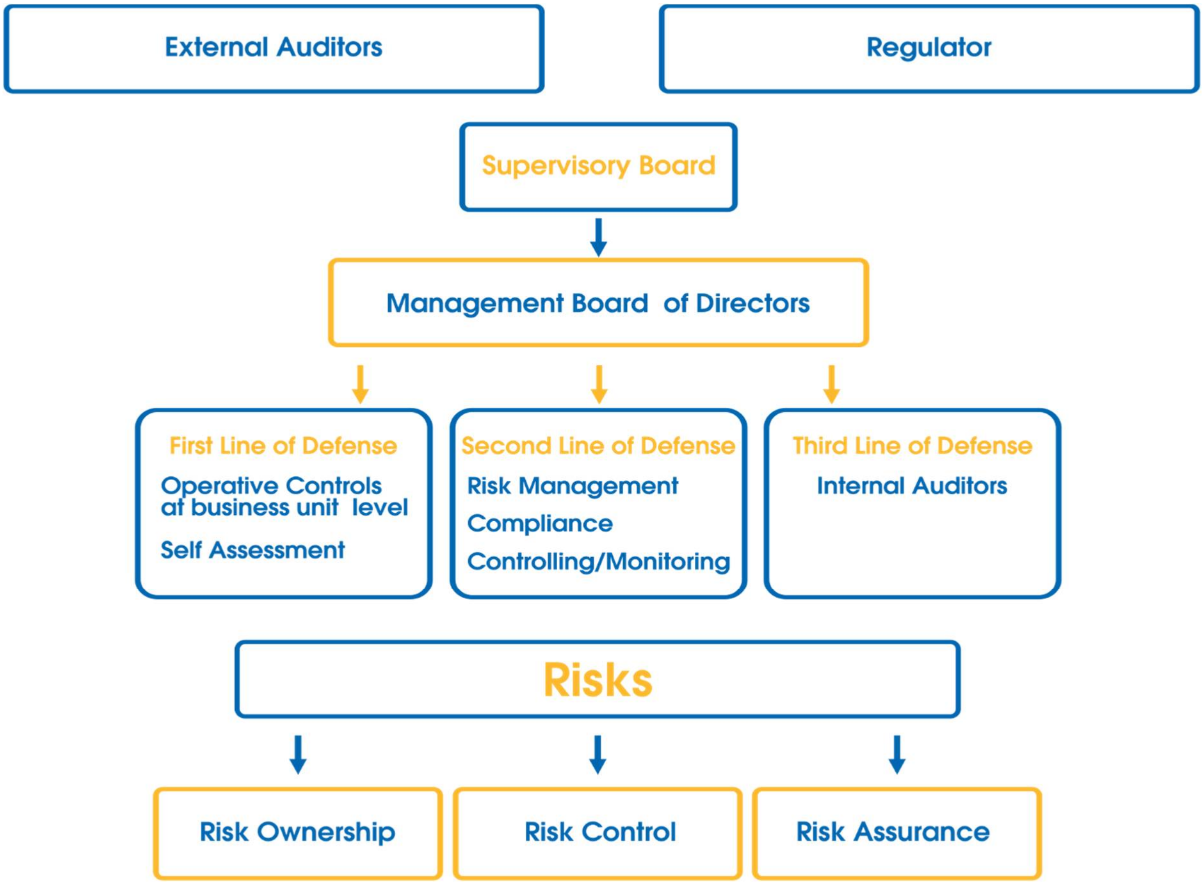


RISK MANAGEMENT STRUCTURE

Given the volatility of financial markets, and uncertainty of macro-economic situation the function of Risk Management receives paramount importance. The Bank has developed a risk management framework with the aim to create an image of Basisbank as a stable and reliable bank. Core risk management responsibilities are embedded in the Management Board responsibilities and delegated to senior risk managers and senior risk management committees responsible for execution and oversight. Cross-risk analysis and regular reviews are conducted across the Group to validate that sound risk management practices and a holistic awareness of risk exist.

Implementation of robust and sound risk management system throughout the bank included amongst others formation of the independent Risk Management unit; creation of the risk-profile committees (Credit, Risk Management, Assets and Liabilities Committee-ALCO) which adhere to the risk management practices and ensure sound risk management practices and decision making; formation of an independent Internal Audit Department, which reports directly to the Supervisory Board, in order to give the Board unbiased information about adequacy of existing policies and procedures; initiation of risk management approach in analytical tools, practices, and decision making; developing a system of financial and managerial reporting to meet regulatory requirement and needs of Management Board; detection and classification of different types of risks which the Bank potentially faces; drafting policies, procedures and guidelines which govern management of risks in Basisbank. As a result, risk governance in Basisbank is organized across three lines of defense: at business unit level for operational day-to day management of risk, Risk Department level for internal controls and oversight of risk and Internal audit Level, for assurance to senior management and the board that the first and second lines' efforts are consistent with expectations. Responsibility for risk management resides at all levels within the Group, from the Supervisory Board and Management Board (The Executive Management) level down through to each business unit manager and risk officer.

EFFECTIVE RISK MANAGEMENT



At a strategic level, risk management objectives supported by the risk governance structure are:

- To define Basisbank's strategy, which is based on the Group's Risk Appetite and the Strategic and Capital Plan
- To optimize risk/return decisions by taking them as closely as possible to the business;
- To ensure that business growth plans are property supported by effective risk infrastructure;
- To manage risk profile so that financial soundness remains possible under a range of adverse business conditions.
- To monitor activities and correct deficiencies in internal control functions

Information and communication is essential for effective Risk Governance. In Basisbank it involves inclusion of key types of data in the record keeping process, such as internal financial, operational and compliance data, as well as external market information on events and conditions relevant to decision making. An effective internal control system requires that significant risks are identified and assessed on an ongoing basis.

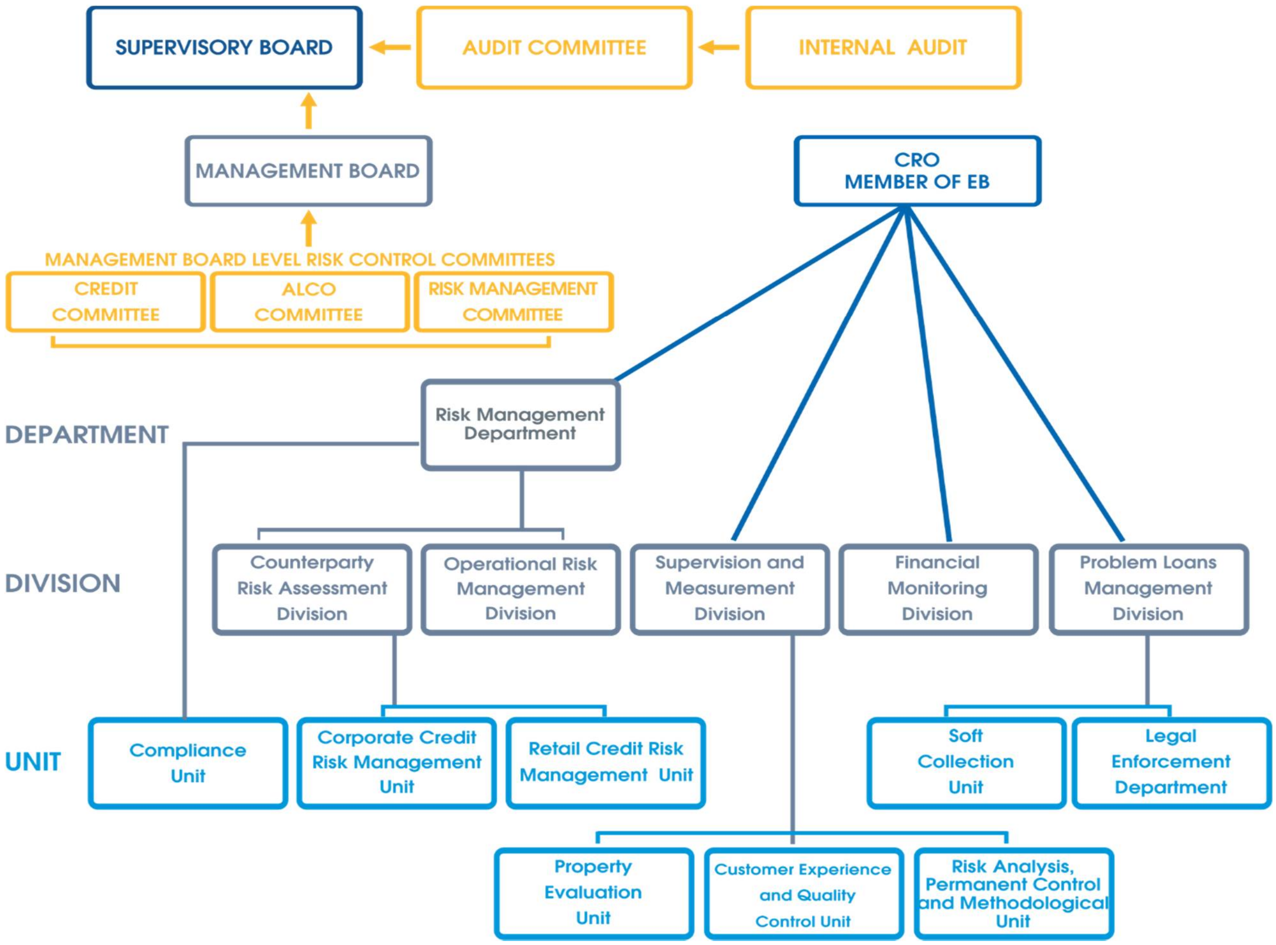
Individual policies for Credit, Operational and Anti-Money Laundering (AML) policies enable the Bank to measure, aggregate and report risk internally, as well as use this information for regulatory purposes. Further, Bank's internal methodologies and manuals provide description of processes from credit decisions - granting, pricing and approval, to portfolio management and capital adequacy.

CONTINUOUS RISK GOVERNANCE

he Bank maintains and adheres to the best Corporate Governance standards - The Basisbank is a signatory to the Corporate Governance Code for Commercial Banks adopted by the Banking Association of Georgia (CG Code) in 2009. Our operations are regulated and supervised within banking supervision framework by NBG which focuses on licensing, capital adequacy, liquidity, risks' concentration, Corporate Governance Code as well as organizational and reporting requirements, provides for the regulation of Risk management in Commercial banks, risk governance principles, internal control systems, etc.

Risk Governance Structure in Basisbank ensures effective segregation of duties between all levels of personnel in the bank from senior management to front line personnel in order to achieve goals defined in Business strategy. Risk Oversight function is split between following risk management units: The Supervisory Board, the Management Board, Audit Committee, Risk Management committee, Assets and Liabilities Management Committee (“ALCO”), Risk Management department, Treasury department, and Credit Committees.

RISK OVERSIGHT



The Supervisory Board and the Executive Board have a sound understanding of risk management and its importance to the sustainable and strategic development of the Bank.

Supervisory Board - is setting “the tone on the top” by establishing and fostering a high ethical and responsible culture in the bank. The Supervisory Board has overall responsibility for the oversight of the risk management framework. As a top governing body of the Bank, the Supervisory Board approves and exercises control over the implementation of the Bank's strategy and its budget, sets the general approach and principles for risk management by assessing the Bank’s risk profile, the adequacy and effectiveness of the Bank’s risk management framework, approves individual risk strategies, setts risk appetite and the risk control framework.

The Risk Management policies are approved by the Supervisory Board of the Bank aim to identify, analyze and manage the risks faced by the Group. They assign responsibility to the management for specific risks, set appropriate risk limits, set the requirements for internal control frameworks, and continuously monitor risk levels and adherence to limits. Risk management policies and procedures are reviewed regularly to reflect changes in market conditions, emerging best practices, products and services offered.

Audit Committee – is an independent control function which regularly reviews internal controls and processes; reviews bank's internal control system, evaluates its objectivity and correctness; provides oversight of the bank's internal and external auditors' recommendations; approves and makes recommendations to the Supervisory Board on monitoring financial accounting process; provides oversight of the effectiveness of the risk management system, particularly of the internal control system and the internal audit system. The audit committee reports to the Supervisory Board on quarterly basis on key risk portfolios, on risk strategy and supports the Supervisory Board in monitoring the implementation of this strategy; monitors the Management Board's activities that promote the company's compliance with legal requirements, regulations and internal policies.

The Management Board - is responsible for managing the Bank, so that the main goals and objectives, as well as performance targets of the Bank are achieved and the daily operations are performed in accordance with the regulatory requirements and the Bank's Terms of Reference. The Management Board defines appropriate procedures for managing all inherent risks in each business line, structures business to reflect risk, ensures adequate segregation of duties and defines operational responsibilities of subordinate staff, ensures existence of adequate procedures in place. The Management Board is responsible for monitoring and implementation of risk mitigation measures and operation of the Group within the established risk parameters.

Management oversight and control culture for Basisbank involves inclusion of key items related to internal control into the regular tasks of the Management Board. Daily activities of Management Board in the scope of oversight and control function include:

- Reviews of performance reports, which enables them to streamline the progress toward the Bank's goals and control the activity at division and departmental level;
- Regular reviews of whether the bank's strategy and risk and capital limits are appropriate and if compliance with exposure and capital limits is maintained;
- Follow-up on non-compliance to ensure that the management at an appropriate level is aware of the transaction or situation;
- Requiring approval and authorization for transactions above certain limits;
- Review of evaluations of internal controls;
- Ensuring prompt follow-ups on recommendations and concerns expressed by auditors and supervisory authorities related to internal control weaknesses.

The Management Board establishes committees and functional units within the bank to ensure overall oversight and management of risk.

Risk Management Committee monitors the Bank's risk profile; evaluates adequacy requirements for principal risks, including evaluation, monitoring and risk limits; debates and agrees actions on the risk profile and risk strategy across the Bank; discusses all policies and documents proposed for approval to the Supervisory Board prior to their submission; evaluates effectiveness of the bank's internal control and risk management systems together with the Internal Audit Committee; reviews results the tests of risk management environment conducted by external audit and develops corresponding recommendations; periodically reviews existing risk limit systems.

ALCO Committee reviews current and prospective liquidity positions and monitors alternative funding sources; reviews maturity/re-pricing schedules with particular attention to the maturity distribution of large amounts of assets and liabilities maturing; develops parameters for the pricing and maturity distributions of deposits, loans and investments; develops alternative strategies which take into account changes in interest rate levels and trends, deposit and loan products and related market/banking regulations, etc.; performs an independent review of the validation and reasonableness of the inputs, assumptions, and output of the ALM model(s) and procedures; approves limit structure on counterparty risk.

Credit Committee acts in the best interest of the Bank and in compliance with internal policies and procedures; evaluates potential clients' financial standing and their ability to repay the loan; reviews loan applications and makes decisions within the authority delegated to the committee; reviews loan collection practices to improve loan underwriting and collection efforts.

The Chief Risk Officer (“CRO”), who is a member of the Management Board, is a top-level executive responsible for overall risk management in credit, market and operational risks, who provides overall leadership, vision, and direction for Enterprise Risk Management (ERM) and develops a framework of management policies, including setting the overall risk appetite of the Bank. Responsibilities of CRO include comprehensive control of risk and continuing development of methods for risk measurement; setting risk limits and creating risk maps; communicating a clear vision of the firm's risk profile to the board and to key stakeholders. CRO has unimpeded direct access to Supervisory board, regularly reports to SB about the Bank's risk profile, its adherence to defined risk appetite, significant internal and external developments which could have material effect on bank's risks.

Risk Management Department evaluates credit, market and operational risks related to various transactions or operations and draws up suggestions about modifications necessary in structure, procedures, makes assessment of expected credit losses (ECL); manages and evaluates credit, market and operational risks; elaborates ICAAP (internal capital adequacy assessment process) and GRAPE (General Risk Assessment Program) framework, by coordinating them with the risk owners; elaborates and introduces methods of risk mitigation, specifically related to credit risk management; evaluates bank’s lending performance and compares it to the past periods; reviews all policies and procedures prior to submission for approval to the Management Board.

RISK APPETITE AND KEY RISK TYPES

Risk appetite is the amount of risk that an organization is prepared to accept, tolerate, or be exposed to at any point in time. As it is evident that risk inherent in the operations of the Bank cannot be reduced to zero, based on careful cost-benefit analysis, the Bank has to elaborate its risk tolerance framework.

Both external and internal risk factors are identified and managed throughout the Group's organizational structure. Particular emphasis is placed on developing risk maps that are used to identify a wide range of risk factors and serve as a basis for determining the level of comfort over the current risk mitigation procedures.

Management of each material risk types is defined within the ICAAP framework of the Bank. Risk appetite of BasisBank has been set as a limit system which enables the Bank continuously monitor the exposure to the relevant risk factors.

The limits are defined by the Management Board and have to be in line with strategic planning and external requirements (legal requirements on capital and liquidity; Group level / owner requirements). The Bank considers risk assessment in a systematic way, which is achieved via different stress tests and Internal Capital Adequacy Assessment Process (ICAAP). Capital adequacy ratio, Liquidity Position, market risk are assessed within the regularly performed benchmark analysis and under more severe stress tests conditions.

The risk map of the institution shows the complete picture of all risk types evaluated in Basisbank under the ICAAP. For each type of risk its relevancy is assessed and the methodological approach to measure and mitigate the risk is outlined in the ICAAP policy document.

If the risk is considered significant and it is quantifiable, the Bank defines internal methodology to calculate the respective capital needed to cover the risk. Other relevant risk types that cannot be quantified are treated through appropriate internal processes.

Internal processes aim to minimize potential losses arising from non-quantified risk types. If the risk is found irrelevant, no special treatment is available.

However, the regular review of ICAAP ensures that at least yearly all risk types are assessed, and risk types that are irrelevant and became relevant over time are addressed in an appropriate matter.

KEY RISK TYPES: IDENTIFICATION AND ASSESSMENT

Financial risk comprises credit risk, market risk (including currency risk, interest rate risk and price risk), and liquidity risk. The primary objective of the financial risk management function is to establish risk limits, and then ensure that exposure to risks stays within these limits.

Credit risk - The Group exposes itself to credit risk, which is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to meet its obligations. Exposure to credit risk arises as a result of the Group's lending and other transactions with counterparties, giving rise to financial assets and off-balance sheet credit-related commitments. Credit risk is obviously the most important type of risk for banks and banks' supervisory authorities. The Bank's credit strategy is to create diversified and profitable loan portfolio while maintaining maximum quality.

Credit risk management **-** The estimation of credit risk for risk management purposes is complex and involves use of models, as the risk varies depending on market conditions, expected cash flows and the passage of time. The assessment of credit risk for a portfolio of assets entails further estimations of the likelihood of defaults occurring, associated loss ratios and default correlations between counterparties.

Management of Credit Risk in Basisbank includes different activities embedded in the daily activities.

Establishment of an appropriate credit risk management environment - In Basisbank this is achieved through written Credit Policy and Credit Manual related to target markets. In this formalized documents portfolio mix, price and non-price terms, the structure of limits, approval authorities and processing of exceptions and management reporting issues are addressed and outlined.

The Group structures the levels of credit risk it undertakes by placing concentration limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Limits on the level of credit risk by product and industry sector are approved regularly by management. Such risks are monitored on a regular basis and are subject to an annual, or more frequent, review.

Credit risk, both at portfolio and transactional levels, is managed by a system of Credit Committees to facilitate efficient decision-making. A hierarchy of credit committees is established depending on the type and amount of the exposure. Loan applications originating with the relevant client relationship managers are passed on to the relevant credit committee for the approval of the credit limit.

- The senior credit committee reviews and approves limits above USD 300 thousand, Approvals are given by e-mail or the committee meets when necessary. It is also responsible for issuing guidance to lower-level credit committees;
- The junior credit committees review and approve credit limits between USD 100-300 thousand. Approvals are given by e-mail or the committee meets when necessary;
- Applications up to USD100 thousand are approved by risk management department. Exceptions are retail loans up to USD 20 thousand that are approved by retail lending group.

Sound credit-granting process - In Basisbank this involves the consideration of a number of factors in credit granting. Depending on the type of credit exposure and the nature of the credit relationship, these could be the purpose of the credit and sources of repayment, the current risk profile of the borrower or counterparty and collateral and its sensitivity to economic and market developments, the borrower's repayment history and current capacity to repay, historical financial trends and future cash flow projections. During the credit analysis, consideration is given to the borrower's business expertise, the borrower's economic sector and its position within that sector. These elements are part of scoring models developed for both, Retail and Corporate business lines. Corporate and Retail Credit Risk Management Departments (under Risk Management Division) take part in credit risk assessment of the client. For Individual borrowers the bank has developed simplified scoring model, which enables the Bank to assess the credit repayment capacity of the borrower, based on the analysis of financial standing of the borrowers and their past repayment history. The scoring for retail and corporate is used primarily in the credit approval process for pricing purposes: pricing of each loan is risk adjusted, based on the scoring of the client and riskiness of the product.

Credit risk grading system - For measuring credit risk and grading financial instruments by the amount of credit risk, the Group applies an Internal Rating System for legal entities, or risk grades estimated by external international rating agencies (Standard & Poor's - "S&P", Fitch, Moody's) for Central Governments, Interbank exposures, International Financial Institutions (IFIs) Securities and other financial assets, when applicable.

Risk Mitigation and Residual risk - Exposure to credit risk is also managed, in part, by obtaining collateral as well as corporate and personal guarantees to mitigate the credit risk. The limits for collateral coverage are different depending on product type and borrower segment. To reduce the potential residual risk of collaterals, the Bank uses discounts on the market value of the collaterals when calculating collateral coverage during the lending processes and during portfolio management. The Group obtains collateral valuation at the time of granting loans and annually re-evaluates real estate properties pledged for the loans which are included in top 100 borrower group list by carrying amount as at reporting date. Apart from top-100 borrower groups, for the loans with carrying amount more than GEL 100 thousand, the Group requests re-evaluation of the pledged real-estate collaterals if a new loan is disbursed under the pledge of the given collateral or in case of restructuring of the given commitment in case the last valuation is more than 1 year ago. Legal Department regularly (at least yearly) reviews the collateral contract template and modifies if necessary based on new regulation environment or experiences on the execution of collaterals. Minimum collateral coverage (maximum amount of unsecured portfolio) using discounted values are defined for each customer types by the Credit Policy.

Maintenance of appropriate credit administration, measurement and monitoring processes - involves regular monitoring of a number of key items related to the condition of individual borrowers. These items include the current financial condition of the borrower or counterparty; compliance with existing covenants, collateral coverage and contractual payment delinquencies. Also it involves the monitoring of share of exposure in the total loan portfolio to specific types of borrowers to avoid risk concentration. Such concentrations occur when there are high levels of direct or indirect loans to a single counterparty, a group of interrelated borrowers, or a particular industry or economic sector.

Maintenance of appropriate portfolio quality reporting - Portfolio quality and lending limits determined by Credit Policy are regularly followed by the Credit Risk Management in its control function and presented to the management of the Bank via portfolio reporting. Portfolio report contains information about the distribution of the portfolio over the rating classes, amounts in delays, exposures by sectors and HHI index, dynamics of PD, LGD figures, etc. In order to monitor exposure to credit risk, regular reports are produced by the dedicated staff of Financial Reporting and Risk departments based on a structured analysis focusing on the customer's business and financial performance. Any significant interaction with customers with deteriorating creditworthiness are reported to and reviewed by the Risk Committee, the Management Board and the Supervisory Board.

Stress testing **-** The bank performs regular stress tests to monitor impact of adverse macroeconomic, as well as bank specific events on regulatory capital buffer and on bank's performance as a whole or at different levels of aggregation. Stress tests are used as an effective tool of risk assessment and management, in order to assess its capital adequacy and in case of need create additional capital buffer for adverse changes. Stress tests amongst others cover events of broad economic crises with recession, impact of currency movements, decrease in employment levels, sector specific stress tests, closing of export markets (political risks), and default of several large exposures.

In order to determine stressful scenarios, the Bank uses the NBG's stress-test methodology manual. According to the manual, the slowdown of the global economic activity causes recession to our region, the US dollar appreciates against all currencies and pushes interest rate raise resulted from the increased risk premium. The change in macroeconomic parameters occur in line with recession in the region, in particular: 5% reduction in gross domestic product, reduction of commodity (gold and other) prices; depreciation of national currency by 20%; a 30% reduction of real estate prices in USD; the interest rate increase by 2 percentage points, to assess credit losses on interest gap revaluation and variable lending rates; reduction of the number of employees by 5%; reduced employee revenue by 5%.

Additionally, micro and retail portfolios are divided into sub-portfolios of loans issued with the analysis of borrowers' solvency performed and of those issued without performing such analysis. An additional 20% default is assigned to each loan in the portfolio of the loans issued without performing the borrowers' solvency analysis. The Bank calculates the financial and loan service ratios and the loan loss reserves for relevant stress scenarios for the selected loan portfolios (it is inadmissible to improve the reserve category after stress) and the subsequently results are applied to the rest of the portfolio. No additional provision has been created in financial year 2018 for credit losses based on the results of regulatory stress testing.

Market and liquidity risks **-** are managed by the Asset and Liability Management Committee (ALCO) in coordination with the Treasury Department and the Risk Management department. The Treasury Department performs monitoring by holding regular meetings with operational units in order to obtain expert judgments in their areas of expertise, executes the daily control of liquidity gaps, interest rate exposures, and controls and manages foreign exchange risk exposure.

Market Risk **-** The most likely sources of market risk are interest rate risk and foreign exchange rate risk.

Interest rate risk is the current or prospective risk to both the earnings and capital of institutions arising from adverse movements in interest rates. From a credit institution's perspective, an interest rate risk may occur for both its trading book portfolio and banking book transactions (traditional credit/deposit and investment transactions).

Types of interest rate risks relevant for the Bank are:

- Re-pricing risk, i.e. risk deriving from the different maturity structure of receivables and payables and from pricing that is based on different interest rates or different periods;
- A re-pricing risk is generated when there is a mismatch between the maturity structure of assets and liabilities and if pricing takes place at different intervals or at differently based interest rates (e.g. receivables at a fixed interest rate and liabilities at a variable interest rate).
- Yield curve risk, i.e. risk originating in changes of the shape and steepness of the yield curve.

Foreign exchange risk rises from an open or imperfectly hedged positions in a particular currency as a result of unexpected movements in the level of exchange rates (that may lead to losses in the local or reporting currency of the market participant).

Oversight and control of market risk is set out to ensure that the bank's policies and procedures for managing interest rate risk and FX risk on both, long-term and day-to-day basis are adequate and that clear lines of authority and responsibility for managing and controlling market risk are maintained. The Bank maintains a comprehensive interest rate risk reporting and review process, as well as effective internal controls, sets appropriate limits on risk taking, establishes adequate systems and standards for measuring risk and performance, valuing position, repricing maturity gap.

Liquidity Risk - Liquidity risk is defined as the risk of inability of the bank to honor its financial obligations under normal or stressed conditions. Liquidity is the ability of the Bank to fund increases in assets and meet obligations as they come due, without incurring unacceptable losses. The fundamental role of banks in the maturity transformation of short-term deposits into long-term loans makes banks inherently vulnerable to liquidity risk, affects markets as a whole. Virtually every financial transaction or commitment has implications for a bank's liquidity. Effective liquidity risk management helps ensure a bank's ability to meet cash flow obligations, which are uncertain as they are affected by external events and other agents' behaviour.

The bank relies on Basel 3 liquidity management methodologies and on other internal assessment models developed in line with best international practice and manages liquidity risk according to the internal policies of Anti-Money Laundering (AML) and Liquidity Management, with detailed definition of processes and limit systems connected to liquidity management (cumulative maturity mismatch limit, Liquidity Coverage Ratio (LCR), Net Stable Funding Ratio (NSFR)).

Liquidity management process includes establishment and regular re-assessment of liquidity requirements based on the bank's asset and liability structure and general market conditions; development and control of corresponding liquidity risk limits; addressing funding structure and mismatch volume, fund raising capacity, etc.; developing and monitoring liquidity and fund management principles; liquidity forecasting under normal business conditions and for stressed scenarios; developing contingency plan which is to clearly set out the strategies for addressing liquidity shortfalls in emergency situations.

Operational Risk - Operational risk is defined as the risk of financial loss occurring from inadequate internal policies, system and control failures, human errors, fraud or management failure and natural disasters. The operational risk management exists on three levels in the Bank: business units/departments level, Operational Risk Management level and Internal Audit level. In order to effectively measure and manage operational risk, appropriate operational risk management environment is developed through internal reporting of operational risk as a distinct risk category related to the bank's safety and soundness on one hand, and by effective and comprehensive internal audit function, carried out by operationally independent, appropriately trained and competent staff, on the other hand.

The Bank's Operational Risk policy provides a comprehensive framework for operational risk identification, measurement and management. The policy defines the principles for how operational risk is to be identified, assessed, monitored, and controlled or mitigated. A system of checks to identify strengths and weaknesses of the operational risk environment is defined and contingency and business continuity plans are in place to ensure the ability to operate as going concern and minimize losses in the event of severe business disruption.

Although the Bank calculates capital requirement for operational risk using the Basic Indicators Approach (BIA approach), some qualitative elements of more advanced risk quantification are used, which serve as a basis of more comprehensive operational risk management.
Within the scope of ICAAP framework, the Bank assess other risks to which the bank can be exposed, some of these risks are described below:

Business Risk - means current or prospective risk of earnings and capital decrease arising from changes in the business environment and from adverse business decisions, or from the overlooking of changes in the business environment, inadequate implementation of decisions or poor reactions to changes in the competitive environment.

Regulatory Risk - Banking sector is highly regulated and moreover the environment continues to evolve in an unpredictable way, therefore the bank is exposed to regulatory risk, i.e. of non-compliance with regulatory requirements. In addition to mandatory capital adequacy ratios, the regulator (National Bank of Georgia) sets lending limits and other economic ratios, including, lending, liquidity and investment ratios. The Bank is required to comply with minimum reserve requirements and provide regular periodic reports.

The bank is also regulated by respective tax code and number of other laws in Georgia, which are relevant for the Bank through its everyday business activities. Additional regulatory requirements arise among others through: the Anti-Money Laundering (AML) and Counter-Terrorist Financing Policy; the Anti-Bribery, Anti-Corruption and Anti-Facilitation of Tax Evasion Policy, the Whistleblowing Policy, the Law of Georgia on Personal Data Protection (PDP).

In line with the Bank's integrated control framework, the bank carefully evaluates the impact of each legislative and regulatory change as part of its formal risk identification and assessment processes and has established systems and processes to ensure full regulatory compliance, with the Compliance Unit of Risk Management Department in charge of these processes.

Operational Risk Department identifies potential breaches of PDP law via analyzing customer complaints, the operational risk event databases and introduces changes in operational practices to improve personal data protection and avoid leakage of personal information in the environment of rapidly increasing automation.

Financial Monitoring Department on the other hand enhances compliance to regulatory requirements via creating operational framework for regulations imposed by the Financial Monitoring Service of Georgia (FMS), with the main objective of preventing illicit income legalization and terrorism financing.

The management of environmental and social risks - includes, on the one hand, efficient consumption of natural resources and responsible waste management in the daily business activities of the bank, and integration of responsible financing principles in the bank's lending activity on the other.

In order to effectively implement responsible financing principles, on 2018 Basisbank made significant changes in its environmental and social risk management policy by developing the Due Diligence and E&S Risk Assessment procedures. The bank also introduced the exclusion list. It specifies the types of the activities that the bank does not finance. The activities on the exclusion list can be, in some way, linked to production/trade of weapons and military materials, forced and child labor, illegal pharmaceuticals, production/trade of certain pesticides and herbicides, gambling and casinos, etc. These documents are based on the active Georgian legislative framework, best practice and recommendations of the international financial institutions.

As part of the environmental and social risk assessment process, all business loans are subject to standard procedure of verifying the project in the exclusion list. At a later stage, based on the data and documents provided by the client, assessments after the onsite visit, and information received from independent sources, the responsibility of the potential client is assessed, along with the client's degree of environmental and social risk management. The bank refers to the IFC's Environmental and Social Performance Standards for its assessments. The bank is also empowered to set covenants for the client for the purpose of enhancing the client's environmental and social responsibility (e.g. improvement of the fire safety system and upgrade of working conditions).

Country Risk - refers to potential losses that may be generated by an (economic, political, etc.) event that occurs in a specific country, where the event can be controlled by that country's government but not by the credit grantor/investor. The Bank implemented limit system by introducing Country Risk Management Policy in order to measure its exposure to country risk based on the external rating of the countries.

Reputation Risk - may originate in the lack of compliance with industry service standards, failure to deliver on commitments, lack of customer-friendly service and fair market practices, low or inferior service quality, unreasonably high costs, a service style that does not harmonize with market circumstances or customer expectations, inappropriate business conduct or unfavorable authority opinion and actions.

The Bank wants to avoid high volatility in its earnings and net value due to events arising from the poor reactions to changes in the competitive environment and/or erroneous corporate decisions. Therefore, the Bank is committed to mitigate potential risks by the adequate, well-elaborated business strategy and manage inherent risks via developing systems of early risk detection and internal policies and procedures to ensure risk-aware decisions and actions in its day-to-day business activities.

REMUNERATION POLICY

The report includes information on the policy and compensation system for the remuneration for JSC Basisbank's top management. The Supervisory Board and the Management Board are the top management of the Bank.

The Supervisory Board establishes the terms of employment and remuneration of the members of the Management Board, while the general meeting of shareholders determines the issues of compensation of members of the supervisory board.

Detailed information about the remuneration generated by management in 2018 is given in Appendix II, Table 24/27.

REMUNERATION SYSTEM OF DIRECTORATE MEMBERS

The system of reimbursement of the directorate members includes both fixed and variable parts.

The compensation system and structure are reflected in the individual contracts of the Management Board members. The fixed individual salaries of the directorate members are reviewed by way of consultations between the Director and the Supervisory Board. The variable portion of the remuneration is regulated by a contract with the members of the directorate, which is common to all members; the amount of annual compensation depends on the Bank's financial results.

Calculation of Variable Remuneration - Variable payment is issued in the form of bonuses. A bonus is an additional reimbursement payable to the Director for the fulfilment of the contractual liabilities. In July 2013, the Bank's Supervisory Board approved the top management bonus system, which includes both cash and share based payments.

The total bonus determination is based on the financial results of the previous reporting year, which is confirmed by external audit opinion (one of the world's four largest international audit companies), the goal of the team is, first of all, determined by the profitability and growth indicators set by the Supervisory Board. At the same time, the normative ratios must be observed along with the agreements stipulated in the contracts concluded with international financial institutions.

All expenses related to the top management's bonus scheme are recognized in the reporting period. Please refer to Appendix II, table 24/27.

SHARE BASED PAYMENTS

At least 50% (fifty percent) of the compensated amount shall be used to purchase the bank's shares in pre-determined conditions. The total amount of shares to be transferred depends on the value of the share; the results are evaluated based on the audited financial consolidated statement of the previous reporting year prepared in accordance with the IFRS standard.

Management shares are subject to limitation within two years from the date of purchase ("blocking period"). Following the expiry of such period, half of the shares held by the directors are relieved of the block. All the shares owned by the Directors may be fully transferred to the new holders only after the expiry of contractual obligations.

Shares will be issued by setting the terms of service, which will be valid until the rights and obligations of the scheme participant are expired. Before these terms expire, the shares only carry the right to receive dividends. They are not entitled to voting right and are not subject to alienation or transfer to third parties. These terms imply continuous employment; during this period the transfer of the full rights on the shares to the scheme participants is not completed.

The holders were granted rights on 2015 shares in July, 2016. By the decision of the Bank's Supervisory Board, all post-transfer restrictions were lifted for the shares issued before 2016 (116,630 shares).

Table 24 shows the remuneration of the directors based on shares (see Appendix II) of Pillar 3 Annual Report. The reviewed pay scheme is based on local accounting standards.