Pillar 3 Annual Report 2018

თიბისი ბანკი
TBC BANK

Contents

Introduction

The main purpose of this report is to detail the requirements of TBC Bank's Pillar 3 about capital adequacy and remuneration as defined by the National Bank of Georgia in line with the Basel III framework.

Management Statement

The Bank's Supervisory Board confirms the accuracy and the authenticity of all the data and information outlined in the Pillar 3's present statement. The document is prepared in full compliance with the internal processes agreed with the Supervisory Board. Itis in line with all the requirements of "Rule for disclosure of information by commercial banks within the framework of Pillar 3" approved by the Order #92/04 of the President of the National Bank of Georgia, on 22 June, 2017 and other rules and norms established by the National Bank of Georgia.

Location of Pillar 3 Disclosures

This report provides the Basel 3 Pillar 3 disclosures to the extent that these required pillar 3 disclosures are not included in the TBC Bank Group PLC Annual Report 2018.

The Following table provides the location of the required Pillar 3 disclosures in the TBC Bank Group PLC Annual Report 2018:

Pillar 3 disclosure topic	Primary location in Annual Report 2018
Shareholder rights	Director's Governance Statement – Special rights and transfer restrictions (page 116)
Governance – committee membership and responsibilities	Director's Governance Statement – Committee membership and division of responsibilities (page 110); Board committees (page 109)
Governance – Independence of the Board	Director's Governance Statement – Board Composition (page 110); Chairman's governance overview (page 108)
Governance – Board members' biographies	Governance – Board's biographies (page 120-124)
Governance – Viability	Governance – Viability statement (page 118)
Governance – Committee meetings	Director's Governance Statement – Board and Committee Meeting attendance (page 111-112)
Governance – Board's effectiveness	Governance – Annual Board effectiveness evaluation (page 112)
Governance – Delegation of authorities	Governance – The Board and Board's Committees (page 108-109)

Bank's Management Board - Biographies	The Bank's Management Board Biographies (page 126-128)
Remuneration Policy for the non-executive directors and top management	Remuneration Report in the annual report pages [136-155]
Bank's strategy	Business Model and Strategy – Strategy (page 14-19)

Pillar 3 disclosure topic	Primary location in other report 2018
Shareholders' income	http://www.tbcbank.ge/web/en/financial-reporting-to-nbg Transfer to shareholder

Key Indicators of Bank

Capital Ratios as a Percentage of Risk Weighted Assets("RWA"):

	31 December 2018	31 December 2017*	31 December 2016
Common equity Tier 1 ratio	12.39%	12.90%	9.94%
Tier 1 ratio	12.76%	13.37%	10.39%
Total regulatory capital ratio	17.87%	17.53%	14.19%

* Significant changes in 2017 are due to changes introduced by the NBG in its methodology to calculate the Risk Weighted Exposures. In particular, excluding currency-induced credit risk (CICR) from Risk Weighted Risk Assets ("RWRA"), which will be reflected in Pillar 2 capital buffer requirements. For further details, see the link of NBG's official press release: https://www.nbg.gov.ge/index.php?m=340&newsid=3248&lng=eng

Profit Indicators:

	31 December 2018	31 December 2017	31 December 2016
Total Interest Income / Average Annual Assets	8.62%	8.50%	9.08%
Total Interest Expense / Average Annual Assets	3,75%	4.05%	3.60%
Earnings from Operations / Average Annual Assets	4,47%	3.97%	4.61%
Net Interest Margin	4.87%	4.45%	5.49%
Return on Average Assets (ROA)	2.72%	2.77%	3.63%
Return on Average Equity (ROE)	21.30%	20.10%	21.91%

Asset Quality:

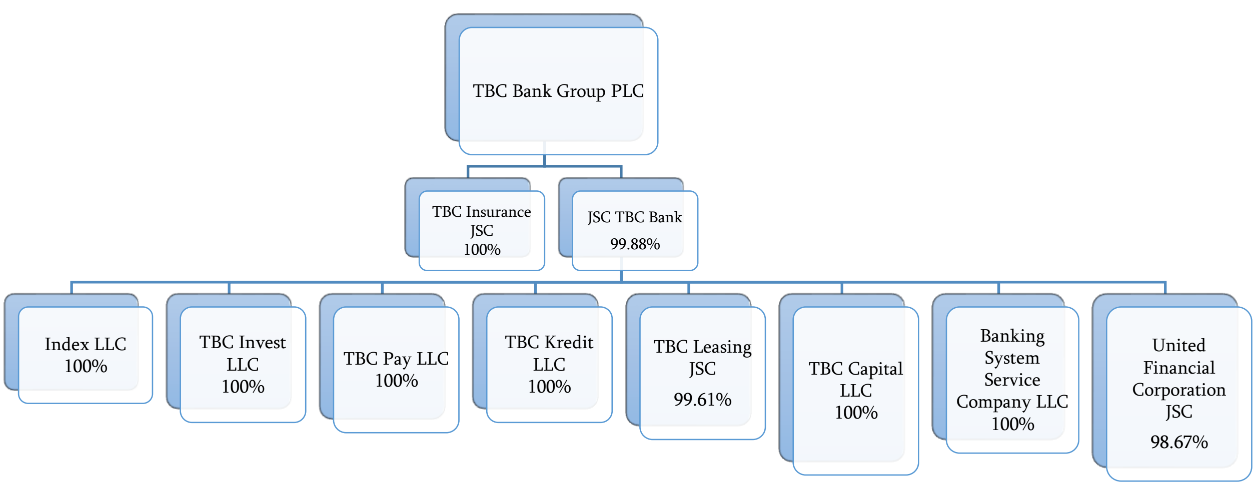
	31 December 2018	31 December 2017	31 December 2016
Non-Performing Loans / Total Loans	3.59%	3.22%	4.33%
LLR / Total Loans	4.15%	4.31%	5.22%
FX Loans / Total Loans	59.84%	59.37%	66.06%
FX Assets / Total Assets	55.45%	55.86%	59.16%
Loan Growth – YTD	20.98%	44.63%	27.64%

Liquidity:

	31 December 2018	31 December 2017	31 December 2016
Liquid Assets/Total Assets	21.27%	20.87%	19.15%
FX Liabilities/Total Liabilities	63.32%	64.60%	72.66%
Current & Demand Deposits/Total Assets	39.28%	40.03%	37.95%

Group Structure

The chart below illustrates the structure of the TBC Group:



For additional information about the consolidation of enterprises, please see the Annex.

As of 31 December 2018, the shareholders directly owning more than 5% of the Bank's total outstanding shares were as follows:

Beneficiary Owner	Share
Mamuka Khazaradze	13.52%
Badri Japaridze	6.76%
European Bank for Reconstruction and Development	8.17%
JPMorgan Asset Management	8.39%
Schroder Investment Management	7.07%
Dunross& Co.	5.50%

The Bank's Management Board and Committees

The Bank's Board of Directors consisted with eight members:

Vakhtang Butskhrikidze
Paata Ghadzadze[1]
Tornike Gogichaishvili
Nino Masurashvili
David Chkonia
Giorgi Shagidze
Nikoloz Kurdiani
George Tkhelidze

The following committees are at the Directors' level:

Committee Member	Managing of Conflict of Interests Committee	Information Security Steering Committee	Customer Experience Management Committee	Assets and Liabilities Management Committee (ALCO)	Management Board Risk Committee	Operational Risks Committee	Business segment Credit Committee
CEO	X		X	X	X	X	X
First Deputy CEO						X	
CFO				X	X		
CIO		X					

[1]Paata Gadzadze stepped down from the Management Board of TBC Bank on January 1, 2019. He will continue to serve as Chief Executive Officer of TBC Insurance.

CRO	X	X		X	X	X	X
COO		X	X			X	
Head of Retail Banking			X	X	X	X	
Head of Marketing and MSME			X	X	X	X	
Head of Corporate and Investment Banking				X	X	X	
Head of Operational Risks		X				X	
Head of Compliance Risk Department	X	X				X	
Head of Compliance Risk and Control Unit	X						
Head of Analytic Department of Security Service		X					
Head of Information Security		X					
Head of Debt Capital Markets				X			
Head of ERM				X			
Head of FRMD				X			

Head of Treasury				X			
Head of Customer Experience Department			X				
Heads of Underwriting							X
Head of Problem Assets Management							X
Head of Corporate Rehabilitation							X

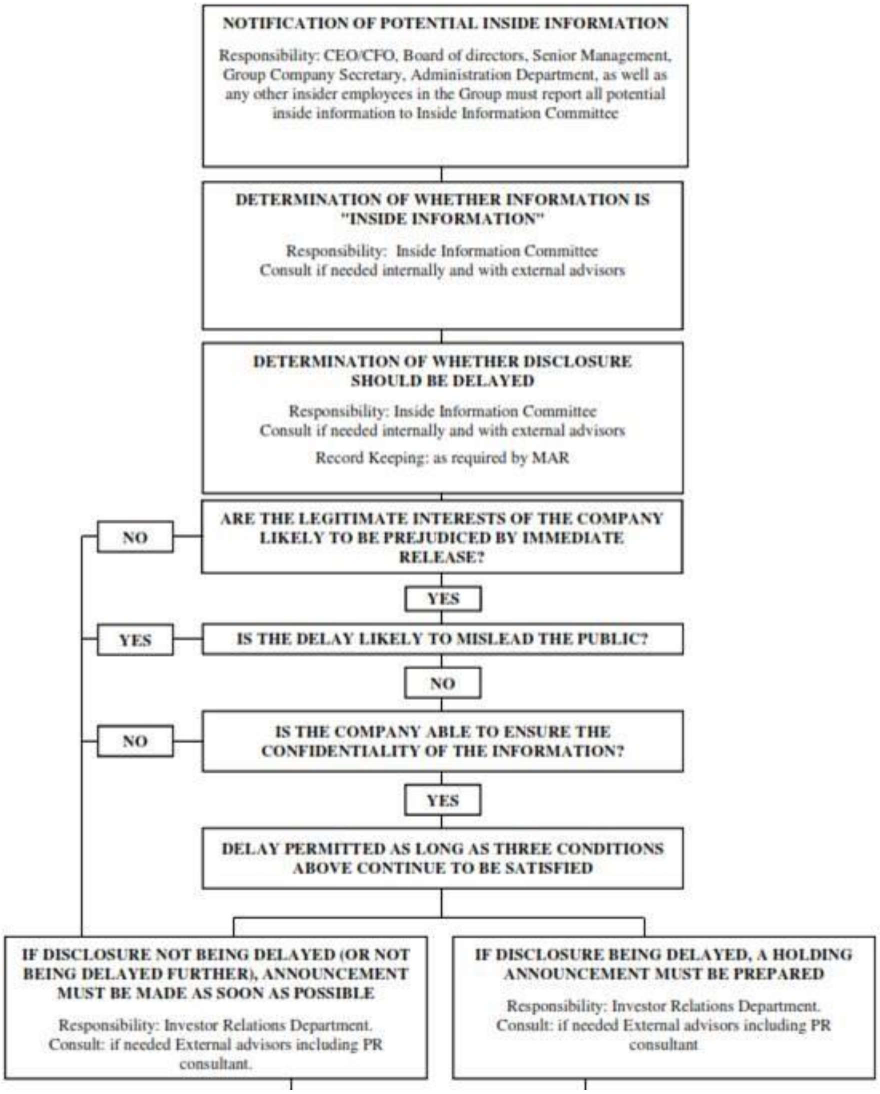
The Bank has adopted Inside Information Disclosure Policy, which is designed to ensure that the Company's regulatory public announcements in relation to inside information are made in a timely manner, are factually correct, do not omit any material information and are expressed in a clear and objective manner that allows investors to assess the impact of the information when making investment decisions.

For this purpose, the Bank has established the Inside Information Committee, which is chaired by the CEO and consist of the following members: the CEO, CFO, and Head of IR, General Counsel and Head of Compliance Department.

The Inside Information Committee will decide whether the information provided is inside information and requires disclosure. If deemed necessary, the Inside Information Committee will consult internally and with external advisors on a timely basis and as appropriate in making this decision. If disclosure is required, the Investor Relations Department will make the necessary arrangements for the disclosure of the relevant information via a RIS unless a delay in making an announcement is permitted.

Schedule 1

Flowchart of Announcement Procedures



The Banks Management Board Responsibilities

First Deputy CEO[2]

The First Deputy CEO reports to the Chief Executive Officer and assumes a strategic role in the overall management of the Bank. The First Deputy CEO's primary responsibility is to plan, implement, manage, and control two main directions: a) all human resources-related activities and b) Asset Management of Non-Resident Entities. However, starting from 1 January 2019, the role will not exist and the departments will be managed by other members of the management board.

Deputy CEO, Chief Financial Officer

The Chief Financial Officer (CFO) reports to the Chief Executive Officer and to the Supervisory Board and has a strategic role in the overall management of the Bank. The CFO has the primary responsibility for planning, implementing, managing and controlling all finance-related activities. These include investor relations and fund raising, treasury activities, financial analysis, strategic planning and budgeting, financial accounting, regulatory reporting, taxation and all other relevant matters.

Deputy CEO, Corporate and Investment Banking

The Director of Corporate and Investment Banking reports to the Chief Executive Officer and to the Supervisory Board and assumes an important role in the overall management of the Bank. He has primary responsibility for planning, implementing, managing and controlling of the Bank's corporate and investment business. The Director of Corporate and Investment Banking manages the division to the end of provision of the wide range of financial services to its clients. Activities include lending, clearing, investing deposits as well as organizing specialized products for clients with high turnovers, such as financial institutions, major companies and commercial state companies.

Deputy CEO, Chief Risk Officer

The Chief Risk Officer (CRO) reports to the Chief Executive Officer and to the Supervisory Board. The CRO holds the primary responsibility for managing the Bank's risk management-related activities, including risk identification, measurement, mitigation, monitoring and reporting.

Deputy CEO, Chief Operating Officer

The Chief Operating Officer (COO) reports to the Chief Executive Officer. The COO's responsibilities include the management of the centralized back office, card processing, cash management, loan

[2] After Paata Gadzadze's stepping down form the Management Board, the position of the First Deputy CEO has been abolished

administration, customer experience and support, correspondent banking, procurement, logistics, collateral management and appraisal and cash center.

Deputy CEO, Retail Banking

The Director of Retail Banking reports to the Chief Executive Officer and holds the primary responsibility for designing and delivering the strategy for the Bank's retail business, its product range and designated market. The Retail Director is hence responsible of developing new product and service delivery channels as well as planning and managing business activities for the retail segment, such as sales, service quality, profitability, risk, branch operations, digital and other channels and retail reporting, budgeting and analysis.

Deputy CEO, Marketing Communications and MSME Banking

The Director of Marketing Communications and MSME Banking reports to the Chief Executive Officer. The role entails planning, implementing, managing, and controlling all the Bank's activities related to the micro and SME segments as well as to marketing.

Risk Management

Risk Management Strategy

One of TBC Bank's main priorities is to establish and maintain a functioning strong and sustainable risk management, adaptable to on-going business developments and able to respond promptly to emerging risks.

The key objective of the risk strategy is to promote a solid and independent, business minded risk management system. The risk management aims primarily to contribute to the development of TBC's business strategy by supporting risk-adjusted profitability maximisation and guaranteeing TBC's sustainable development through the implementation of an efficient risk management system.

Four major principles are adopted to enable the accomplishment of the risk management's major objectives:

- **Governing risks transparently in order to earn understanding and trust.** Consistency and transparency in risk-related processes and policies are preconditions for gaining the trust of the various stakeholders. Communicating risk goals and strategic priorities to governing bodies and business departments and providing a comprehensive follow-up in an accountable manner are key priorities for the risk management staff;
- **Managing risks prudently to promote sustainable growth and resiliency.** Risk management acts as a backstop against excessive risk-taking. The capital adequacy management and strong forward-looking tools and decision-making processes ensure the Bank's sustainability and resiliency;

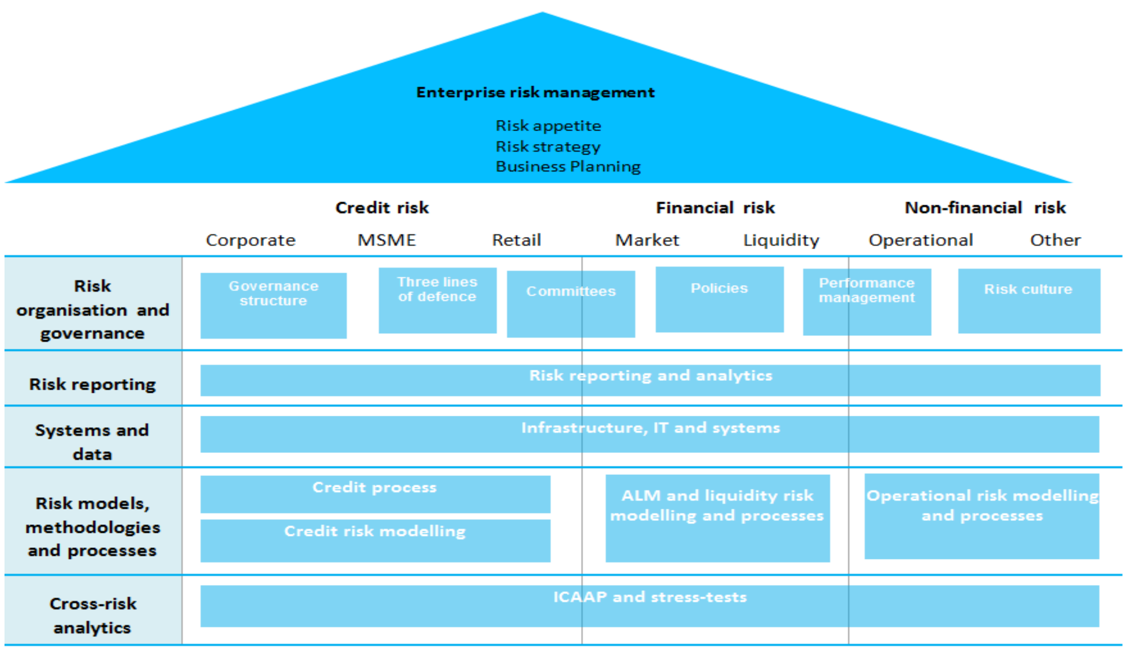
- **Ensuring that risk management underpins the strategy implementation.** The staff responsible for the risk management provide assurance on the objectives' feasibility through the risk identification and management. Identifying and adequately pricing risks, as well as taking risk mitigation actions, support the achievement of the desired returns and planned targets;
- **Using risk management to gain a competitive advantage.** Comprehensive, transparent, and prudent risk governance facilitates understanding and trust from multiple stakeholders, ensuring the sustainability and resilience of the business model and the positioning of risk management as the Bank's competitive advantage and strategic enabler.

The abovementioned principles must be embedded into the overall risk governance structure as well as individual risk management tools and techniques.

Risk Management Framework

The risk management framework incorporates all necessary components for a comprehensive risk governance. It is comprised of the enterprise risk management, credit, financial and non-financial risk management, risk reporting and supporting IT infrastructure, cross-risk analytical tools and techniques such as capital adequacy management and stress-testing.

The diagram below illustrates the risk management framework:



Risk Governance

The Bank conducts its risk management activities within the framework of its unified risk management system. The involvement of all levels of governance, the clear division of authority, and the effective communication between the different entities facilitates the accuracy of the Bank's strategic and risk objectives, the adherence to the established risk appetite, and the sound risk management.

The Bank's governance structure ensures an adequate oversight and accountability, as well as a clear separation of duties. The Supervisory Board hold the joint overall responsibility to set the tone at the Bank's top and monitor the compliance with the established objectives, while the Management Board governs and directs the Bank's daily activities.

The Supervisory Board's oversight is coupled with the permanent involvement of the senior management in the Bank's risk management and the exercise of top-down risk allocation by the enterprise risk management function. This ensures a clarity of the risk objectives, a constant monitoring of the risk profile against the risk appetite, and a rapid response and actions to address a prompt escalation of risk-related concerns.

The risk governance structure consists of two board levels; the Supervisory Board and the Management Board, each with their dedicated risk committees. The Supervisory Board and the Bank's senior management govern the risk objectives through the Risk Appetite Statement (details about Risk Appetite Framework are on page 26).

The Supervisory Board features two committees:

- **The Risk, Ethics and Compliance Committee** supervises the risk profile and risk governance practice within the Bank;
- **The Audit Committee** is responsible for implementing key accounting policies and facilitating both internal and external auditor activities.

The Management Board comprises four committees:

- **The Risk Committee** was established to guide the Bank-wide risk management activities and monitor major risk trends in order to ensure that the risk profile complies with the established risk appetite;

- **The Operational Risk Committee** takes decisions related to the operational risk governance;
- **The Assets and Liabilities Management Committee (ALCO)** is responsible for the implementation of asset-liability management policies;
- **Information security committee** is responsible for managing the security of the Bank's IT systems.

The individual risks' daily management is based on the "three lines of defence" principle. Business lines are the primary risks' holders. Risk teams act as the second line of defence by sanctioning transactions and developing tools and techniques for risk identification as well as the required analysis, measurement, monitoring and reporting.

The committees established at the operational levels are charged with making transaction-level decisions as part of a framework comprised of clear and sophisticated delegations of authority based on the "four-eye" principle. All new products and projects pass through risk teams to ensure risks are comprehensively analysed. These control arrangements guarantee that the Bank makes informed decisions that are adequately priced and that no risks exceeding the Bank's established targets are taken. Dedicated teams manage credit, liquidity, market, operational and other non-financial risks.

Apart from these risk teams, the Risk governance includes the centralized enterprise risk management (ERM). The ERM Department is tasked to ensure the effective development, communication, and implementation of the risk strategy and risk appetite across the Bank. Its function facilitates cross-risk activities such as aggregation, analytics and reporting and also addresses issues that are not specific to a single type of risk. Accordingly, the ERM complements the role of other risk actions to ensure the coverage of key risk activities and responsibilities and builds capabilities in a centralised team.

The Bank's strong and independent risk-management structure enables to fulfil all required risk management functions within the second line of defence by highly skilled professionals.

In addition to the risk teams subordinated to the Chief Risk Officer, the Compliance Department reports directly to the CEO and is specifically in charge of anti-money laundering and compliance risk management.

As the third line of defence, the internal audit department is responsible for providing an independent and objective assurance, as well as recommendations, to the Bank about how further improve operations and risk management.

Key Risks

The Risk of Macroeconomic Environment Deterioration of the Country

The slowdown of economic growth in Georgia will have an adverse impact on borrowers' repayment capacity and restrain their future investment and expansion plans. These occurrences will be reflected in the Bank's portfolio quality and profitability, and also slow down the portfolio growth rates. Negative macroeconomic developments can compromise the Bank's performance through different parameters such as increasing unemployment slowing down of economic growth, exchange rate and inflation volatility, investment environment deterioration, worsening of consumer and business confidence etc. Given that Georgia is a small open economy, the political and economic instability in the neighbouring and main trading partner countries negatively affects the country's economic outlook through a worsening current account (e.g. decreasing exports and inflows from tourism as well as lower remittances and foreign direct investments).

As the Bank operates primarily in, and sources nearly all of its revenue from, Georgia, its business, financial condition and operations are, and will continue to be, highly dependent on the country's general economic conditions.

Between 2011 and 2018, the Georgian economy recorded an average real GDP growth of 4.6% per annum. In 2018, economic growth amounted to 4.8%. This indicates a solid growth or Georgian economy and underlines the economy's resilience and strong growth potential, especially taking into account the contractionary fiscal stance throughout the year and unfavourable developments in the region. In order to decrease its vulnerability to the economic cycles and adverse economic developments, the Bank identifies exposure to cyclical industries and limits sector concentrations within its risk appetite framework.

The Bank has established a macroeconomic monitoring process. This enables a close and constant observation of the economic developments both in Georgia and its neighbours and the identification of early warning signals signalling imminent economic risks. The system allows the Bank to timely assess significant economic and political occurrences and analyse their implications for the loan portfolio. The identified implications are duly translated into specific action plans with regards to reviewing the underwriting standards and risk appetite metrics.

Additionally, the stress testing and scenario analysis applied during the credit review and portfolio monitoring processes enable the Bank to have an advance evaluation of the impact of macroeconomic shocks on the business and the portfolio.

The resilience towards a changing macroeconomic environment is incorporated into the credit underwriting standards. This is reflected in conservative requirements of debt-servicing capabilities and collateral coverage.

Credit risk

As a provider of banking services, the Bank is exposed to the risk of loss due to the failure of a customer or counterparty to meet its obligations to settle outstanding amounts in accordance with agreed terms. Credit risk is the most material risk the Bank faces since it is engaged mainly in traditional lending activities with a simple balance sheet. Thus, the Bank allocates significant resources to its management. Due to the Georgian economy's significant reliance on foreign currencies, the currency-induced credit risk is significant and it relates to risks arising from foreign currency-denominated loans to unhedged borrowers in the portfolio. Credit risk also includes concentration risk, which is associated to the quality deterioration of the credit portfolio, due to large exposures provided to single borrowers or groups of connected borrowers, or loan concentration in specific economic industries.

The credit risk management's major objectives are to develop a sound credit approval process for informed risk-taking and procedures for effective risk identification, monitoring and measurement.

Currency-induced credit risk

Currency induced credit risk is one of the most significant risks that could negatively impact the Bank's portfolio quality given that a large part of its exposure is denominated in foreign currency. As of 31 December 2018, 59.84% of total gross loans and advances to customers (before provision for loan impairment) were denominated in foreign currencies. In December, 2017 foreign currency loan share was stood at 59.41%.

Dollarization of the banking sector has decreasing trend that has positive effect on currency induced credit risk reduction. In addition, as a result of legislative changes since 2019 loans up to GEL 200,000 are required to be disbursed in local currency that promotes increasing de-dollarization level.

The Bank applies various management tools and techniques to mitigate currency induced credit risks encompassing all phases of credit risk management. Specific attention is paid to un-hedged borrowers, which are the most sensitive to currency depreciation. The Bank applies conservative lending standards to un-hedged borrowers to ensure that they can withstand a certain amount of currency depreciation without credit quality deterioration.

Apart from the measures, which are in place throughout the underwriting process, the Bank regularly monitors and assesses the quality of foreign currency denominated loans to assess potential impact of currency depreciation on the portfolio. Based on this assessment the Bank ensures that it holds sufficient capital buffers against unexpected losses.

Given the experience and knowledge built throughout the recent currency volatility, the Bank is in a good position to promptly address and mitigate emerging exchange rate depreciation risks.

Concentration Risk

The Bank is exposed to concentration risk, defined as potential deterioration in portfolio quality due to large exposures or individual industries. Deterioration of financial standing of individual borrowers, with large outstanding liabilities may entail increased credit losses and high impairment charges. Credit losses may also increase due to negative macroeconomic developments in certain industries in case the Bank's concentration in this industry is relatively high.

In order to manage concentration risks effectively, as a part of its risk appetite framework, the Bank limits both single-name and sector concentrations. Lower limits are assigned to industries with perceived higher risks.

Stringent monitoring tools are in place to ensure compliance with the established limits. The Bank constantly checks the concentrations of its exposure to single counterparties, as well as sectors. Significant counterparties are assessed on an individual basis, and in-depth analysis of industries is undertaken. These processes ensure that the Bank's concentration levels and associated risks are in compliance with predefined limits.

Along with managing concentration levels in the portfolio, the Bank estimates unexpected losses and respective economic capital for concentrations of both single name borrower and sectors using the

Herfindahl-Hirschman Index (HHI), thus ensuring that sufficient capital is held against concentration risk.

Liquidity Risk

The liquidity risk is the risk that the Bank may either not have sufficient financial resources available to meet all its obligations and commitments as they fall due, or be only able to access those resources at a high cost.

Both funding and market liquidity risks can emerge from various factors that are beyond the Bank's control. Due to the financial market instability, factors such as a downgrade in credit ratings or other negative developments may affect the price or ability to access funding necessary to make payments in respect of the Bank's future indebtedness. Liquidity risk is categorised into two risk types: funding liquidity risk and market liquidity risk.

Funding Liquidity Risk

The funding liquidity risk is the risk arising from the Bank's inability to convert assets to cash or to obtain funding from other sources of funds at due date. To manage this risk, the Bank has internally developed a model using a liquidity coverage ratio (LCR) and a net stable funding ratio (NSFR), both under Basel III liquidity guidelines.

Additionally, the Bank applies stress-tests and "what-if" scenario analyses and monitors the National Bank of Georgia's minimum liquidity ratio.

In 2017, the central bank introduced its own LCR for liquidity risk management purposes. In addition to the Basel III guidelines, the ratio applies conservative approaches to the weighting of mandatory reserves and deposit withdrawal rates depending on the client Bank's concentration. From September 2017, the Bank also monitors compliance with the NBG's LCR limits. In addition to the total LCR limit, the NBG has also defined limits per currency for the GEL and foreign currencies.

Market Liquidity Risk

The market liquidity risk is the risk that the Bank cannot easily offset or eliminate a position at the then-current market price because of inadequate market depth or market disruption. To manage it, the Bank follows the Basel III guidelines on high-quality liquidity asset eligibility in order to ensure that the Bank's high-quality liquid assets can be sold without causing a significant movement in price and with minimum value loss.

In addition, the Bank has a liquidity contingency plan, which forms part of the overall prudential liquidity policy. The plan is designed to ensure that the Bank can meet its funding and liquidity requirements and maintain its core business operations in deteriorating liquidity conditions that could arise outside the ordinary course of its business.

Market Risk

The market risk is the risk of losses in on- and off-balance-sheet positions arising from movements in market prices.

The Bank's strategy does not foresee the involvement in trading financial instruments or investments in commodities. Accordingly, the Bank's only exposure to market risk is the foreign exchange risk in its "structural book", comprising its regular commercial banking activities, which have no trading, arbitrage or speculative intent.

Foreign Currency Risk

Due to the Georgian economy's significant reliance on foreign currencies, movements in foreign exchange rates can adversely affect the Bank's financial position. This risk stems from the open currency positions created due to mismatches in foreign currency assets and liabilities. The National Bank of Georgia requires the Bank to monitor both balance sheet and total aggregate balance (including off-balance-sheet) open currency positions and to maintain the latter within 20% of the Bank's regulatory capital. For the year ended 31 December 2018, the Bank maintained an aggregate balance open currency position of 7.6%.

On 13 August 2018, NBG introduced new regulation regarding the changing of OCP calculation method, according to this regulation, from March 2019, special reserves assigned to FX balance-sheet assets would be deductible gradually for OCP calculation purposes and fully implemented by September 2020.

In addition, the Supervisory Board sets further limits on open currency positions. The ALCO has set limits on the level of exposure by currency and for total aggregate position that are more conservative than those set by the National Bank of Georgia and the Supervisory Board. The heads of the treasury and financial risk management departments separately monitor daily the Bank's compliance with these limits. Compliance with these limits is also reported daily to the Management Board, and periodically to the Supervisory Board and its Risk, Ethics and Compliance Committee. A value-at-risk (VAR) analysis in line with the Basel guidelines is used to assess the Bank's minimum capital requirements under the Internal Capital Adequacy Assessment Process (ICAAP) framework monthly.

Interest Rate Risk

The interest rate risk is a potential loss, arising from changes in market interest rates. This risk can result from maturity mismatches of assets and liabilities as well as from the re-pricing characteristics of such assets and liabilities. The deposits and most of the loans offered by the Bank are at fixed interest rates, while a portion of the Bank's borrowing is based on a floating interest rate.

The Bank's floating rate borrowings are, to a certain extent, hedged because the National Bank of Georgia pays a floating interest rate on the minimum reserves that TBC Bank holds with it. Furthermore, respective clauses are included in many of the Bank's loan agreements and all deposit agreements with customers allowing the Bank to adjust the interest rate on the loan/deposit in case of adverse interest rate movements, thereby limiting exposure to interest rate risk.

The Bank employs an advanced framework for the management of interest rate risk by developing appropriate approaches, calculation methodologies for assessing NII and EV sensitivities in case of different scenarios of interest rate changes. The framework considers as well the establishment of appropriate limits, monitoring compliance with them and preparing forecasts. The interest rate risk is managed by the financial risk management department and is monitored by the ALCO, which decides on actions that are necessary for effective interest rate risk management and follows up on their implementation. The major features of the interest rate risk management development, and the respective reporting, are periodically provided to the Management Board, the Supervisory Board, the Board and the Risk, ethics and compliance committees.

The Bank measures four types of interest rate risk based on the source of the risk: (I) re-pricing risk, (ii) yield curve risk, (iii) basis risk, and (IV) optionality (embedded option) risk.

The Bank considers numerous stress scenarios, including different yield curve shifts and behavioural adjustments to cash flows (such as deposit withdrawals or loan prepayments). For each scenario the Bank evaluates both NII and EV sensitivities. Appropriate limits are set by the Supervisory Board and the Management Board's Risk Committee.

In order to evaluate the capital for interest rate risk, the bank uses possible parallel yield curve shift scenarios on net interest income over a one-year period.

Net Interest Margin

Any decline in the Bank's net interest income or net interest margin could lead to a reduction in profitability.

The net interest income accounts for the majority of the Bank's total income. Consequently, fluctuations in its net interest margin affect the results of operations. High competition on the local banking sector could drive interest rates down, compromising the Bank's profitability. At the same time, the cost of funding is largely exogenous to the Bank and is derived based on both the national and international markets.

In 2018, the net interest margin increased by 0.4 pp YoY to 6.9%.

The increase was driven by the advanced analytics across the Bank concerning proper customer segmentation and pricing as well as targeting the right product mix, however increased competition as well as downward trend of interest rates creates potential threat for the NIM.

Finally, the Bank limits its direct exposure to the LIBOR and local refinancing rates or, where not feasible, prices them appropriately between assets and liabilities. As of 31 December 2018, GEL 4, 259 million in assets (27% of total assets) and GEL 1,785 million in liabilities (13% of total liabilities) were floating, linked to the LIBOR/FED/ECB (deposit facility) rates. During the same period, GEL 3,174 million of assets (20% of total assets) and GEL 2,286 million of liabilities (17% of total liabilities) were floating, linked to the National Bank of Georgia's refinancing rate.

The recent regulation regarding the responsible lending will decrease the consumer portfolio growth rate in the short and medium term, thus negatively affect the Bank's NIM with the estimated range of 30 -50 pp. The government's initiative to decrease the cap on interest rates from 100% to 50% also had negative impact on the NIM. However, considering that such portfolio is not material for the Bank, the respective impact on NIM will be limited.

The high current margin levels, increase in fee and commission income, and continuous cost optimisation efforts represent a safeguard against margin declines posing profitability concerns for the Bank. During 2018, the Bank continued to actively work on the margin management with the help of a reputable external consultant. The margin management program, which included an adequate pricing framework and profitability analysis to further assist in the decision making process, will remain one of the Bank's key focus areas in 2019.

Counterparty Risk

TBC Bank performs banking services such as lending in the interbank money market, settling a transaction in the interbank foreign exchange market, entering into interbank transactions related to trade finance or investing in securities. Hence, the Bank is exposed to the risk of losses due to the failure of a counterparty bank to meet its obligations. To manage the counterparty risk, the Bank defines limits on an individual basis for each counterparty and as well on a portfolio basis by limiting the expected loss from both treasury and trade finance exposures. As of 31 December 2018, TBC Bank's interbank exposure was concentrated with banks that external agencies, such as Fitch Ratings, Moody's and Standard and Poor's, have assigned high A-grade credit ratings.

Operational Risk

The operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. From the operation risk perspective, cyber-attacks and fraud have become the relevant risks in recent years.

Cyber Attack

The risk of potential cyber-attacks, which have become sophisticated, may lead to significant security breaches. Such risks change rapidly and require continued focus and investment.

No major cyber-attack attempts have targeted Georgian commercial banks in recent years. Nonetheless, the Bank's rising dependency on IT systems increases its exposure to potential cyber-attacks.

The Bank actively monitors, detects, and prevents risks arising from cyber-attacks. Staff monitor the developments on both local, and international markets to increase awareness of emerging forms of cyber-attacks. Intrusion prevention and DDoS protection systems are in place to protect the Bank from external cyber-threats. Security incident and event monitoring systems in conjunction with respective processes and procedures are in place to handle cyber-incidents effectively.

Fraud Events

Frauds can be committed by both external and internal parties and they may materially impact the Bank's profitability and reputation. During the year2018 the Bank faced a few instances of fraud events which resulted in low material impact to the Bank's profitability.

The Bank actively monitors, detects, and prevents risks arising from fraud events. There are permanent monitoring processes in place to timely detect unusual activities. The efficient risk management protects the Bank from this type of risks.

The Bank continuously works on the fine-tuning of internal processes, as well as on the implementation of the industry's best practices in order to mitigate the losses arising from operational risk events.

The risk and control self-assessment exercise focuses on identifying residual risks in key processes, subject to respective corrective actions.

Please see the Annex for the operational risk-related quantitative data.

Reputational Risk

The reputational risk (RR) arises as consequence of other risk types' occurrence. The essential condition of other risk types becoming RR is that the risk event becomes public and may have an adverse effect on the Bank's reputation.

Key units for RR management, as the Public Relations Department, Operational Risk Management Department, Legal Department and Compliance Department work in coordinated manner to proactively identify reputational risks and apply respective mitigation measures.

The reputational risk is taken into account by the management during the decision-making processes. Key elements of the RR management are ''know your client", "know your employee" and "know your partner" rules. The criteria, according to which clients, employees and partners are assessed, are described in corresponding internal documents.

The RR assessment is performed during the new product approval process. In addition, regular risk and control self-assessment exercises are used as an efficient tool to identify inherent reputational risks.

As for communication with external parties (including media), only authorised employees are permitted to give interviews or disseminate any particular information. The Public Relations Department regularly monitors the mass media.

Regulatory Risk

The Bank's activities are highly regulated and thus, face regulatory risk. The national regulator, the National Bank of Georgia, can increase the prudential requirements across the whole sector as well as for specific institutions within it. Therefore, the Bank's profitability and performance may be compromised by an increased regulatory burden, including higher capital requirements.

Alongside with mandatory capital adequacy ratios, the regulator sets lending limits and other economic ratios, including lending, liquidity and investment ratios.

During 2018, the NBG introduced several regulatory changes concerning the responsible lending standards.

Under the Georgian banking regulations, the Bank is required, among other things, to comply with minimum reserve requirements and mandatory financial ratios and regularly file periodic reports. The Bank is also regulated by respective tax code or other relevant laws in Georgia. The Bank's operations remain in full compliance with all relevant legislation and regulations. The Bank is also subject to financial covenants in its debt agreements.

The Bank has established systems and processes to ensure full regulatory compliance, which are embedded in all levels of the Bank's operations. The dedicated Compliance Department reports directly to the Chief Executive Officer and bears the primary responsibility for regulatory compliance. The Bank's RECC is responsible for regulatory compliance at the Supervisory Board level. In terms of banking regulations and Georgia's taxation system, the Bank is closely engaged with the regulator to ensure that new procedures and requirements are discussed in detail before their implementation. There was also an extensive dialogue with the regulator regarding the new regulation on responsible lending. Together with the new regulation on responsible lending, the government introduced initiatives to ensure continuous broad access to financing. These include simplification of the tax code to incentivize income registration rate. Although decisions made by regulators are beyond the Bank's control, significant regulatory changes are usually preceded by a consultation period that allows all lending institutions to provide feedback and adjust their business practice.

The Bank was subject to an inspection by the NBG in connection with certain transactions which took place in 2007 and 2008. The inspection alleged that these transactions between the Bank and certain entities were not in technical compliance with the Georgian law regulating conflicts of interest. In February 2019, the Company, the Bank and the NBG issued a joint statement confirming the settlement of this investigation. In accordance with this statement the Bank: (I) paid approximately GEL 1 million; and (ii) implemented a restructuring of the Bank's Supervisory Board whereby the founding shareholders stepped down from the Supervisory Board. In addition, TBC Bank continues to cooperate with the NBG to further improve the quality of the Bank's corporate governance and the Company will arrange an external review of the Bank's related party transactions, practices and procedures.

Separately, it is noted that the Georgian Office of Public Prosecution has also launched an investigation into the same matter and there have not been any material developments to date.

Compliance Risk

The compliance risk is defined as the risk of regulatory or legal sanctions, material financial losses or reputation defamation, which may result from the Bank's negligence or inappropriate implementation of the relevant laws, regulations and rules, ethics, and behaviour code.

Georgia is a fast-paced developing country with the goal of European integration and its legislative base is constantly updated.

Besides the national legislation, JSC TBC Bank is subject to the UK and the EU regulations, since the shares of the Bank's mother company are traded in the premium segment of the London Stock Exchange.

Consequently, continuous monitoring, analysis, and timely implementation of national and international legislative amendments pose a significant challenge to the Bank.

The risk management of the Bank's compliance handles the following processes:

- Introduction of corporate ethics and risk sensing culture;
- Management of conflict of interests;
- Management of incidents;
- Prevention of bribery, anti-corruption, and tax avoidance;
- Prevention of illicit income legalisation and terrorism funding;
- Protection of consumers' rights;
- Protection of the capital adequacy and other prudential coefficients required under local regulation and contractual agreements.

In order to ensure the management of these processes, the Bank has developed policies, instructions, rules, and provisions, which are mandatory for all its employees.

The Bank's Compliance Risk Management Department provides the identification, assessment, monitoring and periodic review of the compliance risk.

The Bank's Compliance Risk Management Department is directly subordinated to the CEO and is accountable to the Risk, Ethics and Compliance Committee of the Supervisory Board.

Credit Risk Mitigation

For the purposes of credit risk mitigation, the Bank actively uses various types of collateral. Real estate, movable property, intangible assets, financial assets, suretyship and third party guarantee can be used by the Bank as collateral. The Bank has appropriate processes in place to ensure that the market value of collateral is defined properly and collaterals serve as an effective tool for credit risk mitigation.

Key Policy and Procedures for Collateral Management & Appraisal

The Bank uses collateral for credit risk mitigation purposes and therefore effective collateral management is of particular importance for maintaining credit risks within the acceptable level.

The Bank's collateral management policy and the manual for collateral management and appraisal procedures has been developed taking into consideration the recommendations and standards of BCBS (BASEL COMMITTEE ON BANKING SUPERVISION), IVSC (INTERNATIONAL VALUATION STANDARDS COUNCIL) and is approved by the Bank's Management Board Risk Committee.

The collateral management policy is based on the following main principles:

- Adequacy of collateral valuations;
- Legal enforcement (authenticity and enforceability of agreements);
- Effectiveness of collateral monitoring;
- Reporting systems.

The collateral management policy defines types of assets that the Bank can consider as collateral, outlines the appraisal policy and regulates collateral monitoring and reporting frameworks.

Collateral valuations are undertaken by appraisers of the Collateral Management & Appraisal Department, which is independent from the lending process in order to avoid potential conflict of interest. In individual cases, such as lending to related parties of the Bank, repossession of the properties or complex valuations, the valuation is performed by appropriately selected external appraisers.

Collateral monitoring is carried out regularly by using individual or statistical approaches. Collaterals with higher value are re-evaluated annually, while statistical methods are used to monitor other collaterals.

In addition, the Bank regularly controls the gold market price, to determine the adequacy of valuations being in place and adjust current valuations as required.

Main Types of Collateral

According to the Bank's Collateral Management Policy, collaterals are divided into 5 groups:

- Real estate;
- Movable property;
- Intangible asset;
- Suretyship, guarantee.

Required collaterals are defined based on the credit product type and borrower's risk profile. The Bank's credit portfolio is well secured, with the main type of collateral being real estate.

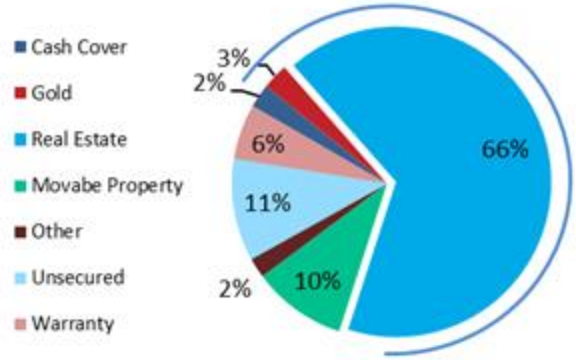
For the purpose of capital adequacy calculation, the Bank uses the following types of collateral:

- Cash deposits;
- Third party guarantees.

In order collateral to be used for the purpose of capital adequacy estimations, the requirements of the National Bank shall be satisfied in accordance with the provisions of the Capital Adequacy Requirements of the Commercial Banks.

Information on Credit Risk Concentrations According to Mitigation Tools

The Bank's credit portfolio is well secured. 65% of the portfolio is secured with real estate, 5% is secured by cash deposits and jewellery (3% and 2% respectively). Other types of collateral are: movable property and third-party guarantees.



Main Types of Guarantees and Contracts Received as Collateral

The significant part of guarantees and counter guarantees that are used as collateral for credit risk mitigation, are banking guarantees/counter guarantees. The Bank's assessment process is held by the Financial Risk Management (FRM) department in accordance with the business requirements. In particular, the request for financing of various banking products arises from the Treasury, Trade Financing and Business Units.

Interbank Limit Assessment Procedure

According to the procedure, the Trade Finance department receives the application about the guarantee/letter of credit/factoring request from a counter guarantee bank and provides the financial risk management department with the respective information. In addition, the Treasury and Financial Service department sends a request about setting the limit on the bank for treasury purposes. The Compliance Department checks the counter-party bank, the applicant, the beneficiary and the financing operation in case of Trade Finance request, and the counter-party bank, in case of Treasury request. After receiving a positive recommendation from Compliance Department, the assessment of counter-party bank is conducted by the FRM department based on the "Counterparty risk limits assessment methodology".

The limits of counter-party banks are set according to ratings assigned by the international rating agencies (Moody's; Fitch Ratings; S&P) and/or ratings derived from an internally-developed model[3], based on which maturity of transactions is defined with the respective limits.

If the counter-guarantee banks average international rating is more than or equal to"BBB", the FRM uses the latter rating for defining the limit and assesses the bank's main financial and non-financial metrics.

[3]If the counterparty is a resident bank, the final rating is defined based on the internal model developed. In case of non-resident banks, where the average international rating is more than or equal to"BBB", the final rating is derived as a minimum between average international and internal ratings.

If the bank is assessed by one international rating agency, or its average credit rating is less than ”BBB”, the bank’s assessment is done by an internally developed model, based on the following factors:

- **Bank’s Financial Metrics:**
  - Capital adequacy;
  - Credit portfolio quality;
  - Liquidity and funding;
  - Profitability.
- **Warning Signals:**
  - Governance;
  - Risk management framework;
  - International credit rating;
  - Operating environment;
  - Regulatory environment and other signals.

After analysing the counter-guarantee bank’s financial and non-financial metrics, the FRM presents its recommendation to the respective decision-making committee. In order to ensure the compliance with the decision-making tiers and flawless implementation of risk approval process, the FRM uses the “Asset and Liability Management Committee Policy” and the “Instruction on Counter-party Risk Approval Committee Decision-Making Process” as a guideline.

The FRM may consider setting general limit for the counter-party bank, if the Trade Finance department deems it necessary, due to possible frequent future transactions.

The counter-party limits monitoring is carried out on a daily basis by the Assets and Liabilities Management Group (ALM). In case of limit breaches, the ALM informs the FRM and Settlements and Correspondent Banking Department in order to take immediate actions for mitigation

TBC Bank has in place a Counter-Party Risk Management Policy, which determines the principles of the process for the counterparty risk management and it regulates the activities of the departments and employees involved.

The FRM reviews the Interbank Limit Assessment Methodology on an annual basis.

International Ratings

With regards to the credit rating, the Bank may use the evaluations made by the following organisations: Fitch, Moody's, and S&P. The credit ratings are used for the following risk classes:

- unconditional and conditional requirements for multilateral development banks;
- unconditional and conditional requirements for commercial banks;
- Unconditional and conditional requirements for central governments and central banks.

The credit rating mapping to credit rating quality is outlined in the table below:

Allowed Credit Rating	Credit rating quality	Fitch	Moody's	S&P

Mapping of credit rating quality– with long-term credit rating	1	From AAA to AA-	From Aaa to Aa3	From AAA to AA-
	2	From A+ to A-	From A1 to A3	From A+ to A-
	3	From BBB+ to BBB-	From Baa1 to Baa3	From BBB+ to BBB-
	4	From BB+ to BB-	From Ba1 to Ba3	From BB+ to BB-
	5	From B+ to B-	From B1 to B3	From B+ to B-
	6	CCC+ and worse	Caa1 and worse	CCC+ and worse

Risk Appetite

The Bank has developed a risk appetite framework that ensures risk-culture communication with the Bank's management and Supervisory Board.

The risk appetite framework includes quantitative and qualitative risk indicators, sets limits and defines acceptable levels for identified risks to support the Bank's business strategy.

The risk appetite framework includes the risk assessment and management for all major categories of risk (credit, financial, operational, liquidity, market, capital, supervisory indicators). The cascading indicators of risk appetite support identification of risks in a more efficient and timely manner, dissemination of information, and planning of relevant activities prior to risk occurrence.

For the effective risk management, the process involves identifying, assessing, determining the desired level of risks, monitoring, and carrying out risk mitigation activities, in case, it exceeds the boundaries established by the Bank.

The risk identification is a continuous process. Once the risk is identified, it is assessed and materiality level is determined. For all potential and principal risks, the risk appetite framework sets limits that are acceptable for each parameter to comply with the Bank's risks and business strategies. After the evaluation of risks and determination of materiality levels, enterprise risk management department is responsible for consolidation and further monitoring of such risks.

The risk appetite framework sets three levels, corresponding to the Bank’s three-layered approach to risk:

- **Green Zone** – desired risk level for the bank, which is important to maintain the Bank's long-term strategy;
- **Yellow zone** – an acceptable level of risk, but it is necessary to take actions to return the risk to the desired green zone;
- **Red zone** – A warning risk level that requires quick solutions and activities to mitigate the risk.

For each level, the risk appetite framework sets out necessary actions to ensure the continuous management and monitoring of risk parameters and prompt activities, in case the desired green zone of risk profile is violated.

The Bank’s Supervisory Board is responsible for approving the risk appetite. The enterprise risk department is responsible for day to day management of risk appetite framework.

The information about the risk appetite outcomes and the necessary updates are provided in the monthly reports of the Bank's Management Board. Quarterly results are presented at the Risk Ethics and Compliance Committee session.

Capital Management

The internal capital adequacy assessment process is a cornerstone for the Bank’s resiliency and sustainability. The prudent capital adequacy management incorporates:

- **Internal capital adequacy assessment**. The Bank have in place an internal capital adequacy assessment process in order to estimate its unexpected losses and hold enough capital against them;
- **Short/long-term forecasting of Capital Adequacy.** For the effective management of capital adequacy the Bank is carrying out capital adequacy forecasting, to timely identify factors that can affect it and avoid breaching capital adequacy limits;
- **Enterprise-Wide stress testing (EWST)**.Under the internal capital adequacy process the Bank conducts enterprise wide stress testing exercises in order to estimate losses under the predefined scenario. The enterprise-wide stress testing is held annually and results are reported to the management and risk ethics and compliance committee of the Supervisory Board. The Bank periodically provides additional sensitivity analysis against currency depreciation and changes in the macroeconomic environment to ensure prudent capital management. In 2018, the Bank held the second round of stress test according to scenario defined by the regulator. The results of regulatory stress testing are expected to be considered while setting stress test buffer under Pillar 2.

Determination of Capital Adequacy Limits

Within risk appetite framework, the Bank sets capital adequacy limits as for Tier1 and Total Capital ratios. These limits ensure that the Bank holds enough capital to meet Basel III rising requirements, which are compliant with estimated economic capital and stress test results.

Capital Allocation and Pricing

Effective capital governance implies determination of accurate capital levels for all assets and its effective allocation, for loan pricing purposes. The process ensures capital optimization and generation of target profitability.

Risk Reporting

The effective risk analysis and management process facilitates a correct, reliable, and timely reporting which is provided by the Risk Reporting Department.

The Risk Management Department analyses the credit portfolio on a monthly basis. It analyses all portfolio’s indicators such as the volume, growth rate, structure, overdoes, vintage analysis, concentration level, maturity, non-performing loans, write-off coefficients, provision charges etc.

Each ratio is analysed for the total portfolio, as well as for each segment with the respect of historical and planned indicators. In addition, operational and financial risks are also examined monthly, alongside the compliance of the risk profile with the risk appetite limits.

The risk management results and analysis are presented to the Management Board in a monthly report and quarterly results are discussed with the Risk, Ethics and Compliance Committee of the Supervisory Board.

These reports cover the following main issues:

- Brief overview of the country's economic situation;
- Risk appetite;
- Credit risk results;
- Liquidity risk results;
- Operational risk results;
- Financial risk results;
- Market risk results;
- Capital management.

In addition to the above-mentioned topics, the committee get updates and discusses other relevant topics such as:

- Regulatory changes;
- Update on the risk strategic objectives;
- Important methodological or strategic changes;

Remuneration Policy for Top Management and Non-executive Directors

For the non-executive directors and top management see annual report pages [136-155]

Material Risk Takers

Material risk takes are considered the staff who have a material impact on the Bank's risk profile. Below is outlined the key criteria the Bank applies to define the material risk takers (MRT):

- The staff being a member of the management function or supervisory board function;
- The staff member is responsible and accountable for the activities of the independent risk management function, compliance function or internal audit function;
- The staff member heads a function responsible for legal affairs, finance, including taxation and budgeting, human resources, remuneration policy, information technologies;
- The senior management and senior staff responsible for material business units, for management of specific risk categories such as liquidity, operational, market risk, etc.;
- The staff member has the authority to approve or veto the introduction of new products;
- Any other staff the Bank considers having a significant influence on the Bank's risk profile.

There were 53 employees identified as MRTs as of December 2018.

Remuneration throughout the Bank

The middle management in the Bank including material risk takers as well as some other key employees receive their entire salary in cash and are also eligible to cash and share bonus. The share bonuses granted are subject to 3 years of continued employment condition and holding period gradually lifting the conditions.

All other employees in the Bank receive cash salaries and may be eligible to receive cash bonuses. Executive director and employee pay is studied and determined through the use of appropriate market data usually with input from a compensation consultant.

All employees receive a competitive benefit package in line with Georgian market practice and are entitled to participate in the pension scheme on a voluntary basis.

Share-based compensation scheme

Each year, subject to predefined performance conditions, a certain number of shares will be awarded to the Bank's middle managers. The performance features represent the performance indicators that are set on an individual basis are used to calculate the number of shares to be awarded to each employee. Share salaries are subject to a condition of continuous employment for 3 years and malus and clawback provisions. These conditions are lifted as follows: 10% of the award on the first anniversary from the award date, a further 10%, on the second anniversary from award date and the final 80% of the on the third anniversary from the award date.

Before those conditions are met, the awarded shares cannot be sold or transferred to third parties. This approach ensures that the participants' interests are closely aligned with the Group's long-term strategy and shareholders' interests.

Considering Risks in the Bank's Remuneration System

Remuneration policies and procedures at the Bank provide maintaining the balance between the Bank's business goals and the desired risk profile.

The remuneration system ensures that the evaluation and relevant compensation for the employees with controlling performance (risk management, compliance and internal audit) are independent from the business results of the business units under their supervision and/or control and are assessed taking into account their performance's effectiveness and quality.

The Bank's remuneration system is consistent with the risk management strategy. It includes a variable payment component that covers the Bank's main risks: credit, operational, financial (liquidity and market risks), regulatory and compliance risk (detailed information on each risk is given in chapter on Key Risks).

The variable remuneration includes components with both a quantitative and qualitative evaluation. It is set at the beginning of each year and is assigned on an individual basis, according to the activity and function of the structural unit. The quantitative and qualitative goals of each direction are defined in accordance with the Bank's strategy and risk appetite and ensure the fulfillment of the Bank's overall objectives. The goals in the remuneration component are taken into consideration for the risk management staff as well as the employees of business lines. For a better understanding of the remuneration's variable components, there are a number of possible risk indicators representing an example of a quantitative goal:

- Non-performing loans ratio – In a variable remuneration system, credit risks are taken into consideration according to the given risk indicator. Performance levels are defined both at the business segment level and the overall Bank level;
- Cost of risk – This risk indicator is another quantitative goal of the credit risks and is also defined both at the business segment level and the overall Bank level;
- Net operational loss ratio – The quantitative indicator of these operational risks provides the motivation for reducing losses generated from the Bank's operational risks.

Examples of qualitative goals may include particular objectives, such as improving current risk models or implementing new risk assessment tools that serve effective implementation of the bank's strategic goals, optimize processes or improve risk management.