# Financial Statements and Independent Auditor's Report

# "EVOCABANK" CLOSED JOINT STOCK COMPANY

31 December 2018

# Contents

Grant Thornton

# Independent auditor's report

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To the shareholders of "EVOCABANK" CLOSED JOINT STOCK COMPANY

## *Opinion*

We have audited the financial statements of "EVOCABANK" CLOSED JOINT STOCK COMPANY (the "Bank"), which comprise the statement of financial position as of 31 December 2018, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Bank as of 31 December 2018 and of its financial performance and its 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 Financial Statements* section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (the "IESBA Code") together with the ethical requirements that are relevant to our audit of the financial statements in the Republic of Armenia, and we have fulfilled our other ethical responsibilities in accordance with those ethical requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## *Other information*

Management is responsible for the other information. The other information comprises the information included in the annual report of the Bank for the year ended 31 December 2018, but does not include the financial statements and our auditor's report thereon. The annual report is expected to be made available to us after the date of this auditor's report.

Our opinion on the financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

## *Responsibilities of Management and Those Charged with Governance for the Financial Statements*

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

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

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

### *Auditor's Responsibilities for the Audit of the Financial Statements*

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

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

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

We communicate with those charged with governance 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.

Gagik Gyulbudaghyan
Managing Partner

Armen Hovhannisyan
Engagement Partner

18 April 2019

# Statement of profit or loss and other comprehensive income

In thousand Armenian drams

| | Notes | 2018 | 2017 |
|---|---|---|---|
| Interest and similar income | 7 | 8,887,293 | 6,912,868 |
| Interest and similar expense | 7 | (4,291,228) | (3,396,390) |
| Net interest income | | 4,596,065 | 3,516,478 |
| Fee and commission income | 8 | 672,951 | 494,461 |
| Fee and commission expense | 8 | (645,596) | (526,011) |
| Net fee and commission income | | 27,355 | (31,550) |
| Net trading income | 9 | 739,796 | 722,412 |
| Net gains on derecognition of financial assets measured at fair value through other comprehensive income | | 26,841 | - |
| Gains less losses on investments available for sale | | - | 54,049 |
| Other income | 10 | 135,675 | 99,584 |
| Impairment losses | 11 | (356,291) | (73,111) |
| Staff costs | 12 | (1,773,469) | (1,445,188) |
| Depreciation of property and equipment and amortization of intangible assets | 20 | (439,131) | (264,703) |
| Other expenses | 13 | (1,528,066) | (1,801,265) |
| Profit before income tax | | 1,428,775 | 776,706 |
| Income tax expense | 14 | (335,364) | (276,996) |
| Profit for the year | | 1,093,411 | 499,710 |
| Other comprehensive income: | | | |
| *Items that will be reclassified subsequently to profit or loss* | | | |
| *Movement in fair value reserve (debt instruments)* | | | |
| Net change in fair value during the year | | 4,921 | - |
| Net gains realized to statement of profit or loss and other comprehensive income on disposal of investments measured at FVOCI | | (26,607) | - |
| Changes in allowance for expected credit losses | | 2,923 | - |
| Income tax related to the above | | 4,337 | - |
| Net losses on financial investments at fair value through other comprehensive income | | (14,426) | - |
| *Movement in fair value reserve (available –for-sale)* | | | |
| Net unrealized gains from changes in fair value from available-for-sale financial securities | | - | 157,651 |
| Net gains realized to statement of profit or loss and other comprehensive income on disposal of available-for-sale securities | | - | (55,269) |
| Income tax relating to items that will be reclassified | | - | (20,476) |
| Net gains on available-for-sale financial assets | | - | 81,906 |
| Total other comprehensive income for the year, net of tax | | (14,426) | 81,906 |
| Total comprehensive income for the year | | 1,078,985 | 581,616 |

The accompanying notes on pages 11 to 73 are an integral part of these financial statements.

# Statement of financial position

In thousand Armenian drams

| | Notes | 31 December 2018 | 31 December 2017 |
|---|---|---|---|
| *Assets* | | | |
| Cash and cash equivalents | 15 | 23,088,491 | 18,812,252 |
| Amounts due from financial institutions | 16 | 12,890,453 | 8,620,732 |
| Derivative financial assets | 17 | 168 | 852 |
| Investment securities | 18 | | |
| - Securities available for sale | | - | 5,976,769 |
| - Securities held to maturity | | - | 499,366 |
| - Investment securities at fair value through other comprehensive income | | 1,754,501 | - |
| - Investment securities at amortised cost | | 496,231 | - |
| - Securities available-for-sale pledged under repurchase agreements | | - | 5,536,417 |
| - Investment securities at FVOCI pledged under repurchase agreements | | 7,608,062 | - |
| Loans and advances to customers | 19 | 75,424,473 | 56,834,306 |
| Property, equipment and intangible assets | 20 | 5,526,487 | 5,555,956 |
| Repossessed assets | 21 | 2,909,195 | 2,921,907 |
| Other assets | 22 | 599,656 | 446,564 |
| Total asstes | | 130,297,717 | 105,205,121 |
| *Liabilities and equity* | | | |
| *Liabilities* | | | |
| Amounts due to financial institutions | 23 | 23,517,126 | 13,531,924 |
| Financial liabilities held for trading | 24 | 2,080,577 | - |
| Amounts due to customers | 25 | 63,933,542 | 49,830,715 |
| Derivative financial liabilities | 17 | 13,600 | 20,400 |
| Other borrowings | 26 | - | 26,719 |
| Subordinated liabilities | 27 | 10,466,922 | 10,735,989 |
| Current income tax liabilities | | 92,070 | 65,373 |
| Deferred income tax liabilities | 14 | 333,183 | 689,399 |
| Other liabilities | 28 | 955,775 | 807,525 |
| Total liabilities | | 101,392,795 | 75,708,044 |

# Statement of financial position (continued)

In thousand Armenian drams

| | Notes | 31 December 2018 | 31 December 2017 |
|---|---|---|---|
| *Equity* | | | |
| Share capital | 29 | 17,950,000 | 17,950,000 |
| Statutory general reserve | | 162,075 | 52,075 |
| Other reserves | | 2,337,325 | 2,373,774 |
| Retained earnings | | 8,455,522 | 9,121,228 |
| Total equity | | 28,904,922 | 29,497,077 |
| | | | |
| Total liabilities and equity | | 130,297,717 | 105,205,121 |

The financial statements from pages 5 to 73 were signed by the Bank's Chairman of Management Board and Acting Chief Accountant on 18 April 2019.

Emil Soghomonyan
Chairman of Management Board

Nune Musayelyan
Acting Chief Accountant

The accompanying notes on pages 11 to 73 are an integral part of these financial statements.

# Statement of changes in equity

| In thousand Armenian drams | Share capital | Statutory general reserve | Fair value reserve | Revaluation reserve of PPE | Retained earnings | Total |
|---|---|---|---|---|---|---|
| Balance as of 31 December 2017 | 17,950,000 | 52,075 | 822,964 | 1,550,810 | 9,121,228 | 29,497,077 |
| Impact of adopting IFRS 9 (note 6) | - | - | 43,519 | - | (1,288,659) | (1,245,140) |
| Restated balance at 1 January 2018 | 17,950,000 | 52,075 | 866,483 | 1,550,810 | 7,832,569 | 28,251,937 |
| Profit for the year | - | - | - | - | 1,093,411 | 1,093,411 |
| *Other comprehensive income:* | | | | | | |
| Adjustment to reserve on amortization or disposal of property and equipment | - | - | - | (65,542) | 65,542 | - |
| Net change in fair value of debt instrument at FVOCI | - | - | 4,921 | - | - | 4,921 |
| Net amount reclassified to the statement of profit or loss on sale of debt instruments at FVOCI | - | - | (26,607) | - | - | (26,607) |
| Net changes in allowance for expected credit losses of debt instruments at FVOCI | | | 2,923 | | | 2,923 |
| Income tax relating to components of other comprehensive income | - | - | 4,337 | | - | 4,337 |
| Total comprehensive income for the year | - | - | (14,426) | (65,542) | 1,158,953 | 1,078,985 |
| Distribution to reserve | - | 110,000 | - | - | (110,000) | - |
| Dividends to shareholders | - | - | - | - | (426,000) | (426,000) |
| Total transactions with owners | - | 110,000 | - | - | (536,000) | (426,000) |
| Balance as of 31 December 2018 | 17,950,000 | 162,075 | 852,057 | 1,485,268 | 8,455,522 | 28,904,922 |
| Balance as of 1 January 2017 | 17,950,000 | 52,075 | 741,058 | 1,556,972 | 9,049,526 | 29,349,631 |
| Profit for the year | - | - | - | - | 499,710 | 499,710 |
| *Other comprehensive income:* | | | | | | |
| Adjustment to reserve on amortization of property and equipment | - | - | - | (6,162) | 6,162 | - |
| Net unrealized gains from changes in fair value | | | 157,651 | | | 157,651 |
| Net gains realized to statement of profit or loss on disposal of available-for-sale investments | - | - | (55,269) | - | - | (55,269) |
| Income tax relating to components of other comprehensive income | - | - | (20,476) | - | - | (20,476) |
| Total comprehensive income for the year | - | - | 81,906 | (6,162) | 505,872 | 581,616 |
| Dividends to shareholders | - | - | - | - | (434,170) | (434,170) |
| Total transactions with owners | - | - | - | - | (434,170) | (434,170) |
| Balance as of 31 December 2017 | 17,950,000 | 52,075 | 822,964 | 1,550,810 | 9,121,228 | 29,497,077 |

The accompanying notes on pages 11 to 73 are an integral part of these financial statements.

# Statement of cash flows

In thousand Armenian drams

| | 2018 | 2017 |
|---|---|---|
| *Cash flows from operating activities* | | |
| Profit before tax | 1,428,775 | 776,706 |
| *Adjustments for* | | |
| Amortization and depreciation allowances | 439,131 | 264,703 |
| Net (gains)/losses from sale of property and equipment | 3,253 | (2,057) |
| Net losses on disposal of other assets | 98,097 | 447,854 |
| Impairment losses | 356,291 | 73,111 |
| Net losses from fair value changes of trading liabilities | 114,265 | - |
| Net (gains)/losses from revaluation of derivative financial instruments | (2,608) | 4,163 |
| Net losses from revaluation of non-trading assets and liabilities | 128,529 | 40,659 |
| Interest receivable | (72,444) | (24,729) |
| Interest payable | 688,251 | 394,311 |
| *Cash flows from operating activities before changes in operating assets and liabilities* | 3,181,540 | 1,974,721 |
| *(Increase)/decrease in operating assets* | | |
| Amounts due from other financial institutions | (4,364,262) | (1,403,378) |
| Derivative financial assets | - | (4,163) |
| Loans and advances to customers | (21,585,087) | (9,499,188) |
| Repossessed assets | 642,729 | 216,949 |
| Other assets | (153,818) | (279,745) |
| *Increase/(decrease) in operating liabilities* | | |
| Amounts due to financial institutions | 8,162,645 | 4,204,330 |
| Amounts due to customers | 14,148,617 | 9,411,007 |
| Derivative financial liabilities | (3,508) | 1,725 |
| Other liabilities | 187,843 | (52,900) |
| Net cash flow from operating activities before income tax | 216,699 | 4,569,358 |
| Income tax paid | (349,261) | (472,796) |
| Net cash from/(used in) operating activities | (132,562) | 4,096,562 |
| *Cash flows from investing activities* | | |
| (Purchase)/sale of investment securities | 4,122,878 | (2,002,083) |
| Purchase of property, equipment and intangible assets | (412,912) | (806,320) |
| Sale of property and equipment | - | 19,184 |
| Net cash from/(used in) investing activities | 3,709,966 | (2,789,219) |

# Statement of cash flows (continued)

In thousand Armenian drams

| | 2018 | 2017 |
|---|---|---|
| *Cash flow from financing activities* | | |
| Dividends paid | (426,000) | (78,197) |
| Loans from financial institutions | 1,410,733 | 1,361,431 |
| Other long term loans | (26,000) | (246,548) |
| Net cash from financing activities | 958,733 | 1,036,686 |
| Net increase in cash and cash equivalents | 4,536,137 | 2,344,029 |
| Cash and cash equivalents at the beginning of the year | 18,812,252 | 16,049,033 |
| Exchange differences on cash and cash equivalents | (259,898) | 419,190 |
| Cash and cash equivalents at the end of the year (note 15) | 23,088,491 | 18,812,252 |

***Supplementary information:***

| | | |
|---|---|---|
| Interest received | 8,814,849 | 6,888,139 |
| Interest paid | (3,602,977) | (3,002,079) |

The accompanying notes on pages 11 to 73 are an integral part of these financial statements.

# Notes to the financial statements

## 1 Principal activities

"EVOCABANK" CJSC (the "Bank") is the renamed "Prometey Bank" CJSC is a Closed Join Stock Company, which was incorporated on 01.06.1990. The Bank is regulated by the legislation of RA and conducts its business under license number 27, granted on 02.10.1991 by the Central Bank of Armenia (the "CBA").

The Bank is a member of Individuals deposit compensation guarantee state system of RA , as well as member of Union of Banks of Armenia, ArCa, MasterCard payment systems.

The Bank accepts deposits from the public and extends credits, transfers payments in Armenia and abroad, exchanges currencies and provides other banking services to its commercial and retail customers.

The head office of the Bank and its 11 branches are located in Yerevan; one branch is located in Gyumri, one branch in Abovyan and another branch is located in Vanadzor.

The registered office of the Bank is located at: 44/2 Hanrapetutyan str. Yerevan 0010, Republic of Armenia.

## 2 Armenian business environment

Armenia continues to undergo political and economic changes. The stability and development of the Armenian economy largely depends on these changes, as well as developments in the Eurasian Economic Union with which the integration of the Armenian economy continues.

Management of the Bank believes that in the current conditions appropriate measures are implemented in order to ensure economic stability of the Bank.

## 3 Basis of preparation

### 3.1 Statement of compliance

The financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards ("IFRS") as developed and published by the International Accounting Standards Board (IASB), and Interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC").

The Bank prepares statements for regulatory purposes in accordance with legislative requirements of the Republic of Armenia. These financial statements are based on the Bank's books and records as adjusted and reclassified in order to comply with IFRS.

### 3.2 Basis of measurement

The financial statements have been prepared on a fair value basis for financial instruments at fair value through profit or loss and at fair value through other comprehensive income (before 1 January 2018 available for sale assets). Other financial assets and liabilities are stated at amortized cost and non-financial assets and liabilities are stated at historical cost, with the exception of land and buildings, which are stated at revalued amount.

### 3.3 Functional and presentation currency

Functional currency of the Bank is the currency of the primary economic environment in which the Bank operates. The Bank's functional currency and the Bank's presentation currency is Armenian Dram ("AMD"), since this currency best reflects the economic substance of the underlying events and transactions of the Bank. The financial statements are presented in thousands of AMD, unless otherwise stated, which is not convertible outside Armenia.

## 3.4 Changes in accounting policies

The Bank applied for the first time certain standards and amendments, which are effective for annual periods beginning on or after 1 January 2018. The Bank has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

### *IFRS 9 Financial Instruments*

IFRS 9 replaces IAS 39 for annual periods on or after 1 January 2018. The Bank has not restated comparative information for 2017 for financial instruments in the scope of IFRS 9. Therefore, the comparative information for 2017 is reported under IAS 39 and is not comparable to the information presented for 2018. Differences arising from the adoption of IFRS 9 have been recognised directly in retained earnings as of 1 January 2018 and are disclosed in note 6.

#### *Changes to classification and measurement*

To determine their classification and measurement category, IFRS 9 requires all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics.

The IAS 39 measurement categories of financial assets (fair value through profit or loss (FVPL), available for sale (AFS), held-to-maturity and amortised cost) have been replaced by:

- Debt instruments at amortised cost,
- Debt instruments at fair value through other comprehensive income (FVOCI), with gains or losses recycled to profit or loss on derecognition,
- Equity instruments at FVOCI, with no recycling of gains or losses to profit or loss on derecognition,
- Financial assets FVPL.

The accounting for financial liabilities remains largely the same as it was under IAS 39, except for the treatment of gains or losses arising from an entity's own credit risk relating to liabilities designated at FVPL. Such movements are presented in OCI with no subsequent reclassification to the income statement.

The Bank's classification of its financial assets and liabilities is explained in note 4.4.2. The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in note 6.

#### *Changes to the impairment calculation*

The adoption of IFRS 9 has fundamentally changed the Bank's accounting for loan loss impairments by replacing IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. IFRS 9 requires the Bank to record an allowance for ECLs for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts. Under IFRS 9, no impairment loss is recognised on equity investments. The allowance is based on the ECLs associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination. If the financial asset meets the definition of purchased or originated credit impaired (POCI), the allowance is based on the change in the ECLs over the life of the asset.

Details of the Bank's impairment assessment are disclosed in note 35.1.2. The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in note 6.

### *IFRS 7*

To reflect the differences between IFRS 9 and IAS 39, IFRS 7 Financial Instruments: Disclosures was updated and the Bank has adopted it, together with IFRS 9, for the year beginning 1 January 2018. Changes include transition disclosures as shown in note 6, detailed qualitative and quantitative information about the ECL calculations such as the assumptions and inputs used are set out in note 35.1.2.

Other new standards and amendments described below and applied for the first time in 2018, did not have a material impact on the annual financial statements of the Bank.

- *"Revenue from contracts with customers" (IFRS 15) and "Revenue from contracts with customer", Clarifications (Amendment to IFRS 15)*

- *"Share based payments" classification and measurement of share-based payment transactions (Amendment to IFRS 2)*
- *Annual Improvements to IFRSs 2014-2017 Cycle – Amendments to IFRS 1 and IAS 28*
- *Amendments to IAS 40 Investment Property: Transfers of Investment Property*
- *IFRIC 22 Foreign Currency Transactions and Advance Consideration.*

## 3.5 Standards and interpretations not yet applied by the Bank

At the date of authorization of these financial statements, certain new standards, amendments and interpretations to the existing Standards have been published but are not yet effective. The Bank has not early adopted any of these pronouncements.

Management anticipates that all of the pronouncements will be adopted in the Bank's accounting policy for the first period beginning after the effective date of the pronouncement.

Management does not anticipate a material impact on the Bank's financial statements from these Amendments, they are presented below.

### *IFRS 16 Leases*

IFRS 16 will replace IAS 17 "Leases" and three related Interpretations. It completes the IASB's long running project to overhaul lease accounting. Leases will be recorded in the statement of financial position in the form of a right-of-use asset and a lease liability. There are two important reliefs provided by IFRS 16 for assets of low value and short-term leases of less than 12 months.

IFRS 16 is effective from periods beginning on or after 1 January 2019. Early adoption is permitted; however, the Bank have decided not to early adopt.

Management is in the process of assessing the full impact of the Standard. So far, the Bank:

- has decided to make use of the practical expedient not to perform a full review of existing leases and apply IFRS 16 only to new or modified contracts. As some leases will be modified or renewed in 2019, the Bank has reassessed these leases and concluded they will be recognised on the statement of financial position as a right-of-use asset
- believes that the most significant impact will be that the Bank will need to recognise a right of use asset and a lease liability for the office and production buildings currently treated as operating leases. This will mean that the nature of the expense of the above cost will change from being an operating lease expense to depreciation and interest expense
- concludes that there will not be a significant impact to the finance leases currently held on the statement of financial position

The Bank is planning to adopt IFRS 16 on 1 January 2019 using the Standard's modified retrospective approach. Under this approach the cumulative effect of initially applying IFRS 16 is recognised as an adjustment to equity at the date of initial application. Comparative information is not restated.

Choosing this transition approach results in further policy decisions the Bank need to make as there are several other transitional reliefs that can be applied. These relate to those leases previously held as operating leases and can be applied on a lease-by-lease basis. The Bank are currently assessing the impact of applying these other transitional reliefs.

IFRS 16 has not made any significant changes to the accounting for lessors, and therefore the Bank does not expect any changes for leases where they are acting as a lessor.

### *Other standards*

- IFRIC 23 Uncertainty over Income Tax Treatments (effective from 1 January 2019),
- Amendment to IFRS 9 "Financial instruments"-Prepayment features with negative compensation (effective from 1 January 2019),

- Amendment to IAS 19 "Employee benefits" – Plan amendment, curtailment or settlement (effective from 1 January 2019),
- Annual Improvements to IFRSs 2015-2017 (effective from 1 January 2019).

# 4 Summary of significant accounting policies

The following significant accounting policies have been applied in the preparation of the financial statements. The accounting policies have been consistently applied.

## 4.1 Recognition of income and expenses

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

### *The effective interest rate method*

Under both IFRS 9 and IAS 39, interest income is recorded using the effective interest rate (EIR) method for all financial instruments measured at amortised cost, financial instruments designated at FVPL. Interest income on interest bearing financial assets measured at FVOCI under IFRS 9, similarly to interest bearing financial assets classified as available-for-sale or held to maturity under IAS 39 are also recorded by using the EIR method. The EIR is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.

The EIR (and therefore, the amortised cost of the asset) is calculated by taking into account any discount or premium on acquisition, fees and costs that are an integral part of the EIR. The Bank recognises interest income using a rate of return that represents the best estimate of a constant rate of return over the expected life of the loan. Hence, it recognises the effect of potentially different interest rates charged at various stages, and other characteristics of the product life cycle (including prepayments, penalty interest and charges).

If expectations regarding the cash flows on the financial asset are revised for reasons other than credit risk, the adjustment is booked as a positive or negative adjustment to the carrying amount of the asset in the balance sheet with an increase or reduction in interest income. The adjustment is subsequently amortised through Interest and similar income in the income statement.

### *Calculation of interest income and expense*

In calculating interest income and expense, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit-impaired) or to the amortised cost of the liability.

However, for financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the net amortised cost of the financial asset. If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis.

For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying the credit-adjusted effective interest rate to the amortised cost of the asset. The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset improves.

For information on when financial assets are credit-impaired, refer to note 4.4.6.

### *Fee and commission income*

Loan origination fees for loans issued to customers are deferred (together with related direct costs) and recognised as an adjustment to the effective yield of the loans. Fees, commissions and other income and expense items are generally recorded on an accrual basis when the service has been provided. Portfolio and other management advisory and service fees are recorded based on the applicable service contracts. Asset management fees related to investment funds are recorded over the period the service is provided. The same principle is applied for wealth management, financial planning and custody services that are continuously provided over an extended period of time.

### *Dividend income*

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

### *Net trading income*

Net trading income comprises gains less losses related to trading assets and liabilities, and includes all realized and unrealized fair value changes, interest, dividends and foreign exchange differences related to trading assets and liabilities. Net trading income also includes gains less losses from trading in foreign currencies and is recognized in profit or loss when the corresponding service is provided.

## 4.2 Foreign currency

Transactions in foreign currencies are initially recorded in the functional currency rate ruling at the date of the transactions. Gains and losses resulting from the translation of trading assets are recognised in the statement of profit or loss and other comprehensive income in net trading income, while gains less losses resulting from translation of non-trading assets are recorded in the statement of profit or loss and other comprehensive income in other income or other expense. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date.

Changes in the fair value of monetary securities denominated in foreign currency classified as available for sale are analysed between translation differences resulting from changes in the amortised cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in the amortised cost are recognised in profit or loss, and other changes in the carrying amount are recognised in the own equity.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as the dates of the initial transactions (applicable for the financial statements as of 31 December 2017). 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. Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items, such as equities classified as equity investment in respect of which an election has been made to present subsequent changes in fair value in OCI (available-for-sale equity instruments before 1 January 2018) are included in the fair value reserve in equity.

Differences between the contractual exchange rate of a certain transaction and the prevailing average exchange rate on the date of the transaction are included in gains less losses from trading in foreign currencies in net trading income.

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

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| AMD/1 US Dollar | 483.75 | 484.10 |
| AMD/1 EUR | 553.65 | 580.10 |

## 4.3 Taxation

Income tax on the profit for the year comprises current and deferred tax.  Income tax is recognized in the statement of profit or loss and other comprehensive income except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years. In the case when financial statements are authorized for issue before appropriate tax returns are submitted, taxable profits or losses are based on estimates.  Tax authorities might have more stringent position in interpreting tax legislation and in reviewing tax calculations. As a result, tax authorities might claim additional taxes for those transactions, for which they did not claim previously. As a result, significant additional taxes, fines and penalties could arise. Tax review can include 3 calendar years immediately preceding the year of a review. In certain circumstances tax review can include even more periods.

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.

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 utilized. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

The Republic of Armenia also has various operating taxes, which are assessed on the Bank's activities. These taxes are included as a component of other expenses in the statement of profit or loss and other comprehensive income.

## 4.4 Financial instruments

### 4.4.1 Recognition and initial measurement

The Bank initially recognises loans and advances, deposits, debt securities issued and subordinated liabilities on the date on which they are originated. All other financial instruments (including regular-way purchases and sales of financial assets) are recognised on the trade date, which is the date on which The Bank becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue.

### 4.4.2 Classification

#### *Financial assets – Policy applicable from 1 January 2018*

On initial recognition, a financial asset is classified as measured at: amortised cost, FVOCI or FVTPL.

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

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

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

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

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

All other financial assets are classified as measured at FVTPL.

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

#### *Business model assessment*

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

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

### *Assessment whether contractual cash flows are solely payments of principal and interest (The SPPI test)*

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin. In assessing whether the contractual cash flows are solely payments of principal and interest, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Bank considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Bank's claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
- features that modify consideration of the time value of money – e.g. periodical reset of interest rates.

### *Reclassifications*

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Bank changes its business model for managing financial assets. Financial liabilities are never reclassified.

### ***Financial assets – Policy applicable before 1 January 2018***

The Bank classified its financial assets into one of the following categories:

- loans and receivables;
- held to maturity;
- available-for-sale; and
- at FVTPL, and within this category as:
  - held for trading; or
  - designated as at FVTPL.

### *Financial liabilities*

The Bank classifies its financial liabilities as measured at amortised cost or FVTPL.

## 4.4.3 Derecognition

### *Financial assets*

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire (see also note 4.4.4), or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in OCI is recognised in profit or loss.

From 1 January 2018 any cumulative gain/loss recognised in OCI in respect of equity investment securities designated as at FVOCI is not recognised in profit or loss on derecognition of such securities. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability.

The Bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. In such cases, the transferred assets are not derecognised. Examples of such transactions are securities lending and sale-and-repurchase transactions.

When assets are sold to a third party with a concurrent total rate of return swap on the transferred assets, the transaction is accounted for as a secured financing transaction similar to sale-and repurchase transactions, because the Bank retains all or substantially all of the risks and rewards of ownership of such assets.

In transactions in which the Bank neither retains nor transfers substantially all of the risks and rewards of ownership of a financial asset and it retains control over the asset, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

In certain transactions, the Bank retains the obligation to service the transferred financial asset for a fee. The transferred asset is derecognised if it meets the derecognition criteria. An asset or liability is recognised for the servicing contract if the servicing fee is more than adequate (asset) or is less than adequate (liability) for performing the servicing.

### *Financial liabilities*

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

## 4.4.4 Modifications of financial assets and financial liabilities

### *Financial assets*

If the terms of a financial asset are modified, the Bank evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised (refer to note 4.4.3) and a new financial asset is recognised at fair value.

### ***Policy applicable from 1 January 2018***

If the cash flows of the modified asset carried at amortised cost are not substantially different, then the modification does not result in derecognition of the financial asset. In this case, The Bank recalculates the gross carrying amount of the financial asset and recognises the amount arising from adjusting the gross carrying amount as a modification gain or loss in profit or loss. If such a modification is carried out because of financial difficulties of the borrower (refer to note 4.4.6), then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income.

***Policy applicable before 1 January 2018***

If the terms of a financial asset were modified because of financial difficulties of the borrower and the asset was not derecognised, then impairment of the asset was measured using the pre-modification interest rate.

*Financial liabilities*

The Bank derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognised at fair value. The difference between the carrying amount of the financial liability extinguished and the new financial liability with modified terms is recognised in profit or loss.

### 4.4.5 Offsetting

Financial assets and liabilities, and income and expenses, are offset and the net amount reported in the financial statements 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 realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under IFRS, or for gains and losses arising from a group of similar transactions such as in the Bank's trading activity.

### 4.4.6 Impairment

***Policy applicable from 1 January 2018***

The Bank assesses on a forward-looking basis the expected credit losses ('ECL') on the following financial instruments that are not measured at FVTPL:

- financial assets measured at amortised cost
- financial assets measured at fair value through other comprehensive income
- lease receivables
- loan commitments
- financial guarantee contracts

No impairment loss is recognised on equity investments.

The Bank measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured as 12-month ECL:

- debt investment securities that are determined to have low credit risk at the reporting date; and
- other financial instruments on which credit risk has not increased significantly since their initial recognition.

The Bank considers a debt security to have low credit risk when their credit risk rating is equivalent to the globally understood definition of 'investment grade.

12-month ECL (12mECLs) are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

Lifetime expected credit losses (LTECLs) are the expected credit losses that result from all possible default events over the expected life of a financial instrument.

*Measurement of ECL*

Both LTECLs and 12mECLs are calculated on either an individual basis or a collective basis, depending on the nature of the underlying portfolio of financial instruments.

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. This is further explained in note 35.1.2.

Based on the above process, The Bank groups its financial instruments into Stage 1, Stage 2, Stage 3 and POCI, as described below:

- Stage 1: When loans are first recognised, The Bank recognises an allowance based on 12mECLs. 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 LTECLs. 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 LTECLs.
- 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 income is subsequently recognised based on a credit-adjusted EIR. ECLs are only recognised or released to the extent that there is a subsequent change in the expected credit losses.

Expected credit losses are the discounted product of the Probability of Default (PD), Exposure at Default (EAD), and Loss Given Default (LGD), defined as follows:

- PD (the Probability of Default) 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 Exposure at Default) 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 Loss Given Default) 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 PD, the EAD and the LGD are further explained in note 35.1.2.

### *Restructured financial assets*

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised (refer to note 4.4.4) and ECL are measured as follows.

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset.
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

### *Credit-impaired financial assets*

At each reporting date, The Bank assesses whether financial assets carried at amortised cost and debt financial assets carried at FVOCI are credit-impaired. A financial asset is ‘credit-impaired’ when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred. Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by The Bank on terms that The Bank would not consider otherwise;

- it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation; or
- the disappearance of an active market for a security because of financial difficulties.

A loan that has been renegotiated due to a deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment.

In making an assessment of whether an investment in sovereign debt is credit-impaired, The Bank considers the following factors.

- The market's assessment of creditworthiness as reflected in the bond yields.
- The rating agencies' assessments of creditworthiness.
- The country's ability to access the capital markets for new debt issuance.

### *Presentation of allowances for ECL in the statement of financial position*

Loss allowances for ECL are presented in the statement of financial position as follows:

- financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- debt instruments measured at FVOCI: no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the fair value reserve.
- loan commitments and financial guarantee contracts: generally, as a provision;
  - When estimating LTECLs for undrawn loan commitments, The Bank estimates the expected portion of the loan commitment that will be drawn down over its expected life. The expected cash shortfalls are discounted at an approximation to the expected EIR on the loan.
  - where a financial instrument includes both a drawn and an undrawn component, and The Bank cannot identify the ECL on the loan commitment component separately from those on the drawn component: The Group presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision;
  - The Bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the income statement, and the ECL provision. For this purpose, The Bank estimates ECLs based on the present value of the expected payments to reimburse the holder for a credit loss that it incurs The shortfalls are discounted by the risk-adjusted interest rate relevant to the exposure. The ECLs related to financial guarantee contracts are recognised within Provisions.

### *Write-offs*

Loans and debt securities are written off (either partially or in full) when there is no realistic prospect of recovery. This is generally the case when The Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. However, financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due.

## ***Policy applicable before 1 January 2018***

### *Assets carried at amortized cost*

A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset ("loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Criteria used to determine that there is objective evidence of an impairment loss may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty (for example, equity ratio, net income percentage of sales), default or delinquency in interest or principal payments, breach of loan covenants or conditions, deterioration in the value of collateral, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on financial assets carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced through use of an allowance account. The amount of the loss shall be recognised in the statement of profit or loss and other comprehensive income. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. The Bank may measure impairment on the basis of an instrument's fair value using an observable market price.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not the foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Bank's internal credit grading system that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in The Bank and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist.

Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period (for example, changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses in The Bank and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realized or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If future write-off is later recovered, the recovery is credited to the allowance account.

Impairment allowances of financial assets have been identified in the financial statements on the basis of existing economic conditions. Bank is not able to predict how conditions may change in Armenia, and what impact these changes may have on the adequacy of the impairment allowance of financial assets in future periods.

### *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. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

### *Available-for-sale financial assets*

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in the statement of income, is transferred from equity to the statement of income. Reversals of impairment in respect of equity instruments classified as available-for-sale are not recognised in the statement of income but accounted for in other comprehensive income in a separate component of equity. Reversals of impairment losses on debt instruments are reversed through the statement of profit or loss and other comprehensive income if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in profit or loss.

## 4.5 Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, balances on correspondent accounts with the Central Bank of Armenia (excluding those funds deposited for the settlement of ArCa payment cards), and amounts due from other banks, which can be converted into cash at short notice, including highly liquid investments maturing within 90 days from the date of acquisition that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash and cash equivalents are carried at amortised cost.

## 4.6 Amounts due from financial institutions

In the normal course of business, the Bank maintains advances or deposits for various periods of time with other banks. Loans and advances to banks with a fixed maturity term are subsequently measured at amortized cost using the effective interest method. Those that do not have fixed maturities are carried at amortized cost based on maturities estimated by management. Amounts due from other financial institutions are carried net of any allowance for impairment losses.

## 4.7 Loans and advances

Loans and advances are financial assets with fixed or determinable payments, which arise when the Bank provides money directly to a debtor with no intention of trading the receivable.

Loans granted by the Bank with fixed maturities are initially recognized at fair value plus related transaction costs. Where the fair value of consideration given does not equal the fair value of the loan, for example where the loan is issued at lower than market rates, the difference between the fair value of consideration given and the fair value of the loan is recognized as a loss on initial recognition of the loan and included in the statement of profit or loss and other comprehensive income as losses on origination of assets. Subsequently, the loan carrying value is measured using the effective interest method. Loans to customers that do not have fixed maturities are accounted for under the effective interest method based on expected maturity. Loans to customers are carried net of any allowance for impairment losses.

## 4.8 Investment securities

### ***Policy applicable from 1 January 2018***

The "investment securities" caption in the statement of financial position includes:

- debt investment securities measured at amortised cost; these are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method;
- debt and equity investment securities mandatorily measured at FVTPL or designated as at FVTPL; these are at fair value with changes recognised immediately in profit or loss;
- debt securities measured at FVOCI; and
- equity investment securities designated as at FVOCI.

For debt securities measured at FVOCI, gains and losses are recognised in OCI, except for the following, which are recognised in profit or loss in the same manner as for financial assets measured at amortised cost:

- interest revenue using the effective interest method;
- ECL and reversals; and
- foreign exchange gains and losses.

When debt security measured at FVOCI is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss.

The Bank elects to present in OCI changes in the fair value of certain investments in equity instruments that are not held for trading. The election is made on an instrument-by-instrument basis on initial recognition and is irrevocable.

Gains and losses on such equity instruments are never reclassified to profit or loss and no impairment is recognised in profit or loss. Dividends are recognised in profit or loss unless they clearly represent a recovery of part of the cost of the investment, in which case they are recognised in OCI. Cumulative gains and losses recognised in OCI are transferred to retained earnings on disposal of an investment.

### *Policy applicable before 1 January 2018*

Investment securities were initially measured at fair value plus, in the case of investment securities not at FVTPL, incremental direct transaction costs, and subsequently accounted for depending on their classification as either held-to-maturity, FVTPL or available-for-sale.

#### *Held-to-maturity investments*

Held-to-maturity investments are financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention and ability to hold to maturity. Were the Bank to sell other than insignificant amount of held-to-maturity assets not close to their maturity, the entire category would be reclassified as available-for-sale. Held-to-maturity investments are carried at amortized cost using the effective interest rate method, less any allowance for impairment.

#### *Available-for-sale financial assets*

Assets available for sale represent debt and equity assets that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. After initial recognition available-for sale financial assets are measured at fair value with gains or losses being recognised as a separate component of other comprehensive income until the investment is derecognised or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in equity is included in the statement of profit or loss and other comprehensive income. However, interest calculated using the effective interest method is recognised in the statement of profit or loss and other comprehensive income. Dividends on available-for-sale equity instruments are recognised in profit or loss when the Bank's right to receive payment is established.

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions, reference to the current market value of another instrument, which is substantially the same and discounted cash flow analysis. Otherwise the investments are stated at cost less any allowance for impairment.

#### *Fair value through profit or loss*

The Bank designates some investment securities as at fair value, with fair value changes recognised immediately in profit or loss.

## 4.9 Repurchase and reverse repurchase agreements

Sale and repurchase agreements ("repos") are treated as secured financing transactions. Securities sold under sale and repurchase agreements are retained in the 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 and faced as the separate balance sheet item. The corresponding liability is presented within amounts due to financial institutions or customers.

Securities purchased under agreements to resell ("reverse repo") are recorded as amounts due from other financial institutions or loans and advances to customers as appropriate and are not recognized in the statement of financial position.

The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

If assets purchased under an agreement to resell are sold to third parties, the obligation to return the securities is recorded as a trading liability and measured at fair value.

## 4.10 Securities lending and borrowing

Securities lending and borrowing transactions are usually collateralised by securities or cash. The transfer of the securities to counterparties is only reflected in the statement of financial position if the risks and rewards of ownership are also transferred. Cash advanced or received as collateral is recorded as an asset or liability.

Securities borrowed are not recognized in the statement of financial position, unless they are sold to third parties, in which case the obligation to return the securities is recorded as a trading liability and measured at fair value with any gains or losses included in "Net trading income".

## 4.11 Leases

### *Operating - Bank as lessee*

Leases of assets under which the risks and rewards of ownership are effectively retained by the lessor are classified as operating leases. Lease payments under an operating lease are recognised as expenses on a straight-line basis over the lease term and included in other operating expenses.

## 4.12 Property, plant and equipment

Property, plant and equipment ("PPE") are recorded at historical cost less accumulated depreciation. Bank's buildings and land are presented at fair value less accumulated depreciation. If the recoverable value of PPE is lower than its carrying amount, due to circumstances not considered to be temporary, the respective asset is written down to its recoverable value. Land is carried at fair value.  It has unlimited useful life and thus is not depreciated.

Depreciation is calculated using the straight-line method based on the estimated useful life of the asset. The following depreciation rates have been applied:

| | Useful life (years) | Rate (%) |
|---|---|---|
| Buildings | 40 | 2.5 |
| Computers | 3-5 | 33.3-20 |
| Vehicles | 8 | 12.5 |
| Other fixed assets | 5-8 | 20-96 |

Leasehold improvements are capitalized and depreciated over the shorter of the lease term and their useful lives on a straight-line basis. Assets under the course of construction are accounted based on actual expenditures less any impairment losses. Upon completion of construction assets are transferred to property plant and equipment and accounted at their carrying amounts. Assets under the course of construction are not depreciated until they are ready for usage.

Repairs and maintenance are charged to the statement of profit or loss and other comprehensive income during the period in which they are incurred. The cost of major renovations is included in the carrying amount of the asset when it is incurred and when it satisfies the criteria for asset recognition. Major renovations are depreciated over the remaining useful life of the related asset.

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are included in operating profit.

The frequency of revaluation depends on changes in fair value of assets. In case of significant divergences between fair value of revalued assets and their carrying amounts further revaluation is conducted. Revaluation is conducted for the whole class of property, plant and equipment.

Any revaluation surplus is credited to the revaluation reserve for property and equipment included in the revaluation reserve for property and equipment in equity section of the balance sheet, except to the extent that it reverses a revaluation decrease of the same asset previously recognised in the statement of income, in which case the increase is recognised in the statement of income. A revaluation deficit is recognised in the statement of income, 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.

Along with the usage of fixed assets, the difference of the calculated depreciation based on the revalued amount of the asset and calculated depreciation based on the cost of the asset is transferred to retained earnings.

In case of sale or write-off of fixed assets the balance relating to revaluation reserve of that fixed assets is totally transferred to retained earnings.

## 4.13 Intangible assets

Intangible assets include computer software and licences.

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 either finite or indefinite. Intangible assets with finite lives are amortised on a straight-line basis over the useful economic lives and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with finite useful lives are reviewed at least at each financial year-end.

Costs associated with maintaining computer software programmes are recorded as an expense as incurred.

## 4.14 Repossessed assets

In certain circumstances, assets are repossessed following the foreclosure on loans that are in default. Repossessed assets are measured at the lower of cost and fair value less costs to sell.

## 4.15 Grants

Grants relating to the assets are included in other liabilities and are credited to the statement of profit or loss and other comprehensive income on a straight line basis over the expected lives of the related assets.

## 4.16 Borrowings

Borrowings, which include amounts due to the Central Bank, amounts due to other international and RA financial institutions, amounts due to customers, debt securities issued and subordinated debt are initially recognised at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the statement of profit or loss and other comprehensive income when the liabilities are derecognised as well as through the amortisation process.

If the Bank purchases its own debt, it is removed from the balance sheet and the difference between the carrying amount of the liability and the consideration paid is recognised in the statement of income.

## 4.17 Financial guarantees and loan commitments

"Financial guarantees" are contracts that require the Bank to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when it is due in accordance with the terms of a debt instrument. "Loan commitments" are firm commitments to provide credit under pre-specified terms and conditions.

Financial guarantees issued or commitments to provide a loan at a below-market interest rate are initially measured at fair value and the initial fair value is amortised over the life of the guarantee or the commitment. Subsequently, they are measured as follows:

- from 1 January 2018: at the higher of this amortised amount and the amount of loss allowance; and
- before 1 January 2018: at the higher of this amortised amount and the present value of any expected payment to settle the liability when a payment under the contract has become probable.

Liabilities arising from financial guarantees are included within provisions.

## 4.18 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.

## 4.19 Equity

### *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 is recognised as additional paid-in capital.

### *Retained earnings*

Include accumulated earnings of current and previous periods.

### *Dividends*

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

### *Property revaluation surplus*

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

### *Fair value reserve for investments securities at FVOCI*

This reserve records fair value changes in investment securities at fair value through other comprehensive income.

# 5 Critical accounting estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of policies and the reported amounts of assets and liabilities, income and expense. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from these estimates.

The most significant areas of judgements and estimates with regards to these financial statements are presented below:

### *Business models and SPPI*

The Bank assesse of the business model within which the assets are held and assesse of whether the contractual terms of the financial asset are solely payments of principal and interest on the principal amount outstanding (refer to note 4.4.2).

### *Measurement of fair values*

Management uses valuation techniques to determine the fair value of financial instruments (where active market quotes are not available) and non-financial assets. This involves developing estimates and assumptions consistent with how market participants would price the instrument. Management bases its assumptions on observable data as far as possible but this is not always available. In that case management uses the best information available. Estimated fair values may vary from the actual prices that would be achieved in an arm's length transaction at the reporting date (refer to note 32).

### *Useful Life of property and equipment*

Useful life evaluation of property and equipment is the result of judgement, based on the experience with similar assets. Future economic benefits are embodied in assets and mainly consumed along with usage. However, such factors as operational, technical or commercial depreciation often lead to decrease of asset's economic benefit. Management evaluates the remaining useful life according to the asset's current technical condition and estimated period, during which the Bank expects to receive benefits. For the evaluation of remaining useful life are considered the following main factors: expectable usage of assets, depending on the operational factors and maintenance program, that is depreciation and technical and commercial depreciation arising from the changes in the market conditions.

### *Related party transactions*

In the normal course of business, the Bank enters into transactions with its related parties. These transactions are priced predominantly at market rates. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis (refer to note 31).

### *Impairment of financial instruments*

The Bank assess of whether credit risk on the financial asset has increased significantly since initial recognition and incorporation of forward-looking information in the measurement of ECL (refer to note 35.1.2), as well as the key assumptions used in estimating recoverable cash flows (refer to note 4.4.6).

### *Tax legislation*

Armenian tax legislation is subject to varying interpretations. Refer to note 30.

## 6 Transition disclosure

The following set out the impact of adopting IFRS 9 on the statement of financial position, and retained earnings including the effect of replacing IAS 39's incurred credit loss calculations with IFRS 9's ECLs.

The following table shows the original measurement categories in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Bank's financial assets and financial liabilities as at 1 January 2018.

| In thousand Armenian drams | Original classification under IAS 39 | New classification under IFRS 9 | Original carrying amount under IAS 39 | New carrying amount under IFRS 9 |
|---|---|---|---|---|
| *Financial assets* | | | | |
| Cash and cash equivalents | Loans and receivables | Amortised cost | 18,812,252 | 18,812,252 |
| Derivative financial assets | FVTPL | FVTPL | 852 | 852 |
| Amounts due from financial institutions | Loans and receivables | Amortised cost | 8,620,732 | 8,561,631 |
| Loans and advances to customers including lease receivables | Loans and receivables | Amortised cost | 56,834,306 | 55,326,693 |
| Investment securities – debt | Available for sale | FVOCI | 5,933,944 | 5,933,944 |
| Investment securities – debt | Held to maturity | Amortised cost | 499,366 | 499,366 |
| Investment securities - equity | Available for sale | FVOCI | 42,825 | 42,825 |
| Securities pledged under repurchase agreements | Available for sale | FVOCI | 5,536,417 | 5,536,417 |
| Other financial assets | Loans and receivables | Amortised cost | 196,364 | 206,653 |
| Total financial assets | | | 96,477,058 | 94,920,633 |
| *Financial liabilities* | | | | |
| Amounts due to financial institutions | Amortised cost | Amortised cost | 13,531,924 | 13,531,924 |
| Amounts due to customers | Amortised cost | Amortised cost | 49,830,715 | 49,830,715 |
| Derivative financial assets | FVOCI | FVOCI | 20,400 | 20,400 |
| Other borrowings | Amortised cost | Amortised cost | 26,719 | 26,719 |
| Subordinated debt | Amortised cost | Amortised cost | 10,735,989 | 10,735,989 |
| Other financial liabilities | Amortised cost | Amortised cost | 625,997 | 625,997 |
| Total financial liabilities | | | 74,771,744 | 74,771,744 |

A reconciliation between the carrying amounts under IAS 39 to the balances reported under IFRS 9 as of 1 January 2018 is, as follows.

| In thousand Armenian drams | IAS 39 carrying amount 31 December 2017 | Reclassifi-cation | Remeasure-ment /ECL/ | IFRS 9 carrying amount 1 January 2018 |
|---|---|---|---|---|
| *Financial assets* | | | | |
| *Amortised cost* | | | | |
| *Cash and cash equivalents* | | | | |
| Opening balance | 18,812,252 | | | |
| Remeasurement | | - | - | |
| Closing balance | | | | 18,812,252 |

| In thousand Armenian drams | IAS 39 carrying amount 31 December 2017 | Reclassification | Remeasurement /ECL/ | IFRS 9 carrying amount 1 January 2018 |
|---|---|---|---|---|
| *Amounts due from financial institutions* | | | | |
| Opening balance | 8,620,732 | | | |
| Remeasurement | | - | (59,101) | |
| Closing balance | | | | 8,561,631 |
| *Loans and advances to customers* | | | | |
| Opening balance | 56,834,306 | | | |
| Remeasurement | | - | (1,507,613) | |
| Closing balance | | | | 55,326,693 |
| *Investment securities – debt* | | | | |
| Opening balance | - | | | |
| From held-to-maturity | | 499,366 | - | |
| Closing balance | | | | 499,366 |
| *Investment securities held to maturity* | 499,366 | | | |
| To amortised cost | | (499,366) | - | |
| Closing balance | - | - | | - |
| *Other financial assets* | | | | |
| Opening balance | 196,364 | | | |
| Remeasurement | | - | 10,289 | |
| Closing balance | | | | 206,653 |
| Total amortised cost | 84,963,020 | - | (1,556,425) | 83,406,595 |
| *Available-for-sale* | | | | |
| *Investment securities* | | | | |
| Opening balance | 11,513,186 | | | |
| To FVOCI – Equity | | (42,825) | - | |
| To FVOCI – Debt | | (5,933,944) | - | |
| To FVOCI – Debt under repurchase agreements | | (5,536,417) | - | |
| Closing balance | 11,513,186 | (11,513,186) | | - |
| *Investment securities at FVOCI* | | | | |
| Opening balance | - | | | |
| From available-for-sale | | 5,933,944 | | 5,933,944 |
| From equity instruments | | 42,825 | | 42,825 |
| From securities pedged under repurchase agreements | | 5,536,417 | | 5,536,417 |
| Closing balance | | 11,513,186 | - | 11,513,186 |
| Total FVOCI | - | 11,513,186 | | 11,513,186 |

| In thousand Armenian drams | IAS 39 carrying amount 31 December 2017 | Reclassifi-cation | Remeasure-ment /ECL/ | IFRS 9 carrying amount 1 January 2018 |
|---|---|---|---|---|
| FVTPL | | | | |
| *Financial derivatives* | 852 | - | - | 852 |
| Total FVTPL | 852 | - | - | 852 |
| | | | | |
| *Financial liabilities* | | | | |
| *Amortised cost* | | | | |
| *Amounts due to financial institutions* | 13,531,924 | - | - | 13,531,924 |
| *Amounts due to customers* | 49,830,715 | - | - | 49,830,715 |
| *Subordinated debt* | 10,735,989 | - | - | 10,735,989 |
| *Other borrowings* | 26,719 | | | 26,719 |
| *Other financial liabilities* | 625,997 | - | - | 625,997 |
| Total amortised cost | 74,751,344 | - | - | 74,751,344 |
| *FVTPL* | | | | |
| *Derivative liabilities* | 20,400 | - | - | 20,400 |
| Total FVTPL | 20,400 | - | - | 20,400 |

The impact of transition to IFRS 9 on reserves and retained earnings is as follows.

| In thousand Armenian drams | Reserves and retained earnings |
|---|---|
| *Fair value reserve* | |
| Closing balance under IAS 39 (31 December 2017) | 822,964 |
| Recognition of expected credit losses under IFRS 9 for debt financial assets at FVOCI | 43,519 |
| Deferred tax in relation to the above | |
| Opening balance under IFRS 9 (1 January 2018) | 866,483 |
| *Retained earnings* | |
| Closing balance under IAS 39 (31 December 2017) | 9,121,228 |
| Recognition of IFRS 9 ECLs including those measured at FVOCI (see below) | (1,599,944) |
| Deferred tax in relation to the above | 311,285 |
| Opening balance under IFRS 9 (1 January 2018) | 7,832,569 |
| | |
| Total change in equity due to adopting IFRS 9 | (1,245,140) |

The following table reconciles:

- the closing impairment allowance for financial assets in accordance with IAS 39 as of 31 December 2017; to
- the opening ECL allowance determined in accordance with IFRS 9 as at 1 January 2018.

| In thousand Armenian drams | Loan loss provision under IAS 39 at 31 December 2017 | Remeasurement | ECLs under IFRS 9 at 1 January 2018 |
|---|---|---|---|
| *Impairment allowance for* | | | |
| Amounts due from financial institutions | - | 59,101 | 59,101 |
| Loans and receivables s per IAS 39/financial assets at amortised cost under IFRS 9 | 757,270 | 1,507,613 | 2,264,883 |
| Available-for-sale debt investment securities per IAS 39/debt financial assets at FVOCI under IFRS 9 | - | 43,519 | 43,519 |
| Other financial assets | 22,839 | (10,289) | 12,550 |
| Total impairment allowance | 780,109 | 1,599,944 | 2,380,053 |

# 7 Interest and similar income and expense

| In thousand Armenian drams | 2018 | 2017 |
|---|---|---|
| Loans to customers | 7,042,400 | 4,978,311 |
| Investment securities at FVOCI (2017 available-for-sale) | 1,061,774 | 1,290,509 |
| Reverse repurchase transactions | 417,141 | 389,197 |
| Amounts due from financial institutions | 339,767 | 216,339 |
| Investment securities at amortised cost (2017 held-to-maturity) | 26,211 | 26,334 |
| Interest accrued on individually impaired financial assets | - | 12,178 |
| Total interest and similar income | 8,887,293 | 6,912,868 |
| Customer accounts | 2,221,597 | 1,887,606 |
| Repurchase transactions | 383,723 | 313,403 |
| Subordinated debt | 434,742 | 437,028 |
| Debt securities issued | 313,721 | 299,832 |
| Financial institutions accounts | 937,445 | 448,564 |
| Other borrowings | - | 9,957 |
| Total interest and similar expense | 4,291,228 | 3,396,390 |

## 8 Fee and commission income and expense

| In thousand Armenian drams | 2018 | 2017 |
|---|---|---|
| Settlement operations/transfers | 327,083 | 276,807 |
| Plastic cards operations | 236,626 | 131,101 |
| Cash operations | 54,253 | 47,516 |
| Other fees and commissions | 54,989 | 39,037 |
| Total fee and commission income | 672,951 | 494,461 |
| Cash/non-cash currency translation | 219,017 | 237,548 |
| Settlement operations/transfers | 173,490 | 131,409 |
| Plastic cards operations | 206,881 | 104,228 |
| Correspondent accounts maintenance | 39,724 | 50,539 |
| Other expenses | 6,484 | 2,287 |
| Total fee and commission expense | 645,596 | 526,011 |

## 9 Net trading income

| In thousand Armenian drams | 2018 | 2017 |
|---|---|---|
| Gains less losses from trading in foreign currencies | 848,323 | 728,192 |
| Fair value changes of trading liabilities | (114,265) | - |
| Gains less losses from foreign exchange translation of trading assets | 3,522 | - |
| Net losses from disposal of derivative instruments | (392) | (1,617) |
| Net gains/(losses) from revaluation of derivative instruments | 2,608 | (4,163) |
| Total net trading income | 739,796 | 722,412 |

## 10 Other income

| In thousand Armenian drams | 2018 | 2017 |
|---|---|---|
| Fines and penalties received | 69,081 | 52,458 |
| Income from issue of guarantees and letters of credit | 42,561 | 26,116 |
| Gains from grants relating to assets | 2,074 | 2,074 |
| Net income from sale of PPE | - | 2,057 |
| Income from dividends | 1,713 | 1,510 |
| Other income | 20,246 | 15,369 |
| Total other income | 135,675 | 99,584 |

## 11 Impairment losses/(reversal)

| In thousand Armenian drams | Note | 12-month ECL | Lifetime ECL not credit-impaired | Lifetime ECL credit-impaired | Total 2018 | Total 2017 |
|---|---|---|---|---|---|---|
| Cash and cash equivalents | 15 | - | - | - | - | 7,310 |
| Amounts due from financial institutions | 16 | 15 | - | - | 15 | - |
| Loans and advances to customers | 19 | 128,150 | (251,102) | 474,551 | 351,599 | 79,156 |
| Investment securities measured at FVOCI | 18 | 2,923 | - | - | 2,923 | - |
| Other assets | 22 | 1,754 | - | - | 1,754 | (13,355) |
| Total impairment losses/(reversal) | | 132,842 | (251,102) | 474,551 | 356,291 | 73,111 |

## 12 Staff costs

| In thousand Armenian drams | 2018 | 2017 |
|---|---|---|
| Compensations of employees, related taxes included | 1,754,506 | 1,416,855 |
| Staff training expenses | 6,455 | 10,515 |
| Other staff costs | 12,508 | 17,818 |
| Total staff costs | 1,773,469 | 1,445,188 |

## 13 Other expenses

| In thousand Armenian drams | 2018 | 2017 |
|---|---|---|
| Advertising costs | 283,554 | 305,811 |
| Communications | 139,739 | 83,553 |
| Repair and maintenance expenses of tangible assets | 133,314 | 125,667 |
| Foreign currency translation net losses of non-trading assets and liabilities | 128,529 | 40,659 |
| Deposit guarantee fund expenses | 124,451 | 86,586 |
| Net loss from disposal of other assets | 98,097 | 447,854 |
| Operating lease | 89,114 | 104,137 |
| Maintenance expenses of intangible assets | 76,881 | 75,573 |
| Security | 74,224 | 71,460 |
| Office supplies | 69,576 | 65,981 |
| Taxes, other than income tax, duties | 65,339 | 92,045 |
| Consulting and other services | 61,929 | 32,156 |
| Representative and organizational expenses | 46,663 | 183,250 |
| Cash collection expenses | 22,974 | 22,476 |
| Business trip expenses | 22,170 | 20,120 |
| Financial system mediator expenses | 10,596 | 9,215 |
| Net loss on disposal of property, equipment and Intangible assets | 3,253 | - |
| Other expenses | 77,663 | 34,722 |
| Total other expense | 1,528,066 | 1,801,265 |

## 14 Income tax expense

| In thousand Armenian drams | 2018 | 2017 |
|---|---|---|
| Current tax expense | 375,958 | 319,719 |
| Deferred tax | (40,594) | (42,723) |
| Total income tax expense | 335,364 | 276,996 |

The corporate income tax within the Republic of Armenia is levied at the rate of 20% (2017: 20%). Differences between IFRS and RA statutory tax regulations give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for profit tax purposes. Deferred income tax is calculated using the principal tax rate of 20%.

Numerical reconciliation between the tax expenses and accounting profit is provided below:

| In thousand Armenian drams | 2018 | Effective rate (%) | 2017 | Effective rate (%) |
|---|---|---|---|---|
| Profit before tax | 1,428,775 | | 776,706 | |
| Income tax at the rate of 20% | 285,755 | 20 | 155,341 | 20 |
| Non-taxable income | (27,752) | (2) | (302) | - |
| Non-deductible expenses | 51,655 | 4 | 113,825 | 14 |
| Foreign exchange losses | 25,706 | 2 | 8,132 | 1 |
| Income tax expense | 335,364 | 24 | 276,996 | 35 |

Deferred tax calculation in respect of temporary differences:

| In thousand Armenian drams | 2017 | Impact of adopting IFRS 9 | Recognized in profit or loss | Recognized in other comprehensive income | 2018 Net | 2018 Deferred tax asset | 2018 Deferred tax liability |
|---|---|---|---|---|---|---|---|
| Amounts due from financial institutions | (6,921) | 11,820 | (3,171) | - | 1,728 | 1,728 | - |
| Investments in securities | (205,739) | - | - | 4,337 | (201,402) | - | (201,402) |
| Loans and advances to customers | (90,189) | 301,523 | 22,503 | - | 233,837 | 233,837 | - |
| Property and equipment | (380,079) | - | 17,632 | - | (362,447) | - | (362,447) |
| Other assets | (15,029) | (2,058) | 3,544 | - | (13,543) | - | (13,543) |
| Other liabilities | 8,558 | - | 86 | - | 8,644 | 8,644 | - |
| Deferred tax asset/(liability) | (689,399) | 311,285 | 40,594 | 4,337 | (333,183) | 244,209 | (577,392) |

| In thousand Armenian drams | 31 December 2016 | Recognized in profit or loss | Recognized in other comprehensive income | 31 December 2017 |
|---|---|---|---|---|
| Other liabilities | 10,773 | (2,215) | - | 8,558 |
| Total deferred tax asset | 10,773 | (2,215) | - | 8,558 |
| Amounts due from financial institutions | (7,091) | 170 | - | (6,921) |
| Securities available-for-sale | (185,263) | - | (20,476) | (205,739) |
| Property and equipment | (380,714) | 635 | - | (380,079) |
| Loans to customers | (140,000) | 49,811 | - | (90,189) |
| Other assets | (9,351) | (5,678) | - | (15,029) |
| Total deferred tax liability | (722,419) | 44,938 | (20,476) | (697,957) |
| Net deferred tax liability | (711,646) | 42,723 | (20,476) | (689,399) |

# 15 Cash and cash equivalents

| In thousand Armenian drams | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Correspondent account with the CBA | 13,257,204 | 8,970,461 |
| Cash on hand | 9,227,728 | 7,704,022 |
| Correspondent accounts with banks | 603,559 | 637,214 |
| Deposits for less than 90 days with the CBA | - | 1,500,555 |
| Total cash and cash equivalents | 23,088,491 | 18,812,252 |

Correspondent account with Central Bank of Armenia represents the obligatory minimum reserve deposits with the CBA, which as of 31 December 2018 is computed at 2% (2017: 2%) of certain obligations of the Bank denominated in Armenian drams and 18% (2017: 18%) of certain obligations of the Bank, denominated in foreign currency and amounts to AMD 9,421,720 thousand (2017: AMD 8,088,892 thousand). There are no restrictions on the withdrawal of funds from the CBA, however, if mini mum average requirement is not met, the Bank could be subject to penalties. Mandatory reserve deposits in the CBA are non-interest bearing.

An analysis of changes in the ECLs on cash and cash equivalents as follows:

| In thousand Armenian drams | ECL/impairment |
|---|---|
| *Cash and cash equivalents* | |
| At 1 January 2017 | - |
| Net remeasurement of loss allowance | 7,310 |
| Amounts written off | (7,310) |
| Balance at 31 December 2017 | - |
| Net remeasurement of loss allowance | - |
| Balance at 31 December 2018 | - |

The ECLs relating to cash and cash equivalents here rounds to zero, that's why it's not disclosed here.

## 16 Amounts due from financial institutions

| In thousand Armenian drams | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Reverse repurchase agreements | 7,058,330 | 5,885,446 |
| Loans to banks | 754,740 | - |
| Loans to financial institutins | 4,088,008 | 2,076,366 |
| Deposited funds with CBA | 721,500 | 362,500 |
| Deposited funds in other banks and financial institutions | 133,425 | 70,821 |
| Other proceeds from financial institutions | 201,928 | 225,599 |
| | 12,957,931 | 8,620,732 |
| Less loss allowance on amounts due from other financial institutions | (67,478) | - |
| Total amounts due from other financial institutions | 12,890,453 | 8,620,732 |

Deposited funds with the CBA include a guaranteed deposit for settlements via ArCa payment system.

Blocked deposits with financial institutions represent a blocked deposit for membership in Master Card payment system (2017: either).

An analysis of changes in the ECLs on amount due from other financial institutions as follows:

| In thousand Armenian drams | 31 December 2018 | 31 December 2017 |
|---|---|---|
| | 12-month ECL | Total |
| *Amount due from other financial institutions* | | |
| ECL allowance as at 1 January 2018 | 59,101 | - |
| Net remeasurement of loss allowance | 15 | - |
| Net recovery | 8,362 | |
| Balance at 31 December | 67,478 | - |

Fair value of assets pledged and carrying value of loans under reverse repurchase agreements are presented as follows:

| In thousand Armenian drams | 2018 | | 2017 | |
|---|---|---|---|---|
| | Fair value of collateral | Carrying value of loans | Fair value of collateral | Carrying value of loans |
| RA state securities | 7,450,774 | 7,058,330 | 6,056,948 | 5,885,446 |
| Total assets pledged and loans under reverse repurchase agreements | 7,450,774 | 7,058,330 | 6,056,948 | 5,885,446 |

As of 31 December 2018 the Bank has securities acquired under repurchase agreements amounts to AMD 2,080,577 thousand (2017: nil) and their liability is accounted in “Trading liabilities” on the face of the statement of financial position) which were resold to third parties.

## 17 Derivative financial instruments

Currency and interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currencies. The Bank's credit risk represents the potential cost to replace the swap contracts if counterparties fail to fulfil their obligation.

The aggregate contractual or notional amount of derivative financial instruments on hand, the extent to which instruments are favourable or unfavourable, and thus the aggregate fair values of derivative financial assets and liabilities, can fluctuate significantly from time to time.

The fair values of derivative instruments held are set out below.

| In thousand Armenian drams | 31 December 2018 | | |
|---|---|---|---|
| | **Notional amount** | **Fair value of assets** | **Fair value of liabilities** |
| *Foreign exchange contracts* | | | |
| Foreign exchange swap contracts | 357,807 | 168 | - |
| Foreign exchange forward contracts | 1,176,593 | - | 13,600 |
| Total derivative financial instruments | 1,534,400 | 168 | 13,600 |

| In thousand Armenian drams | 31 December 2017 | | |
|---|---|---|---|
| | **Notional amount** | **Fair value of assets** | **Fair value of liabilities** |
| *Foreign exchange contracts* | | | |
| Foreign exchange swap contracts | 745,109 | 852 | - |
| Foreign exchange forward contracts | 1,916,000 | - | 20,400 |
| Total derivative financial instruments | 2,661,109 | 852 | 20,400 |

## 18 Investment securities

| In thousand Armenian drams | **31 December 2018** | **31 December 2017** |
|---|---|---|
| *Investment securities at amortised cost* | | |
| RA state bonds held to maturity | - | 499,366 |
| Corporate bonds at amortised cost | 496,231 | - |
| | 496,231 | 499,366 |
| *Investment securities measured at FVOCI* | | |
| RA state bonds measured at FVOCI | 287,411 | - |
| Corporate bonds measured at FVOCI | 1,424,265 | - |
| Shares in RA organizations measured at FVOCI | 42,825 | - |
| RA state bonds available-for-sale | - | 4,496,050 |
| Corporate bonds available-for-sale | - | 1,437,894 |
| Shares in RA organizations available-for-sale | - | 42,825 |
| Total investment securities measured at FVOCI (2017 Available-for-sale) | 1,754,501 | 5,976,769 |
| Debt investment securities measured at FVOCI (2017 available-for-sale) pledged under repurchase agreements | 7,608,062 | 5,536,417 |

An analysis of changes in the ECLs on debt investment securities measured at FVOCI, including pledged under repurchase agreements as follow:

| In thousand Armenian drams | 2018 | 2017 |
|---|---|---|
| | 12-month ECL | Total |
| ECL allowance as at 1 January 2018 | 43,519 | - |
| Net remeasurement of loss allowance | 2,923 | - |
| Balance at 31 December | 46,442 | - |

The above loss allowance is not recognised in the statement of financial position because the carrying amount of debt investment securities at FVOCI (2017: available-for-sale) is their fair value.

All debt securities have fixed coupons.

The Bank has not reclassified any financial assets measured at amortised cost rather than fair value during the year (2017: nil).

Investment securities measured at FVOCI (2017: available-for-sale) by effective interest rates and maturity date comprise:

| In thousand Armenian drams | 31 December 2018 | | 31 December 2017 | |
|---|---|---|---|---|
| | % | Maturity | % | Maturity |
| Government bonds | 7.19-16.39 | 2019-2036 | 10.3-16.39 | 2018-2036 |
| Corporate bonds | 10.16-13.15 | 2019-2022 | 5.42-13.15 | 2018-2022 |

Investment securities measured at amortised cost (2017: Held-to-maturity) upon profitability and maturity terms:

| In thousand Armenian drams | 31 December 2018 | | 31 December 2017 | |
|---|---|---|---|---|
| | % | Maturity | % | Maturity |
| RA state bonds | 5.42 | 2020 | 5.42 | 2020 |

The ECLs relating to investment securities at amortised cost rounds to zero, that's why it's not disclosed here.

## 19 Loans and advances to customers

| In thousand Armenian drams | 31 December 2018 | | | 31 December 2017 | | |
|---|---|---|---|---|---|---|
| | Gross carrying amount | ECL allowance | Carrying amount | Gross carrying amount | Impairment allowance | Carrying amount |
| *Mortgage and consumer lending* | | | | | | |
| Mortgage | 8,958,472 | (16,353) | 8,942,119 | 6,284,298 | (26,238) | 6,258,060 |
| Consumer lending | 16,519,614 | (995,724) | 15,523,890 | 4,296,396 | (65,708) | 4,230,688 |
| Overdrafts | 1,552,954 | (65,855) | 1,487,099 | 2,907,035 | (36,851) | 2,870,184 |
| Repurchase agreements | 91,763 | (104) | 91,659 | 887,014 | - | 887,014 |
| *Commercial lending* | | | | | | |
| Construction | 5,413,220 | (86,918) | 5,326,302 | 2,266,614 | (8,067) | 2,258,547 |
| Industry | 12,817,884 | (320,614) | 12,497,270 | 8,056,239 | (62,601) | 7,993,638 |
| Trading | 14,079,991 | (228,047) | 13,851,944 | 20,883,533 | (248,726) | 20,634,807 |
| Other | 18,322,228 | (618,038) | 17,704,190 | 12,010,447 | (309,079) | 11,701,368 |
| Total | 77,756,126 | (2,331,653) | 75,424,473 | 57,591,576 | (757,270) | 56,834,306 |

The ECL allowance in these tables includes ECL on loan commitments for products such as credit cards and overdrafts, because the Bank cannot separately identify the ECL on the loan commitment component from those on the financial instrument component.

During the year ended 31 December 2018 the Bank obtained assets by taking possession of collateral for loans and advances to customers. As of 31 December 2018 the carrying amount of such assets was AMD 728,114 thousand (2017: AMD 182 thousand). The Bank is intended to sell these assets in a short period.

As of 31 December 2018 the weighted average effective interest rates on loans and advances to customers was 13.80% for loans in AMD (2017: 15.8%) and 8.82 % for loans in USD, EUR and other freely convertible currencies (2017: 9.18%).

As of 31 December 2018 the Bank had five borrowers and groups of related parties (2017: three), whose loan balances exceed 10% of equity (26.55% of gross loan portfolio). The gross value of these loans as of 31 December 2018 amounts to AMD 20,649,984 thousand (2017: AMD 19,446,703 thousand, 34.26% of gross loan portfolio provided to four borrowers and groups of related parties). Loss allowances on these loans amounts to AMD 263,239 thousand (2017: AMD 64,154 thousand).

The Bank accepted securities as collateral for commercial loans, which it is permitted to sell or repledge. Fair value of assets pledged and carrying value of loans under reverse repurchase agreements as of 31 December 2018 are presented as follows:

| In thousand Armenian drams | 31 December 2018 | | 31 December 2017 | |
|---|---|---|---|---|
| | Fair value of collateral | Carrying value of loans | Fair value of collateral | Carrying value of loans |
| RA state bonds | 94,417 | 91,763 | 973,647 | 887,014 |
| Total securities and loans under reverse repurchase agreements | 94,417 | 91,763 | 973,647 | 887,014 |

An analysis of changes in ECL allowances in relation to mortgage and consumer lending and commercial lending are as follows.

| In thousand Armenian drams | | | | 2018 |
|---|---|---|---|---|
| | 12-month ECL | Lifetime ECL not credit-impaired | Lifetime ECL credit-impaired | Total |
| *Mortgage and consumer lending* | | | | |
| ECL allowance as at 1 January 2018 | 52,240 | 30,529 | 33,851 | 116,620 |
| Changes due to financial assets recognised in opening balance that have: | | | | |
| Transfer to 12-month ECL | 1,125 | (283) | (842) | - |
| Transfer to Lifetime ECL not credit-impaired | (28,875) | 29,867 | (992) | - |
| Transfer to Lifetime ECL credit-impaired | - | (2,143) | 2,143 | - |
| Net remeasurement of loss allowance | 411,474 | 118,160 | 613,254 | 1,142,888 |
| Recoveries | - | - | 144,338 | 144,338 |
| Amounts written off during the year | - | - | (325,810) | (325,810) |
| Balance at 31 December | 435,964 | 176,130 | 465,942 | 1,078,036 |

| In thousand Armenian drams | | | | 2018 |
|---|---|---|---|---|
| | 12-month ECL | Lifetime ECL not credit-impaired | Lifetime ECL credit-impaired | Total |
| *Commercial lending* | | | | |
| ECL allowance as at 1 January 2018 | 722,410 | 574,016 | 851,837 | 2,148,263 |
| Changes due to financial assets recognised in opening balance that have: | | | | |
| Transfer to 12-month ECL | 370 | (244) | (126) | - |
| Transfer to Lifetime ECL not credit-impaired | - | 94,739 | (94,739) | - |
| Transfer to Lifetime ECL credit-impaired | - | (13,659) | 13,659 | - |
| Net remeasurement of loss allowance | (283,324) | (369,262) | (138,703) | (791,289) |
| Recoveries | - | - | 717,697 | 717,697 |
| Amounts written off during the year | - | - | (821,054) | (821,054) |
| Balance at 31 December 2018 | 439,456 | 285,590 | 528,571 | 1,253,617 |

The increase in ECLs of the portfolio was driven by an increase in the gross size of the portfolio and movements between stages as a result of increases in credit risk and a deterioration in economic conditions. Further analysis of economic factors is outlined in note 35.1.2

An analysis of the allowance for impairment losses under IAS 39 for loans and advances, by class, for the year to 31 December 2017 is, as follows

| In thousand Armenian drams | | | 2017 |
|---|---|---|---|
| | Mortgage and consumer lending | Commercial lending | Total |
| At 1 January 2017 | 146,075 | 568,429 | 714,504 |
| Charge for the year | 29,284 | 49,872 | 79,156 |
| Net (amounts written off)/recoveries | (46,562) | 10,172 | (36,390) |
| At 31 December 2017 | 128,797 | 628,473 | 757,270 |
| | | | |
| Individual impairment | 43,954 | 453,917 | 497,871 |
| Collective impairment | 84,843 | 174,556 | 259,399 |
| | 128,797 | 628,473 | 757,270 |
| Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance | 91,007 | 826,791 | 917,798 |

As of 31 December 2018, loans to customers in amount of AMD 3,917,976 thousand (2017: AMD 2,836,193 thousand) serve as collateral for loans due to financial institutions.

Maturity analysis of loans and advances to customers are disclosed in note 34.

Credit, currency and interest rate analyses of loans and advances to customers are disclosed in note 35. Information on related parties is disclosed in note 31.

# 20 Property and equipment

| In thousand Armenian drams | Land and buildings | Leasehold improve-ments | Computer equipment | Vehicles | Office equipment | Capital investments on property and equipment | Intangible assets | Total |
|---|---|---|---|---|---|---|---|---|
| *Cost* | | | | | | | | |
| At 1 January 2017 | 4,098,684 | 109,623 | 714,707 | 132,487 | 491,386 | 79,642 | 154,996 | 5,781,525 |
| Additions | 526,698 | 5,325 | 285,286 | 15,862 | 172,064 | 249,417 | 58,772 | 1,313,424 |
| Disposals | (2,652) | (49,223) | (29,153) | (8,500) | (112,605) | (2,997) | (3,636) | (208,766) |
| Reclassification | 290,283 | 35,779 | - | - | - | (326,062) | - | - |
| At 31 December 2017 | 4,913,013 | 101,504 | 970,840 | 139,849 | 550,845 | - | 210,132 | 6,886,183 |
| Additions | - | 30,259 | 226,282 | 18,763 | 77,821 | - | 59,787 | 412,912 |
| Disposals | - | (38,503) | (17,482) | | (41,460) | - | (12,830) | (110,275) |
| At 31 December 2018 | 4,913,013 | 93,260 | 1,179,640 | 158,612 | 587,206 | - | 257,089 | 7,188,820 |
| *Accumulated depreciation* | | | | | | | | |
| At 1 January 2017 | 190,181 | 95,414 | 389,086 | 55,898 | 423,329 | | 103,255 | 1,257,163 |
| Charge for the year | 75,054 | 9,529 | 109,823 | 21,849 | 32,698 | | 15,750 | 264,703 |
| Disposals | (4) | (46,624) | (20,649) | (8,500) | (112,226) | - | (3,636) | (191,639) |
| At 31 December 2017 | 265,231 | 58,319 | 478,260 | 69,247 | 343,801 | - | 115,369 | 1,330,227 |
| Charge for the year | 168,191 | 9,912 | 177,266 | 16,229 | 45,807 | - | 21,726 | 439,131 |
| Disposals | - | (38,379) | (17,482) | - | (41,340) | - | (9,824) | (107,025) |
| At 31 December 2018 | 433,422 | 29,852 | 638,044 | 85,476 | 348,268 | - | 127,271 | 1,662,333 |
| *Carrying amount* | | | | | | | | |
| At 31 December 2017 | 4,647,782 | 43,185 | 492,580 | 70,602 | 207,044 | - | 94,763 | 5,555,956 |
| At 31 December 2018 | 4,479,591 | 63,408 | 541,596 | 73,136 | 238,938 | - | 129,818 | 5,526,487 |

### *Revaluation of assets*

The lands and buildings owned by the Bank were revaluated by an independent appraiser on 19 December 2014 using a combination of the market, income and cost methods resulting in a revaluation of AMD 2,022,783 thousand. Management have based their estimate on the results of the independent appraisal.

Additions to buildings included reclassified assets from repossessed assets at the amount of AMD 507,104 thousand.

For the fair value measurement and movement of PPE see note 32.3

The management believes that at 31 December 2018 the fair value of the buildings does not differ significantly from their revalued amounts.

If the net book value of revalued buildings that would have been recognised under the historic cost, the carrying amounts will be presented as follows:

In thousand Armenian drams

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Cost | 2,032,627 | 2,032,627 |
| Accumulated depreciation | (675,106) | (620,895) |
| Carrying amount | 1,357,521 | 1,411,732 |

### *Fully depreciated items*

As of 31 December 2018 fixed assets and intangible assets included fully depreciated assets at the amount of AMD 530,009 thousand (2017: AMD 571,807 thousand).

### *Restrictions on title of fixed assets and intangible assets*

As of 31 December 2018, the Bank does not possess any fixed assets and intangible assets pledged as security for liabilities or whose title is otherwise restricted.

### *Contractual commitments*

As of 31 December 2018 the Bank had contractual commitments of making investments in fixed assets and intangible assets at the amount AMD 8,880 thousand (2017: nil)

## 21 Repossessed assets

Details of confiscated assets serving as collateral for loans issued by the Bank at 31 December are presented below.

In thousand Armenian drams

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Real estate | 2,881,904 | 2,890,995 |
| Vehicles | 2,391 | - |
| Other assets | 24,900 | 30,912 |
| Total repossessed assets | 2,909,195 | 2,921,907 |

At the date of confiscation the collateral is measured at the lower of the carrying amount of non-repaid loan liabilities and the fair value of collateral.

It is the Bank's policy to properly and timely dispose the collateral. The Bank does not principally use non-cash collaterals for carrying out its activity. Assets are measured at the lower of carrying amount and fair value less costs to sell.

## 22 Other assets

| In thousand Armenian drams | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Receivables and other proceeds | 263,835 | 159,419 |
| Proceeds on cash transfers | 114,075 | 59,784 |
| Other financial assets | 377,910 | 219,203 |
| Less allowance for assets impairment | (12,703) | (22,839) |
| Total other financial assets | 365,207 | 196,364 |
| Prepayments | 132,597 | 182,529 |
| Materials | 55,354 | 42,627 |
| Other | 46,498 | 25,044 |
| Total non-financial assets | 234,449 | 250,200 |
| Total other assets | 599,656 | 446,564 |

An analysis of changes in the ECLs/ (impairment) on other assets is as follows:

| In thousand Armenian drams | 2018 | 2017 |
|---|---|---|
| | ECL | Total |
| *Other financial assets* | | |
| ECL allowance as at 1 January 2018/(Loss allowance at 1 January 2017) | 12,550 | 9,632 |
| Net remeasurement of loss allowance | 1,754 | (13,355) |
| Net (amounts written off)/recovery | (1,601) | 26,562 |
| Balance at 31 December | 12,703 | 22,839 |

## 23 Amounts due to financial institutions

| In thousand Armenian drams | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Repurchase agreements with the CBA | 6,089,068 | - |
| Repurchase agreements with banks | 1,226,003 | 5,436,004 |
| Loans from banks and other financial institutions | 5,862,367 | 4,446,962 |
| Deposits from financial institutions | 10,187,058 | 3,452,983 |
| Current accounts of banks and oher financial institutions | 152,630 | 195,975 |
| Total amounts due to financial institutions | 23,517,126 | 13,531,924 |

Loans from financial institutions have fixed interest rates.

As of 31 December 2018 the weighted average effective interest rates on amounts due to financial institutions were 7.4% for borrowings in AMD (2017: 8.04%), and 5.82% for loans in USD, EUR and other freely convertible currencies (2017: 7.14%).

As of 31 December 2018 the Bank had two borrowers (as of 31 December 2017: one), whose deposit and loan balances exceed 10% of equity. The total amount of such loans as of 31 December 2018 was AMD 10,972,132 thousand (2017: AMD 3,285,312 thousand)

The Bank has not had any defaults of principal, interest or other breaches with respect to its liabilities during the period (2017: either).

## 24 Trading financial liabilities

In thousand Armenian drams

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Securities from financial institutions (note 16) | 2,080,577 | - |
| Total trading financial liabilities | 2,080,577 | - |

## 25 Amounts due to customers

In thousand Armenian drams

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| *Legal entities* | | |
| Current/Settlement accounts | 9,370,775 | 9,743,148 |
| Time deposits | 5,052,238 | 4,714,085 |
| | 14,423,013 | 14,457,233 |
| *Individuals* | | |
| Current/Settlement accounts | 10,300,367 | 5,963,385 |
| Time deposits | 39,210,162 | 29,410,097 |
| | 49,510,529 | 35,373,482 |
| Total amounts due to customers | 63,933,542 | 49,830,715 |

As of 31 December 2018 time deposits of legal entities / individuals are deposits amounting to AMD 6,579,069 thousand (2017: AMD 984,255 thousand) held as security against loans to customers, guarantees issued and other transaction related contingent obligations. The fair value of those deposits approximates the carrying amount.

As of 31 December 2018 the Bank had only one group of related customers (2017: three), whose loan balances exceed 10% of equity. The gross value of these loans as of 31 December 2018 amounted to AMD 9,193,928 thousand (2017: AMD 16,920,400 thousand).

As of 31 December 2018 the weighted average effective interest rates on amounts due to customers was 10% for borrowings in AMD (2017: 10%), 5.23% for borrowings in USD, EUR (2017: 6%) and 6.4% for borrowings in Ruble (2017: 6.84%).

## 26 Other borrowings

| In thousand Armenian drams | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Loans from the CBA | - | 26,719 |
| Total other borrowings | - | 26,719 |

Loans from the RA Government and the CBA include loans received within the frames of "Small and Medium Loaning program" of the German Armenian fund.

The weighted average effective interest rate of the attracted loan was 7.5% at 31 December 2017.

The Bank has not had any defaults of principal, interest or other breaches.

## 27 Subordinated debt

| In thousand Armenian drams | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Subordinated debt from individuals | 4,908,790 | 4,912,334 |
| Bonds issued | 5,558,132 | 5,823,655 |
| Total subordinated debt | 10,466,922 | 10,735,989 |

Subordinate debt represents a long term borrowing agreement, which, in case of the Bank's default, would be secondary to the Bank's other obligations, including deposits and other debt instruments.

During 2016 The Bank has received a subordinated debt in amount of US dollar 10,000 thousand maturing in 2026. The interest rate is 9% (Refer to note 31).

During 2015 10,000 subordinated coupon bonds have been issued with nominal value of Euro 1000, 5.5% of interest rate and maturity up to 2020.

The Bank has not had any defaults of principal, interest or other breaches with respect to its liabilities during the period (2017: nil).

## 28 Other liabilities

| In thousand Armenian drams | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Dividend liabilities | 426,000 | 426,000 |
| Accounts payables | 165,740 | 102,590 |
| Due to personnel | 93,517 | 97,407 |
| Total other financial liabilities | 685,257 | 625,997 |
| Tax payable, other than income tax | 215,266 | 127,133 |
| Grants related to assets | 47,706 | 49,780 |
| Other | 7,546 | 4,615 |
| Total other non-financial liabilities | 270,518 | 181,528 |
| Total other liabilities | 955,775 | 807,525 |

### *Grants related to assets*

| In thousand Armenian drams | 2018 | 2017 |
|---|---|---|
| At 1 January | 49,780 | 51,854 |
| Recognition of income | (2,074) | (2,074) |
| At 31 December | 47,706 | 49,780 |

## 29 Equity

As at 31 December 2018 the Bank's registered and paid-in charter capital was AMD 17,950,000 thousand. In accordance with the Bank's statues, the share capital consists of 144,000 ordinary shares, all of which have a par value of AMD 100,000 each and 35,500 non-redeemable preference shares, all of which have a par value of AMD 100,000 each.

The respective shareholdings as of 31 December 2018 and 2017 may be specified as follows:

| In thousand Armenian drams | 31 December 2018 | | 31 December 2017 | |
|---|---|---|---|---|
| | Paid-in share capital | % of total paid-in capital | Paid-in share capital | % of total paid-in capital |
| "ZakNefteGazStroy Prometey" OJSC | - | - | 6,642,000 | 37.0 |
| Vazgen Gevorgyan | - | - | 561,600 | 3.13 |
| "Prometey City" LLC | 17,196,100 | 95.80 | 10,746,400 | 59.87 |
| Other shareholders | 753,900 | 4.20 | - | - |
| | 17,950,000 | 100 | 17,950,000 | 100 |

As of 31 December 2018, the Bank did not possess any of its own shares.

The holders of ordinary shares are entitled to receive dividends as declared and are entitled to one vote per share at annual and general meetings of the Bank.

In 2018 the shareholders of the Bank has not increased its share capital (2017: either).

In 2018 the Bank accrued dividends totaling AMD 426,000 thousand on preferred shares (2017: AMD 434,170 thousand).

Distributable among participants reserves equal the amount of retained earnings, determined according to the Armenian legislation. Non-distributable reserves are represented by a reserve fund, which is created as required by the statutory regulations, in respect of general banking risks, including future losses and other unforeseen risks or contingencies. The reserve has been created in accordance with the Bank's statutes that provide for the creation of a reserve for these purposes of not less than 5 % of the Bank's charter capital reported in statutory books.

## 30 Contingent liabilities and commitments

### *Tax and legal matters*

The taxation system in Armenia is relatively new and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are sometimes unclear, contradictory and subject to varying interpretation. Taxes are subject to review and investigation by tax authorities, which have the authority to impose fines and penalties. In the event of a breach of tax legislation, no liabilities for additional taxes, fines or penalties may be imposed by tax authorities once three years have elapsed from the date of the breach.

These circumstances may create tax risks in Armenia that are more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Armenian tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on these financial statements, if the authorities were successful in enforcing their interpretations, could be significant. Management believes that the Bank has complied with all regulations and has completely settled all its tax liabilities.

Management believes that the Bank has complied with all regulations and has completely settled all its tax liabilities.

Management also believes that the ultimate liability, if any, arising from legal actions and complaints taken against the Bank, will not have a material adverse impact on the financial condition or results of future operations of the Bank.

### *Loan commitments and financial guarantees*

In the normal course of business, the Bank is a party to financial instruments with off-balance sheet risk in order to meet the needs of its customers.  These instruments, involving varying degrees of credit risk, are not reflected in the statement of financial position.

As of 31 December the nominal or contract amounts were:

| In thousand Armenian drams | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Undrawn loan commitments | 3,376,304 | 3,741,993 |
| Guarantees | 1,872,576 | 2,136,265 |
| Total commitments and contingent liabilities | 5,248,880 | 5,878,258 |

The ECL allowance on loans includes ECL on loan commitments for products such as credit cards and overdrafts, because the Bank cannot separately identify the ECL on the loan commitment component from those on the financial instrument component.

The ECL relating to financial guarantees rounds to zero, that's why it's not disclosed here.

### *Operating lease commitments – Bank as a lessee*

In the normal course of business the Bank enters into commercial lease agreements for office territory.

The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

| In thousand Armenian drams | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Not later than 1 year | 25,903 | 19,471 |
| Total operating lease commitments | 25,903 | 19,471 |

Information on the Bank’s capital nature contractual commitments is disclosed in note 20.

## 31 Transactions with related parties

In accordance with IAS 24 Related Party Disclosures, parties are considered to be related if one party has ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. For the purpose of the present financial statements, related parties include participants, members of Bank's Management as well as other persons and enterprises related with and controlled by them respectively.

The ultimate participant of the Bank is Vazgen Gevorgyan, who is related with other shareholders of the Bank.

A number of banking transactions are entered into with related parties in the normal course of business. These transactions were carried out on commercial terms and at market rates.

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

| In thousand Armenian drams | 2018 | | 2017 | |
|---|---|---|---|---|
| | **Shareholders and parties related with them** | **Key management personnel and parties related with them** | **Shareholders and parties related with them** | **Key management personnel and parties related with them** |
| *Statement of financial position* | | | | |
| *Loans and advances to customers* | | | | |
| Loans outstanding at 1 January | - | 218,492 | 99,596 | 362,671 |
| Loans issued during the year | 4,916,410 | 707,197 | 2,552 | 493,690 |
| Loan repayments during the year | (205,523) | (508,648) | (102,148) | (637,869) |
| Loans outstanding at 31 December | 4,710,887 | 417,041 | - | 218,492 |
| Less allowance for loan impairment | (2,826) | (940) | - | (2,185) |
| Loans outstanding at 31 December | 4,708,061 | 416,101 | - | 216,307 |
| *Amounts due to customers* | | | | |
| At 1 January | 3,139,533 | 717,900 | 1,172,422 | 1,077,180 |
| Received during the year | 22,394,073 | 4,184,701 | 6,004,534 | 2,845,890 |
| Repayments during the year | (19,034,895) | (3,660,557) | (4,037,423) | (3,205,170) |
| At 31 December | 6,498,711 | 1,242,044 | 3,139,533 | 717,900 |
| *Subordinated debt* | 4,908,789 | - | 4,912,334 | - |
| *Statement of profit or loss and other comprehensive income* | | | | |
| Interest income on loans | 222,137 | 28,932 | - | 24,164 |
| Impairment losses/(reversal) | 2,826 | (1,245) | 996 | 1,442 |
| Interest expense on deposits | (269,126) | (49,139) | (112,006) | (48,671) |
| Interest expense on subordinated debt | (434,737) | - | (434,377) | - |
| Commission income | 3,431 | 1,345 | 636 | 530 |
| Net gains/(losses) from derivative instruments | 2,608 | - | (2,016) | - |
| Other income | 15,799 | 2,561 | 377 | 867 |
| Other operating expenses | (20,531) | (6,779) | (58) | (4,475) |

Compensation of key management personnel was comprised of the following:

| In thousand Armenian drams | 2018 | 2017 |
|---|---|---|
| Salaries and bonuses | 540,926 | 393,488 |
| Total key management compensation | 540,926 | 393,488 |

The loans issued to parties related with the Bank are repayable over 1-15 years and have effective interest rates of 6-18% (2017: 7-24%).

# 32 Fair value measurement

The Bank's management determines the policies and procedures for both recurring fair value measurement, such as unquoted trading and available-for-sale securities, unquoted derivatives and for non-recurring measurement, such as assets held for sale.

External valuers are involved for valuation of significant assets, such as properties and repossessed assets. Involvement of external valuers is decided upon annually by the Bank's Board.

Financial and non-financial assets and liabilities measured at fair value in the statement of financial position are presented below.  This hierarchy groups financial and non-financial assets and liabilities into three levels based on the significance of inputs used in measuring the fair value of the financial assets and liabilities. The fair value hierarchy has the following levels:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities

- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset and liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)

- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

## 32.1 Financial instruments that are not measured at fair value

The table below presents the fair value of financial assets and liabilities not measured at their fair value in the statement of financial position and analyses them by the level in the fair value hierarchy into which teach fair value measurement is categorised.

| In thousand Armenian drams | | | | | 31 December 2018 |
|---|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total fair values | Total carrying amount |
| *Financial assets* | | | | | |
| Cash and cash equivalents | - | 23,088,491 | - | 23,088,491 | 23,088,491 |
| Amounts due from financial institutions | - | 12,890,453 | - | 12,890,453 | 12,890,453 |
| Loans and advances to customers | - | 75,216,193 | - | 75,216,193 | 75,424,473 |
| Investment securities at amortised cost | - | 482,784 | - | 482,784 | 496,231 |
| Other assets | - | 365,207 | - | 365,207 | 365,207 |
| *Financial liabilities* | | | | | |
| Amounts due to financial institutions | - | 23,517,126 | - | 23,517,126 | 23,517,126 |
| Amounts due to customers | - | 63,933,542 | - | 63,933,542 | 63,933,542 |
| Subordinated debt | - | 10,466,922 | - | 10,466,922 | 10,466,922 |
| Other liabilities | - | 685,257 | - | 685,257 | 685,257 |

| In thousand Armenian drams | 31 December 2017 | | | | |
|---|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total fair values | Total carrying amount |
| *Financial assets* | | | | | |
| Cash and cash equivalents | - | 18,812,252 | - | 18,812,252 | 18,812,252 |
| Amounts due from financial institutions | - | 8,620,732 | - | 8,620,732 | 8,620,732 |
| Loans and advances to customers | - | 56,834,306 | - | 56,834,306 | 56,834,306 |
| Investments held to maturity | - | 513,630 | - | 513,630 | 499,366 |
| Other assets | - | 196,364 | - | 196,364 | 196,364 |
| *Financial liabilities* | | | | | |
| Amounts due to financial institutions | - | 13,531,924 | - | 13,531,924 | 13,531,924 |
| Amounts due to customers | - | 49,830,715 | - | 49,830,715 | 49,830,715 |
| Subordinated debt | - | 10,735,989 | - | 10,735,989 | 10,735,989 |
| Other borrowings | - | 26,719 | - | 26,719 | 26,719 |
| Other liabilities | - | 625,997 | - | 625,997 | 625,997 |

### *Amounts due from and to financial institutions*

For assets and liabilities maturing within one month, the carrying amount approximates fair value due to the relatively short-term maturity of these financial instruments. For the assets and liabilities maturing in over one month, the fair value was estimated as the present value of estimated future cash flows discounted at the appropriate year-end market rates, which are mainly the same as current interest rates.

### *Loans to customers*

The fair value of floating rate instruments is normally their carrying amount. The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Discount rates used depend on credit risk of the counterparty and ranged from 5.5% to 24% per annum (2017: 5.5% to 24% per annum). îhe fair value of the impaired loans is calculated based on expected cash flows from the sale of collateral. The value of collateral is based on appraisals performed by independent, professionally-qualified property valuers.

### *Due to financial institutions and customers*

The fair value of deposits from financial institutions and customers is estimated using discounted cash flow techniques, applying the rates that are offered for deposits of similar maturities and terms. The fair value of deposits payable on demand is the amount payable at the reporting date.

### *Other borrowings*

The fair value of borrowings with fixed and unquoted interest rates is set based on the calculation of future cash flows, which are discounted applying the rates that are offered new debt instruments of similar maturities and terms.

## 33.2 Financial instruments that are measured at fair value

| In thousand Armenian drams | 31 December 2018 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| *Financial assets* | | | | |
| Financial and non-financial bonds | 990,003 | 721,673 | - | 1,711,676 |
| Equity instruments | - | 42,825 | - | 42,825 |
| Securities pledged under repurchase agreements | - | 7,608,062 | - | 7,608,062 |
| Derivative financial assets | - | 168 | - | 168 |
| Total | 990,003 | 8,372,728 | - | 9,362,731 |
| *Financial liabilities* | | | | |
| Trading financial liabilities | - | 2,080,577 | - | 2,080,577 |
| Derivative financial liabilities | - | 13,600 | - | 13,600 |
| Total | - | 2,094,177 | - | 2,094,177 |
| Net fair value | 990,003 | 6,278,551 | - | 7,268,554 |

| In thousand Armenian drams | 31 December 2017 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| *Financial assets* | | | | |
| Financial and non-financial bonds | 990,137 | 4,943,807 | - | 5,933,944 |
| Securities pledged under repurchase agreements | - | 5,536,417 | - | 5,536,417 |
| Derivative financial assets | - | 852 | - | 852 |
| Total | 990,137 | 10,481,076 | - | 11,471,213 |
| *Financial liabilities* | | | | |
| Derivative financial liabilities | - | 20,400 | - | 20,400 |
| Total | - | 20,400 | - | 20,400 |
| Net fair value | 990,137 | 10,460,676 | - | 11,450,813 |

There have been no transfers between levels 1 and 2 in the reporting period.

The methods and valuation techniques used for the purpose of measuring fair value are unchanged compared to the previous reporting period.

### *Quoted investments*

All the listed securities and bonds have been issued by publicly traded companies in Armenia.

### *Unquoted debt securities*

The fair value of unquoted debt securities at FVOCI is measured using a valuation technique, which uses current market rates to discount future cash flows of the financial instruments.

### *Unquoted equity investments*

For determining the fair value of unquoted equity instruments the Bank uses a combination of market and income approaches. The market approach and the income approach are common valuation techniques for equity investments that are not publicly traded. Under the market approach, the Bank uses prices and other relevant information generated by market transactions involving identical or comparable securities. Under the income approach, future amounts are converted into a single present amount (e.g. a discounted cash flows model). The market approach is preferred as the main inputs used are typically observable. In 2017 unquoted equity instruments were measured at cost and were therefore excluded from this disclosure.

### *Derivatives*

Where derivatives are traded either on exchanges or liquid over-the-counter market the Bank uses the closing price at the reporting date.

Normally, the derivatives entered into by the Bank are not traded in active markets. The fair values of these contracts are estimated using valuation techniques that maximises the use of observable market inputs, eg. market exchange rates (Level 2). Most derivatives entered into by the Bank are included in Level 2.

## 33.3 Fair value measurement of non-financial assets and liabilities

| In thousand Armenian drams | | | | **31 December 2018** |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| *Non-financial assets* | | | | |
| Property, and equipment | | | | |
| *Buildings and land* | - | - | 4,913,013 | 4,913,013 |
| Total | - | - | 4,913,013 | 4,913,013 |
| Net fair value | - | - | 4,913,013 | 4,913,013 |

| In thousand Armenian drams | | | | **31 December 2017** |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| *Non-financial assets* | | | | |
| Property and equipment | | | | |
| *Buildings and land* | - | - | 4,913,013 | 4,913,013 |
| Total | - | - | 4,913,013 | 4,913,013 |

Fair value of the Group's main property assets is estimated based on appraisals performed by independent, professionally-qualified property valuers. The significant inputs and assumptions are developed in close consultation with management. The valuation processes and fair value changes are reviewed by the board of directors and audit committee at each reporting date.

The land and building were revalued by an independent appraiser on 19 December 2014 using a combination of the market, income and cost methods.

### *Fair value measurements in Level 3*

The Bank's non-financial assets and liabilities classified in Level 3 uses valuation techniques based on significant inputs that are not based on observable market data.

The non- financial assets within this level can be follows:

| In thousand Armenian drams | 2018 | 2017 |
|---|---|---|
| Balance as of 1 January 2018 | 4,913,013 | 4,098,684 |
| Purchases and reclassification | - | 816,981 |
| Sales | - | (2,652) |
| Net fair value as of 31 December | 4,913,013 | 4,913,013 |

## 33 Offsetting of financial assets and financial liabilities

In the ordinary course of business, the Bank performs different operations with financial instruments which may be presented in net amounts 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 realise the asset and settle the liability simultaneously.

The table below presents financial assets and financial liabilities that are offset in the statement of financial position or are subject to an enforceable master netting arrangement or similar agreement that covers similar financial instruments, irrespective of whether they are offset in the statement of financial position.

| In thousand Armenian drams | 31 December 2018 | | | | | |
|---|---|---|---|---|---|---|
| | | | | Related amounts that are not offset in the statement of financial position | | |
| | Gross amount of recognised financial assets/ liabilities | Gross amount of recognised financial assets/ liabilities in the statement of financial position | Net amount of financial liabilities in the statement of financial position | Financial instruments in the statement of financial position | Cash collateral received | Net |
| *Financial assets* | | | | | | |
| Reverse repurchase agreements (note 16, 19) | 7,150,093 | - | 7,150,093 | 7,150,093 | - | - |
| *Financial liabilities* | | | | | | |
| Repurchase agreements (note 18, 23) | 7,315,071 | - | 7,315,071 | 7,608,062 | - | (292,991) |

| In thousand Armenian drams | 31 December 2017 | | | | | |
|---|---|---|---|---|---|---|
| | | | | Related amounts that are not offset in the statement of financial position | | |
| | Gross amount of recognised financial assets/ liabilities | Gross amount of recognised financial assets/ liabilities in the statement of financial position | Net amount of financial liabilities in the statement of financial position | Financial instruments in the statement of financial position | Cash collateral received | Net |
| *Financial assets* | | | | | | |
| Reverse repurchase agreements (note 16, 19) | 6,772,460 | - | 6,772,460 | 6,772,460 | - | - |
| *Financial liabilities* | | | | | | |
| Repurchase agreements (note 18, 23) | 5,436,004 | - | 5,436,004 | 5,536,417 | - | (100,413) |

## 34 Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities analyzed according to when they are expected to be recovered or settled. Refer to note 35.3 for the Bank's contractual undiscounted repayment obligations.

| In thousand Armenian drams | 31 December 2018 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Demand and less than 1 month | From 1 to 12 months | Subtotal less than 12 months | From 1 to 5 years | More than 5 years | Subtotal over 12 months | Total |
| *Assets* | | | | | | | |
| Cash and cash equivalents | 23,088,491 | - | 23,088,491 | - | - | - | 23,088,491 |
| Amounts due from financial institutions | 8,093,830 | 4,257,371 | 12,351,201 | 539,252 | - | 539,252 | 12,890,453 |
| Derivative financial assets | 168 | - | 168 | - | - | - | 168 |
| Loans and advances to customers | 1,853,446 | 18,893,273 | 20,746,719 | 40,183,526 | 14,494,228 | 54,677,754 | 75,424,473 |
| Investment securities | | | | | | | |
| - Investment securities at fair value through other comprehensive income | 58,912 | 1,110,589 | 1,169,501 | 585,000 | - | 585,000 | 1,754,501 |
| - Investments securities at amortised cost | 5,024 | 7,457 | 12,481 | 483,750 | - | 483,750 | 496,231 |
| - Securities pledged under repurchase agreements | 565,720 | 342,342 | 908,062 | 4,900,000 | 1,800,000 | 6,700,000 | 7,608,062 |
| Other assets | 363,311 | 1,896 | 365,207 | - | - | - | 365,207 |
| | 34,028,902 | 24,612,928 | 58,641,830 | 46,691,528 | 16,294,228 | 62,985,756 | 121,627,586 |
| *Liabilities* | | | | | | | |
| Amounts due to financial institutions | 8,888,241 | 6,924,948 | 15,813,189 | 5,606,381 | 2,097,556 | 7,703,937 | 23,517,126 |
| Trading financial liabilities | 2,080,577 | - | 2,080,577 | - | - | - | 2,080,577 |
| Amounts due to customers | 21,007,767 | 23,862,223 | 44,869,990 | 19,063,126 | 426 | 19,063,552 | 63,933,542 |
| Derivative financial liabilities | - | 4,600 | 4,600 | 9,000 | - | 9,000 | 13,600 |
| Subordinated debt | 21,610 | 71,312 | 92,922 | 5,536,500 | 4,837,500 | 10,374,000 | 10,466,922 |
| Other liabilities | 679,257 | 6,000 | 685,257 | - | - | - | 685,257 |
| | 32,677,452 | 30,869,083 | 63,546,535 | 30,215,007 | 6,935,482 | 37,150,489 | 100,697,024 |
| Net position | 1,351,450 | (6,256,155) | (4,904,705) | 16,476,521 | 9,358,746 | 25,835,267 | 20,930,562 |
| Accumulated gap | 1,351,450 | (4,904,705) | | 11,571,816 | 20,930,562 | | |

| In thousand Armenian drams | 31 December 2017 | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Demand and less than 1 month** | **From 1 to 12 months** | **Subtotal less than 12 months** | **From 1 to 5 years** | **More than 5 years** | **Subtotal over 12 months** | **Total** |
| *Assets* | | | | | | | |
| Cash and cash equivalents | 18,812,252 | - | 18,812,252 | - | - | - | 18,812,252 |
| Amounts due from financial institutions | 6,372,511 | 1,375,174 | 7,747,685 | 785,635 | 87,412 | 873,047 | 8,620,732 |
| Derivative financial assets | 852 | - | 852 | - | - | - | 852 |
| Loans to customers | 3,697,309 | 13,196,574 | 16,893,883 | 27,014,591 | 12,925,832 | 39,940,423 | 56,834,306 |
| Securities available-for-sale | - | 959,819 | 959,819 | 3,979,304 | 1,037,646 | 5,016,950 | 5,976,769 |
| Securities held-to-maturity | - | 7,580 | 7,580 | 491,786 | - | 491,786 | 499,366 |
| Securities pledged under repurchase agreements | - | 3,148,055 | 3,148,055 | 1,349,944 | 1,038,418 | 2,388,362 | 5,536,417 |
| Other financial assets | 196,364 | - | 196,364 | - | - | - | 196,364 |
| | 29,079,288 | 18,687,202 | 47,766,490 | 33,621,260 | 15,089,308 | 48,710,568 | 96,477,058 |
| *Liabilities* | | | | | | | |
| Amounts due to financial institutions | 7,254,146 | 2,538,655 | 9,792,801 | 2,250,940 | 1,488,183 | 3,739,123 | 13,531,924 |
| Derivative financial liabilities | - | 5,680 | 5,680 | 14,720 | - | 14,720 | 20,400 |
| Amounts due to customers | 17,331,044 | 16,588,526 | 33,919,570 | 15,911,145 | - | 15,911,145 | 49,830,715 |
| Subordinated debt | 21,367 | 72,622 | 93,989 | 5,801,000 | 4,841,000 | 10,642,000 | 10,735,989 |
| Other borrowings | - | - | - | 26,719 | - | 26,719 | 26,719 |
| Other liabilities | 195,997 | 430,000 | 625,997 | - | - | - | 625,997 |
| | 24,802,554 | 19,635,483 | 44,438,037 | 24,004,524 | 6,329,183 | 30,333,707 | 74,771,744 |
| Net position | 4,276,734 | (948,281) | 3,328,453 | 9,616,736 | 8,760,125 | 18,376,861 | 21,705,314 |
| Accumulated gap | 4,276,734 | 3,328,453 | | 12,945,189 | 21,705,314 | | |

# 35 Risk management

The Bank's activities expose it to a variety of financial risks and those activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks.

Risk 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. The Bank is exposed to credit risk, liquidity risk and market risk, the latter being subdivided into trading and non-trading risks. 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 Board of Directors is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

## *Board of Directors*

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

### *Management Board*

The Management Board is responsible for implementation, realization and control of processes, which are connected with risk management.

### *Risk Controlling Unit*

The Risk Controlling Unit is responsible for monitoring compliance with risk principles, policies and limits across the Bank. This unit also ensures the complete capture of the risks in risk measurement and reporting systems.

### *Internal audit*

Risk management processes throughout the Bank are audited annually by the internal audit function, which 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 Board of the Bank and the Management Board.

### *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 worst 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 Board of the Bank and the Management Board. The report includes aggregate credit exposure, hold limit exceptions, liquidity ratios and risk profile changes. On a monthly basis detailed reporting of industry, customer and geographic risks takes place by maturity. The Management 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.

A daily briefing is given to the members of the Management Board, which includes Bank normative, current balance of the Bank, daily change in income and expenses and changes in off-balance sheet articles.

### *Excessive risk concentration*

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

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.

## 35.1 Credit risk

The Bank takes on exposure to credit risk, which is the risk that a counterparty will cause a financial loss for the Bank by failing to discharge an obligation. Credit risk is the most important risk for the Bank's business; management therefore carefully manages its exposure to credit risk. Credit exposures arise principally in lending activities that lead to loans and advances, and investment activities that bring debt securities and other bills into the Bank's asset portfolio. There is also credit risk in off-balance sheet financial instruments, such as loan commitments. The credit risk management and control are centralised in credit risk management team of Bank's Risk Management Department and reported to the Board of Directors and Management Board.

The carrying amounts of the Bank's financial assets best represent the maximum exposure to credit risk related to them, without taking account of any collateral held or other credit enhancements.

### 35.1.1 Credit quality analysis

The following table contains an analysis of the credit risk exposure of financial instruments for which an ECL allowance is recognised. The gross carrying amount of financial assets below also represents the Bank's maximum exposure to credit risk on these assets, without taking account of any collateral held or other credit enhancements. For loan commitments and financial guarantee contracts, the amounts in the table represent the amounts committed or guaranteed, respectively.

| In thousand Armenian drams | 31 December 2018 | | | | 31 December 2017 |
|---|---|---|---|---|---|
| Internal rating grade | Stage 1 12-month ECL | Stage 2 Lifetime ECL not credit-impaired | Stage 3 Lifetime ECL credit-impaired | Total | Total |
| *Cash and cash equivalents* | | | | | |
| High | 23,088,491 | - | - | 23,088,491 | 18,812,252 |
| Standard | - | - | - | - | - |
| Low | - | - | - | - | - |
| Non-performing | - | - | - | - | - |
| Gross carrying amount | 23,088,491 | - | - | 23,088,491 | 18,812,252 |
| Loss allowance | - | - | - | - | - |
| Net carrying amount | 23,088,491 | - | - | 23,088,491 | 18,812,252 |
| *Amounts due from banks and other financial institutions* | | | | | |
| High | - | - | - | - | - |
| Standard | 12,957,931 | - | - | 12,957,931 | 8,620,732 |
| Low | - | - | - | - | - |
| Non-performing | - | - | - | - | - |
| Gross carrying amount | 12,957,931 | - | - | 12,957,931 | 8,620,732 |
| Loss allowance | (67,478) | - | - | (67,478) | - |
| Net carrying amount | 12,890,453 | - | - | 12,890,453 | 8,620,732 |
| *Loans and advances to mortgage and consumer customers* | | | | | |
| High grade | 25,866,739 | - | - | 25,866,739 | 14,126,053 |
| Standard grade | 215,239 | 41,576 | - | 256,815 | 54,108 |
| Substandard grade | - | 232,512 | - | 232,512 | 1,201 |
| Non-performing grade | - | - | 766,737 | 766,737 | 193,381 |
| Gross carrying amount | 26,081,978 | 274,088 | 766,737 | 27,122,803 | 14,374,743 |
| Loss allowance | (435,964) | (176,130) | (465,942) | (1,078,036) | (128,797) |
| Net carrying amount | 25,646,014 | 97,958 | 300,795 | 26,044,767 | 14,245,946 |
| *Loans and advances to commercial customers* | | | | | |
| High grade | 43,901,441 | - | - | 43,901,441 | 41,904,375 |
| Standard grade | 18,047 | 1,452,448 | - | 1,470,495 | 25,216 |
| Substandard grade | - | 37,450 | - | 37,450 | 7,872 |
| Non-performing grade | - | - | 5,223,937 | 5,223,937 | 1,279,370 |
| Gross carrying amount | 43,919,488 | 1,489,898 | 5,223,937 | 50,633,323 | 43,216,833 |
| Loss allowance | (439,456) | (285,590) | (528,571) | (1,253,617) | (628,473) |
| Net carrying amount | 43,480,032 | 1,204,308 | 4,695,366 | 49,379,706 | 42,588,360 |

| | | | | | |
|---|---|---|---|---|---|
| *Debt investment securities at amortised cost (2017: held-to-maturity)* | | | | | |
| High | - | - | - | - | - |
| Standard * | 496,231 | - | - | 496,231 | 499,366 |
| Low | - | - | - | - | - |
| Non-performing | - | - | - | - | - |
| Gross carrying amount | 496,231 | - | - | 496,231 | 499,366 |
| Loss allowance | - | - | - | - | - |
| Net carrying amount | 496,231 | - | - | 496,231 | 499,366 |
| *Debt investment securities at FVOCI including the pledged securities (2017: available-for-sale)* | | | | | |
| High | | - | - | | |
| Standard | 9,362,563 | - | - | 9,362,563 | 11,513,186 |
| Low | - | - | - | - | - |
| Non-performing | - | - | - | - | - |
| Gross carrying amount-fair value | 9,362,563 | - | - | 9,362,563 | 11,513,186 |
| *Other financial assets* | | | | | |
| High | | - | - | | |
| Standard | 377,910 | - | - | 377,910 | 219,203 |
| Low | | - | - | - | |
| Non-performing | | - | - | - | |
| Gross carrying amount | 377,910 | - | - | 377,910 | 219,203 |
| Loss allowance | (12,703) | - | - | (12,703) | (22,839) |
| Net carrying amount | 365,207 | - | - | 365,207 | 196,364 |
| *Loan commitments and financial guarantee* | | | | | |
| High | 5,205,679 | - | - | 5,205,679 | 5,872,448 |
| Standard | 3,434 | 39,081 | - | 42,515 | 5,325 |
| Low | - | 364 | - | 364 | 485 |
| Non-performing | - | - | 322 | 322 | - |
| | 5,209,113 | 39,445 | 322 | 5,248,880 | 5,878,258 |

Credit exposures arising from derivative transactions refer to note 17.

## 35.1.2 Impairment assessment

### *Policy applicable from 1 January 2018*

The references below show where the Bank's impairment assessment and measurement approach is set out in this report. It should be read in conjunction with the Summary of significant accounting policies (Refer to note 4.4.6).

### *Significant increase in credit risk*

At each reporting date, The Bank assess whether the credit risk on a financial instrument has increased significantly since initial recognition. When making the assessment, The Bank use the change in the risk of a default occurring over the expected life of the financial instrument instead of the change in the amount of expected credit losses.

The bank considers both quantitative and forward-looking qualitative criteria in order to assess whether a significant increase in credit risk has occurred.

However, when information that is more forward-looking than past due status (either on an individual or a collective basis) is not available without undue cost or effort, The Bank use past due information to determine whether there have been significant increases in credit risk since initial recognition.

### *Criteria for loans and advances to customers*

The criteria for Loans and advances to customers are presented in the following paragraphs. All presented criteria have the same weight in determining a significant increase in credit risk.

- 30 days past due. More than 30 days past due is an indicator of a significant increase in credit risk.
- Past due - other than 30 days. Significant increase in credit risk is considered when although at the reporting date, days past due are less than 30, during the last 6 months there was at least one case of more than 60 days past due.
- Relative change in 12-month PD. A significant change in 12-month PD is considered as factor of changes in lifetime PD. This is indicative of a significant increase in credit risk. This criterion is used when The Bank has an internal credit rating system.
- Relative change in lifetime PD. A significant change in lifetime PD is indicative of a significant increase in credit risk. This criterion is used when The Bank has an internal credit rating system
- Default (‘stage 3’) during the last 12 months. Significant increase in credit risk is considered when although at the reporting date the outstanding amount of the facility is not classified as default, during the last 12 months it was at least once in stage 3.
- Loans in the probation period. Significant increase in credit risk is considered in case of a forborne performing loan or forborne non-performing loan, which is in the probation period (period after cure period). wherein, the loan should not have overdue days of more than 30 days or any indication of an unlikeliness to pay.

### *Criteria for amounts due from financial institutions*

The criteria for credit institutions and other financial corporations are presented in the following paragraphs. All presented criteria have the same weight in determining a significant increase in credit risk.

- 30 days past due. More than 30 days past due is an indicator of a significant increase in credit risk.
- For correspondent and current accounts 7 days’ pas due. More than 7 days past due is an indicator of a significant increase in credit risk.
- Past due - other than 30 days. Significant increase in credit risk is considered when although at the reporting date, days past due are less than 30, during the last 6 months there was at least one case of more than 60 days past due.
- Change notches external credit score/ rate. For this criterion, the corporate rating will be taken into account. A significant change notches in the credit score assigned by the Big Three credit rating agencies (Standard & Poor's, Moody's, and Fitch) is indicative of a significant increase in credit risk. A significant increase in credit risk is taken into account when the S & P rating goes down each time by one level, started from B2 (S&P) (or the equivalent of Moody's and Fitch). In cases where a financials institutions don't have a corporate rating in a rating agency and The Bank does not have an equivalent internal rating system, the corporate default rate corresponding to sovereign rating of the country is taken into consideration.
- Relative change in 12-month PD. A significant change in 12-month PD is considered as factor of changes in lifetime PD. This is indicative of a significant increase in credit risk. This criterion is used when The Bank has an internal credit rating system.
- Relative change in lifetime PD. A significant change in lifetime PD is indicative of a significant increase in credit risk. This criterion is used when The Bank has an internal credit rating system
- Default (‘stage 3’) during the last 12 months. Significant increase in credit risk is considered when although at the reporting date the outstanding amount of the facility is not classified in default, during the last 12 months it was at least once in stage 3.

### *Criteria for Investment securities*

The criteria for securities are presented in the following paragraphs. All presented criteria have the same weight in determining a significant increase in credit risk.

- Relative change in 12-month PD. A significant change in 12-month PD is considered as factor of changes in lifetime PD. This is indicative of a significant increase in credit risk. This criterion is used when the Entity has an internal credit rating system.
- Relative change in lifetime PD. A significant change in lifetime PD is indicative of a significant increase in credit risk. This criterion is used when the Entity has an internal credit rating system
- Change notches external credit score/ rate. For this criterion, the country's rating will be taken into account government securities or corporate rating will be taken into account for corporate securities. A significant change notches in the credit score assigned by the Big Three credit rating agencies (Standard & Poor's, Moody's, and Fitch) is indicative of a significant increase in credit risk. A significant increase in credit risk is taken into account when the S & P rating goes down one level each time, beginning with B2 (S&P) (or the equivalent of Moody's and Fitch). In cases where an issuers of securities don't have a corporate rating in a rating agency and The Bank does not have an equivalent internal rating system, the corporate default rate corresponding to sovereign rating of the country is taken into consideration.

### *Exit criteria from significant deterioration stage*

If none of the indicators that are used by The Bank to assess whether significant increase in credit risk has occurred, is present, transfer from stage 2 to stage 1 is performed, with the exception of forborne loans for which a probation period is used.

### *Credit risk grades*

The Bank allocates each exposure to a credit risk grade based on a variety of data that is determined to be predictive of the risk of default and applying experienced credit judgement. Credit risk grades are defined using qualitative and quantitative (primarily driven by days past due) factors that are indicative of risk of default. These factors vary depending on the nature of the exposure and the type of borrower.

### *Collective or individual assessment*

The Bank calculates ECLs either on a collective or an individual basis. Asset classes where the Bank calculates ECL on an individual basis include:

- Individually significant loans of Stage 3, regardless of the class of financial assets
- The large and unique exposures
- The treasury, trading and interbank relationships such as Due from Banks, Securities pledged under repurchase agreements and debt instruments at FVOCI
- Exposures that have been classified as POCI when the original loan was derecognised and a new loan was recognised as a result of a credit driven debt restructuring.

Those assets for which ECL does not calculated individually the bank groups into segment on the basis of shared credit risk characteristics as described below.

- Type of loan (for example, corporate, mortgage, credit card, consumer loan, etc.)
- The type of customer (for example, a physical person or legal entity or by industry type),
- Type of collateral (for example, property, receivables, etc.),
- Currency
- Other relevant characteristics.

### *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 interbank balances defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements.

As a part of a qualitative assessment of whether a customer is in default, the Bank also considers a variety of instances that may indicate unlikeliness to pay. 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:

- lawsuit, execution or enforced execution in order to collect debt,
- license of the borrower is withdrawn,
- the borrower is a co-debtor when the main debtor is in default,
- multiple restructurings on one exposure,
- there are justified concerns about a borrower's future ability to generate stable and sufficient cash flows,
- the borrower's overall leverage level has significantly increased or there are justified expectations of such changes to leverage; equity reduced by 50% within a reporting period due to losses;
- debt service coverage ratio indicates that debt is not sustainable
- loss of major customer or tenant,
- connected customer has filed for bankruptcy,
- restructuring with a material part which is forgiven (net present value (NPV) loss),
- credit institution or leader of consortium starts bankruptcy/insolvency proceedings

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 three 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. The Bank's criterion for 'cure' for ECL purposes is less stringent than the 12 months' requirement for forborne non-performing exposures.

### *Forborne and modified loan*

The Bank sometimes makes concessions or modifications to the original terms of loans as a response to the borrower's financial difficulties, rather than taking possession or to otherwise enforce collection of collateral. The Bank considers a loan forborne when such concessions or modifications are provided as a result of the borrower's present or expected financial difficulties and the Bank would not have agreed to them if the borrower had been financially healthy. Indicators of financial difficulties include defaults on covenants, or significant concerns raised by the Credit Risk Department. Forbearance may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, any impairment is measured using the original EIR as calculated before the modification of terms. It is the Bank's policy to monitor forborne loans to help ensure that future payments continue to be likely to occur.

Derecognition decisions and classification between Stage 2 and Stage 3 are determined on a case-by-case basis.

The Bank defines the "cure" period as a 12-month period after forbearance, which is applied for forborne non-performing exposures. Given the fact that it is impossible to determine financial difficulties immediately after forbearance, it is necessary to use the "cure" period to determine whether the loan was effectively cured. All forborne non-performing loans must remain at stage 3 after the forbearance date, despite the behavior of the loan (no overdue days, etc.).

The Bank defines the probation period as 24-month period after "cure" period, which is applied for forborne performing exposures (excluding any grace period). Once an asset has been classified as forborne performing exposures, it will remain forborne for a minimum 24-month probation period.

In order for the loan to be reclassified out of the forborne category, the customer has to meet all of the following criteria:

- All of its facilities has to be considered performing
- The probation period of two years has passed from the date the forborne contract was considered performing

- Regular payments of more than an insignificant amount of principal or interest have been made during at least half of the probation period
- The customer does not have any contract that is more than 30 days past due.

If modifications are substantial, the loan is derecognised, as explained in note 4.4.4.

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

In thousand Armenian drams

| | **2018** |
|---|---|
| Amortised costs of financial assets modified during the period | 1,341,141 |
| Net modification loss | (201,759) |

### *Probability of Default (PD)*

The PD represents the likelihood of a borrower defaulting on its financial obligation, either over the next 12 months (12mECL), or over the remaining lifetime (LTECLs) of the obligation.

The Lifetime PD is developed by applying a maturity profile to the current 12M PD. The maturity profile looks at how defaults develop on a portfolio from the point of initial recognition throughout the lifetime of the loans. The maturity profile is based on historical observed data and is assumed to be the same across all assets within a portfolio and credit grade band. This is supported by historical analysis.

### *Loss given default (LGD)*

LGD is determined based on the factors which impact the recoveries made post default. These vary by product type.

- For secured products, this is primarily based on collateral type and projected collateral values, historical discounts to market/book values due to forced sales, time to repossession and recovery costs observed.
- For unsecured products, LGD’s are typically set at product level due to the limited differentiation in recoveries achieved across different borrowers. These LGD’s are influenced by collection strategies, including contracted debt sales and price.

### *Exposure at default (EAD)*

The 12-month and lifetime EADs are determined based on the expected payment profile, which varies by product type.

- For products with contractual terms, this is based on the contractual repayments owed by the borrower over a 12-month or lifetime basis. This will also be adjusted for any expected overpayments made by a borrower. Early repayment/refinance assumptions are also incorporated into the calculation.
- For revolving products, the exposure at default is predicted by taking current drawn balance and adding a “credit conversion factor” which allows for the expected drawdown of the remaining limit by the time of default. These assumptions vary by product type and current limit utilization band, based on analysis of the Bank's recent default data.

### *Forward looking information*

An overview of the approach to estimating ECLs is set out in note 4.4.6, estimates and assumptions. To ensure completeness and accuracy, the Bank obtains the data used from third party sources (WB, CBA, Government of RA and etc.). In order to generate the influence of the macroeconomic factors, the Bank determining the weights to the selected macroeconomic factors and to the multiple scenarios (Base, Upside and Downside), which are predicted. To calculate the macroeconomic adjustment for ECL the Bank uses a wide range of forecast information as economic inputs for its models, including:

- GDP growth
- Net current transfers from abroad (current US dollar)

- Unemployment
- Bank's nonperforming loans to total gross loans
- Trade growth
- Industry growth
- Official exchange rate
- Real estate prices (average price in Yerevan)

### *Impairment assessment policy applicable before 1 January 2018*

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment into areas: individually assessed allowances and collectively assessed allowances.

### *Individually assessed allowances*

The Bank determines the allowances appropriate for each individually significant loan or advance on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the realizable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

### *Collectively assessed allowances*

Allowances are assessed collectively for losses on loans and advances that are not significant (including credit cards, residential mortgages and unsecured consumer lending) and for individually significant loans and advances where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is not yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the approximate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired.

Financial guarantees and letters of credit are assessed and provision made in a similar manner as for loans.

### *Loans and advances neither past due or impaired*

The table below shows the credit quality by class of asset for loans and advances not impaired and not past due based on the historical counterparty default rates.

| In thousand Armenian drams | 31 December 2017 |
|---|---|
| Loans to customers | |
| Industry | 0.43% |
| Construction | 0.36% |
| Trading | 0.05% |
| Consumer | 0.96% |
| Mortgage | 0.26% |
| Service | 1.37% |
| Other | 0.20% |

### *Past due but not impaired loans*

Past due loans and advances include those that are only past due by a few days. The majority of the past due loans are not considered to be impaired.

Analysis of past due loans by sector is provided below.

| In thousand Armenian drams | | | | | 31 December 2017 |
|---|---|---|---|---|---|
| | Less than 30 days | 31 to 60 days | 61 to 90 days | More than 91 days | Total |
| Industry | - | - | - | 50,702 | 50,702 |
| Construction | - | - | - | 206,025 | 206,025 |
| Trading | 11,987 | - | 7,872 | 130,067 | 149,926 |
| Consumer | - | 1,012 | 189 | 64,444 | 65,645 |
| Mortgage | 54,108 | - | - | 37,930 | 92,038 |
| Other | 13,229 | - | - | 65,785 | 79,014 |
| Total | 79,324 | 1,012 | 8,061 | 554,953 | 643,350 |

## 35.1.3 Risk concentrations

### *Geographical sectors*

The majority of the Banks assets is allocated in the Republic of Armenia.

### *Industry sectors*

The analysis of loan portfolio by industry sectors is represented in note 19.

## 35.1.4 Collateral and other credit enhancement

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are in place covering the acceptability and valuation of each type of collateral.

The main types of collateral obtained are, as follows:

- For securities lending and reverse repurchase transactions, cash or securities
- For commercial lending, charges over real estate properties, movable properties, equipment, inventory and trade receivables and, in special circumstances, government guarantees
- For consumer lending residential properties and other collateral.
- For mortgages over residential properties

The Bank also obtains guarantees from parent companies for loans to their subsidiaries. Management monitors the market value of collateral and will request additional collateral in accordance with the underlying agreement.

As at 31 December 2018 allowance for ECL on loans at the total amount of 14,596,410 thousand has not been recognized because of collaterals.

Longer-term finance and lending to corporate entities are generally secured; revolving individual credit facilities are generally unsecured. In addition, in order to minimise the credit loss, the Bank will seek additional collateral from the counterparty as soon as impairment indicators are noticed for the relevant individual loans and advances.

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Generally, no collaterals are required for provision of loans and advances to financial institutions, especially to Banks. The exception is collaterals obtained under repurchase agreements and securities borrowing transactions. Debt securities, treasury and other eligible bills are generally unsecured.

The analysis of gross loan portfolio of loans and advances to customers by collateral is represented as follows:

In thousand Armenian drams

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Real estate | 40,735,716 | 34,115,934 |
| Inventories | 3,616,352 | 3,420,404 |
| Movable property and other fixed assets | 5,690,036 | 4,560,419 |
| Cash flows | 4,262,932 | 6,078,981 |
| Guarantees | 4,791,195 | 4,426,136 |
| Precious metals, gold | 1,016,118 | 921,245 |
| RA state bonds | 91,790 | 887,014 |
| Deposits | 5,153,052 | 361,747 |
| Other | 2,207,877 | 1,289,887 |
| Unsecured | 10,191,058 | 1,529,809 |
| Total loans and advances, gross | 77,756,126 | 57,591,576 |

The amounts presented in the table above are carrying values of the loans, and do not necessarily represent the fair value of the collaterals. Estimates of market values of collaterals are based on valuation of the collateral at the date when loans were provided. Generally, they are not updated unless loans are assessed as credit-impaired.

At 31 December 2018, the net carrying amount of credit-impaired loans and advances to customers amounted to 5,990,674 thousand (2017: 917,798 thousand) and the value of identifiable collateral held against those loans and advances amounted to 13,499,310 thousand (2017: 1,062,455 thousand)

## 35.2 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 and foreign exchange rates. The Bank classifies exposures to market risk into either trading or non-trading portfolios. The market risk for the trading portfolio is managed and monitored based on a VaR methodology which reflects the interdependency between risk variables. Non-trading positions are managed and monitored using other sensitivity analyses. Except for the concentrations within foreign currency, the Bank has no significant concentration of market risk.

## 35.2.1 Market risk – Non-trading

### *Interest rate risk*

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The Board of Directors has established limits on the interest rate gaps for stipulated periods. Positions are monitored on a daily basis.

The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Bank's statement of profit or loss and other comprehensive income.

The sensitivity of the statement of profit or loss and other comprehensive income is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2018. The sensitivity of equity is calculated by revaluating fixed rate available-for-sale financial assets at 31 December 2018 for the effects of the assumed changes in interest rates. The sensitivity of equity is analysed by maturity of the asset or swap. The total sensitivity of equity is based on the assumption that there are parallel shifts in the yield curve, while the analysis by maturity displays the sensitivity to non-parallel changes.

| In thousand Armenian drams | | | 31 December 2018 | | | | |
|---|---|---|---|---|---|---|---|
| | | | Sensitivity of equity | | | | |
| Currency | Change in basis points | Sensitivity of net interest income | Up to 6 months | 6 months to 1 year | 1 year to 5 years | More than 5 years | Total |
| AMD | +1 | - | (1,618) | (2,604) | (100,115) | (161,041) | (265,378) |
| AMD | (1) | - | 1,632 | 2,640 | 102,992 | 182,037 | 289,301 |

| In thousand Armenian drams | | | 31 December 2017 | | | | |
|---|---|---|---|---|---|---|---|
| | | | Sensitivity of equity | | | | |
| Currency | Change in basis points | Sensitivity of net interest income | Up to 6 months | 6 months to 1 year | 1 year to 5 years | More than 5 years | Total |
| USD | +1 | - | (7,929) | - | (93,500) | (149,848) | (251,277) |
| USD | (1) | - | 7,989 | - | 96,435 | 169,269 | 273,693 |

### *Currency risk*

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

The tables below indicate the currencies to which the Bank had significant exposure at 31 December 2018 on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculated the effect of a reasonably possible movement of the currency rate against the Armenian dram, with all other variables held constant on the statement of profit or loss and other comprehensive income (due to the fair value of currency sensitive non-trading monetary assets and liabilities). A negative amount in the table reflects a potential net reduction in statement of profit or loss and other comprehensive income or equity, while a positive amount reflects a net potential increase.

| In thousand Armenian drams | 31 December 2018 | | 31 December 2017 | |
|---|---|---|---|---|
| Currency | Change in currency rate in % | Effect on profit before tax | Change in currency rate in % | Effect on profit before tax |
| USD | +5 | 92,088 | +5 | 30,173 |
| EUR | +5 | (975) | +5 | 1,001 |

The Bank's exposure to foreign currency exchange risk is as follow:

| In thousand Armenian drams | | | | 2018 |
|---|---|---|---|---|
| | Armenian Dram | Freely convertible currencies | Non-freely convertible currencies | Total |
| *Assets* | | | | |
| Cash and cash equivalents | 10,653,274 | 11,674,161 | 761,056 | 23,088,491 |
| Amounts due from financial institutions | 11,320,681 | 1,479,967 | 89,805 | 12,890,453 |
| Investment securities | 9,362,563 | 496,231 | - | 9,858,794 |
| Loans to customers | 24,319,225 | 50,851,289 | 253,959 | 75,424,473 |
| Other assets | 58,746 | 238,993 | 67,468 | 365,207 |
| | 55,714,489 | 64,740,641 | 1,172,288 | 121,627,418 |
| *Liabilities* | | | | |
| Amounts due to financial institutions | 23,323,266 | 193,337 | 523 | 23,517,126 |
| Trading financial liabilities | 2,080,577 | - | - | 2,080,577 |
| Amounts due to customers | 11,952,492 | 50,995,032 | 986,018 | 63,933,542 |
| Subordinated debt | - | 10,466,922 | - | 10,466,922 |
| Other liabilities | 660,462 | 24,563 | 232 | 685,257 |
| Total | 38,016,797 | 61,679,854 | 986,773 | 100,683,424 |
| Total effect of derivative financial instruments | 1,534,400 | (1,190,025) | (357,807) | (13,432) |
| Net position as of 31 December 2018 | 19,232,092 | 1,870,762 | (172,292) | 20,930,562 |
| Commitments and contingent liabilities as of 31 December 2018 | 2,845,790 | 2,399,893 | 3,197 | 5,248,880 |
| Total financial assets | 39,693,474 | 55,324,515 | 1,458,217 | 96,476,206 |
| Total financial liabilities | 20,532,033 | 53,422,293 | 797,018 | 74,751,344 |
| Total effect of derivative financial instruments | 1,916,000 | (1,207,842) | (727,706) | (19,548) |
| Net position as of 31 December 2017 | 21,077,441 | 694,380 | (66,507) | 21,705,314 |
| Commitments and contingent liabilities As of 31 December 2017 | 4,182,324 | 1,687,298 | 8,636 | 5,878,258 |

Freely convertible currencies represent mainly US dollar and Euro. Non-freely convertible amounts relate to currencies of CIS countries, excluding Republic of Armenia.

## 35.3 Liquidity risk

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 bases. 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 highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Bank also has committed lines of credit that it can access to meet liquidity needs. In addition, the Bank maintains an obligatory minimum reserve deposits with the Central Bank of Armenia equal to 2% of certain obligations of the Bank denominated in Armenian drams and 18% on certain obligations of the Bank denominated in foreign currency (refer to note 15). The liquidity position is assessed and managed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Bank.

The liquidity management of the Bank requires considering the level of liquid assets necessary to settle obligations as they fall due; maintaining access to a range of funding sources; maintaining funding contingency plans and monitoring balance sheet liquidity ratios against regulatory requirements. The Bank calculates liquidity ratios in accordance with the requirement of the Central Bank of Armenia.

The indicators as of 31 December is as follows:

| | | Unaudited |
|---|---|---|
| As of 31 December, these ratios were as follows: | **31 December 2018, %** | **31 December 2017, %** |
| N2/1- Total liquidity ratio (Highly liquid assets/ Total assets) | 22.93 | 29.25 |
| N2/2- Current liquidity ratio (Highly liquid assets /liabilities on demand) | 139.67 | 183.19 |

### *Analysis of financial liabilities by remaining contractual maturities*

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December 2018 based on contractual undiscounted repayment obligations. Refer to note 34 for the expected maturities of these liabilities. 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.

| In thousand Armenian drams | | | | | | **31 December 2018** |
|---|---|---|---|---|---|---|
| | **Demand and less than 1 month** | **From 1 to 12 months** | **From 1 to 5 years** | **More than 5 years** | **Total gross amount outflow** | **Carrying value** |
| *Non-derivative financial liabilities* | | | | | | |
| Amounts due to financial institutions | 8,895,684 | 7,528,321 | 8,203,894 | 3,651,468 | 28,279,367 | 23,517,126 |
| Trading financial liabilities | 2,080,577 | - | - | - | 2,080,577 | 2,080,577 |
| Amounts due to customers | 21,010,940 | 24,730,161 | 22,011,266 | 520 | 67,752,887 | 63,933,542 |
| Subordinated debt | 23,282 | 433,711 | 7,280,215 | 6,537,765 | 14,274,973 | 10,466,922 |
| Other liabilities | 679,257 | 6,000 | - | - | 685,257 | 685,257 |
| Total undiscounted non-derivative financial liabilities | 32,689,740 | 32,698,193 | 37,495,375 | 10,189,753 | 113,073,061 | 100,683,424 |

| In thousand Armenian drams | 31 December 2018 | | | | | |
|---|---|---|---|---|---|---|
| | Demand and less than 1 month | From 1 to 12 months | From 1 to 5 years | More than 5 years | Total gross amount outflow | Carrying value |
| *Derivative financial instruments* | | | | | | |
| *Foreign exchange forward contracts* | | | | | | |
| Inflow | - | 382,400 | 1,152,000 | - | 1,534,400 | 1,534,400 |
| Outflow | - | (387,000) | (1,161,000) | - | (1,548,000) | (1,548,000) |
| *Foreign exchange swap contracts* | | | | | | |
| Inflow | 357,975 | - | - | - | 357,975 | 357,975 |
| Outflow | (357,807) | - | - | - | (357,807) | (357,807) |
| Commitments and contingent liabilities | 3,437,851 | 89,354 | 1,721,675 | - | 5,248,880 | 5,248,880 |

| In thousand Armenian drams | As of 31 December 2017 | | | | | |
|---|---|---|---|---|---|---|
| | Demand and less than 1 month | From 1 to 12 months | From 1 to 5 years | More than 5 years | Total gross amount outflow | Carrying value |
| *Non-derivative financial liabilities* | | | | | | |
| Amounts due to financial institutions | 7,351,882 | 2,703,707 | 2,922,520 | 1,703,946 | 14,682,055 | 13,531,924 |
| Amounts due to customers | 17,352,970 | 17,127,620 | 17,479,437 | - | 51,960,027 | 49,830,715 |
| Subordinated debt | 23,396 | 412,294 | 7,567,442 | 6,541,265 | 14,544,397 | 10,735,989 |
| Other borrowings | - | - | 37,437 | - | 37,437 | 26,719 |
| Other liabilities | 195,997 | 430,000 | - | - | 625,997 | 625,997 |
| Total undiscounted non-derivative financial liabilities | 24,924,245 | 20,673,621 | 28,006,836 | 8,245,211 | 81,849,913 | 74,751,344 |
| *Derivative financial instruments* | | | | | | |
| *Foreign exchange forward contracts* | | | | | | |
| Inflow | - | 381,600 | 1,534,400 | - | 1,916,000 | 1,916,000 |
| Outflow | - | (387,280) | (1,549,120) | - | (1,936,400) | (1,936,400) |
| *Foreign exchange swap contracts* | | | | | | |
| Inflow | 745,961 | - | - | - | 745,961 | 745,961 |
| Outflow | (745,109) | - | - | - | (745,109) | (745,109) |
| Commitments and contingent liabilities | 3,746,993 | 388,171 | 1,743,094 | - | 5,878,258 | 5,878,258 |

## 35.4 Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's involvement with financial instruments, including processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour.

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to the Board. This responsibility is supported by the development of overall standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorisation of transactions;
- requirements for the reconciliation and monitoring of transactions;
- compliance with regulatory and other legal requirements, including the minimal requirements of the Central Bank of Armenia on internal control system;
- documentation of controls and procedures;
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified;
- requirements for the reporting of operational losses and proposed remedial action;
- development of contingency plans;
- training and professional development;
- ethical and business standards; and
- risk mitigation.

Compliance with Bank standards is supported by a programme of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of the Bank to which they relate, with summaries submitted to the Board.

# 36 Reconciliation of liabilities arising from financing activities

The changes in the Bank's liabilities arising from financing activities can be classified as follows:

| In thousand Armenian drams | | | | 2018 |
|---|---|---|---|---|
| | Loans from financial institutions | Subordinated debt | Other long-term borrowings | Total |
| As of 1 January 2018 | 4,446,962 | 10,735,989 | 26,719 | 15,209,670 |
| *Cash-flows* | 1,410,733 | - | (26,000) | 1,384,733 |
| Repayments | (88,299,519) | - | (26,000) | (88,325,519) |
| Amounts received | 89,710,252 | - | - | 89,710,252 |
| Non-cash | 4,672 | (269,067) | (719) | (265,114) |
| Foreign exchange gains | - | (268,000) | - | (268,000) |
| Accrued interest | 4,672 | (1,067) | (719) | 2,886 |
| As of 31 December 2018 | 5,862,367 | 10,466,922 | - | 16,329,289 |

| In thousand Armenian drams | | | | 2017 |
|---|---|---|---|---|
| | Loans from financial institutions | Subordinated debt | Other long-term borrowings | Total |
| As of 1 January 2017 | 3,076,965 | 10,048,198 | 273,267 | 13,398,430 |
| *Cash-flows* | 1,361,431 | - | (246,548) | 1,114,883 |
| Repayments | (76,873,039) | - | 24,907 | (76,848,132) |
| Amounts received | 78,234,470 | - | (271,455) | 77,963,015 |
| Non-cash | 8,566 | 687,791 | - | 696,357 |
| Foreign exchange gains | - | 681,105 | - | 681,105 |
| Accrued interest | 8,566 | 6,686 | - | 15,252 |
| As of 31 December 2017 | 4,446,962 | 10,735,989 | 26,719 | 15,209,670 |

# 37 Capital adequacy

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision ("BIS rules/ratios") and adopted by the Central Bank of Armenia 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 maximise 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, polices and processes from the previous years.

The minimum ratio between total capital and risk weighted assets required by the Central Bank of Armenia is 12%.

Regulatory capital consists of Tier 1 capital, which comprises share capital, retained earnings including current year profit, and general reserve. Regulatory capital is calculated in accordance with the requirements of the Central Bank of Armenia and accounting standards of the Republic of Armenia. The other component of regulatory capital is Tier 2 capital, which includes revaluation and other reserves and subordinated debt.

The risk-weighted assets are measured by means of a hierarchy of risk weights classified according to the nature of and reflecting an estimate of credit, market and operating risks.

As of 31 December 2018 and 2017 the amount of regulatory capital, risk waited assets and capital adequacy ratio calculated in accordance with the requirements of Central Bank of Armenia are provided below.

| In thousand Armenian drams | Unaudited | |
|---|---|---|
| | 31 December 2018 | 31 December 2017 |
| Tier 1 capital | 24,492,648 | 23,690,226 |
| Tier 2 capital | 8,718,464 | 9,916,939 |
| Total regulatory capital | 33,211,112 | 33,607,165 |
| Risk-weighted assets | 122,913,072 | 109,042,077 |
| Capital adequacy ratio | 27.02% | 30.82% |

The Bank has complied with all externally imposed capital requirements through the period.

With the aim to enhance the efficiency of the banking system activity, strengthening the ability to resist the shocks in different economic situations, as well as providing more efficient and available banking services, in 2004 the Board of RA the Central Bank of Armenia has set the minimal required total capital at AMD 30,000,000 thousand as of 1 January 2018.