

OJSC Kapital Bank

Consolidated financial statements

*Year ended 31 December 2021
together with independent auditor's report*

Contents

Independent auditor's report

Consolidated financial statements

| | |
|--|---|
| Consolidated statement of financial position..... | 1 |
| Consolidated statement of profit or loss..... | 2 |
| Consolidated statement of comprehensive income | 3 |
| Consolidated statement of changes in equity | 4 |
| Consolidated statement of cash flows | 5 |

Notes to the consolidated financial statements

| | |
|---|----|
| 1. Principal activities | 6 |
| 2. Basis of preparation..... | 7 |
| 3. Summary of accounting policies | 7 |
| 4. Significant accounting judgments and estimates | 20 |
| 5. Cash and cash equivalents | 21 |
| 6. Amounts due from credit institutions..... | 21 |
| 7. Investment securities | 22 |
| 8. Loans to customers | 23 |
| 9. Property and equipment | 36 |
| 10. Intangible assets..... | 37 |
| 11. Right of use assets and lease liability..... | 37 |
| 12. Taxation..... | 37 |
| 13. Credit loss expense and other impairment and provisions | 39 |
| 14. Other assets and liabilities..... | 39 |
| 15. Amounts due to customers | 40 |
| 16. Debt securities issued | 41 |
| 17. Amounts due to the Central Bank of the Republic of Azerbaijan and government organizations..... | 41 |
| 18. Amounts due to credit institutions..... | 42 |
| 19. Subordinated loan | 42 |
| 20. Equity | 42 |
| 21. Commitments and contingencies..... | 43 |
| 22. Net fee and commission income..... | 46 |
| 23. Other operating income | 46 |
| 24. Personnel expenses | 46 |
| 25. General and administrative expenses | 47 |
| 26. Risk management..... | 47 |
| 27. Fair value measurements | 57 |
| 28. Maturity analysis of assets and liabilities | 61 |
| 29. Related party disclosures | 62 |
| 30. Changes in liabilities arising from financing activities | 63 |
| 31. Investments in associates | 63 |
| 32. Capital adequacy..... | 64 |
| 33. Events after the reporting period | 65 |

Independent auditor's report

To the Shareholders and Supervisory Board of
OJSC Kapital Bank

Opinion

We have audited the consolidated financial statements of OJSC Kapital Bank and its subsidiary (the "Bank"), which comprise the consolidated statement of financial position as at 31 December 2021, and the consolidated statement of profit or loss, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Bank as at 31 December 2021, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

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

Responsibilities of management and Audit Committee for the consolidated financial statements

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

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

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

Auditor's responsibilities for the audit of the consolidated financial statements

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

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

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

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

Ernst & Young Holdings (CIS) B.V.

Baku, Azerbaijan

2 March 2022

Consolidated statement of financial position**As at 31 December***(Amounts presented are in thousands of Azerbaijani manats)*

| | Notes | 2021 | 2020 |
|--|--------------|------------------|------------------|
| Assets | | | |
| Cash and cash equivalents | 5 | 2,607,885 | 1,884,332 |
| Amounts due from credit institutions | 6 | 254,867 | 111,664 |
| Investment securities | 7 | 1,134,388 | 982,817 |
| Investment in associates | 31 | 3,141 | 2,023 |
| Loans to customers | 8 | 2,519,429 | 2,061,516 |
| Property and equipment | 9 | 63,427 | 61,673 |
| Right-of-use assets | 11 | 34,034 | 36,819 |
| Intangible assets | 10 | 25,655 | 23,667 |
| Current income tax assets | | 5,552 | - |
| Other assets | 14 | 112,965 | 100,422 |
| Total assets | | 6,761,343 | 5,264,933 |
| Liabilities | | | |
| Amounts due to the Central Bank of the Republic of Azerbaijan and government organizations | 17 | 339,803 | 234,209 |
| Amounts due to credit institutions | 18 | 8,016 | 12,470 |
| Amounts due to customers | 15 | 5,328,530 | 4,015,298 |
| Deferred income tax liabilities | 12 | 42,243 | 25,111 |
| Current income tax liabilities | | - | 27,310 |
| Lease liabilities | 11 | 38,954 | 40,749 |
| Debt securities issued | 16 | 59,578 | 59,578 |
| Subordinated loan | 19 | 8,521 | 8,521 |
| Other liabilities | 14 | 138,625 | 126,097 |
| Total liabilities | | 5,964,270 | 4,549,343 |
| Equity | | | |
| Share capital | 20 | 245,850 | 245,850 |
| Additional paid-in capital | | 20,870 | 20,870 |
| Unrealized gain on investment securities | | 7,094 | 6,902 |
| Revaluation reserve for premises | | 1,339 | 1,162 |
| Retained earnings | | 521,920 | 440,806 |
| Total equity | | 797,073 | 715,590 |
| Total liabilities and equity | | 6,761,343 | 5,264,933 |

Signed and authorized for release on behalf of the Management Board of the Bank:

Rovshan Allahverdiyev

Chairman of the Management Board

Emin Mammadov

Board Member, Chief Financial Officer

2 March 2022



Consolidated statement of profit or loss**For the year ended 31 December***(Amounts presented are in thousands of Azerbaijani manats)*

| | Notes | 2021 | 2020 |
|--|--------------|------------------|------------------|
| Interest income | | | |
| Loans to customers | | 443,080 | 416,950 |
| Investment securities | | 65,506 | 34,378 |
| Cash and cash equivalents | | 1,735 | 9,896 |
| Amounts due from credit institutions | | 1,523 | 1,418 |
| Interest income calculated using effective interest rate | | 511,844 | 462,642 |
| Interest expense | | | |
| Amounts due to customers | | (53,156) | (44,243) |
| Lease liabilities | 11 | (4,441) | (4,663) |
| Amounts due to the Central Bank of the Republic of Azerbaijan and government organizations | | (6,542) | (3,686) |
| Debt securities issued | 16 | (3,995) | (78) |
| Amounts due to credit institutions | | (694) | (426) |
| Other | | (510) | (510) |
| | | (69,338) | (53,606) |
| Net interest income | | 442,506 | 409,036 |
| Credit loss expense on financial assets | 13 | (36,344) | (14,181) |
| Net interest income after credit loss expense | | 406,162 | 394,855 |
| Net fee and commission income | 22 | 118,955 | 98,728 |
| Net gains from foreign currencies | | 42,445 | 30,765 |
| Net losses on initial recognition of financial instruments | | (1,955) | - |
| Share of losses of associates | 31 | (2,368) | (1,937) |
| Other operating income | 23 | 13,886 | 8,655 |
| Non-interest income | | 170,963 | 136,211 |
| Personnel expenses | 24 | (131,591) | (117,840) |
| General and administrative expenses | 25 | (90,658) | (70,421) |
| Depreciation of property and equipment and amortisation of intangible assets | 9, 10 | (23,448) | (18,550) |
| Depreciation of right-of-use assets | 11 | (7,488) | (6,985) |
| (Provision)/reversal of impairment for credit related commitments and other impairment | 13 | (17,285) | 6,819 |
| Non-interest expenses | | (270,470) | (206,977) |
| Profit before income tax expense | | 306,655 | 324,089 |
| Income tax expense | 12 | (66,196) | (70,253) |
| Profit for the year | | 240,459 | 253,836 |

The accompanying notes on pages 6 to 65 are an integral part of these consolidated financial statements.

Consolidated statement of comprehensive income**For the year ended 31 December***(Amounts presented are in thousands of Azerbaijani manats)*

| | Notes | 2021 | 2020 |
|---|--------------|----------------|----------------|
| Profit for the year | | 240,459 | 253,836 |
| Other comprehensive income | | | |
| <i>Other comprehensive income to be reclassified to profit or loss in subsequent periods</i> | | | |
| Net change in fair value of debt instruments at fair value through other comprehensive income | | 312 | 105 |
| Reclassification of cumulative gains on disposal of debt instruments at fair value through other comprehensive income to the income statement | | (105) | - |
| Income tax relating to components of other comprehensive income | | (41) | (21) |
| Net other comprehensive income to be reclassified to profit or loss in subsequent periods | | 166 | 84 |
| <i>Other comprehensive income not to be reclassified to profit or loss in subsequent periods</i> | | | |
| Revaluation of premises | 9 | 221 | (344) |
| Gains on equity instruments at fair value through other comprehensive income | | 32 | 1,284 |
| Income tax relating to components of other comprehensive income | | (50) | (188) |
| Total other comprehensive income not to be reclassified to profit or loss in subsequent periods | | 203 | 752 |
| Other comprehensive income for the year, net of tax | | 369 | 836 |
| Total comprehensive income for the year | | 240,828 | 254,672 |

The accompanying notes on pages 6 to 65 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity**For the year ended 31 December***(Amounts presented are in thousands of Azerbaijani manats)*

| | Share capital | Additional paid-in capital | Unrealized gain on investment securities | Revaluation reserve for premises | Retained earnings | Total equity |
|--|--------------------------|---|---|---|------------------------------|-------------------------|
| 1 January 2020 | 225,850 | 20,870 | 5,791 | 1,437 | 310,576 | 564,524 |
| Profit for the year | - | - | - | - | 253,836 | 253,836 |
| Other comprehensive income/ (loss) for the year | - | - | 1,111 | (275) | - | 836 |
| Total comprehensive income for the year | - | - | 1,111 | (275) | 253,836 | 254,672 |
| Issuance of preference shares (Note 20) | 20,000 | - | - | - | - | 20,000 |
| Dividends to shareholders of the Bank (Note 20) | - | - | - | - | (123,606) | (123,606) |
| 31 December 2020 | 245,850 | 20,870 | 6,902 | 1,162 | 440,806 | 715,590 |
| Profit for the year | - | - | - | - | 240,459 | 240,459 |
| Other comprehensive income for the year | - | - | 192 | 177 | - | 369 |
| Total comprehensive income for the year | - | - | 192 | 177 | 240,459 | 240,828 |
| Dividends to shareholders of the Bank (Note 20) | - | - | - | - | (159,345) | (159,345) |
| 31 December 2021 | 245,850 | 20,870 | 7,094 | 1,339 | 521,920 | 797,073 |

The accompanying notes on pages 6 to 65 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows**For the year ended 31 December***(Amounts presented are in thousands of Azerbaijani manats)*

| | Notes | 2021 | 2020 |
|--|--------------|------------------|------------------|
| Cash flows from operating activities | | | |
| Interest received | | 510,549 | 445,005 |
| Interest paid | | (73,237) | (64,133) |
| Fees and commissions received | | 200,129 | 133,185 |
| Fees and commissions paid | | (71,006) | (36,666) |
| Net realized gains from foreign currency operations | | 36,828 | 33,805 |
| Other operating income received | | 13,047 | 6,657 |
| Personnel expenses paid | | (135,315) | (107,522) |
| General and administrative expenses paid | | (87,614) | (66,034) |
| Cash flows from operating activities before changes in operating assets and liabilities | | 393,381 | 344,297 |
| <i>Net (increase)/decrease in operating assets</i> | | | |
| Amounts due from credit institutions | | (142,165) | 15,402 |
| Loans to customers | | (513,698) | (226,674) |
| Other assets | | (15,244) | (7,575) |
| <i>Net increase/(decrease) in operating liabilities</i> | | | |
| Amounts due to customers | | 1,342,419 | 630,585 |
| Amounts due to the Central Bank of the Republic of Azerbaijan and government organizations | | 105,594 | 8,725 |
| Amounts due to credit institutions | | (4,353) | 6,574 |
| Other liabilities | | 2,038 | 10,383 |
| Net cash flows from operating activities before income tax | | 1,167,972 | 781,717 |
| Income tax paid | | (82,000) | (3,000) |
| Net cash from operating activities | | 1,085,972 | 778,717 |
| Cash flows used in investing activities | | | |
| Purchase of investment securities | | (1,653,310) | (3,022,413) |
| Proceeds from sale and redemption of investment securities | | 1,506,743 | 2,507,021 |
| Investment in associates | | (3,486) | (3,960) |
| Purchase of property and equipment | | (20,073) | (26,088) |
| Proceeds from sale of property and equipment | | 3,156 | - |
| Purchase of intangible assets | | (9,299) | (6,659) |
| Net cash used in investing activities | | (176,269) | (552,099) |
| Cash flows used in financing activities | | | |
| Proceeds from issue of preference shares | 20 | - | 20,000 |
| Lease liability paid | 11 | (10,561) | (9,787) |
| Proceeds from debt securities issued | | - | 59,500 |
| Dividends paid to shareholders of the Bank | 20 | (170,945) | (100,805) |
| Net cash used in financing activities | | (181,506) | (31,092) |
| Effect of exchange rates changes on cash and cash equivalents | | (4,644) | 3,604 |
| Net increase in cash and cash equivalents | | 723,553 | 199,130 |
| Cash and cash equivalents, beginning | | 1,884,332 | 1,685,202 |
| Cash and cash equivalents, ending | 5 | 2,607,885 | 1,884,332 |

The accompanying notes on pages 6 to 65 are an integral part of these consolidated financial statements.

(Amounts presented are in thousands of Azerbaijani manats)

1. Principal activities

Open Joint Stock Company Kapital Bank (the "Bank") was established in accordance with the legislation of the Republic of Azerbaijan. The Bank operates under banking license No. 244 issued by the Central Bank of the Republic of Azerbaijan ("the CBAR") on 25 February 2000.

The Bank's principal business activity is corporate and retail banking operations. This includes deposit taking and commercial lending in freely convertible currencies and in Azerbaijani manat ("AZN"), transfer payments in Azerbaijan and abroad, support of clients' export/import transactions, foreign currency exchange and other banking services to its commercial and retail customers. As at 31 December 2021, the Bank's network comprised of head office, 23 divisions (2020: 19) and 104 branches (2020: 102).

The Bank participates in the State deposit insurance program, which was introduced by the Azeri Law, *Insurance of Individual Deposits in the Republic of Azerbaijan* dated 29 December 2006. Azerbaijan Deposit Insurance Fund fully guarantees deposits for a period of three years in local currency with an interest rate up to 12% (2020: 10%), as well as deposits in foreign currency with an interest rate up to 2.5% (2020: 2.5%).

The number of Bank's employees as at 31 December 2021 was 4,100 (2020: 3,620).

The Bank's registered legal address is 71 Fuzuli Street, Baku, AZ1014, Azerbaijan.

As at 31 December, the following shareholders owned the outstanding shares of the Bank:

| Shareholder | 2021 % | 2020 % |
|--------------------|---------------|---------------|
| PASHA Holding LLC | 99.88 | 99.88 |
| Individuals | 0.12 | 0.12 |
| Total | 100.00 | 100.00 |

As at 31 December 2021 and 2020, the Bank is ultimately owned by Mrs. Leyla Aliyeva, Mrs. Arzu Aliyeva, Mr. Arif Pashayev and Mr. Mir Jamal Pashayev, who exercise collective control over the Bank.

As at 31 December 2021 and 2020, the Bank owns 100% of "Birkart non-bank credit organization" Limited Liability Company (the "subsidiary" or "Birkart NBCO"), which was established by the Bank on 3 May 2018 in accordance with the legislation of the Republic of Azerbaijan. During 2021, the Bank additionally paid up in full for 355 new AZN 10 shares of the subsidiary and as of 31 December 2021, the share capital of the subsidiary totalled AZN 8,540 (2020: AZN 4,990). The first branch of "Birkart NBCO" was opened on 3 April 2019. As at 31 December 2021, "Birkart NBCO" has 29 branches (2020: 28) and 36 employees (2020: 43). The subsidiary facilitates lending via Birkart plastic cards and other bank-related financial services, such as leasing, factoring and issuance of bank guarantees.

On 6 March 2020 the subsidiary purchased 25% of the share capital in "Competo" LLC (the "associate") amounting to AZN 50. "Competo" LLC was established on 9 February 2018 and is operating in retail banking IT and consulting service. During 2020 and 2021, the shareholders of "Competo" LLC, including "Birkart NBCO" LLC, made additional capital injections into "Competo" LLC in proportion to their ownership percentage, and as at 31 December 2021 the total value of net investment made to the associate, after deducting the Bank's share of associate's losses, amounts to AZN 2,429 (2020: AZN 2,023), which is 25% of the total share capital of the associate. The Bank uses equity method of accounting for its investment in associate. The associate's net loss for the year ended 31 December 2021 amounted to AZN 12,302 (2020: AZN 9,455), of which the bank recognised 25%, or AZN 3,076 (2020: AZN 1,937 post-acquisition) in its consolidated statement of profit or loss.

On 18 August 2021 the subsidiary purchased 20% of the share capital in "Komtec LTD" LLC (the "associate") amounting to AZN 4. "Komtec LTD" was established in 2008 and is operating in the market of electronic payments and cash payment terminals. As at 31 December 2021, the total value of net investment made by the Birkart NBCO" LLC to the associate amounts to AZN 712 (2020: nil), which is 20% of the total share capital of the associate. The Bank included this investment in the consolidated statement of financial position. The Bank uses equity method of accounting for its investment in the associate. The associate's net profit for the year ended 31 December 2021 amounted to AZN 9,581, of which the bank recognised 20% of post-acquisition profit, or AZN 708, in its consolidated statement of profit or loss.

As at 31 December 2021, the subsidiary owns 100% of "Red Hearts" Charity Foundation, which was established by the subsidiary on 15 December 2020. As at 31 December 2021, the subsidiary fully paid up issued and outstanding share capital totaling AZN 10 divided into 10 shares, each with a par value of AZN 1.

OJSC Kapital Bank and its subsidiary (together – the "Bank") were consolidated in these financial statements.

(Amounts presented are in thousands of Azerbaijani manats)

2. Basis of preparation

General

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

The Azerbaijani manat is the functional and presentation currency of the Bank as the majority of the transactions are denominated, measured, or funded in Azerbaijani manat. Transactions in other currencies are treated as transactions in foreign currencies. The Bank maintains its records and prepares its consolidated financial statements in Azerbaijani manat and in accordance with IFRS. These consolidated financial statements are presented in thousands of Azerbaijani manat ("AZN"), except per share amounts and unless otherwise indicated. These consolidated financial statements have been prepared under the historical cost convention except for premises and investment securities at FVOCI and derivative financial assets and liabilities which have been measured at fair value.

Effect of COVID-19 pandemic

Due to the rapid spread of COVID-19 pandemic in 2020, which continued in 2021, many governments, including the Azerbaijan Government, have introduced various measures to combat the outbreak, including travel restrictions, quarantines, closure of business and other venues and lockdown of certain areas. These measures have affected the global supply chain, demand for goods and services, as well as scale of business activity. It is expected that pandemic itself, as well as the related public health and social measures, may influence the business of the entities in a wide range of industries.

Support measures were introduced by the Government and the Central Bank of Azerbaijan to counter the economic downturn caused by the COVID-19 pandemic. These measures include, among others, subsidized lending to affected industries and individuals and easing of certain regulatory restrictions to help the financial sector maintain its capabilities to provide resources and to help customers avoid liquidity shortages as a result of the COVID-19 containment measures.

The Bank continues to assess the effect of the pandemic and changing economic conditions on its activities, financial position and financial results.

Estimation uncertainty

To the extent that information is available as at 31 December 2021, the Bank has reflected revised estimates of expected future cash flows in its ECL assessment (Note 8), estimation of fair values of financial instruments (Note 27).

3. Summary of accounting policies

Changes in accounting policies

The Bank applied for the first time certain amendments to the standards, which are effective for annual periods beginning on or after 1 January 2021. The Bank has not early adopted any standards, interpretations or amendments that have been issued but are not yet effective.

On 28 May 2020, the IASB issued *COVID-19-Related Rent Concessions* – amendment to IFRS 16 *Leases*.

The amendments provide relief to lessees from applying IFRS 16 guidance on lease modification accounting for rent concessions arising as a direct consequence of the COVID-19 pandemic. As a practical expedient, a lessee may elect not to assess whether a COVID-19 related rent concession from a lessor is a lease modification. A lessee that makes this election accounts for any change in lease payments resulting from the COVID-19 related rent concession the same way it would account for the change under IFRS 16, if the change were not a lease modification.

The amendment was intended to apply until 30 June 2021, but as the impact of the COVID-19 pandemic is continuing, on 31 March 2021, the IASB extended the period of application of the practical expedient to 30 June 2022. The amendment applies to annual reporting periods beginning on or after 1 April 2021. However, the Bank has not received COVID-19-related rent concessions, but plans to apply the practical expedient if it becomes applicable within allowed period of application.

Several other amendments effective since 1 January 2021 were applied but do not have an impact on the consolidated financial statements of the Bank.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Basis of consolidation

Subsidiaries, which are those entities which are controlled by the Bank, are consolidated. Control is achieved when the Bank is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Bank controls an investee if, and only if, the Bank has:

- ▶ Power over the investee (i.e., existing rights that give it the current ability to direct the relevant activities of the investee);
- ▶ Exposure, or rights, to variable returns from its involvement with the investee;
- ▶ The ability to use its power over the investee to affect its returns.

Generally, there is a presumption that a majority of voting rights results in control. To support this presumption and when the Bank has less than a majority of the voting or similar rights of an investee, the Bank considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- ▶ The contractual arrangement(s) with the other vote holders of the investee;
- ▶ Rights arising from other contractual arrangements;
- ▶ The Bank's voting rights and potential voting rights.

Subsidiaries are consolidated from the date on which control is transferred to the Bank and are no longer consolidated from the date that control ceases. All intra-group transactions, balances and unrealised gains on transactions between group companies are eliminated in full; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Bank.

A change in the ownership interest of a subsidiary, without a change of control, is accounted for as an equity transaction. Losses are attributed to the non-controlling interests even if that results in a deficit balance. If the Bank loses control over a subsidiary, it derecognises the assets (including goodwill) and liabilities of the subsidiary, the carrying amount of any non-controlling interests, the cumulative translation differences, recorded in equity; recognises the fair value of the consideration received, the fair value of any investment retained and any surplus or deficit in profit or loss and reclassifies the parent's share of components previously recognised in other comprehensive income to profit or loss.

Investments in associates

Associates are entities in which the Bank generally has between 20% and 50% of the voting rights, or is otherwise able to exercise significant influence, but which it does not control or jointly control. Investments in associates are accounted for under the equity method and are initially recognised at cost, including goodwill. Subsequent changes in the carrying value reflect the post-acquisition changes in the Bank's share of net assets of the associate. The Bank's share of its associates' profits or losses is recognised in profit or loss, and its share of movements in reserves is recognised in other comprehensive income. However, when the Bank's share of losses in an associate equals or exceeds its interest in the associate, the Bank does not recognise further losses, unless the Bank is obliged to make further payments to, or on behalf of, the associate.

Unrealised gains on transactions between the Bank and its associates are eliminated to the extent of the Bank's interest in the associates; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Fair value measurement

The Bank measures financial instruments carried at FVPL and FVOCI and non-financial assets such as premises at fair value at each balance sheet date.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- ▶ In the principal market for the asset or liability; or
- ▶ In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Bank. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Fair value measurement (continued)

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- ▶ Level 1 – quoted (unadjusted) market prices in active markets for identical assets or liabilities;
- ▶ Level 2 – valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable;
- ▶ Level 3 – valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

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

Financial assets and liabilities

Initial recognition

Date of recognition

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

Initial measurement

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments. Financial instruments are initially measured at their fair value and, except in the case of financial assets and financial liabilities recorded at FVPL, transaction costs are added to, or subtracted from, this amount.

Measurement categories of financial assets and liabilities

The Bank classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms, measured at either:

- ▶ Amortised cost;
- ▶ FVOCI;
- ▶ FVPL.

The Bank classifies and measures its derivative and trading portfolio at FVPL. The Bank may designate financial instruments at FVPL, if so doing eliminates or significantly reduces measurement or recognition inconsistencies.

Financial liabilities, other than loan commitments and financial guarantees, are measured at amortised cost or at FVPL when they are held for trading, are derivative instruments or the fair value designation is applied.

Amounts due from credit institutions, loans to customers, investments securities at amortised cost

The Bank only measures amounts due from credit institutions, loans to customers, investment debt securities and other financial investments at amortized cost if both of the following conditions are met:

- ▶ The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows;
- ▶ The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (SPPI).

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

The details of these conditions are outlined below.

Business model assessment

The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.

The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- ▶ How the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel;
- ▶ The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed;
- ▶ How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected);
- ▶ The expected frequency, value and timing of sales are also important aspects of the Bank's assessment.

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Bank's original expectations, the Bank does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

The SPPI test

As a second step of its classification process the Bank assesses the contractual terms of financial asset to identify whether they meet the SPPI test.

'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium/discount).

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Bank applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

In contrast, contractual terms that introduce a more than de minimis exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

Debt instruments at FVOCI

The Bank measures debt instruments at FVOCI when both of the following conditions are met:

- ▶ The instrument is held within a business model, the objective of which is achieved by both collecting contractual cash flows and selling financial assets;
- ▶ The contractual terms of the financial asset meet the SPPI test.

FVOCI debt instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value recognised in OCI. Interest revenue and foreign exchange gains and losses are recognised in profit or loss in the same manner as for financial assets measured at amortised cost. On derecognition, cumulative gains or losses previously recognised in OCI are reclassified from OCI to profit or loss.

The ECLs for debt instruments measured at FVOCI do not reduce the carrying amount of these financial assets in the consolidated statement of financial position, which remains at fair value. Instead, an amount equal to the allowance that would arise if the assets were measured at amortised cost is recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss. The accumulated loss recognised in OCI is recycled to the profit and loss upon derecognition of the asset.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

Equity instruments at FVOCI

Upon initial recognition, the Bank occasionally elects to classify irrevocably some of its equity investments as equity instruments at FVOCI when they meet the definition of equity under IAS 32 *Financial Instruments: Presentation* and are not held for trading. Such classification is determined on an instrument-by-instrument basis.

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

Financial guarantees, letters of credit and undrawn loan commitments

The Bank issues financial guarantees, letters of credit and loan commitments.

Financial guarantees are initially recognised in the financial statements at fair value, being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the consolidated statement of profit or loss, and an ECL provision.

Undrawn loan commitments and letters of credits are commitments under which, over the duration of the commitment, the Bank is required to provide a loan with pre-specified terms to the customer. Similar to financial guarantee contracts, these contracts are in the scope of the ECL requirements.

The Bank occasionally issues loan commitments at below market interest rates drawdown. Such commitments are initially recognized at fair value and subsequently measured at the higher of the amount of the ECL allowance and the amount initially recognised less, when appropriate, the cumulative amount of income recognised.

Performance guarantees

Performance guarantees are contracts that provide compensation if another party fails to perform a contractual obligation. Performance guarantees do not transfer credit risk. The risk under performance guarantee contracts is the possibility that the failure to perform the contractual obligation by another party occurs.

Reclassification of financial assets and liabilities

The Bank does not reclassify its financial assets subsequent to their initial recognition, apart from the exceptional circumstances in which the Bank changes the business model for managing financial assets. Financial liabilities are never reclassified. The Bank did not reclassify any of its financial assets and liabilities in 2021.

Cash and cash equivalents

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

Derivative financial instruments

In the normal course of business, the Bank enters into various derivative financial instruments including futures, forwards, swaps and options in the foreign exchange and capital markets. Such financial instruments are held for trading and are recorded at fair value. The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the consolidated statement of profit or loss as net gains from foreign currencies as net gains/(losses) from financial instruments at fair value through profit or loss or net gains/(losses) from foreign currencies, depending on the nature of the instrument.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Derivative financial instruments (continued)

An embedded derivative is a component of a hybrid instrument that also includes a non-derivative host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided that, in the case of a non-financial variable, it is not specific to a party to the contract. A derivative that is attached to a financial instrument, but is contractually transferable independently of that instrument, or has a different counterparty from that instrument, is not an embedded derivative, but a separate financial instrument.

Derivatives embedded in liabilities and non-financial host contracts are treated as separate derivatives and recorded at fair value if they met the definition of a derivative (as defined above), their economic characteristics and risks were not closely related to those of the host contract, and the host contract was not itself held for trading or designated at FVPL. The embedded derivatives separated from the host were carried at fair value in the trading portfolio with changes in fair value recognised in the consolidated statement of profit or loss.

Financial assets are classified based on the business model and SPPI assessments.

Repurchase and reverse repurchase agreements and securities lending

Sale and repurchase agreements ("repos") are treated as secured financing transactions. Securities sold under sale and repurchase agreements are retained in the consolidated statement of financial position and, in case the transferee has the right by contract or custom to sell or repledge them, reclassified as securities pledged under sale and repurchase agreements. The corresponding liability is presented within amounts due to credit institutions or customers. Securities purchased under agreements to resell ("reverse repo") are recorded as investment securities or loans to customers as appropriate. The difference between sale and repurchase price is treated as interest revenue and accrued over the life of repo agreements using the effective interest method.

Securities lent to counterparties are retained in the consolidated statement of financial position. Securities borrowed are not recorded in the consolidated statement of financial position, unless these are sold to third parties, in which case the purchase and sale are recorded within gains less losses from trading securities in the consolidated statement of profit or loss. The obligation to return them is recorded at fair value as a trading liability.

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to customers, amounts due to the Central Bank of the Republic of Azerbaijan and government organizations, amounts due to credit institutions and debt securities issued. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method.

Gains and losses are recognised in profit or loss when the borrowings are derecognised as well as through the amortization process.

If the Bank purchases its own debt, it is removed from the consolidated statement of financial position and the difference between the carrying amount of the liability and the consideration paid is recognised in profit or loss.

Leases

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

Right-of-use assets

The Bank recognises right-of-use assets at the commencement date of the lease (i.e., the date the underlying asset is available for use). Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any remeasurement of lease liabilities. The cost of right-of-use assets includes the amount of lease liabilities recognised, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received. Unless the Bank is reasonably certain to obtain ownership of the leased asset at the end of the lease term, the recognised right-of-use assets are depreciated on a straight-line basis over the shorter of its estimated useful life and the lease term. Right-of-use assets are subject to impairment.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Leases (continued)

Lease liabilities

At the commencement date of the lease, the Bank recognises lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments (including in-substance fixed payments) less any lease incentives receivable, variable lease payments that depend on an index or a rate, and amounts expected to be paid under residual value guarantees. The lease payments also include the exercise price of a purchase option reasonably certain to be exercised by the Bank and payments of penalties for terminating a lease, if the lease term reflects the Bank exercising the option to terminate. The variable lease payments that do not depend on an index or a rate are recognised as expense in the period on which the event or condition that triggers the payment occurs.

In calculating the present value of lease payments, the Bank uses the incremental borrowing rate at the lease commencement date if the interest rate implicit in the lease is not readily determinable. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made. In addition, the carrying amount of lease liabilities is remeasured if there is a modification, a change in the lease term, a change in the in-substance fixed lease payments or a change in the assessment to purchase the underlying asset.

Short-term leases and leases of low-value assets

The Bank applies the short-term lease recognition exemption to its short-term leases (i.e., those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). It also applies the lease of low-value assets recognition exemption to leases of office equipment that are considered of low value (i.e., below USD 5 thousand). Lease payments on short-term leases and leases of low-value assets are recognised as expense on a straight-line basis over the lease term.

Offsetting of financial instruments

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

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

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

Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions.

The Bank derecognises a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognised as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognised loans are classified as Stage 1 for ECL measurement purposes, unless the new loan is deemed to be POCI. Restructuring of impaired loans does not result in derecognition of financial instrument. When assessing whether or not to derecognise a loan to a customer, amongst others, the Bank considers the following factors:

- ▶ Change in currency of the loan;
- ▶ Change in counterparty;
- ▶ If the modification is such that the instrument would no longer meet the SPPI criterion.

If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Bank records a modification gain or loss, presented within interest income calculated using EIR in the consolidated statement of profit or loss, to the extent that an impairment loss has not already been recorded.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Derecognition of financial assets and liabilities

Financial assets

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

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

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

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

Write-off

Financial assets are written off either partially or in their entirety only when the Bank has stopped pursuing the recovery. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to credit loss expense. A write-off constitutes a derecognition event.

Financial liabilities

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

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

Taxation

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

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

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

Azerbaijan also has various operating taxes that are assessed on the Bank's activities. These taxes are included as a component of general and administrative expenses.

Current and deferred taxes are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity, respectively.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Property and equipment

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

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

Following initial recognition at cost, premises are carried at a revalued amount, which is the fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Valuations are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

Accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Any revaluation surplus is credited to the revaluation reserve for property and equipment included in other comprehensive income, except to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss, in which case the increase is recognised in profit or loss. A revaluation deficit is recognised in profit or loss, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the revaluation reserve for property and equipment.

An annual transfer from the revaluation reserve for property and equipment to retained earnings is made for the difference between depreciation based on the revalued carrying amount of the assets and depreciation based on the assets original cost. Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

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

| | <u>Years</u> |
|--|--------------|
| Premises | 20 |
| Leasehold improvements | 10 |
| Computers and other office equipment | 5 |
| Furniture, fixtures, vehicles and others | 5 |

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

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

Intangible assets

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be finite. Intangible assets with finite lives are amortised over the useful economic lives of 1 to 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of obligation can be made.

Retirement and other employee benefit obligations

The Bank does not have any pension arrangements separate from the State pension system of the Republic of Azerbaijan, which requires current contributions by the employer calculated as a percentage of current gross salary payments; such expense is charged in the period the related salaries are earned. In addition, the Bank has no significant post-employment benefits.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Share capital

Share capital

Ordinary shares and non-redeemable preference shares with discretionary dividends are both classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from the proceeds in equity. Any excess of the fair value of consideration received over the par value of shares issued and other contributions made by shareholders are recognised as additional paid-in capital.

Dividends

Dividends are recognised as a liability and deducted from equity at the reporting date only if they are declared before or on the reporting date. Dividends are disclosed when they are proposed before the reporting date or proposed or declared after the reporting date but before the financial statements are authorised for issue.

Contingencies

Contingent liabilities are not recognised in the consolidated statement of financial position but are disclosed unless the possibility of any outflow in settlement is remote. A contingent asset is not recognised in the consolidated statement of financial position but disclosed when an inflow of economic benefits is probable.

Recognition of income and expenses

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

Interest and similar income and expense

The Bank calculates interest income on debt financial assets measured at amortized cost or at FVOCI by applying the EIR to the gross carrying amount of financial assets other than credit-impaired assets. EIR is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest revenue or expense.

When a financial asset becomes credit-impaired, the Bank calculates interest revenue by applying the effective interest rate to the net amortised cost of the financial asset. If the financial assets cures and is no longer credit-impaired, the Bank reverts to calculating interest revenue on a gross basis.

For purchased or originated credit-impaired (POCI) financial assets, the Bank calculates interest income by calculating the credit-adjusted EIR and applying that rate to the amortised cost of the asset. The credit-adjusted EIR is the interest rate that, at original recognition, discounts the estimated future cash flows (including credit losses) to the amortised cost of the POCI assets.

Fees and commissions

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

- ▶ Income earned from the provision of service is recognized as revenue as the service are provided (for example, servicing plastic card operations, settlement operations, cash operations and others);
- ▶ Income which forms an integral part of the effective interest rate of a financial instrument is recognized as an adjustment to the effective interest rate and recorded in 'interest income'.

Customer loyalty programs

The Bank offers a number customer loyalty programs. Accounting for such programs varies depending on who is identified as the customer, and whether the Bank acts as an agent or as a principal under the contract. For point-based programs, the Bank generally recognized a liability for the accumulated points that are expected to be utilized by the customers, which is reversed to profit or loss as the points expire. Cashbacks on plastic card transactions reduce fee and commission income.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Recognition of income and expenses (continued)

Dividend income

Revenue is recognized when the Bank's right to receive the payment is established.

Foreign currency translation

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

Differences between the contractual exchange rate of a transaction in a foreign currency and the CBAR exchange rate on the date of the transaction are included in gains from dealing operations.

The Bank used the following official exchange rates at 31 December in the preparation of these financial statements:

| | <u>2021</u> | <u>2020</u> |
|-------------|-------------|-------------|
| 1 US dollar | AZN 1.7000 | AZN 1.7000 |
| 1 euro | AZN 1.9265 | AZN 2.0890 |

Standards issued but not yet effective

The new and amended standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements are disclosed below. The Bank intends to adopt these new and amended standards and interpretations, if applicable, when they become effective.

IFRS 17 Insurance Contracts

In May 2017, the IASB issued IFRS 17 *Insurance Contracts* (IFRS 17), a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, IFRS 17 will replace IFRS 4 *Insurance Contracts* (IFRS 4) that was issued in 2005. IFRS 17 applies to all types of insurance contracts (i.e., life, non-life, direct insurance and re-insurance), regardless of the type of entities that issue them, as well as to certain guarantees and financial instruments with discretionary participation features. A few scope exceptions will apply. IFRS 17 introduces new accounting requirements for banking products with insurance features that may affect the determination of which instruments or which components thereof will be in the scope of IFRS 9 or IFRS 17.

Credit cards and similar products that provide insurance coverage: most issuers of these products will be able to continue with their existing accounting treatment as a financial instrument under IFRS 9. IFRS 17 excludes from its scope credit card contracts (and other similar contracts that provide credit or payment arrangements) that meet the definition of an insurance contract if, and only if, the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer.

When the insurance coverage is provided as part of the contractual terms of the credit card, the issuer is required to:

- ▶ Separate the insurance coverage component and apply IFRS 17 to it;
- ▶ Apply other applicable standards (such as IFRS 9, IFRS 15 *Revenue from Contracts with Customers* or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*) to the other components

Loan contracts that meet the definition of insurance but limit the compensation for insured events to the amount otherwise required to settle the policyholder's obligation created by the contract: Issuers of such loans – e.g. a loan with waiver on death – have an option to apply IFRS 9 or IFRS 17. The election would be made at a portfolio level and would be irrevocable.

IFRS 17 is effective for reporting periods beginning on or after 1 January 2023, with comparative figures required. Early application is permitted, provided the entity also applies IFRS 9 and IFRS 15 on or before the date it first applies IFRS 17.

The Bank is currently in the process of assessing the impact of adopting IFRS 17 on its consolidated financial statements.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

Amendments to IAS 1: Classification of Liabilities as Current or Non-current

In January 2020, the IASB issued amendments to paragraphs 69 to 76 of IAS 1 to specify the requirements for classifying liabilities as current or non-current. The amendments clarify:

- ▶ What is meant by a right to defer settlement;
- ▶ That a right to defer must exist at the end of the reporting period;
- ▶ That classification is unaffected by the likelihood that an entity will exercise its deferral right;
- ▶ That only if an embedded derivative in a convertible liability is itself an equity instrument would the terms of a liability not impact its classification.

The amendments are effective for annual reporting periods beginning on or after 1 January 2023 and must be applied retrospectively. The Bank is currently assessing the impact the amendments will have on current practice and whether existing loan agreements may require renegotiation.

Reference to the Conceptual Framework – Amendments to IFRS 3

In May 2020, the IASB issued Amendments to IFRS 3 *Business Combinations – Reference to the Conceptual Framework*. The amendments are intended to replace a reference to the Framework for the Preparation and Presentation of Financial Statements, issued in 1989, with a reference to the Conceptual Framework for Financial Reporting issued in March 2018 without significantly changing its requirements.

The Board also added an exception to the recognition principle of IFRS 3 to avoid the issue of potential 'day 2' gains or losses arising for liabilities and contingent liabilities that would be within the scope of IAS 37 or IFRIC 21 *Levies*, if incurred separately.

At the same time, the Board decided to clarify existing guidance in IFRS 3 for contingent assets that would not be affected by replacing the reference to the Framework for the Preparation and Presentation of Financial Statements.

The amendments are effective for annual reporting periods beginning on or after 1 January 2022 and apply prospectively. The amendments are not expected to have a material impact on the Bank.

Property, Plant and Equipment: Proceeds before Intended Use – Amendments to IAS 16

In May 2020, the IASB issued *Property, Plant and Equipment – Proceeds before Intended Use*, which prohibits entities deducting from the cost of an item of property, plant and equipment, any proceeds from selling items produced while bringing that asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Instead, an entity recognises the proceeds from selling such items, and the costs of producing those items, in profit or loss.

The amendment is effective for annual reporting periods beginning on or after 1 January 2022 and must be applied retrospectively to items of property, plant and equipment made available for use on or after the beginning of the earliest period presented when the entity first applies the amendment.

The amendments are not expected to have a material impact on the Bank.

Onerous Contracts – Costs of Fulfilling a Contract – Amendments to IAS 37

In May 2020, the IASB issued amendments to IAS 37 to specify which costs an entity needs to include when assessing whether a contract is onerous or loss-making.

The amendments apply a "directly related cost approach". The costs that relate directly to a contract to provide goods or services include both incremental costs and an allocation of costs directly related to contract activities. General and administrative costs do not relate directly to a contract and are excluded unless they are explicitly chargeable to the counterparty under the contract.

The amendments are effective for annual reporting periods beginning on or after 1 January 2022. The Bank will apply these amendments to contracts for which it has not yet fulfilled all its obligations at the beginning of the annual reporting period in which it first applies the amendments.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

IFRS 1 First-time Adoption of International Financial Reporting Standards – Subsidiary as a first-time adopter

As part of its 2018-2020 annual improvements to IFRS standards process, the IASB issued an amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*. The amendment permits a subsidiary that elects to apply paragraph D16(a) of IFRS 1 to measure cumulative translation differences using the amounts reported by the parent, based on the parent's date of transition to IFRS. This amendment is also applied to an associate or joint venture that elects to apply paragraph D16 (a) of IFRS 1.

The amendment is effective for annual reporting periods beginning on or after 1 January 2022 with earlier adoption permitted.

The Bank is currently assessing the impact of the amendments to determine the impact they will have on the Bank's accounting policy disclosures.

IFRS 9 Financial Instruments – Fees in the '10 per cent' test for derecognition of financial liabilities

As part of its 2018-2020 Annual Improvements to IFRS standards process, the IASB issued an amendment to IFRS 9.

The amendment clarifies the fees that an entity includes when assessing whether the terms of a new or modified financial liability are substantially different from the terms of the original financial liability. These fees include only those paid or received between the borrower and the lender, including fees paid or received by either the borrower or lender on the other's behalf. An entity applies the amendment to financial liabilities that are modified or exchanged on or after the beginning of the annual reporting period in which the entity first applies the amendment.

The amendment is effective for annual reporting periods beginning on or after 1 January 2022 with earlier adoption permitted. The Bank will apply the amendments to consolidated financial liabilities that are modified or exchanged on or after the beginning of the annual period in which it will first apply the amendment and does not expect this will result in a material impact on its consolidated financial statements.

Definition of Accounting Estimates – Amendments to IAS 8

In February 2021, the IASB issued amendments to IAS 8, in which it introduces a definition of 'accounting estimates'. The amendments clarify the distinction between changes in accounting estimates and changes in accounting policies and the correction of errors. Also, they clarify how entities use measurement techniques and inputs to develop accounting estimates.

The amendments are effective for annual reporting periods beginning on or after 1 January 2023 and apply to changes in accounting policies and changes in accounting estimates that occur on or after the start of that period. Earlier application is permitted as long as this fact is disclosed.

The amendments are not expected to have a material impact on the Bank.

Disclosure of Accounting Policies – Amendments to IAS 1 and IFRS Practice Statement 2

In February 2021, the IASB issued amendments to IAS 1 and IFRS Practice Statement 2 *Making Materiality Judgements*, in which it provides guidance and examples to help entities apply materiality judgements to accounting policy disclosures. The amendments aim to help entities provide accounting policy disclosures that are more useful by replacing the requirement for entities to disclose their 'significant' accounting policies with a requirement to disclose their 'material' accounting policies and adding guidance on how entities apply the concept of materiality in making decisions about accounting policy disclosures.

The amendments to IAS 1 are applicable for annual periods beginning on or after 1 January 2023 with earlier application permitted. Since the amendments to the Practice Statement 2 provide non-mandatory guidance on the application of the definition of material to accounting policy information, an effective date for these amendments is not necessary.

The Bank is currently assessing the impact of the amendments to determine the impact they will have on the Bank's accounting policy disclosures.

(Amounts presented are in thousands of Azerbaijani manats)

4. Significant accounting judgments and estimates

Estimation uncertainty

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

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. Additional details are provided in Note 27.

Impairment losses on financial assets

The measurement of impairment across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances. The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- ▶ The Bank's internal credit grading model, which assigns PDs to the individual grades;
- ▶ The Bank's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a LTECL basis and the qualitative assessment;
- ▶ The segmentation of financial assets when their ECL is assessed on a collective basis;
- ▶ Development of ECL models, including the various formulae and the choice of inputs;
- ▶ Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs;
- ▶ Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

More details are provided in Notes 8 and 26.

Leases – estimating the incremental borrowing rate

The Bank cannot readily determine the interest rate implicit in the lease, therefore, it uses its incremental borrowing rate (IBR) to measure lease liabilities. The IBR is the rate of interest that the Bank would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. The IBR therefore reflects what the Bank 'would have to pay', which requires estimation when no observable rates are available (for example, when the Bank does not enter into financing transactions) or when they need to be adjusted to reflect the terms and conditions of the lease (for example, when leases are not in the Bank's functional currency).

The Bank estimates the IBR using observable inputs (such as market interest rates) when available and is required to make certain entity-specific estimates (such as the Bank's credit rating).

Taxation

Tax legislation in Azerbaijan is subject to varying interpretations, and changes can occur frequently. Management believes that as at 31 December 2021 and 2020 its interpretation of the relevant legislation is appropriate and that the Bank's tax position will be sustained.

(Amounts presented are in thousands of Azerbaijani manats)

5. Cash and cash equivalents

Cash and cash equivalents comprise:

| | <u>2021</u> | <u>2020</u> |
|---|-------------------------|-------------------------|
| Cash on hand | 689,219 | 620,992 |
| Current accounts with the CBAR | 1,779,540 | 1,066,319 |
| Current accounts with other credit institutions | 108,281 | 119,075 |
| Time deposits with the CBAR up to 90 days | – | 60,402 |
| Reverse repurchase agreements up to 90 days | 24,145 | 17,544 |
| Cash in transit | 6,700 | – |
| Cash and cash equivalents | <u>2,607,885</u> | <u>1,884,332</u> |

As at 31 December 2021, current accounts with other credit institutions consist of non-interest-bearing correspondent accounts balances with resident and non-resident banks in the amount of AZN 19,100 (2020: AZN 82,286) and AZN 89,181 (2020: AZN 36,789), respectively.

All balances of cash equivalents are allocated to Stage 1. The ECL relating to cash equivalents of the Bank rounds to zero.

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

| | <u>2021</u> | <u>2020</u> |
|---|-----------------------|-----------------------|
| Loans to credit institutions | 78,244 | 18,565 |
| Time deposits with credit institutions | 68,315 | – |
| Blocked accounts with the credit institutions | 51,262 | 48,565 |
| Obligatory reserve with the CBAR | 30,350 | 29,687 |
| Other amounts from credit institutions | 26,696 | 14,847 |
| Amounts due from credit institutions | <u>254,867</u> | <u>111,664</u> |

As at 31 December 2021, blocked accounts with credit institutions in amount of AZN 43,529 (2020: 43,124) mainly represented funds blocked by three (2020: two) non-resident credit institutions against letters of guarantee issued to eleven (2020: eight) customers. In addition, funds are blocked by two (2020: two) non-resident credit institutions in amount of AZN 7,733 (2020: AZN 5,441) on behalf of Master Card Incorporated and Visa incorporated.

As at 31 December 2021, loans to credit institutions include AZN 78,244 (2020: AZN 18,565) issued to one non-resident and two resident banks and two resident non-bank credit institutions (2020: one non-resident bank and three resident non-bank credit institutions).

As at 31 December 2021, time deposits with credit institutions consist of interest bearing short-term deposit placed in one non-resident bank in the amount of AZN 68,315 (2020: zero).

Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBAR at 0.5% of the previous month average balances of certain liabilities in AZN and 1% of the previous month average balances of certain liabilities in foreign currencies respectively, attracted from customers by the credit institutions. The Bank's ability to withdraw such deposit is restricted by statutory legislation.

All balances of amounts due from credit institutions are allocated to Stage 1. The ECL relating to amounts due from credit institutions of the Bank rounds to zero.

(Amounts presented are in thousands of Azerbaijani manats)

7. Investment securities

Investment securities comprise:

| | <u>2021</u> | <u>2020</u> |
|---|--------------------------------|------------------------------|
| Debt securities at amortized cost | | |
| Notes issued by the Ministry of Finance of the Republic of Azerbaijan | 752,237 | 495,774 |
| Corporate bonds | 222,344 | 135,532 |
| Notes issued by the CBAR | 16,559 | 135,743 |
| Reverse repurchase agreements for more than 90 days | – | 171,038 |
| Less – impairment loss allowance | (2,995) | (2,150) |
| | <u>988,145</u> | <u>935,937</u> |
| Debt securities at FVOCI | | |
| Bonds issued by the Azerbaijan Mortgage and Credit Guarantee Fund | 134,779 | 37,663 |
| | <u>134,779</u> | <u>37,663</u> |
| Equity securities at FVOCI | | |
| Corporate shares | 11,464 | 9,217 |
| | <u>11,464</u> | <u>9,217</u> |
| Investment securities | <u><u>1,134,388</u></u> | <u><u>982,817</u></u> |

An analysis of changes in the gross carrying amounts and associated ECLs in relation to debt securities at amortized cost during the year ended 31 December 2021 is as follows:

| Debt securities at amortised cost | Stage 1 | Stage 2 | Stage 3 | Total |
|--|-----------------------|----------------|----------------|-----------------------|
| Gross carrying value as at 1 January 2021 | 938,087 | – | – | 938,087 |
| New assets originated or purchased | 513,974 | – | – | 513,974 |
| Assets repaid | (460,921) | – | – | (460,921) |
| As at 31 December 2021 | <u>991,140</u> | <u>–</u> | <u>–</u> | <u>991,140</u> |

| Debt securities at amortised cost | Stage 1 | Stage 2 | Stage 3 | Total |
|--|-----------------------|----------------|----------------|-----------------------|
| ECLs as at 1 January 2021 | (2,150) | – | – | (2,150) |
| New assets originated or purchased | (1,178) | – | – | (1,178) |
| Assets repaid | 333 | – | – | 333 |
| As at 31 December 2021 | <u>(2,995)</u> | <u>–</u> | <u>–</u> | <u>(2,995)</u> |

An analysis of changes in the gross carrying values and associated ECLs in relation to securities at FVOCI during the year ended 31 December 2021 is as follows:

| Debt securities at FVOCI | Stage 1 | Stage 2 | Stage 3 | Total |
|--|-----------------------|----------------|----------------|-----------------------|
| Gross carrying value as at 1 January 2021 | 37,663 | – | – | 37,663 |
| New assets originated or purchased | 134,882 | – | – | 134,882 |
| Assets sold | (37,766) | – | – | (37,766) |
| As at 31 December 2021 | <u>134,779</u> | <u>–</u> | <u>–</u> | <u>134,779</u> |

| Debt securities at FVOCI | Stage 1 | Stage 2 | Stage 3 | Total |
|------------------------------------|---------------------|----------------|----------------|---------------------|
| ECLs as at 1 January 2021 | (105) | – | – | (105) |
| New assets originated or purchased | (312) | – | – | (312) |
| Assets sold | 105 | – | – | 105 |
| As at 31 December 2021 | <u>(312)</u> | <u>–</u> | <u>–</u> | <u>(312)</u> |

(Amounts presented are in thousands of Azerbaijani manats)

7. Investment securities (continued)

An analysis of changes in the gross carrying amounts and associated ECLs in relation to debt securities at amortized cost during the year ended 31 December 2020 is as follows:

| <i>Debt securities at amortised cost</i> | <i>Stage 1</i> | <i>Stage 2</i> | <i>Stage 3</i> | <i>Total</i> |
|--|----------------|----------------|----------------|------------------|
| Gross carrying value as at 1 January 2020 | 395,088 | - | - | 395,088 |
| New assets originated or purchased | 892,064 | - | - | 892,064 |
| Assets repaid | (349,065) | - | - | (349,065) |
| As at 31 December 2020 | 938,087 | - | - | 938,087 |

| <i>Debt securities at amortised cost</i> | <i>Stage 1</i> | <i>Stage 2</i> | <i>Stage 3</i> | <i>Total</i> |
|--|----------------|----------------|----------------|----------------|
| ECLs as at 1 January 2020 | - | - | - | - |
| New assets originated or purchased | (2,150) | - | - | (2,150) |
| As at 31 December 2020 | (2,150) | - | - | (2,150) |

An analysis of changes in the gross carrying values and associated ECLs in relation to securities at FVOCI during the year ended 31 December 2020 is as follows:

| <i>Debt securities at FVOCI</i> | <i>Stage 1</i> | <i>Stage 2</i> | <i>Stage 3</i> | <i>Total</i> |
|--|----------------|----------------|----------------|-----------------|
| Gross carrying value as at 1 January 2020 | 70,048 | - | - | 70,048 |
| New assets originated or purchased | 37,718 | - | - | 37,718 |
| Assets sold | (60,886) | - | - | (60,886) |
| As at 31 December 2020 | 46,880 | - | - | 46,880 |

| <i>Debt securities at FVOCI</i> | <i>Stage 1</i> | <i>Stage 2</i> | <i>Stage 3</i> | <i>Total</i> |
|------------------------------------|----------------|----------------|----------------|--------------|
| ECLs as at 1 January 2020 | - | - | - | - |
| New assets originated or purchased | (105) | - | - | (105) |
| As at 31 December 2020 | (105) | - | - | (105) |

8. Loans to customers

Loans to customers comprise:

| | <i>2021</i> | <i>2020</i> |
|---|------------------|------------------|
| Government-related entities | 366,613 | 363,655 |
| Corporate loans | 343,562 | 213,786 |
| Loans to individuals – consumer loans | 1,583,502 | 1,339,324 |
| Loans to individuals – mortgage loans | 292,540 | 229,296 |
| Loans to individuals – entrepreneurs | 60,233 | 15,985 |
| Gross loans to customers at amortised cost | 2,646,450 | 2,162,046 |
| Less: allowance for loan impairment | (127,021) | (100,530) |
| Loans to customers at amortised cost | 2,519,429 | 2,061,516 |

Loans are extended to the following types of customers:

| | <i>2021</i> | <i>2020</i> |
|----------------------------------|------------------|------------------|
| Government related entities | 366,613 | 363,655 |
| Private entities | 343,562 | 213,786 |
| Individuals | 1,876,042 | 1,568,620 |
| Individual entrepreneurs | 60,233 | 15,985 |
| Loans to customers, gross | 2,646,450 | 2,162,046 |

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Concentration of loans to customers (continued)

Loans are made principally in the following industry sectors:

| | <u>2021</u> | <u>2020</u> |
|----------------------------------|-------------------------|-------------------------|
| Individuals | 1,876,042 | 1,568,620 |
| Manufacturing | 332,750 | 324,467 |
| Trade and services | 245,092 | 98,399 |
| Construction | 112,532 | 63,239 |
| Telecommunication | 34,522 | 43,942 |
| Agriculture and food processing | 22,619 | 29,708 |
| Transport | 9,089 | 15,573 |
| Other | 13,804 | 18,098 |
| Loans to customers, gross | <u>2,646,450</u> | <u>2,162,046</u> |

As at 31 December 2021, the Bank had a concentration of loans represented by AZN 490,402 or 19% of gross loan portfolio (2020: AZN 464,335 or 21%) due from twelve (2020: twelve) largest borrowers of the Bank. An allowance of AZN 5,082 (2020: AZN 7,923) was recognized against these loans.

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost

An analysis of changes in the gross carrying value and corresponding ECL in relation to Government related loans during the year ended 31 December 2021 is as follows:

| Government related entities | Stage 1 | Stage 2 | Stage 3 | Total |
|--|----------------|----------------|----------------|----------------|
| Gross carrying value as at 1 January 2021 | 360,011 | 3,345 | 299 | 363,655 |
| New assets originated or purchased | 55,392 | - | - | 55,392 |
| Assets derecognized or repaid (excluding write-offs) | (48,965) | (3,285) | (184) | (52,434) |
| Transfers to Stage 1 | - | - | - | - |
| Transfers to Stage 2 | (41,563) | 41,563 | - | - |
| Transfers to Stage 3 | - | - | - | - |
| As a 31 December 2021 | 324,875 | 41,623 | 115 | 366,613 |

| Government related entities | Stage 1 | Stage 2 | Stage 3 | Total |
|--|----------------|----------------|----------------|----------------|
| ECL as at 1 January 2021 | (3,410) | (994) | (241) | (4,645) |
| <i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| New assets originated or purchased | (389) | - | - | (389) |
| Assets derecognized or repaid (excluding write-offs) | 1,176 | 143 | 184 | 1,503 |
| Transfers to Stage 1 | - | - | - | - |
| Transfers to Stage 2 | 850 | (850) | - | - |
| Transfers to Stage 3 | - | - | - | - |
| Impact on period end ECL of exposures transferred between stages during the period | - | (97) | - | (97) |
| Changes to inputs used for ECL calculations | (218) | - | 3 | (215) |
| <i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| Unwinding of discount (recognised in interest income) | - | - | (6) | (6) |
| As at 31 December 2021 | (1,991) | (1,798) | (60) | (3,849) |

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

An analysis of changes in the gross carrying value and corresponding ECL in relation to corporate loans during the year ended 31 December 2021 is as follows:

| Corporate loans | Stage 1 | Stage 2 | Stage 3 | Total |
|--|----------------|----------------|----------------|----------------|
| Gross carrying value as at 1 January 2021 | 114,515 | 76,053 | 23,218 | 213,786 |
| New assets originated or purchased | 249,073 | – | – | 249,073 |
| Assets derecognized or repaid (excluding write-offs) | (89,363) | (19,788) | (13,415) | (122,566) |
| Transfers to Stage 1 | 6,241 | (6,241) | – | – |
| Transfers to Stage 2 | (25,016) | 25,091 | (75) | – |
| Transfers to Stage 3 | (2,689) | (2,957) | 5,646 | – |
| Recoveries | – | – | 3,512 | 3,512 |
| Amounts written off | – | – | (243) | (243) |
| As at 31 December 2021 | 252,761 | 72,158 | 18,643 | 343,562 |

| Corporate loans | Stage 1 | Stage 2 | Stage 3 | Total |
|--|----------------|----------------|-----------------|-----------------|
| ECL as at 1 January 2021 | (2,442) | (5,380) | (11,670) | (19,492) |
| <i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| New assets originated or purchased | (9,507) | – | – | (9,507) |
| Assets derecognized or repaid (excluding write-offs) | 1,635 | 2,351 | 8,632 | 12,618 |
| Transfers to Stage 1 | (891) | 891 | – | – |
| Transfers to Stage 2 | 2,833 | (2,875) | 42 | – |
| Transfers to Stage 3 | 687 | 1,068 | (1,755) | – |
| Impact on period end ECL of exposures transferred between stages during the period | 708 | (306) | (413) | (11) |
| Changes to inputs used for ECL calculations | 120 | 1,154 | 962 | 2,236 |
| <i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| Unwinding of discount (recognised in interest income) | – | – | (687) | (687) |
| Recoveries | – | – | (3,512) | (3,512) |
| Amounts written off | – | – | 243 | 243 |
| As at 31 December 2021 | (6,857) | (3,097) | (8,158) | (18,112) |

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

An analysis of changes in the gross carrying value and corresponding ECL in relation to Loans to individuals – consumer loans during the year ended 31 December 2021 is as follows:

| <i>Loans to individuals – consumer loans</i> | <i>Stage 1</i> | <i>Stage 2</i> | <i>Stage 3</i> | <i>Total</i> |
|---|------------------|----------------|----------------|------------------|
| Gross carrying value as at 1 January 2021 | 913,848 | 383,145 | 42,331 | 1,339,324 |
| New assets originated or purchased | 1,082,784 | – | – | 1,082,784 |
| Assets derecognized or repaid (excluding write-offs) | (585,378) | (224,069) | (13,977) | (823,424) |
| Transfers to Stage 1 | 53,413 | (51,909) | (1,504) | – |
| Transfers to Stage 2 | (325,440) | 330,218 | (4,778) | – |
| Transfers to Stage 3 | (52,573) | (10,408) | 62,981 | – |
| Unwinding of discount | 9 | 1,029 | 650 | 1,688 |
| Changes to contractual cash flows due to modifications not resulting in derecognition | 40 | (430) | (853) | (1,243) |
| Recoveries | – | – | 3,964 | 3,964 |
| Amounts written off | – | – | (19,591) | (19,591) |
| As at 31 December 2021 | 1,086,703 | 427,576 | 69,223 | 1,583,502 |

| <i>Loans to individuals – consumer loans</i> | <i>Stage 1</i> | <i>Stage 2</i> | <i>Stage 3</i> | <i>Total</i> |
|--|-----------------|-----------------|-----------------|-----------------|
| ECL as at 1 January 2021 | (11,362) | (26,248) | (31,161) | (68,771) |
| <i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| New assets originated or purchased | (31,164) | – | – | (31,164) |
| Assets derecognized or repaid (excluding write-offs) | 6,801 | 13,982 | 9,735 | 30,518 |
| Transfers to Stage 1 | (3,719) | 2,730 | 989 | – |
| Transfers to Stage 2 | 23,185 | (26,283) | 3,098 | – |
| Transfers to Stage 3 | 979 | 2,352 | (3,331) | – |
| Impact on period end ECL of exposures transferred between stages during the period | 2,822 | (1,011) | (43,344) | (41,533) |
| Changes to inputs used for ECL calculations | 977 | 1,233 | (1,371) | 839 |
| <i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| Unwinding of discount (recognised in interest income) | – | – | (2,526) | (2,526) |
| Recoveries | – | – | (3,964) | (3,964) |
| Amounts written off | – | – | 19,591 | 19,591 |
| As at 31 December 2021 | (11,481) | (33,245) | (52,284) | (97,010) |

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

An analysis of changes in the gross carrying value and corresponding ECL in relation to Loans to individuals – mortgage loans during the year ended 31 December 2021 is as follows:

| <i>Loans to individuals – mortgage loans</i> | <i>Stage 1</i> | <i>Stage 2</i> | <i>Stage 3</i> | <i>Total</i> |
|--|----------------|----------------|----------------|-----------------|
| Gross carrying value as at 1 January 2021 | 226,299 | 1,823 | 1,174 | 229,296 |
| New assets originated or purchased | 83,486 | – | – | 83,486 |
| Assets derecognized or repaid (excluding write-offs) | (19,663) | (450) | (20) | (20,133) |
| Transfers to Stage 1 | 1,695 | (1,111) | (584) | – |
| Transfers to Stage 2 | (1,045) | 1,121 | (76) | – |
| Transfers to Stage 3 | (119) | – | 119 | – |
| Amounts written off | – | – | (109) | (109) |
| As at 31 December 2021 | 290,653 | 1,383 | 504 | 292,540 |

| <i>Loans to individuals – mortgage loans</i> | <i>Stage 1</i> | <i>Stage 2</i> | <i>Stage 3</i> | <i>Total</i> |
|--|----------------|----------------|----------------|----------------|
| ECL as at 1 January 2021 | (1,318) | (890) | (772) | (2,980) |
| <i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| New assets originated or purchased | (645) | – | – | (645) |
| Assets derecognized or repaid (excluding write-offs) | 134 | 225 | (6) | 353 |
| Transfers to Stage 1 | (996) | 582 | 414 | – |
| Transfers to Stage 2 | 21 | (69) | 48 | – |
| Transfers to Stage 3 | 8 | – | (8) | – |
| Impact on period end ECL of exposures transferred between stages during the period | 875 | (85) | (19) | 771 |
| Changes to inputs used for ECL calculations | 886 | 56 | 165 | 1,107 |
| <i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| Unwinding of discount (recognised in interest income) | – | – | (48) | (48) |
| Amounts written off | – | – | 109 | 109 |
| As at 31 December 2021 | (1,035) | (181) | (117) | (1,333) |

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

An analysis of changes in the gross carrying value and corresponding ECL in relation to Loans to individuals – entrepreneurs loans during the year ended 31 December 2021 is as follows:

| <i>Loans to individuals – entrepreneurs</i> | <i>Stage 1</i> | <i>Stage 2</i> | <i>Stage 3</i> | <i>Total</i> |
|--|----------------|----------------|----------------|----------------|
| Gross carrying value as at 1 January 2021 | 5,785 | 5,136 | 5,064 | 15,985 |
| New assets originated or purchased | 52,702 | – | – | 52,702 |
| Assets derecognized or repaid (excluding write-offs) | (3,677) | (4,392) | (683) | (8,752) |
| Transfers to Stage 1 | 16 | (16) | – | – |
| Transfers to Stage 2 | (4,186) | 4,258 | (72) | – |
| Transfers to Stage 3 | (454) | (185) | 639 | – |
| Recoveries | – | – | 345 | 345 |
| Amounts written off | – | – | (47) | (47) |
| As at 31 December 2021 | 50,186 | 4,801 | 5,246 | 60,233 |

| <i>Loans to individuals – entrepreneurs</i> | <i>Stage 1</i> | <i>Stage 2</i> | <i>Stage 3</i> | <i>Total</i> |
|--|----------------|----------------|----------------|----------------|
| ECL as at 1 January 2021 | (341) | (875) | (3,426) | (4,642) |
| <i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| New assets originated or purchased | (3,474) | – | – | (3,474) |
| Assets derecognized or repaid (excluding write-offs) | 217 | 797 | 644 | 1,658 |
| Transfers to Stage 1 | (3) | 3 | – | – |
| Transfers to Stage 2 | 810 | (872) | 62 | – |
| Transfers to Stage 3 | 130 | 65 | (195) | – |
| Impact on period end ECL of exposures transferred between stages during the period | 3 | 24 | (38) | (11) |
| Changes to inputs used for ECL calculations | (69) | 86 | 333 | 350 |
| <i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| Unwinding of discount (recognised in interest income) | – | – | (300) | (300) |
| Recoveries | – | – | (345) | (345) |
| Amounts written off | – | – | 47 | 47 |
| As at 31 December 2021 | (2,727) | (772) | (3,218) | (6,717) |

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

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

| Government related entities | Stage 1 | Stage 2 | Stage 3 | Total |
|--|----------------|----------------|----------------|----------------|
| Gross carrying value as at 1 January 2020 | 133,095 | – | 12,719 | 145,814 |
| New assets originated or purchased | 286,143 | – | – | 286,143 |
| Assets derecognized or repaid (excluding write-offs) | (55,882) | – | (12,420) | (68,302) |
| Transfers to Stage 1 | – | – | – | – |
| Transfers to Stage 2 | (3,345) | 3,345 | – | – |
| Transfers to Stage 3 | – | – | – | – |
| As at 31 December 2020 | 360,011 | 3,345 | 299 | 363,655 |

| Government related entities | Stage 1 | Stage 2 | Stage 3 | Total |
|--|----------------|----------------|----------------|-----------------|
| ECL as at 1 January 2020 | (7,048) | – | (2,966) | (10,014) |
| <i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| New assets originated or purchased | (506) | – | – | (506) |
| Assets derecognized or repaid (excluding write-offs) | 4,324 | – | 2,916 | 7,240 |
| Transfers to Stage 1 | – | – | – | – |
| Transfers to Stage 2 | 43 | (43) | – | – |
| Transfers to Stage 3 | – | – | – | – |
| Impact on period end ECL of exposures transferred between stages during the period | – | (951) | – | (951) |
| Changes to inputs used for ECL calculations | (223) | – | – | (223) |
| <i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| Unwinding of discount (recognised in interest income) | – | – | (191) | (191) |
| As at 31 December 2020 | (3,410) | (994) | (241) | (4,645) |

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

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

| Corporate loans | Stage 1 | Stage 2 | Stage 3 | Total |
|--|----------------|----------------|----------------|----------------|
| Gross carrying value as at 1 January 2020 | 145,801 | 109,524 | 21,357 | 276,682 |
| New assets originated or purchased | 118,508 | – | – | 118,508 |
| Assets derecognized or repaid (excluding write-offs) | (108,029) | (65,510) | (11,560) | (185,099) |
| Transfers to Stage 1 | 2,130 | (2,130) | – | – |
| Transfers to Stage 2 | (34,136) | 34,474 | (338) | – |
| Transfers to Stage 3 | (9,759) | (305) | 10,064 | – |
| Recoveries | – | – | 5,174 | 5,174 |
| Amounts written off | – | – | (1,479) | (1,479) |
| As at 31 December 2020 | 114,515 | 76,053 | 23,218 | 213,786 |

| Corporate loans | Stage 1 | Stage 2 | Stage 3 | Total |
|--|----------------|----------------|-----------------|-----------------|
| ECL as at 1 January 2020 | (2,989) | (5,728) | (8,863) | (17,580) |
| <i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| New assets originated or purchased | (5,178) | – | – | (5,178) |
| Assets derecognized or repaid (excluding write-offs) | 2,045 | 4,669 | 7,357 | 14,071 |
| Transfers to Stage 1 | (497) | 497 | – | – |
| Transfers to Stage 2 | 2,517 | (2,546) | 29 | – |
| Transfers to Stage 3 | 2,218 | 18 | (2,236) | – |
| Impact on period end ECL of exposures transferred between stages during the period | 452 | (1,464) | (2,710) | (3,722) |
| Changes to inputs used for ECL calculations | (1,010) | (826) | (947) | (2,783) |
| <i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| Unwinding of discount (recognised in interest income) | – | – | (605) | (605) |
| Recoveries | – | – | (5,174) | (5,174) |
| Amounts written off | – | – | 1,479 | 1,479 |
| As at 31 December 2020 | (2,442) | (5,380) | (11,670) | (19,492) |

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

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

| Loans to individuals – consumer loans | Stage 1 | Stage 2 | Stage 3 | Total |
|---|----------------|----------------|----------------|------------------|
| Gross carrying value as at 1 January 2020 | 537,456 | 742,372 | 41,955 | 1,321,783 |
| New assets originated or purchased | 709,508 | – | – | 709,508 |
| Assets derecognized or repaid (excluding write-offs) | (323,277) | (341,655) | (5,312) | (670,244) |
| Transfers to Stage 1 | 251,215 | (249,885) | (1,330) | – |
| Transfers to Stage 2 | (240,433) | 244,601 | (4,168) | – |
| Transfers to Stage 3 | (20,603) | (12,500) | 33,103 | – |
| Unwinding of discount | – | 1,034 | – | 1,034 |
| Changes to contractual cash flows due to modifications not resulting in derecognition | (18) | (822) | (590) | (1,430) |
| Recoveries | – | – | 2,213 | 2,213 |
| Amounts written off | – | – | (23,540) | (23,540) |
| As at 31 December 2020 | 913,848 | 383,145 | 42,331 | 1,339,324 |

| Loans to individuals – consumer loans | Stage 1 | Stage 2 | Stage 3 | Total |
|--|-----------------|-----------------|-----------------|-----------------|
| ECL as at 1 January 2020 | (5,767) | (35,010) | (30,771) | (71,548) |
| <i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| New assets originated or purchased | (22,987) | – | – | (22,987) |
| Assets derecognized or repaid (excluding write-offs) | 3,702 | 18,963 | 2,190 | 24,855 |
| Transfers to Stage 1 | (12,346) | 11,552 | 794 | – |
| Transfers to Stage 2 | 17,839 | (20,295) | 2,456 | – |
| Transfers to Stage 3 | 633 | 1,108 | (1,741) | – |
| Impact on period end ECL of exposures transferred between stages during the period | 8,636 | (811) | (23,294) | (15,469) |
| Changes to inputs used for ECL calculations | (1,072) | (1,755) | (421) | (3,248) |
| <i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| Unwinding of discount (recognised in interest income) | – | – | (1,701) | (1,701) |
| Recoveries | – | – | (2,213) | (2,213) |
| Amounts written off | – | – | 23,540 | 23,540 |
| As at 31 December 2020 | (11,362) | (26,248) | (31,161) | (68,771) |

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

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

| <i>Loans to individuals – mortgage loans</i> | <i>Stage 1</i> | <i>Stage 2</i> | <i>Stage 3</i> | <i>Total</i> |
|--|----------------|----------------|----------------|----------------|
| Gross carrying value as at 1 January 2020 | 51,241 | 1,107 | 470 | 52,818 |
| New assets originated or purchased | 180,470 | – | – | 180,470 |
| Assets derecognized or repaid (excluding write-offs) | (3,810) | (127) | (84) | (4,021) |
| Transfers to Stage 1 | 867 | (771) | (96) | – |
| Transfers to Stage 2 | (1,609) | 1,807 | (198) | – |
| Transfers to Stage 3 | (860) | (193) | 1,053 | – |
| Recoveries | – | – | 29 | 29 |
| As at 31 December 2020 | 226,299 | 1,823 | 1,174 | 229,296 |

| <i>Loans to individuals – mortgage loans</i> | <i>Stage 1</i> | <i>Stage 2</i> | <i>Stage 3</i> | <i>Total</i> |
|--|----------------|----------------|----------------|----------------|
| ECL as at 1 January 2020 | (225) | (632) | (297) | (1,154) |
| <i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| New assets originated or purchased | (1,991) | – | – | (1,991) |
| Assets derecognized or repaid (excluding write-offs) | 210 | 71 | 78 | 359 |
| Transfers to Stage 1 | (503) | 441 | 62 | – |
| Transfers to Stage 2 | 625 | (746) | 121 | – |
| Transfers to Stage 3 | 249 | 109 | (358) | – |
| Impact on period end ECL of exposures transferred between stages during the period | 492 | (74) | (300) | 118 |
| Changes to inputs used for ECL calculations | (175) | (59) | (37) | (271) |
| <i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| Unwinding of discount (recognised in interest income) | – | – | (12) | (12) |
| Recoveries | – | – | (29) | (29) |
| As at 31 December 2020 | (1,318) | (890) | (772) | (2,980) |

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

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

| <i>Loans to individuals – entrepreneurs</i> | <i>Stage 1</i> | <i>Stage 2</i> | <i>Stage 3</i> | <i>Total</i> |
|--|----------------|----------------|----------------|----------------|
| Gross carrying value as at 1 January 2020 | 3,574 | 4,233 | 6,970 | 14,777 |
| New assets originated or purchased | 9,427 | – | – | 9,427 |
| Assets derecognized or repaid (excluding write-offs) | (2,106) | (2,656) | (399) | (5,161) |
| Transfers to Stage 1 | 331 | (331) | – | – |
| Transfers to Stage 2 | (4,952) | 4,952 | – | – |
| Transfers to Stage 3 | (489) | (1,062) | 1,551 | – |
| Recoveries | – | – | 76 | 76 |
| Amounts written off | – | – | (3,134) | (3,134) |
| As at 31 December 2020 | 5,785 | 5,136 | 5,064 | 15,985 |

| <i>Loans to individuals – entrepreneurs</i> | <i>Stage 1</i> | <i>Stage 2</i> | <i>Stage 3</i> | <i>Total</i> |
|--|----------------|----------------|----------------|----------------|
| ECL as at 1 January 2020 | (130) | (932) | (4,884) | (5,946) |
| <i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| New assets originated or purchased | (1,325) | – | – | (1,325) |
| Assets derecognized or repaid (excluding write-offs) | 70 | 807 | (147) | 730 |
| Transfers to Stage 1 | (63) | 63 | – | – |
| Transfers to Stage 2 | 884 | (884) | – | – |
| Transfers to Stage 3 | 217 | 337 | (554) | – |
| Impact on period end ECL of exposures transferred between stages during the period | 40 | (245) | (694) | (899) |
| Changes to inputs used for ECL calculations | (34) | (21) | (71) | (126) |
| <i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i> | | | | |
| Unwinding of discount (recognised in interest income) | – | – | (134) | (134) |
| Recoveries | – | – | (76) | (76) |
| Amounts written off | – | – | 3,134 | 3,134 |
| As at 31 December 2020 | (341) | (875) | (3,426) | (4,642) |

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

As at 31 December 2021, the Bank continues to apply certain changes in its process of estimation of expected credit losses in the context of the ongoing COVID-19 pandemic. In particular, it has revised indicators of significant increase in credit risk, updated forward looking information, including forecasts of macroeconomic indicators and scenarios' weights to consider all up-to-date relevant information on local and international economic environment.

Modified and restructured loans

The Bank derecognizes a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognized as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognized loans are classified as Stage 1 for ECL measurement purposes.

If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Bank records a modification gain or loss, to the extent that an impairment loss has not already been recorded.

The table below includes Stage 2 and 3 assets that were modified during the period, with the related modification loss suffered by the Bank.

| | <u>2021</u> | <u>2020</u> |
|---|-------------|-------------|
| Loans modified during the period | | |
| Amortised cost before modification | 50,442 | 22,680 |
| Net modification loss | (1,243) | (1,430) |

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- ▶ For corporate lending, charges over real estate properties and vehicles, third party guarantees;
- ▶ For retail lending, mortgages over residential properties.

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

The Bank calculates LGD rate of several corporate and small lending loans in Stage 3 using discounted value of collaterals. As at 31 December 2021, maximum exposure of such loans amounted to AZN 17,158 (2020: AZN 15,536) for which ECL of AZN 5,448 (2020: AZN 7,199) was recognized. If these loans were not collateralized, ECL amount for these loans would be AZN 14,314 (2020: AZN 13,702) based on collective assessment.

(Amounts presented are in thousands of Azerbaijani manats)

9. Property and equipment

The movements in property and equipment were as follows:

| | <i>Premises</i> | <i>Leasehold improvements</i> | <i>Computers and other office equipment</i> | <i>Furniture, fixtures, vehicles and others</i> | <i>Total</i> |
|--|-----------------|-------------------------------|---|---|-----------------|
| Cost or revaluation | | | | | |
| 1 January 2020 | 5,689 | 10,853 | 19,243 | 82,070 | 117,855 |
| Additions | 435 | 1,697 | 4,112 | 16,136 | 22,380 |
| Disposals | – | – | – | (6) | (6) |
| Effect of revaluation | (644) | – | – | – | (644) |
| 31 December 2020 | 5,480 | 12,550 | 23,355 | 98,200 | 139,585 |
| Additions | 808 | 4,486 | 5,004 | 11,805 | 22,103 |
| Disposals | (163) | (59) | (7,435) | (9,080) | (16,737) |
| Effect of revaluation | (86) | – | – | – | (86) |
| 31 December 2021 | 6,039 | 16,977 | 20,924 | 100,925 | 144,865 |
| Accumulated depreciation and impairment | | | | | |
| 1 January 2020 | – | (2,397) | (11,768) | (49,995) | (64,160) |
| Depreciation charge | (305) | (1,196) | (3,033) | (9,524) | (14,058) |
| Disposals | – | – | – | 6 | 6 |
| Effect of revaluation | 300 | – | – | – | 300 |
| 31 December 2020 | (5) | (3,593) | (14,801) | (59,513) | (77,912) |
| Depreciation charge | (336) | (1,414) | (2,816) | (11,796) | (16,362) |
| Disposals | 15 | 33 | 5,291 | 7,190 | 12,529 |
| Effect of revaluation | 307 | – | – | – | 307 |
| 31 December 2021 | (19) | (4,974) | (12,326) | (64,119) | (81,438) |
| Net book value | | | | | |
| 31 December 2019 | 5,689 | 8,456 | 7,475 | 32,075 | 53,695 |
| 31 December 2020 | 5,475 | 8,957 | 8,554 | 38,687 | 61,673 |
| 31 December 2021 | 6,020 | 12,003 | 8,598 | 36,806 | 63,427 |

As at 31 December 2021, property and equipment amounting to AZN 62,152 (2020: AZN 45,595) were fully depreciated but in use.

As at 31 December 2021, property and equipment contained items in warehouse amounting to AZN 2,714 (2020: AZN 6,391).

The Bank engaged an independent appraiser, KONEKO LLC, to determine the revalued amount of its premises as at 31 December 2021 and 2020. Revalued amount is determined by reference to market-based evidence. The valuation method used was comparison analysis. The revaluation gain amounting to AZN 221 (2020: loss AZN 344) has been recognized within other comprehensive income.

If the premises were measured using the cost model, the carrying amounts would be as follows:

| | 2021 | 2020 |
|----------------------------|--------------|--------------|
| Cost | 8,031 | 7,658 |
| Accumulated depreciation | (4,986) | (4,578) |
| Net carrying amount | 3,045 | 3,080 |

(Amounts presented are in thousands of Azerbaijani manats)

10. Intangible assets

The movements in intangible assets were as follows:

| | <i>License</i> | <i>Computer software</i> | <i>Total</i> |
|---------------------------------|----------------|--------------------------|-----------------|
| Cost | | | |
| 1 January 2020 | 14,839 | 17,702 | 32,541 |
| Additions | 2,883 | 3,071 | 5,954 |
| Disposals | (1,192) | (1,839) | (3,031) |
| 31 December 2020 | 16,530 | 18,934 | 35,464 |
| Additions | 7,533 | 1,541 | 9,074 |
| Disposals | (2,493) | (138) | (2,631) |
| 31 December 2021 | 21,570 | 20,337 | 41,907 |
| Accumulated amortization | | | |
| 1 January 2020 | (4,437) | (5,899) | (10,336) |
| Amortisation charge | (2,601) | (1,891) | (4,492) |
| Disposals | 1,192 | 1,839 | 3,031 |
| 31 December 2020 | (5,846) | (5,951) | (11,797) |
| Amortisation charge | (5,034) | (2,052) | (7,086) |
| Disposals | 2,493 | 138 | 2,631 |
| 31 December 2021 | (8,387) | (7,865) | (16,252) |
| Net book value | | | |
| 31 December 2019 | 10,402 | 11,803 | 22,205 |
| 31 December 2020 | 10,684 | 12,983 | 23,667 |
| 31 December 2021 | 13,183 | 12,472 | 25,655 |

11. Right of use assets and lease liability

The movements in right-of-use assets were as follows:

| | <i>2021</i> | <i>2020</i> |
|--------------------------|---------------|---------------|
| As at 1 January | 36,819 | 41,132 |
| Additions | 5,002 | 2,221 |
| Lease modification | (299) | 451 |
| Depreciation expense | (7,488) | (6,985) |
| As at 31 December | 34,034 | 36,819 |

The movements in lease liability were as follows:

| | <i>2021</i> | <i>2020</i> |
|--------------------------|---------------|---------------|
| As at 1 January | 40,749 | 43,215 |
| Additions | 5,002 | 2,221 |
| Lease modifications | (677) | 439 |
| Interest expense | 4,441 | 4,663 |
| Payments | (10,561) | (9,789) |
| As at 31 December | 38,954 | 40,749 |

12. Taxation

The corporate income tax expense comprises:

| | <i>2021</i> | <i>2020</i> |
|---|-----------------|-----------------|
| Current tax charge | (49,155) | (62,422) |
| Deferred charge – origination of temporary differences | (17,132) | (8,040) |
| Less: deferred tax recognised in other comprehensive income | 91 | 209 |
| Income tax expense | (66,196) | (70,253) |

(Amounts presented are in thousands of Azerbaijani manats)

12. Taxation (continued)

Deferred tax related to items charged or credited to other comprehensive income during the year is as follows:

| | <u>2021</u> | <u>2020</u> |
|--|--------------------|---------------------|
| Net gains on equity instruments designated at fair value through OCI | (47) | (278) |
| Revaluation of premises | (44) | 69 |
| Income tax charged to other comprehensive income | <u>(91)</u> | <u>(209)</u> |

The effective income tax rate differs from the statutory income tax rates. A reconciliation of the income tax expense based on statutory rates with actual is as follows:

| | <u>2021</u> | <u>2020</u> |
|---|------------------------|------------------------|
| Profit before income tax expense | 306,655 | 324,089 |
| Statutory tax rate | 20% | 20% |
| Theoretical income tax expense at the statutory rate | <u>(61,331)</u> | <u>(64,818)</u> |
| Tax effect of items which are not deductible or assessable for taxation purposes | | |
| Non-deductible expenses | (4,850) | (5,410) |
| Other | (15) | (25) |
| Income tax expense | <u>(66,196)</u> | <u>(70,253)</u> |

Deferred tax assets and liabilities as at 31 December and their movements for the respective years comprise:

| | <u>Origination and reversal of temporary differences</u> | | | <u>Origination and reversal of temporary differences</u> | | | 2021 |
|---|--|---|--------------------------------------|--|---|--------------------------------------|------------------------|
| | 2019 | <i>In the statement of profit or loss</i> | <i>In other comprehensive income</i> | 2020 | <i>In the statement of profit or loss</i> | <i>In other comprehensive income</i> | |
| Tax effect of deductible temporary differences | | | | | | | |
| Investment in associate | - | 387 | - | 387 | 86 | - | 473 |
| Amounts due from credit institutions | 122 | 22 | - | 144 | (144) | - | - |
| Intangible assets | 97 | (69) | - | 28 | (28) | - | - |
| Provision for credit related commitments and other impairment | 2,380 | (1,151) | - | 1,229 | (914) | - | 315 |
| Amounts due to customers | - | - | - | - | 812 | - | 812 |
| Right of use assets | 623 | 342 | - | 965 | 124 | - | 1,089 |
| Other liabilities | 6,258 | 2,326 | - | 8,584 | (649) | - | 7,935 |
| Deferred tax assets | <u>9,480</u> | <u>1,857</u> | <u>-</u> | <u>11,337</u> | <u>(713)</u> | <u>-</u> | <u>10,624</u> |
| Cash and cash equivalents | (1,002) | 812 | - | (190) | 190 | - | - |
| Amounts due from credit institutions | - | - | - | - | (221) | - | (221) |
| Investment securities | (1,475) | 1,200 | (278) | (553) | 574 | (47) | (26) |
| Intangible assets | - | - | - | - | (90) | - | (90) |
| Loans to customers | (19,679) | (12,548) | - | (32,227) | (13,645) | - | (45,872) |
| Property and equipment | (2,528) | 96 | 69 | (2,363) | (1,312) | (44) | (3,719) |
| Lease liability | (207) | 28 | - | (179) | 74 | - | (105) |
| Other assets | (1,660) | 724 | - | (936) | (1,898) | - | (2,834) |
| Deferred tax liabilities | <u>(26,551)</u> | <u>(9,688)</u> | <u>(209)</u> | <u>(36,448)</u> | <u>(16,328)</u> | <u>(91)</u> | <u>(52,867)</u> |
| Net deferred income tax (liabilities)/asset | <u>(17,071)</u> | <u>(7,831)</u> | <u>(209)</u> | <u>(25,111)</u> | <u>(17,041)</u> | <u>(91)</u> | <u>(42,243)</u> |

(Amounts presented are in thousands of Azerbaijani manats)

13. Credit loss expense and other impairment and provisions

The table below shows the ECL charges on financial instruments recorded in the consolidated statement of profit or loss for the year ended 31 December 2021:

| | <i>Note</i> | <i>Stage 1</i> | <i>Stage 2</i> | <i>Stage 3</i> | <i>Total</i> |
|--|-------------|----------------|----------------|-----------------|-----------------|
| Investment securities | 7 | (1,052) | – | – | (1,052) |
| Loans to customers at amortised cost | 8 | (5,218) | (4,706) | (25,169) | (35,093) |
| Other financial assets | 14 | 447 | 186 | (832) | (199) |
| Credit loss on financial assets | | (5,823) | (4,520) | (26,001) | (36,344) |
| Financial guarantees | 21 | (406) | 592 | (13,562) | (13,376) |
| Letters of credit | 21 | – | 93 | – | 93 |
| Undrawn loan commitments | 21 | 1,592 | 2,043 | 1,328 | 4,963 |
| Credit related commitments | | 1,186 | 2,728 | (12,234) | (8,320) |
| Total credit loss expense | | (4,637) | (1,792) | (38,235) | (44,664) |

The table below shows the ECL charges on financial instruments recorded in the consolidated statement of profit or loss for the year ended 31 December 2020:

| | <i>Note</i> | <i>Stage 1</i> | <i>Stage 2</i> | <i>Stage 3</i> | <i>Total</i> |
|--|-------------|----------------|----------------|-----------------|-----------------|
| Investment securities | 7 | (2,255) | – | – | (2,255) |
| Loans to customers at amortised cost | 8 | (2,714) | 7,914 | (17,506) | (12,306) |
| Other financial assets | 14 | (119) | 128 | 371 | 380 |
| Credit loss on financial assets | | (5,088) | 8,042 | (17,135) | (14,181) |
| Financial guarantees | 21 | 322 | 1,245 | 54 | 1,621 |
| Letters of credit | 21 | 3 | (137) | 3,062 | 2,928 |
| Undrawn loan commitments | 21 | (1,360) | 4,301 | (1,301) | 1,640 |
| Credit-related commitments | | (1,035) | 5,409 | 1,815 | 6,189 |
| Total credit loss expense | | (6,123) | 13,451 | (15,320) | (7,992) |

The movements in other impairment allowances and provisions were as follows:

| | <i>Performance guarantees</i> | <i>Total</i> |
|-------------------------|-------------------------------|-----------------|
| 1 January 2020 | (3,658) | (3,658) |
| Reversal | 630 | 630 |
| 31 December 2020 | (3,028) | (3,028) |
| Charge | (8,965) | (8,965) |
| 31 December 2021 | (11,993) | (11,993) |

14. Other assets and liabilities

Other assets comprise:

| | <i>2021</i> | <i>2020</i> |
|--|----------------|----------------|
| Other financial assets | | |
| Funds in settlement | 61,273 | 36,499 |
| Receivable from local budget | 21,962 | 7,308 |
| Derivative financial assets | 7,160 | 1,740 |
| Accrued commission | 4,856 | 8,937 |
| Receivables from Azerbaijan Deposit Insurance Fund | 40 | 34,266 |
| Less: allowance for impairment of other assets | (4,414) | (6,720) |
| Total other financial assets | 90,877 | 82,030 |
| Other non-financial assets | | |
| Reposessed collateral | 8,723 | 8,453 |
| Prepayments | 6,465 | 5,846 |
| Deferred expenses | 6,615 | 3,318 |
| Spare parts | 285 | 775 |
| Total other non-financial assets | 22,088 | 18,392 |
| Other assets | 112,965 | 100,422 |

(Amounts presented are in thousands of Azerbaijani manats)

14. Other assets and liabilities (continued)

An analysis of changes in the ECLs for other financial assets for 31 December 2021 is, as follows:

| | <u>Stage 1</u> | <u>Stage 2</u> | <u>Stage 3</u> | <u>Total</u> |
|----------------------------------|----------------|----------------|----------------|----------------|
| ECL at 1 January 2021 | (462) | (223) | (6,035) | (6,720) |
| Reversal/(charge) for the period | 447 | 186 | (832) | (199) |
| Amounts written-off | - | - | 2,505 | 2,505 |
| As at 31 December 2021 | (15) | (37) | (4,362) | (4,414) |

An analysis of changes in the ECLs for other financial assets for 31 December 2020 is as follows:

| | <u>Stage 1</u> | <u>Stage 2</u> | <u>Stage 3</u> | <u>Total</u> |
|----------------------------------|----------------|----------------|----------------|----------------|
| ECL at 1 January 2020 | (343) | (351) | (6,406) | (7,100) |
| Reversal/(charge) for the period | (119) | 128 | 371 | 380 |
| As at 31 December 2020 | (462) | (223) | (6,035) | (6,720) |

Other liabilities comprise:

| | <u>2021</u> | <u>2020</u> |
|--|----------------|----------------|
| Other financial liabilities | | |
| Provisions for credit related commitments and financial guarantees | 24,676 | 16,356 |
| Funds in settlement | 23,685 | 16,952 |
| Accrued expenses | 8,005 | 6,345 |
| Dividend payables to Shareholders | - | 11,600 |
| Total other financial liabilities | 56,366 | 51,253 |
| Other non-financial liabilities | | |
| Payables to employees | 36,152 | 47,040 |
| Contractual liability | 12,455 | 7,485 |
| Provisions for performance guarantees | 11,993 | 3,028 |
| Payables to local budget | 10,498 | 8,875 |
| Deferred revenue | 7,827 | 6,321 |
| Taxes other than income tax | 3,334 | 2,095 |
| Total other non-financial liabilities | 82,259 | 74,844 |
| Other liabilities | 138,625 | 126,097 |

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

| | <u>31 December 2021</u> | | | <u>31 December 2020</u> | | |
|-----------------------------------|-------------------------|--------------------|------------------|-------------------------|-------------------|------------------|
| | <u>Notional amount</u> | <u>Fair values</u> | | <u>Notional amount</u> | <u>Fair value</u> | |
| | | <u>Asset</u> | <u>Liability</u> | | <u>Asset</u> | <u>Liability</u> |
| Foreign exchange contracts | | | | | | |
| Swaps – domestic | 253,498 | 7,160 | - | 104,200 | 1,740 | - |
| Total derivative assets | | 7,160 | - | | 1,740 | - |

15. Amounts due to customers

Amounts due to customers comprise:

| | <u>2021</u> | <u>2020</u> |
|---|------------------|------------------|
| Legal entities | | |
| Current accounts | 3,780,153 | 2,560,332 |
| Term deposits | 270,709 | 218,503 |
| Individuals | | |
| Current accounts | 729,963 | 761,286 |
| Term deposits | 547,705 | 475,177 |
| Amounts due to customers | 5,328,530 | 4,015,298 |
| Held as security against guarantees and letters of credit (Note 21) | (67,414) | (24,032) |

(Amounts presented are in thousands of Azerbaijani manats)

15. Amounts due to customers (continued)

At 31 December 2021, the Bank had amounts due to ten (2020: ten) largest customers with aggregate balance of AZN 2,386,241 or 45% of total amounts due to customers (2020: AZN 1,825,023 or 45%).

An analysis of customer accounts by economic sector follows:

| | 2021 | | 2020 | |
|----------------------------------|------------------|-------------|------------------|-------------|
| | Amount | % | Amount | % |
| Individuals | 1,277,668 | 24% | 1,236,463 | 31% |
| Construction | 923,250 | 18% | 659,651 | 16% |
| Insurance | 903,615 | 17% | 938,660 | 23% |
| Energy | 800,618 | 15% | 305,689 | 8% |
| Trade and services | 653,760 | 12% | 559,571 | 14% |
| Education | 206,998 | 4% | 113,574 | 3% |
| Manufacturing | 172,998 | 3% | 29,465 | 1% |
| Transportation and communication | 170,431 | 3% | 47,011 | 1% |
| Agriculture | 163,476 | 3% | 105,704 | 3% |
| Other | 55,716 | 1% | 19,510 | 0% |
| Amounts due to customers | 5,328,530 | 100% | 4,015,298 | 100% |

16. Debt securities issued

As at 31 December 2021, the Bank had one class of bonds in USD amounting to AZN 59,578 issued in December 2020 and maturing on 24 December 2027 (2020: 24 December 2027). The issuance was conducted through private placement on Baku Stock Exchange, and the bonds were delisted after being purchased by counterparties. The Bank is not obliged to comply with any financial or non-financial covenants in relation to these debt securities.

17. Amounts due to the Central Bank of the Republic of Azerbaijan and government organizations

Amounts due to the CBAR and government organizations comprise:

| | 2021 | 2020 |
|---|----------------|----------------|
| Azerbaijan Mortgage and Credit Guarantee Fund | 234,260 | 199,560 |
| Educational Student Credit Fund | 79,865 | - |
| Entrepreneurship Development Fund of the Republic of Azerbaijan | 21,887 | 29,230 |
| Agency for Agro Credit and Development | 2,171 | 3,165 |
| Central Bank of the Republic of Azerbaijan | 1,620 | 2,160 |
| Ministry of Finance of the Republic of Azerbaijan | - | 94 |
| Amounts due to the CBAR and government organizations | 339,803 | 234,209 |

In 2005, the Bank signed a credit agreement with National Fund for Support of Entrepreneurship, a program under the Ministry of Economic Development of the Republic of Azerbaijan, for financing of small and medium sized enterprises. Name of the fund was change to Entrepreneurship Development Fund of the Republic of Azerbaijan in 2018. Under this program, funds are made available to the Bank at an interest rate of 1% p.a. (2020: 1% p.a.) and mature during 2022-2026 (2020: 2021-2026). The Bank uses these funds to issue loans to eligible borrowers at rates not higher than 7% p.a.

In 2016, the Bank signed a credit agreement with the Azerbaijan Mortgage Fund OJSC for granting long-term mortgage loans to individuals. Name of the fund was change to Azerbaijan Mortgage and Credit Guarantee Fund OJSC in 2018. Under this program, funds are made available to the Bank at interest rates between 1% and 4% p.a. (2020: 1% and 4% p.a.) and mature in 2022-2051 (2020: 2021-2050). The Bank is obliged to make these funds to issue loans to eligible borrowers at rates not higher than 8.0% p.a.

In 2018, the Bank signed a credit agreement with the Agency for Agro Credit and Development, a program under the Ministry of Agriculture of the Republic of Azerbaijan, for financing enterprises in agriculture sector. Under this program, funds are made available to the Bank at interest rates 2% p.a. (2020: 2% p.a.) and mature in 2022-2026 (2020: 2021-2024). The Bank is obliged to make these funds to issue loans to eligible borrowers at rates not higher than 7% p.a. (2020: 7% p.a.).

(Amounts presented are in thousands of Azerbaijani manats)

17. Amounts due to the Central Bank of the Republic of Azerbaijan and government organizations (continued)

In 2021, the Bank signed a credit agreement with Educational Student Credit Fund, a program under the Ministry of Education of the Republic of Azerbaijan, for financing students' education fees. Educational Student Credit Fund was created by the decree of the President of Azerbaijan Republic in 2021 and the charter of this fund is AZN 79,865 which has been transferred to the Fund's current account at the Bank as at 31 December 2021. Under this program, loans terms and interest rates will be defined by the Fund. The Bank will finance loans of eligible students and the Fund will subsequently transfer financed amount to the Bank. The Fund will bear all credit risks associated with those loans.

18. Amounts due to credit institutions

Amounts due to credit institutions comprise:

| | <u>2021</u> | <u>2020</u> |
|---|---------------------|----------------------|
| Current accounts | 7,199 | 11,830 |
| Time deposits from financial institutions | 817 | 640 |
| Amounts due to credit institutions | <u>8,016</u> | <u>12,470</u> |

19. Subordinated loan

At 31 December 2021, the Bank had a subordinated loan from one resident bank with balance of AZN 8,521 (2020: 8,521) denominated in USD.

20. Equity

As at 31 December 2021 and 2020 the Bank's share capital is represented by 15,000,000 ordinary and 4,842,615 preference shares with nominal amount of 12.39 Azerbaijani manat per ordinary and per preference share. Ordinary shares were registered at State Securities Committee of the Republic of Azerbaijan on 17 July 2014, authorized, issued and fully paid up. Each ordinary share carries one vote while preference shares do not carry any voting rights.

On 1 April 2020, in accordance with the decision of shareholders, the Bank authorized to issue non-redeemable preference shares for the total amount of AZN 20,000 and an annual discretionary dividend of 15 % per preference share. On 28 August 2020, the Bank issued the preference shares, which were fully paid by the shareholders by the end of 2020. The share capital of the Bank was contributed by shareholders in Azerbaijani manat and they are entitled to dividends and any capital distribution in Azerbaijani manat. As at 31 December 2021, the balance of share capital is AZN 245,850 (2020: AZN 245,850).

According to the decision of the General Shareholders' Meeting held on 1 April 2021, the Bank declared dividends in respect of the year ended 31 December 2020 in the amount of AZN 152,330 on ordinary shares and in the amount of AZN 7,015 on preference shares (both amounts include 10% withholding tax to be paid on behalf of shareholders). The dividends were fully paid during 2021.

According to the decision of the General Shareholders' Meeting held on 1 April 2020, the Bank declared dividends in respect of the year ended 31 December 2019, in the amount of AZN 69,000 on ordinary shares and in the amount of AZN 6,000 on preference shares. Also, according to the decision of the General Shareholders' Meeting held on 2 June 2020, the Bank declared additional dividends in respect of the year ended 31 December 2019 in the amount of AZN 48,606 on ordinary shares of which AZN 37,006 were fully paid till the end of the year. The remaining portion remained as dividend payable to shareholders as of 31 December 2020 was paid to shareholders in January 2021.

All amounts include 10% withholding tax to be paid on behalf of shareholders.

Revaluation reserve for premises

The revaluation reserve is used to record increases in the fair value of premises and decreases to the extent that such decrease relates to an increase on the same asset previously recognised in equity.

Unrealised gains on investment securities

This reserve records fair value changes on investment securities designated at FVOCI.

(Amounts presented are in thousands of Azerbaijani manats)

21. Commitments and contingencies

Operating environment

The Bank conducts all of its operations in the Republic of Azerbaijan. The economy of Azerbaijan is particularly sensitive to oil and gas prices. During recent years, the Azerbaijani Government has initiated major economic and social reforms to accelerate the transition to a more balanced economy and reduce dependence on the oil and gas sector.

During 2021 the oil prices have been increasing and had reached its 7 year maximum as at 31 December 2021. This resulted in considerable increase of USD inflow into the economy, which added stability to the local currency.

During 2020 and 2021, the CBAR continued to ease monetary conditions while maintaining the stability of the Azerbaijani manat, which was kept flat at 1.7000 for 1 USD throughout the period. As a result, the CBAR refinancing rate was reduced from 7.25% to 6.25% during 2020 and remained flat since then. During the second half of 2021, the CBAR increased refinancing rate due to the increased inflation rates worldwide, and as a result, refinancing rate became 7.25% as at 31 December 2021.

COVID-19 pandemic

During 2020, the global economy was negatively impacted by the spread of the coronavirus pandemic (COVID-19).

During March-August 2020, the increasingly restrictive lockdown measures to combat COVID-19 in many countries significantly reduced economic activity and aggregate spending levels. Social distancing and quarantine measures resulted in the closure of retail, transport, travel, catering, hotel, entertainment and many other businesses. International trade was also significantly reduced. Finally, oil prices tumbled to historic lows but fully recovered by the end of the period. A support package was introduced by the Government and the CBAR to counter the economic downturn caused by the pandemic. These measures include, but are not limited to, subsidized lending to affected industries, payments to unemployed individuals and easing of certain regulatory restrictions to help the financial sector maintain its capabilities to provide resources and help customers avoid liquidity shortages as a result of the COVID-19 containment measures.

On 23 April 2020, the CBAR decided to temporarily reduce the minimum required capital adequacy ratio from 12% to 11% for banks of systematic importance, which include the Bank, and from 10% to 9% for all other banks and keep it at these levels until July 2021. Since July 2021, the required minimum ratios were set back at pre-pandemic levels (12% and 10%, respectively).

With the start of vaccination of Azerbaijani population on 16 January 2021 the Azerbaijani Government decided to gradually eliminate the special strict quarantine regime measures introduced in the previous year to combat the COVID-19 outbreak, such as travel restrictions, closure of business and other venues, lockdowns of certain areas throughout the country.

Despite this relief of strict quarantine regime for preventing coronavirus, the CBAR decided to prolong the easing of certain regulatory restrictions to help the financial sector maintain its capabilities to provide resources.

The Bank's management is monitoring economic developments in the current environment and taking precautionary measures it considers necessary in order to support the sustainability and development of the Bank's business in the foreseeable future. The Bank considers its current liquidity position to be sufficient for its sustainable functioning. The Bank monitors its liquidity position on a daily basis.

Legal

In the ordinary course of business, the Bank is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations of the Bank.

Taxation

Tax legislation in Azerbaijan is subject to varying interpretations, and changes can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. Recent events within the Republic of Azerbaijan suggest that the tax authorities may be taking a more assertive position in their interpretation and application of this legislation and assessments. It is therefore possible that transactions and activities of the Bank that have not been challenged in the past may be challenged at any time in the future. As a result, significant additional taxes, penalties and interest may be assessed by the relevant authorities. Fiscal periods remain open and subject to review by the tax authorities for a period of three calendar years immediately preceding the year in which the decision to conduct a tax review is taken. The last tax audit covered first half of 2017.

Management's interpretation of the relevant legislation as at 31 December 2021 is appropriate and the Bank's tax, currency and customs positions will be sustained.

(Amounts presented are in thousands of Azerbaijani manats)

21. Commitments and contingencies (continued)

Insurance

The Bank has not currently obtained insurance coverage related to liabilities arising from errors or omissions.

Compliance with the CBAR ratios

The CBAR requires banks to maintain certain prudential ratios computed based on statutory financial statements. As at 31 December 2021, the Bank was in compliance with these ratios except for:

- ▶ Maximum credit exposure of a bank per a single borrower or a group of related borrowers that should not exceed 10 percent of the bank's Tier 1 capital on unsecured loan. As at 31 December 2021, the Bank's ratio was 13.90% (2020: 20.50%).

The breach of this ratio was caused by investment made for government related projects.

The breach was subsequently eliminated in January 2022.

Throughout the year the Bank submitted information regarding these breaches to the CBAR on a monthly basis and no sanctions were imposed on the Bank. Management believes that the Bank will not face any sanctions against the Bank in the future.

Financial commitments and contingencies

The Bank provides guarantees and letters of credit to customers with primary purpose of ensuring that funds are available to a customer as required. Guarantees and standby letters of credit represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties. Documentary and commercial letters of credit, which are written undertakings by the Bank on behalf of a customer authorizing a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions, are collateralized by the underlying shipments of goods, to which they relate, or cash deposits and, therefore, carry less risk than a direct borrowing.

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

| | <u>2021</u> | <u>2020</u> |
|--|------------------|------------------|
| Credit related commitments | | |
| Undrawn loan commitments | 855,603 | 676,935 |
| Financial guarantees | 350,726 | 299,836 |
| Letters of credit | 64,821 | 30,925 |
| Performance guarantees | 173,719 | 172,215 |
| Less: provisions for ECL for credit related commitments | (24,676) | (16,356) |
| Less: provisions for performance guarantees (Note 13) | (11,993) | (3,028) |
| Commitments and contingencies (before deducting collateral) | 1,408,200 | 1,160,527 |
| Less: cash held as security against guarantees and letters of credit (Note 15) | (67,414) | (24,032) |
| Commitments and contingencies | 1,340,786 | 1,136,495 |

An analysis of changes in the ECLs during the year ended 31 December 2021 is as follows:

| <u>Financial guarantees</u> | <u>Stage 1</u> | <u>Stage 2</u> | <u>Stage 3</u> | <u>Total</u> |
|---|----------------|----------------|-----------------|-----------------|
| ECLs as at 1 January 2021 | (1,137) | (825) | (27) | (1,989) |
| New exposures | (1,559) | - | - | (1,559) |
| Exposures derecognised or matured (excluding write-offs) | 526 | 536 | 27 | 1,089 |
| Transfers to Stage 1 | (96) | 96 | - | - |
| Transfers to Stage 2 | 137 | (137) | - | - |
| Transfers to Stage 3 | 209 | 61 | (270) | - |
| Impact on period end ECL of exposures transferred between stages during the period | 81 | (11) | (13,319) | (13,249) |
| Changes to inputs used for ECL calculations | 296 | 47 | - | 343 |
| Aa at 31 December 2021 | (1,543) | (233) | (13,589) | (15,365) |

(Amounts presented are in thousands of Azerbaijani manats)

21. Commitments and contingencies (continued)**Financial commitments and contingencies (continued)**

| Undrawn loan commitments | Stage 1 | Stage 2 | Stage 3 | Total |
|---|----------------|----------------|----------------|-----------------|
| ECLs as at 1 January 2021 | (6,363) | (5,749) | (2,118) | (14,230) |
| New exposures | (6,282) | - | - | (6,282) |
| Exposures derecognised or matured (excluding write-offs) | 2,120 | 2,911 | 1,953 | 6,984 |
| Transfers to Stage 1 | (1,426) | 1,338 | 88 | - |
| Transfers to Stage 2 | 3,100 | (3,157) | 57 | - |
| Transfers to Stage 3 | 674 | 33 | (707) | - |
| Impact on period end ECL of exposures transferred between stages during the period | 1,281 | (26) | (69) | 1,186 |
| Changes to inputs used for ECL calculations | 2,125 | 944 | 6 | 3,075 |
| As at 31 December 2021 | (4,771) | (3,706) | (790) | (9,267) |

| Letters of credit | Stage 1 | Stage 2 | Stage 3 | Total |
|---|----------------|----------------|----------------|--------------|
| ECLs as at 1 January 2021 | - | (137) | - | (137) |
| New exposures | (44) | - | - | (44) |
| Exposures derecognised or matured (excluding write-offs) | - | 142 | - | 142 |
| Transfers to Stage 1 | - | - | - | - |
| Transfers to Stage 2 | 44 | (44) | - | - |
| Transfers to Stage 3 | - | - | - | - |
| Impact on period end ECL of exposures transferred between stages during the period | - | (5) | - | (5) |
| As at 31 December 2021 | - | (44) | - | (44) |

An analysis of changes in the ECLs during the year ended 31 December 2020 is as follows:

| Financial guarantees | Stage 1 | Stage 2 | Stage 3 | Total |
|---|----------------|----------------|----------------|----------------|
| ECLs as at 1 January 2020 | (1,459) | (2,070) | (81) | (3,610) |
| New exposures | (1,399) | - | - | (1,399) |
| Exposures derecognised or matured (excluding write-offs) | 937 | 433 | 52 | 1,422 |
| Transfers to Stage 1 | (957) | 957 | - | - |
| Transfers to Stage 2 | 637 | (637) | - | - |
| Transfers to Stage 3 | - | - | - | - |
| Impact on period end ECL of exposures transferred between stages during the period | 884 | (70) | - | 814 |
| Changes to inputs used for ECL calculations | 220 | 562 | 2 | 784 |
| As at 31 December 2020 | (1,137) | (825) | (27) | (1,989) |

| Undrawn loan commitments | Stage 1 | Stage 2 | Stage 3 | Total |
|---|----------------|-----------------|----------------|-----------------|
| ECLs as at 1 January 2020 | (5,003) | (10,050) | (817) | (15,870) |
| New exposures | (7,912) | - | - | (7,912) |
| Exposures derecognised or matured (excluding write-offs) | 2,614 | 4,793 | 812 | 8,219 |
| Transfers to Stage 1 | (3,246) | 3,244 | 2 | - |
| Transfers to Stage 2 | 3,393 | (3,396) | 3 | - |
| Transfers to Stage 3 | 1,828 | 34 | (1,862) | - |
| Impact on period end ECL of exposures transferred between stages during the period | 2,434 | (722) | (240) | 1,472 |
| Changes to inputs used for ECL calculations | (471) | 348 | (16) | (139) |
| As at 31 December 2020 | (6,363) | (5,749) | (2,118) | (14,230) |

(Amounts presented are in thousands of Azerbaijani manats)

21. Commitments and contingencies (continued)

Financial commitments and contingencies (continued)

| <i>Letters of credit</i> | <i>Stage 1</i> | <i>Stage 2</i> | <i>Stage 3</i> | <i>Total</i> |
|---|----------------|----------------|----------------|--------------|
| ECLs as at 1 January 2020 | (3) | – | (3,062) | (3,065) |
| New exposures | (137) | – | – | (137) |
| Exposures derecognised or matured (excluding write-offs) | 3 | – | 3,062 | 3,065 |
| Transfers to Stage 1 | – | – | – | – |
| Transfers to Stage 2 | 137 | (137) | – | – |
| Transfers to Stage 3 | – | – | – | – |
| As at 31 December 2020 | – | (137) | – | (137) |

22. Net fee and commission income

Net fee and commission income comprises:

| | <i>2021</i> | <i>2020</i> |
|--------------------------------------|-----------------|-----------------|
| Servicing plastic card operations | 133,424 | 88,861 |
| Cash operations | 20,948 | 16,819 |
| Settlement operations | 17,818 | 14,164 |
| Guarantees and commitments | 10,293 | 12,392 |
| Other | 6,616 | 5,162 |
| Fee and commission income | 189,099 | 137,398 |
| Servicing plastic card operations | (43,267) | (22,223) |
| Settlement operations | (14,279) | (9,964) |
| Cash operations | (8,092) | (3,443) |
| Guarantees and commitments | (1,434) | (918) |
| Other | (3,072) | (2,122) |
| Fee and commission expense | (70,144) | (38,670) |
| Net fee and commission income | 118,955 | 98,728 |

23. Other operating income

As at 31 December 2021, other operating income of AZN 13,886 (2020: AZN 8,655) primarily comprise income on sale of fixed assets, income from plastic card campaigns and other individually insignificant items.

24. Personnel expenses

Personnel expenses comprise:

| | <i>2021</i> | <i>2020</i> |
|---------------------------------|------------------|------------------|
| Salaries and bonuses | (110,138) | (99,115) |
| Social security costs | (18,859) | (16,343) |
| Other employee related expenses | (2,594) | (2,382) |
| Personnel expenses | (131,591) | (117,840) |

(Amounts presented are in thousands of Azerbaijani manats)

25. General and administrative expenses

General and administrative expenses comprise:

| | <u>2021</u> | <u>2020</u> |
|--|------------------------|------------------------|
| Sponsorship | (15,077) | (14,009) |
| Legal and consultancy | (13,379) | (9,838) |
| Repair and maintenance of property and equipment | (11,998) | (8,686) |
| Communications | (10,088) | (6,457) |
| Marketing and advertising | (8,923) | (6,473) |
| Deposit Insurance Fund expenses | (7,926) | (4,967) |
| Security | (3,989) | (3,897) |
| Office supplies | (3,737) | (3,347) |
| Representation expenses | (3,405) | (2,272) |
| Occupancy and rent | (2,801) | (2,433) |
| Utilities | (1,717) | (1,420) |
| Insurance on properties and equipment | (1,456) | (1,218) |
| Business travel and related expenses | (866) | (487) |
| Transportation and vehicle maintenance | (663) | (574) |
| Taxes other than income tax | (585) | (423) |
| Expenses on Equipment rent | (147) | (429) |
| Regulatory fees | - | (200) |
| Other | (3,901) | (3,291) |
| General and administrative expenses | <u>(90,658)</u> | <u>(70,421)</u> |

26. Risk management

Introduction

Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk and market risk. It is also subject to operating risks.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's strategic planning process.

Risk management structure

The Supervisory Board is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

Supervisory Board

The Supervisory Board is responsible for the overall risk management approach and for approving the risk strategies and principles.

Audit Committee

The Audit Committee has the overall responsibility for the establishment and development of the audit mission and strategy. It is responsible for the fundamental audit issues and monitoring Internal Audit's activities.

Management Board

The Management Board has the responsibility to monitor the overall risk process within the Bank.

Risk Committee

The Risk Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management (continued)

Introduction (continued)

Risk Management

The Risk Management Department is responsible for implementing and maintaining risk related procedures to ensure an independent control process.

Bank Treasury

Bank Treasury is responsible for managing the Bank's assets and liabilities and the overall financial structure. It is also primarily responsible for the funding and liquidity risks of the Bank.

Internal Audit

Risk management processes throughout the Bank are audited annually by the internal audit function that examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Audit Committee.

Risk measurement and reporting systems

The Bank's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also runs worse case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected industries. In addition the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risks types and activities.

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Management Board, the Risk Committee, and the head of each business division. The report includes aggregate credit exposure, hold limit exceptions and liquidity ratios. On a monthly basis detailed reporting of industry, customer and geographic risks takes place. Senior management assesses the appropriateness of the allowance for credit losses on a quarterly basis. The Management Board receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the risks of the Bank.

For all levels throughout the Bank, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information.

A daily briefing is given to the Management Board and all other relevant employees of the Bank on the utilization of market limits and liquidity, plus any other risk developments.

Risk mitigation

Bank actively uses collateral to reduce its credit risks.

Excessive risk concentration

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

In order to avoid excessive concentrations of risks, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management (continued)

Credit risk

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

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

Derivative financial instruments

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded in the consolidated statement of financial position.

Credit-related commitments risks

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

The maximum exposure to credit risk for the components of the consolidated statement of financial position, before the effect of mitigation through the use of master netting and collateral agreements, is best represented by their carrying amounts.

Where financial instruments are recorded at fair value, the carrying value represents the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

For more detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes. The effect of collateral and other risk mitigation techniques is shown in Note 21.

Impairment assessment

The Bank calculates ECL based on several probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the EIR. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive. The mechanics of the ECL calculations are outlined below and the key elements are as follows:

| | |
|-----|---|
| PD | The <i>Probability of Default</i> is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio. |
| EAD | The <i>Exposure at Default</i> is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments. |
| LGD | The <i>Loss Given Default</i> is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD. |

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss or LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss (12mECL). The 12mECL is the portion of LTECL that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Both LTECL and 12mECL are calculated on either an individual basis or a collective basis, depending on the nature of the underlying portfolio of financial instruments.

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management (continued)

Credit risk (continued)

The Bank has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument. Based on the above process, the Bank groups its loans into Stage 1, Stage 2, Stage 3 and POCI, as described below:

- Stage 1: When loans are first recognized, the Bank recognizes an allowance based on 12mECL. Stage 1 loans also include facilities where the credit risk has improved and the loan has been reclassified from Stage 2.
- Stage 2: When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECL. Stage 2 loans also include facilities, where the credit risk has improved and the loan has been reclassified from Stage 3.
- Stage 3: Loans considered credit-impaired. The Bank records an allowance for the LTECL.
- POCI: Purchased or originated credit impaired (POCI) assets are financial assets that are credit impaired on initial recognition. POCI assets are recorded at fair value at original recognition and interest revenue is subsequently recognised based on a credit-adjusted EIR. ECL are only recognised or released to the extent that there is a subsequent change in the lifetime expected credit losses.

Definition of default and cure

The Bank considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments. The Bank considers amounts due from banks defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements.

As a part of a qualitative assessment of whether a customer is in default, the Bank also considers a variety of instances that may indicate unlikelihood to pay. When such events occur, the Bank carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate.

Such events include:

- ▶ Default and Credit-impaired assets:
 - ▶ Loans with principal amount and/or accrued interest and/or any of other payment overdue by more than 90 days from the date specified in the contract;
 - ▶ 2 times within three years restructured loans that have been overdue (in principal amount and/or accrued interest and/or any of other payment) less than 30 days from the date specified in the contract at the moment of each particular restructuring;
 - ▶ "Non-healthy" restructured loans that were PAR 30 at the moment of restructuring; (originally in Stage 3), when NPV loss restructuring is more than 10%;
 - ▶ Any loan considered by management as non-performing (except non-performing loans that meet Stage 2 criteria).
- ▶ Existing of information that borrower will/has enter bankruptcy, insolvency or a similar condition.
- ▶ Default (according to IRB and External Rating).
- ▶ Default on other financial instruments of the same borrower.

It is the Bank's policy to consider a financial instrument as 'cured' and therefore re-classified out of Stage 3 when none of the default criteria have been present for at least six consecutive months. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the updated credit grade, at the time of the cure, and whether this indicates there has been a significant increase in credit risk compared to initial recognition.

Internal rating and PD estimation process

The Bank's Risk Department operates its internal rating models. The Bank runs separate models for its key portfolios in which its corporate customers are rated based on Moody's model. Small and medium enterprises and consumer loans are scored from 1 to 20 and from 1 to 4 using internal grades, respectively. The models incorporate both qualitative and quantitative information and, in addition to information specific to the borrower, utilise supplemental external information that could affect the borrower's behaviour. Where practical, they also build on information from the national and international external rating agencies. PDs, incorporating forward looking information and the IFRS 9 stage classification of the exposure, are assigned for each grade. This is repeated for each economic scenario as appropriate.

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management (continued)

Credit risk (continued)

Treasury and interbank relationships

The Bank's treasury and interbank relationships and counterparties comprise financial services institutions, banks, broker-dealers, exchanges and clearing-houses. For these relationships, the Bank analyses publicly available information such as financial information and other external data, e.g., the external ratings, and assigns the internal rating, as shown in the table below.

Corporate and small business lending

For corporate loans, the borrowers are assessed by specialised credit risk employees of the Bank. The credit risk assessment is based on a credit scoring model that takes into account various historical, current and forward-looking information such as:

- ▶ Historical financial information together with forecasts and budgets prepared by the client. This financial information includes realised and expected results, solvency ratios, liquidity ratios and any other relevant ratios to measure the client's financial performance.
- ▶ Any publicly available information on the clients from external parties. This includes external rating grades issued by rating agencies.
- ▶ Any macro-economic or geopolitical information, e.g., GDP growth relevant for the specific industry and geographical segments where the client operates.
- ▶ Any other objectively supportable information on the quality and abilities of the client's management relevant for the company's performance.

The complexity and granularity of the rating techniques varies based on the exposure of the Bank and the complexity and size of the customer. Some of the less complex small business loans are rated within the Bank's models for retail products.

Consumer lending and residential mortgages

Consumer lending comprises unsecured personal loans, credit cards and overdrafts. These products along with residential mortgages and some of the less complex small business lending are rated by an automated scorecard tool primarily driven by debt to income (DTI) and payment to income (PTI) ratios. Other key inputs into the models are GDP growth, changes in personal income/salary levels, personal indebtedness.

The Bank's internal credit rating grades are as follows:

| Internal rating grade for SME | Moody's based internal/external ratings for Corporate and Financial institutions | Internal rating description |
|--|---|--|
| 1 | Aaa | |
| 2-4 | Aa1 to Aa3 | High grade |
| 5-7 | A1 to A3 | |
| 8-10 | Baa1 to Baa3 | |
| 11-13 | Ba1 to Ba3 | Standard grade |
| 14-16 | B1 to B3 | |
| 17-19 | Caa1 to Caa3 | Sub-standard grade |
| 20 | Ca | |
| Default | C | Impaired |

Internal rating for consumer loans is based on overdue days. High grade rating is used for Central Bank and Ministry of Finance of the Republic of Azerbaijan.

Exposure at default

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments too. To calculate the EAD for a Stage 1 loan, the Bank assesses the possible default events within 12 months for the calculation of the 12mECL. For Stage 2, Stage 3 financial assets, the exposure at default is considered for events over the lifetime of the instruments.

The Bank determines EADs by modelling the range of possible exposure outcomes at various points in time, corresponding the multiple scenarios. The IFRS 9 PDs are then assigned to each economic scenario based on the outcome of Bank's models.

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management (continued)

Credit risk (continued)

Loss given default

For corporate lending assets, LGD values are assessed at least quarterly by account managers and reviewed and approved by the Bank.

The credit risk assessment is based on a standardized LGD assessment framework that results in a certain LGD rate. These LGD rates take into account the expected EAD in comparison to the amount expected to be recovered or realised from any collateral held.

The Bank segments its retail lending products into smaller homogeneous portfolios, based on key characteristics that are relevant to the estimation of future cash flows. The applied data is based on historically collected loss data and involves a wider set of transaction characteristics (e.g., product type) as well as borrower characteristics.

Where appropriate, further recent data is used in order to determine the IFRS 9 LGD rate for each group of financial instruments. When assessing forward-looking information, the expectation is based on multiple scenarios. Examples of key inputs involve changes in, collateral values including property prices for mortgages, commodity prices, payment status or other factors that are indicative of losses in the group.

LGD rates are estimated for the Stage 1, Stage 2, Stage 3 and POCI segment of each asset class.

Significant increase in credit risk

The Bank continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12mECL or LTECL, the Bank assesses whether there has been a significant increase in credit risk since initial recognition.

The Bank also applies a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as moving a customer/facility to the watch list, or the account becoming restructured due to credit event. In certain cases, the Bank may also consider that events explained in "Definition of default" section above are a significant increase in credit risk as opposed to a default. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

When estimating ECLs on a collective basis for a group of similar assets, the Bank applies the same principles for assessing whether there has been a significant increase in credit risk since initial recognition.

Grouping financial assets measured on a collective basis

Dependent on the factors below, the Bank calculates ECLs either on a collective or on an individual basis.

Asset classes where the Bank calculates ECL on an individual basis include:

- ▶ PD for all corporate and small business lending;
- ▶ LGD for Stage 3 corporate and small business lending which are above predetermined threshold and are collateralized.

Asset classes where the Bank calculates ECL on a collective basis include:

- ▶ PD and LGD for all retail consumer and mortgages lending;
- ▶ LGD for all corporate and small business lending which are in Stage 1 and Stage 2;
- ▶ LGD for corporate and small business lending which are in Stage 3, neither are above predetermined threshold nor are collateralized.

Forward-looking information and multiple economic scenarios

In its ECL models, the Bank relies on a broad range of forward-looking information as economic inputs, such as:

- ▶ GDP growth rates;
- ▶ NPL rates;
- ▶ Consumption growth rates;
- ▶ Inflation;
- ▶ Unemployment rate;
- ▶ Monetary policy rate;
- ▶ Dynamics of real and nominal effective exchange rates;
- ▶ Real estate price.

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management (continued)

Credit risk (continued)

The inputs and models used for calculating ECLs may not always capture all characteristics of the market at the date of the financial statements. To reflect this, qualitative adjustments or overlays are occasionally made as temporary adjustments when such differences are significantly material.

The Bank obtains the forward-looking information from third party sources (external rating agencies, governmental bodies e.g. central banks, and international financial institutions). Experts of the Bank's Credit Risk Department determine the weights attributable to the multiple scenarios. The tables show the values of the key forward looking economic variables/assumptions used in each of the economic scenarios for the ECL calculations. The figures for "Subsequent years" represent a long-term average and so are the same for each scenario as at 31 December 2021.

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank's internal credit ratings, as described above. The table below shows the credit quality by class of asset for loan-related lines in the consolidated statement of financial position, based on the Bank's credit rating system.

| 31 December 2021 | Note | | High grade | Standard grade | Sub-standard grade | Impaired | Total |
|--|-------------|---------|-------------------|-----------------------|---------------------------|-----------------|------------------|
| Cash and cash equivalents, except for cash on hand | 5 | Stage 1 | 1,851,567 | 60,399 | - | - | 1,911,966 |
| Amounts due from credit institutions | 6 | Stage 1 | 62,730 | 188,936 | 3,201 | - | 254,867 |
| Loans to customers at amortised cost | 8 | | | | | | |
| - Government related entities | | Stage 1 | - | 290,755 | 34,120 | - | 324,875 |
| | | Stage 2 | - | 655 | 40,968 | - | 41,623 |
| | | Stage 3 | - | - | - | 115 | 115 |
| - Corporate loans | | Stage 1 | 15,032 | 187,386 | 50,343 | - | 252,761 |
| | | Stage 2 | - | 5,122 | 67,036 | - | 72,158 |
| | | Stage 3 | - | - | - | 18,643 | 18,643 |
| - Loans to individuals – consumer loans | | Stage 1 | - | 1,086,537 | 166 | - | 1,086,703 |
| | | Stage 2 | - | 412,016 | 15,560 | - | 427,576 |
| | | Stage 3 | - | - | - | 69,223 | 69,223 |
| - Loans to individuals – mortgage loans | | Stage 1 | - | 289,929 | 724 | - | 290,653 |
| | | Stage 2 | - | 1,161 | 222 | - | 1,383 |
| | | Stage 3 | - | - | - | 504 | 504 |
| - Loans to individuals – entrepreneurs | | Stage 1 | 19 | 48,565 | 1,602 | - | 50,186 |
| | | Stage 2 | - | 1,406 | 3,395 | - | 4,801 |
| | | Stage 3 | - | - | - | 5,246 | 5,246 |
| Debt securities at amortised cost | 7 | Stage 1 | 59,321 | 931,819 | - | - | 991,140 |
| Debt securities at FVOCI | 7 | Stage 1 | 134,779 | - | - | - | 134,779 |
| Financial guarantees | 21 | Stage 1 | 9,622 | 248,271 | 64,149 | - | 322,042 |
| | | Stage 2 | - | 2,084 | 11,931 | - | 14,015 |
| | | Stage 3 | - | - | - | 14,669 | 14,669 |
| Undrawn loan commitments | 21 | Stage 1 | 3,989 | 713,717 | 31,627 | - | 749,333 |
| | | Stage 2 | - | 86,526 | 15,393 | - | 101,919 |
| | | Stage 3 | - | - | - | 4,351 | 4,351 |
| Letters of credit | 21 | Stage 1 | 56,872 | 1,002 | - | - | 57,874 |
| | | Stage 2 | - | 6,947 | - | - | 6,947 |
| Total | | | 2,193,931 | 4,563,233 | 340,437 | 112,751 | 7,210,352 |

*(Amounts presented are in thousands of Azerbaijani manats)***26. Risk management (continued)****Credit risk (continued)**

| 31 December 2020 | Note | | High grade | Standard grade | Sub-standard grade | Impaired | Total |
|--|-------------|---------|-------------------|-----------------------|---------------------------|-----------------|------------------|
| Cash and cash equivalents, except for cash on hand | 5 | Stage 1 | 1,169,802 | 93,538 | - | - | 1,263,340 |
| Amounts due from credit institutions | 6 | Stage 1 | 67,041 | 44,623 | - | - | 111,664 |
| Loans to customers at amortised cost | 8 | | | | | | |
| - Government related entities | | Stage 1 | - | 297,098 | 62,913 | - | 360,011 |
| | | Stage 2 | - | 3,199 | 146 | - | 3,345 |
| | | Stage 3 | - | - | - | 299 | 299 |
| - Corporate loans | | Stage 1 | 9,364 | 64,322 | 40,829 | - | 114,515 |
| | | Stage 2 | - | 9,030 | 67,023 | - | 76,053 |
| | | Stage 3 | - | - | - | 23,218 | 23,218 |
| - Loans to individuals – consumer loans | | Stage 1 | - | 913,462 | 386 | - | 913,848 |
| | | Stage 2 | - | 369,642 | 13,503 | - | 383,145 |
| | | Stage 3 | - | - | - | 42,331 | 42,331 |
| - Loans to individuals – mortgage loans | | Stage 1 | - | 226,299 | - | - | 226,299 |
| | | Stage 2 | - | 452 | 1,371 | - | 1,823 |
| | | Stage 3 | - | - | - | 1,174 | 1,174 |
| - Loans to individuals – entrepreneurs | | Stage 1 | - | 2,921 | 2,864 | - | 5,785 |
| | | Stage 2 | - | 2,996 | 2,140 | - | 5,136 |
| | | Stage 3 | - | - | - | 5,064 | 5,064 |
| Debt securities at amortised cost | 7 | Stage 1 | 846,312 | 91,775 | - | - | 938,087 |
| Debt securities at FVOCI | 7 | Stage 1 | 37,663 | - | - | - | 37,663 |
| Financial guarantees | 21 | Stage 1 | 6,307 | 159,743 | 72,640 | - | 238,690 |
| | | Stage 2 | - | 8,858 | 52,249 | - | 61,107 |
| | | Stage 3 | - | - | 39 | - | 39 |
| Undrawn loan commitments | 21 | Stage 1 | 409 | 520,147 | 26,636 | - | 547,192 |
| | | Stage 2 | 2,000 | 112,937 | 9,332 | - | 124,269 |
| | | Stage 3 | - | - | - | 5,474 | 5,474 |
| Letters of credit | 21 | Stage 1 | 17,843 | - | - | - | 17,843 |
| | | Stage 2 | - | 13,082 | - | - | 13,082 |
| Total | | | 2,156,741 | 2,934,124 | 352,071 | 77,560 | 5,520,496 |

More detailed information with respect to the allowance for impairment of loans to customers is provided in Note 8.

Financial guarantees, letters of credit and loan commitments are assessed and a provision for expected credit losses is calculated in similar manner as for loans.

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management (continued)

Credit risk (continued)

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

| | 2021 | | | | 2020 | | | |
|---|------------------|----------------|-------------------------|------------------|------------------|----------------|-------------------------|------------------|
| | Azerbaijan | OECD | CIS and other countries | Total | Azerbaijan | OECD | CIS and other countries | Total |
| Assets | | | | | | | | |
| Cash and cash equivalents | 2,518,704 | 49,127 | 40,054 | 2,607,885 | 1,847,543 | 25,815 | 10,974 | 1,884,332 |
| Amounts due from credit institutions | 120,872 | 101,058 | 32,937 | 254,867 | 46,475 | 37,354 | 27,835 | 111,664 |
| Investment securities | 973,556 | 142,967 | 17,865 | 1,134,388 | 894,990 | 82,203 | 5,624 | 982,817 |
| Investment in associates | 3,141 | - | - | 3,141 | 2,023 | - | - | 2,023 |
| Loans to customers | 2,517,479 | 273 | 1,677 | 2,519,429 | 2,061,516 | - | - | 2,061,516 |
| Other financial assets | 73,692 | 15,530 | 1,655 | 90,877 | 79,388 | 2,021 | 621 | 82,030 |
| | 6,207,444 | 308,955 | 94,188 | 6,610,587 | 4,931,935 | 147,393 | 45,054 | 5,124,382 |
| Liabilities | | | | | | | | |
| Amounts due to customers | 5,290,056 | 20,878 | 17,596 | 5,328,530 | 3,975,126 | 29,449 | 10,723 | 4,015,298 |
| Amounts due to the Central Bank of the Republic of Azerbaijan, and government organizations | 339,803 | - | - | 339,803 | 234,209 | - | - | 234,209 |
| Debt Securities issued | 59,578 | - | - | 59,578 | 59,578 | - | - | 59,578 |
| Subordinated loan | 8,521 | - | - | 8,521 | 8,521 | - | - | 8,521 |
| Amounts due to credit institutions | 7,628 | 14 | 374 | 8,016 | 12,096 | - | 374 | 12,470 |
| Other financial liabilities | 56,366 | - | - | 56,366 | 51,154 | 99 | - | 51,253 |
| | 5,761,952 | 20,892 | 17,970 | 5,800,814 | 4,340,684 | 29,548 | 11,097 | 4,381,329 |
| Net assets/(liabilities) | 445,492 | 288,063 | 76,218 | 809,773 | 591,251 | 117,845 | 33,957 | 743,053 |

Liquidity risk and funding management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high-grade collateral which could be used to secure additional funding if required.

The Bank maintains a portfolio of marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. In addition, the Bank maintains obligatory reserves with the CBAR, the amount of which depends on the level of customer funds attracted.

The liquidity position is assessed and managed by the Bank based on certain liquidity ratios established by the CBAR. The CBAR requires banks to maintain instant liquidity ratio of more than 30%. As at 31 December, these ratios were as follows:

| | 2021, % | 2020, % |
|--|------------|------------|
| Instant Liquidity Ratio (assets receivable or realisable within one day / liabilities repayable on demand) | 61.31 | 57.89 |

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management (continued)

Liquidity risk and funding management (continued)

Analysis of financial liabilities by remaining contractual maturities

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

| As at 31 December 2021 | Less than 3 months | 3 to 12 months | 1 to 5 years | Over 5 years | Total |
|--|-------------------------------|---------------------------|-------------------------|-------------------------|------------------|
| Financial liabilities | | | | | |
| Amounts due to the Central Bank of the Republic of Azerbaijan and government organizations | 89,700 | 22,935 | 81,559 | 210,386 | 404,580 |
| Amounts due to credit institutions | 7,379 | | 639 | - | 8,018 |
| Amounts due to customers | 4,681,541 | 476,229 | 216,688 | - | 5,374,458 |
| Debt Securities issued | 1,076 | 2,996 | 15,980 | 63,428 | 83,480 |
| Lease liability | 2,947 | 8,537 | 25,153 | 14,822 | 51,459 |
| Subordinated loan | 149 | 383 | 10,520 | - | 11,052 |
| Other financial liabilities | 56,366 | - | - | - | 56,366 |
| Total undiscounted financial liabilities | 4,839,158 | 511,080 | 350,539 | 288,636 | 5,989,413 |

| As at 31 December 2020 | Less than 3 months | 3 to 12 months | 1 to 5 years | Over 5 years | Total |
|--|-------------------------------|---------------------------|-------------------------|-------------------------|------------------|
| Financial liabilities | | | | | |
| Amounts due to the Central Bank of the Republic of Azerbaijan and government organizations | 21,053 | 25,153 | 69,179 | 173,437 | 288,822 |
| Amounts due to credit institutions | 11,853 | 39 | 696 | - | 12,588 |
| Amounts due to customers | 3,466,726 | 437,052 | 135,622 | - | 4,039,400 |
| Debt Securities issued | 999 | 2,996 | 15,980 | 67,423 | 87,398 |
| Lease liability | 2,555 | 7,822 | 24,959 | 10,884 | 46,220 |
| Subordinated loan | 149 | 383 | 2,040 | 8,990 | 11,562 |
| Other financial liabilities | 51,253 | - | - | - | 51,253 |
| Total undiscounted financial liabilities | 3,554,588 | 473,445 | 248,476 | 260,734 | 4,537,243 |

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

| | Less than 3 months | 3 to 12 months | 1 to 5 years | Over 5 years | Total |
|------|-------------------------------|---------------------------|-------------------------|-------------------------|------------------|
| 2021 | 925,449 | 304,494 | 41,207 | - | 1,271,150 |
| 2020 | 762,273 | 184,965 | 60,458 | - | 1,007,696 |

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

The Bank's capability to repay its liabilities relies on its ability to realise an equivalent amount of assets within the same period of time. There is a significant concentration of amounts due to customers represented by government organizations in the period of one year. Any significant withdrawal of these funds would have an adverse impact on the operations of the Bank. This level of funding will remain with the Bank for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment.

The maturity analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due in less than three months in the tables above.

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management (continued)

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchanges, and equity prices. The Bank does not have any significant equity, corporate fixed income, or derivatives holdings.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments.

Currency risk

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

The Assets and Liabilities Management Committee controls currency risk by management of the open currency position on the estimated basis of AZN devaluation and other macroeconomic indicators, which gives the Bank an opportunity to minimize losses from significant currency rates fluctuations toward its national currency. The Treasury Department performs daily monitoring of the Bank's open currency position with the aim to match the requirements of the CBAR.

The tables below indicate the currencies to which the Bank had significant exposure at 31 December on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Azerbaijani manats, with all other variables held constant on the consolidated statement of profit or loss. The effect on equity does not differ from the effect on profit or loss. A negative amount in the table reflects a potential net reduction in profit or loss or equity, while a positive amount reflects a net potential increase.

Impact on profit before tax based on net assets value as at 31 December:

| | <u>31 December 2021</u> | | <u>31 December 2020</u> | |
|-----|-------------------------|-----------------|-------------------------|----------------|
| USD | +20%/-3% | 67,879/(10,182) | +20%/-3% | 35,402/(5,310) |
| EUR | +21%/-9% | 1,713/(734) | +22%/-10% | 1,690/(768) |

Operational risk

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

27. Fair value measurements

Fair value hierarchy

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

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

(Amounts presented are in thousands of Azerbaijani manats)

27. Fair value measurements (continued)

Fair value hierarchy (continued)

For the purpose of fair value disclosures, the Bank has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

| | <i>Date of valuation</i> | <i>Fair value measurement using</i> | | | <i>Total</i> |
|--|------------------------------|--|--|--|------------------|
| | | <i>Quoted prices in active markets (Level 1)</i> | <i>Significant observable inputs (Level 2)</i> | <i>Significant unobservable inputs (Level 3)</i> | |
| Assets measured at fair value | | | | | |
| Investment securities – debt securities at FVOCI | 31 December 2021 | – | 134,779 | – | 134,779 |
| Investment securities – equity securities at FVOCI | 31 December 2021 | 8,461 | – | 3,003 | 11,464 |
| Derivative financial assets at FVPL – Currency swaps | 31 December 2021 | – | 7,160 | – | 7,160 |
| Property and equipment – premises | 31 December 2021 | – | 6,020 | – | 6,020 |
| Assets for which fair values are disclosed | | | | | |
| Cash and cash equivalents | 31 December 2021 | 2,607,885 | – | – | 2,607,885 |
| Amounts due from credit institutions | 31 December 2021 | – | – | 254,867 | 254,867 |
| Investment securities measured at amortised cost | 31 December 2021 | 190,735 | 705,263 | 89,830 | 985,828 |
| Loans to customers | 31 December 2021 | – | 313,709 | 2,228,723 | 2,542,432 |
| Other financial assets (excluding derivative financial assets) | 31 December 2021 | – | – | 83,717 | 83,717 |
| Liabilities for which fair values are disclosed | | | | | |
| Amounts due to customers | 31 December 2021 | – | 4,510,116 | 817,537 | 5,327,653 |
| Amounts due to the CBAR and government organizations | 31 December 2021 | – | 336,012 | 3,488 | 339,500 |
| Amounts due to credit institutions | 31 December 2021 | – | 7,199 | 817 | 8,016 |
| Debt securities issued | 31 December 2021 | – | 59,578 | – | 59,578 |
| Subordinated loan | 31 December 2021 | – | – | 8,521 | 8,521 |
| Other financial liabilities | 31 December 2021 | – | – | 56,366 | 56,366 |

(Amounts presented are in thousands of Azerbaijani manats)

27. Fair value measurements (continued)

Fair value hierarchy (continued)

| | <i>Date of valuation</i> | <i>Fair value measurement using</i> | | | <i>Total</i> |
|--|------------------------------|--|--|--|------------------|
| | | <i>Quoted prices in active markets (Level 1)</i> | <i>Significant observable inputs (Level 2)</i> | <i>Significant unobservable inputs (Level 3)</i> | |
| Assets measured at fair value | | | | | |
| Investment securities – debt securities at FVOCI | 31 December 2020 | - | 37,663 | - | 37,663 |
| Investment securities – equity securities at FVOCI | 31 December 2020 | 8,429 | - | 788 | 9,217 |
| Derivative financial assets at FVPL – Currency swaps | 31 December 2020 | - | 1,740 | - | 1,740 |
| Property and equipment – premises | 31 December 2020 | - | 5,475 | - | 5,475 |
| Assets for which fair values are disclosed | | | | | |
| Cash and cash equivalents | 31 December 2020 | 1,884,332 | - | - | 1,884,332 |
| Amounts due from credit institutions | 31 December 2020 | - | - | 111,664 | 111,664 |
| Investment securities measured at amortized cost | 31 December 2020 | 70,726 | 808,922 | 63,609 | 943,257 |
| Loans to customers | 31 December 2020 | - | 249,912 | 1,809,169 | 2,059,081 |
| Other financial assets (excluding derivative financial assets) | 31 December 2020 | - | - | 80,290 | 80,290 |

| | <i>Date of valuation</i> | <i>Fair value measurement using</i> | | | <i>Total</i> |
|--|------------------------------|--|--|--|------------------|
| | | <i>Quoted prices in active markets (Level 1)</i> | <i>Significant observable inputs (Level 2)</i> | <i>Significant unobservable inputs (Level 3)</i> | |
| Liabilities for which fair values are disclosed | | | | | |
| Amounts due to customers | 31 December 2020 | - | 3,321,618 | 695,621 | 4,017,239 |
| Amounts due to the CBAR and government organizations | 31 December 2020 | - | 228,790 | 5,063 | 233,853 |
| Amounts due to credit institutions | 31 December 2020 | - | 11,830 | 640 | 12,470 |
| Debt securities issued | 31 December 2020 | - | 59,578 | - | 59,578 |
| Subordinated loan | 31 December 2020 | - | - | 8,521 | 8,521 |
| Other financial liabilities | 31 December 2020 | - | - | 51,253 | 51,253 |

(Amounts presented are in thousands of Azerbaijani manats)

27. Fair value measurements (continued)

Fair value hierarchy (continued)

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

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

| | Carrying value 2021 | Fair value 2021 | Unrealized gain/(loss) | Carrying value 2020 | Fair value 2020 | Unrealized gain/(loss) |
|---|------------------------------------|--------------------------------|-----------------------------------|------------------------------------|--------------------------------|-----------------------------------|
| Financial assets | | | | | | |
| Cash and cash equivalents | 2,607,885 | 2,607,885 | – | 1,884,332 | 1,884,332 | – |
| Amounts due from credit institutions | 254,867 | 254,867 | – | 111,664 | 111,664 | – |
| Investment securities – debt securities at amortized cost | 988,145 | 985,828 | (2,317) | 935,937 | 943,257 | 7,320 |
| Loans to customers | 2,519,429 | 2,542,432 | 23,003 | 2,061,516 | 2,059,081 | (2,435) |
| Other financial assets(excluding derivative financial assets) | 83,717 | 83,717 | – | 80,290 | 80,290 | – |
| Financial liabilities | | | | | | |
| Amounts due to customers | 5,328,530 | 5,327,653 | 877 | 4,015,298 | 4,017,239 | (1,941) |
| Amounts due to the CBAR and government organizations | 339,803 | 339,500 | 303 | 234,209 | 233,853 | 356 |
| Amounts due to credit institutions | 8,016 | 8,016 | – | 12,470 | 12,470 | – |
| Debt securities issued | 59,578 | 59,578 | – | 59,578 | 59,578 | – |
| Subordinated loan | 8,521 | 8,521 | – | 8,521 | 8,521 | – |
| Other financial liabilities | 56,366 | 56,366 | – | 51,253 | 51,253 | – |
| Total unrecognized change in unrealized fair value | | | <u>21,866</u> | | | <u>3,300</u> |

Valuation techniques and assumptions

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

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short-term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits and savings accounts without a specific maturity.

Derivatives

Derivatives valued using a valuation technique with market observable inputs are mainly interest rate swaps, currency swaps and forward foreign exchange contracts. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates and interest rate curves. Derivatives valued using a valuation technique with significant non-market observable inputs are primarily long dated option contracts. These derivatives are valued using the binomial models. The models incorporate various non-observable assumptions, which include market rate volatilities.

Investment securities

Investment securities valued using a valuation technique or pricing models primarily consist of unquoted equity and debt securities. These securities are valued using models which sometimes only incorporate data observable in the market and at other times use both observable and non-observable data. The non-observable inputs to the models include assumptions regarding the future financial performance of the investee, its risk profile, and economic assumptions regarding the industry and geographical jurisdiction in which the investee operates.

Financial assets and financial liabilities carried at amortized cost

Fair value of unquoted instruments, loans to customers, customer deposits, amounts due from credit institutions and amounts due to the CBAR and government organizations, and credit institutions and other financial assets and liabilities is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

(Amounts presented are in thousands of Azerbaijani manats)

27. Fair value measurements (continued)

Valuation techniques and assumptions (continued)

Property and equipment – premises

Fair value of the Property and equipment – premises was determined by using market comparable method. This means that valuations performed by the valuator are based on market transaction prices, significantly adjusted for difference in the nature, location or condition of the specific property. As at the date of revaluation, the premises' fair values are based on valuations performed on 31 December 2021 by KONEKO LLC, an accredited independent valuator.

28. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled. See Note 26 "Risk management" for the Bank's contractual undiscounted repayment obligations.

| | 2021 | | | 2020 | | |
|--|--------------------|--------------------|------------------|------------------|--------------------|------------------|
| | Within one year | More than one year | Total | Within one year | More than one year | Total |
| Cash and cash equivalents | 2,607,885 | – | 2,607,885 | 1,884,332 | – | 1,884,332 |
| Amounts due from credit institutions | 99,352 | 155,515 | 254,867 | 19,894 | 91,770 | 111,664 |
| Investment in associate | – | 3,141 | 3,141 | – | 2,023 | 2,023 |
| Investment securities | 486,517 | 647,871 | 1,134,388 | 443,943 | 538,874 | 982,817 |
| Loans to customers | 924,101 | 1,595,328 | 2,519,429 | 850,127 | 1,211,389 | 2,061,516 |
| Property and equipment | – | 63,427 | 63,427 | – | 61,673 | 61,673 |
| Intangible assets | – | 25,655 | 25,655 | – | 23,667 | 23,667 |
| Right of use assets | – | 34,034 | 34,034 | – | 36,819 | 36,819 |
| Current income tax assets | 5,552 | – | 5,552 | – | – | – |
| Other assets | 112,965 | – | 112,965 | 100,422 | – | 100,422 |
| Total | 4,236,372 | 2,524,971 | 6,761,343 | 3,298,718 | 1,966,215 | 5,264,933 |
| Amounts due to customers | 5,137,028 | 191,502 | 5,328,530 | 3,891,107 | 124,191 | 4,015,298 |
| Amounts due to the CBAR and government organizations | 106,553 | 233,250 | 339,803 | 41,338 | 192,871 | 234,209 |
| Amounts due to credit institutions | 7,378 | 638 | 8,016 | 11,846 | 624 | 12,470 |
| Debt securities issued | 78 | 59,500 | 59,578 | 78 | 59,500 | 59,578 |
| Subordinated loan | 21 | 8,500 | 8,521 | 21 | 8,500 | 8,521 |
| Lease liability | 8,590 | 30,364 | 38,954 | 10,187 | 30,562 | 40,749 |
| Deferred income tax liabilities | – | 42,243 | 42,243 | – | 25,111 | 25,111 |
| Current tax liabilities | – | – | – | 27,310 | – | 27,310 |
| Other liabilities | 138,625 | – | 138,625 | 126,097 | – | 126,097 |
| Total | 5,398,273 | 565,997 | 5,964,270 | 4,107,984 | 441,359 | 4,549,343 |
| Net | (1,161,901) | 1,958,974 | 797,073 | (809,266) | 1,524,856 | 715,590 |

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

Management believes that in spite of a substantial portion of amounts due to customers being on demand, diversification of these deposits by number and type of depositors, and the past experience of the Bank indicates that these amounts provide a long-term and stable source of funding for the Bank. Management believes that this level of funding will remain with the Bank for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment.

(Amounts presented are in thousands of Azerbaijani manats)

29. Related party disclosures

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

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

The volumes of related party transactions, outstanding balances at the year-end, and related expense and income for the year are as follows:

| | 2021 | | | | 2020 | | | |
|---|---------------------------------|-------------------------------|-----------------------|--------------------------|---------------------------------|-------------------------------|-----------------------|--------------------------|
| | Share-holders / ultimate owners | Entities under common control | Other related parties | Key management personnel | Share-holders / ultimate owners | Entities under common control | Other related parties | Key management personnel |
| Loans outstanding at 1 January, gross | - | 55,791 | 6,697 | 3,867 | - | 52,596 | 12,823 | 4,663 |
| Loans issued during the year | - | 67,500 | 20,216 | 11,543 | - | 15,509 | 267 | 6,051 |
| Loan repayments during the year | - | (22,484) | (8,619) | (7,085) | - | (12,373) | (7,382) | (6,690) |
| Other movements | - | 53 | 459 | 43 | - | 59 | 989 | (157) |
| Loans outstanding at 31 December, gross | - | 100,860 | 18,753 | 8,368 | - | 55,791 | 6,697 | 3,867 |
| Less: allowance for impairment at 31 December | - | (469) | (510) | (173) | - | (659) | (260) | (32) |
| Loans outstanding at 31 December, net | - | 100,391 | 18,243 | 8,195 | - | 55,132 | 6,437 | 3,835 |
| Due from Credit Institutions | - | 83,232 | - | - | - | 31,471 | - | - |
| Interest income due from Credit Institutions | - | 697 | - | - | - | 784 | - | - |
| Interest income on loans | - | 36,117 | 1,551 | 532 | - | 33,231 | 2,902 | 503 |
| Impairment (charge)/reversal for loans | - | 190 | (250) | (141) | - | (20) | 362 | (9) |
| Right-of-use asset | - | 21,842 | - | - | - | 31,649 | - | - |
| Depreciation of right-of-use assets | - | (4,001) | - | - | - | (4,513) | - | - |
| Other assets | - | 4,610 | 35 | - | 16 | 7,380 | 108 | - |
| Deposits at 1 January | 1,201 | 2,736 | - | 34,452 | - | 6,528 | - | 43,844 |
| Deposits received during the year | 170 | 1,538 | 10,000 | 37,200 | 1,270 | 1,427 | - | 40,402 |
| Deposits repaid during the year | (170) | (3,023) | - | (36,676) | (100) | (5,226) | - | (49,745) |
| Other movements | 78 | (3) | 82 | (282) | 31 | 7 | - | (49) |
| Deposits at 31 December | 1,279 | 1,248 | 10,082 | 34,694 | 1,201 | 2,736 | - | 34,452 |
| Current accounts at 31 December | 10,417 | 24,477 | 5,144 | 12,217 | 1,203 | 18,261 | 4,669 | 10,830 |
| Cash and cash equivalents | - | 12,767 | - | - | - | 63,221 | - | - |
| Investment Securities | - | 29,032 | - | - | - | - | - | - |
| Interest income on Investment securities | - | 178 | - | - | - | - | - | - |
| Lease liability | - | 25,257 | - | - | - | 34,897 | - | - |
| Other liabilities | - | 1,313 | - | - | 11,772 | 243 | 228 | - |
| Debt Securities issued | 25,535 | - | - | 4,955 | 25,535 | - | - | 4,965 |
| Interest expenses on debt securities issued | (1,697) | - | - | (310) | (35) | - | - | (10) |
| Interest expense on lease liability | - | (3,032) | - | - | - | (3,977) | - | - |
| Interest expense on deposits | (81) | (80) | (82) | (768) | (39) | (276) | - | (1,237) |
| General and administrative expenses | (35) | (7,252) | (9,684) | - | (24) | (3,117) | (4,693) | - |
| Personnel expenses | - | (1,268) | - | - | - | - | - | - |
| Commission Income | 1 | 9,246 | 226 | 42 | 104 | 5,613 | 165 | 101 |
| Commission expense | - | (1,767) | (1,204) | - | (856) | (839) | - | - |
| Net gains/(loss) from foreign currencies: dealing | - | 498 | 127 | 12 | - | 502 | 106 | 10 |
| Net gains(losses) on initial recognition of financial instruments | - | 2,107 | - | - | - | - | - | - |
| Letters of credit and guarantees issued | - | 12,642 | 5,114 | - | - | 14,244 | 2,606 | - |
| Unused credit lines | - | 6,231 | 3,747 | 2,038 | - | 3,517 | 3,109 | 2,981 |

(Amounts presented are in thousands of Azerbaijani manats)

29. Related party disclosures (continued)

The compensation of key management personnel is as follows:

| | <u>2021</u> | <u>2020</u> |
|--|----------------------|----------------------|
| Salaries and other benefits | 42,021 | 20,928 |
| Social security costs | 6,752 | 3,251 |
| Total key management personnel compensation | <u>48,773</u> | <u>24,179</u> |

As of 31 December 2021, the Bank has a guarantee from its parent received as collateral in respect of loans issued to borrowers in the amount of AZN 40,770 (2020: AZN 40,795).

30. Changes in liabilities arising from financing activities

| | <u>Note</u> | <u>Subordinated loan</u> | <u>Debt securities issued</u> | <u>Total liabilities from financing activities</u> |
|--|-------------|------------------------------|-----------------------------------|--|
| Carrying amount at 1 January 2020 | | 8,521 | – | 8,521 |
| Proceeds from issue | | – | 59,500 | 59,500 |
| Other | | – | 78 | 78 |
| Carrying amount at 31 December 2020 | | 8,521 | 59,578 | 68,099 |
| Proceeds from issue | | – | – | – |
| Carrying amount at 31 December 2021 | 16, 19 | <u>8,521</u> | <u>59,578</u> | <u>68,099</u> |

31. Investments in associates

The following associate is accounted for under the equity method:

| <u>Associates</u> | <u>Ownership/ voting, %</u> | <u>Principal place of business</u> | <u>Country of incorporation</u> | <u>Nature of activities</u> | <u>Carrying value</u> | <u>Fair value</u> |
|--|-------------------------------------|--|-------------------------------------|---------------------------------|---------------------------|-----------------------|
| 31 December 2021 | | | | | | |
| Competo LLC | 25% | Azerbaijan | Azerbaijan | Financial | 2,429 | 2,429 |
| Komtec Ltd | 20% | Azerbaijan | Azerbaijan | Financial | 712 | 712 |
| Total carrying value of investments in associates | | | | | <u>3,141</u> | <u>3,141</u> |

| <u>Associates</u> | <u>Ownership/ voting, %</u> | <u>Principal place of business</u> | <u>Country of incorporation</u> | <u>Nature of activities</u> | <u>Carrying value</u> | <u>Fair value</u> |
|--|-------------------------------------|--|-------------------------------------|---------------------------------|---------------------------|-----------------------|
| 31 December 2020 | | | | | | |
| Competo LLC | 25% | Azerbaijan | Azerbaijan | Financial | 2,023 | 2,023 |
| Total carrying value of investments in associates | | | | | <u>2,023</u> | <u>2,023</u> |

The table below summarizes the movements in the investment in an associate:

| | <u>2021</u> | <u>2020</u> |
|--|---------------------|---------------------|
| Investment in an associate, 1 January | 2,023 | – |
| Investments made during the year | 3,486 | 3,960 |
| Share of net loss of the associate | (2,368) | (1,937) |
| Investment in an associate, 31 December | <u>3,141</u> | <u>2,023</u> |

At 31 December 2021 the share of loss of an associate of AZN 2,368 (2020: 1,937) has been recorded in the consolidated statement of profit or loss.

(Amounts presented are in thousands of Azerbaijani manats)

31. Investments in associates (continued)

The following table illustrates summarized financial information of associates:

| Assets and liabilities of the associate (Competo LLC) | 2021 | 2020 |
|--|--------------|--------------|
| Assets | 11,341 | 5,390 |
| Liabilities | (6,051) | (4,238) |
| Net assets | 5,290 | 1,152 |

| Revenues and expenses of the associate (Competo LLC) | 2021 | 2020 |
|---|-----------------|----------------|
| Revenues | 3,517 | 2,354 |
| Expenses | (15,819) | (11,809) |
| Net loss for the year | (12,302) | (9,455) |

| Assets and liabilities of the associate (Komtec Ltd) | 2021 | 2020 |
|---|-------------|-------------|
| Assets | 87,630 | X |
| Liabilities | (86,813) | X |
| Net assets | 817 | X |

| Revenues and expenses of the associate (Komtec Ltd) | 2021 | 2020 |
|--|--------------|-------------|
| Revenues | 27,464 | X |
| Expenses | (17,883) | X |
| Net profit for the year | 9,581 | X |

32. Capital adequacy

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

The primary objectives of the Bank's capital management are to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders' value.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

The CBAR capital adequacy ratio

The CBAR requires banks to maintain a minimum capital adequacy ratio of 6% (2020: 6%) and 12% (2020: 11%) for Tier 1 Capital and Total Capital, respectively, based on its guidelines.

As at 31 December 2021 and 2020, the Bank's capital adequacy ratios on this basis were as follows:

| | 2021 | 2020 |
|--|------------------|------------------|
| Tier 1 capital | 403,453 | 273,680 |
| Tier 2 capital | 276,488 | 273,680 |
| Less: deductions from capital | (20,004) | (10,560) |
| Total regulatory capital | 659,937 | 536,800 |
| Risk weighted assets | 4,253,202 | 2,392,738 |
| Capital adequacy ratio (Tier 1) | 9.49% | 11.44% |
| Capital adequacy ratio (Total Capital) | 15.52% | 22.43% |

(Amounts presented are in thousands of Azerbaijani manats)

33. Events after the reporting period

Subsequent to year end, in February 2022, due to the conflict between the Russian Federation and Ukraine, numerous sanctions have been announced by majority of western countries against the Russian Federation. These sanctions are targeted to have a negative economic impact on the Russian Federation.

As of the date of these financial statements, the Bank's total exposure to Russian financial markets amounted to AZN 14,781, which comprised investment securities and current accounts. Currently, the Bank is taking actions to minimize such exposure.

The Bank's management is monitoring the economic situation in the current environment and taking precautionary measures it considers necessary in order to support the liquidity of the Bank's assets in the foreseeable future.