Risk Management Objectives and Principles

TBC Bank operates a strong and independent, business minded risk management system. Its main objective is to contribute to the sustainability of risk adjusted returns through implementation of an efficient risk management system. Four major principles in the course of risk management have been adopted to enable the accomplishment of major objectives:

- **Govern risks in a transparent manner to obtain understanding and trust.** Consistency and transparency in risk related processes and policies represent preconditions for gaining trust from various stakeholders. The communication of risk goals and strategic priorities to governing bodies and the provision of a comprehensive follow-up in an accountable manner are key priorities for risk staff.
- **Promote sustainable growth and TBC Bank's resiliency through prudent risk management.** Risk management represents a backstop against excessive risk-taking. Capital adequacy management and strong forward-looking tools and decision-making ensure TBC Bank's sustainability and resiliency.
- **Ensure that risk management is an enabler of TBC Bank's strategy.** Risk staff provide assurance on the feasibility of the achievement of objectives through risk identification and management. Identification and the adequate pricing of risks, as well as risk mitigation actions, help generate desired returns and achieve planned targets.
- **Ensure that risk management represents a competitive advantage for TBC Bank.** Comprehensive, transparent and prudent risk governance facilitates understanding and trust from multiple stakeholders and ensures the sustainability and resiliency of the business model and the positioning of risk management as TBC Bank's competitive advantage and strategic enabler.

Key Risks

The key risks faced by TBC Bank include credit risk, liquidity and market risks (including interest rate risk and foreign currency risk) and operational risk. Moreover, strategic, reputational and compliance risks are also recognised.

Credit risk

As a provider of banking services, TBC Bank is exposed to risk of losses due to the failure of a customer or counterparty to meet its obligations to settle outstanding amounts in accordance with agreed terms. Credit risk is the most material risk faced by the Bank as long as it is engaged mainly in traditional lending activity with a simple balance sheet. Due to high dollarisation of the economy, currency induced credit risk is one of the significant components of credit risk, which relates to risks arising from foreign currency-denominated loans to un-hedged borrowers in the Bank's portfolio. Credit risk also includes concentration risk, which is the risk related to credit portfolio quality deterioration due to large exposures provided to single borrowers or groups of connected borrowers, or loan concentration in certain economic industries.

Liquidity Risk

Liquidity risk is inherent in banking operations. Both funding and market liquidity risks can emerge from a number of factors which are beyond TBC's control. Due to financial market instability, factors such as a downgrade in credit ratings or other negative developments can affect the price or ability to access funding necessary to make payments in respect of the Bank's future indebtedness.

Market Risk

TBC Bank does not operate a trading book. Thus, its exposure to market risk comprises foreign exchange risk and interest rate risk in the banking book. Accordingly TBC's only exposure to market risk is foreign exchange risk in its "structural book", comprising its regular commercial banking activities having no trading, arbitrage or speculative intent. Due to high dollarisation of the economy in Georgia, movements in foreign exchange rates, can adverse effect TBC's financial position.

Interest Rate Risk

Arises from potential changes in market interest rates that can adversely affect the value of TBC's financial assets and liabilities. This risk can arise from maturity mismatches of assets and liabilities, as well as from the repricing characteristics of such assets and liabilities.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed processes, people and systems or from external events. It includes legal risk, but excludes strategic and reputational risk.

Reputational Risk

Reputational risk is the possible loss of the organisation's reputational capital resulting in decline of the organisation's overall value and/or increased regulatory or other costs. It includes adverse events related to ethics, safety, security, sustainability, quality, and innovation.

Strategic Risk

Changes in market conditions, customer behaviour, and technology may all negatively impact the Bank's results if adaptability to the environment is compromised. Respectively the Bank is exposed to strategic risk.

Compliance Risk

The Bank is exposed to compliance risk given that it is governed by local regulations as well as creditor covenants.

RISK MANAGEMENT
CONTINUED

Key Focus in 2015

2015 was a significant year for the risk management function of TBC Bank as the economy was affected by adverse external developments. The currency depreciated by approximately 30% resulting in debt burden appreciation of the largely dollarised customer base. As a result the Bank's risk management tools and techniques were utilised at their maximum capacity, managing credit risk in a proactive manner and helping to minimise the impact of adverse developments on the Bank's risk profile and profitability. Key focus activities are summarised below.

Intense Portfolio Monitoring

- In response to local currency devaluation, the Bank undertook scrutinised monitoring of the loan book both on a transaction and portfolio level. As a result of this monitoring process, individual borrowers affected by currency devaluation were identified and specific action plans were outlined; vulnerable products and industries were identified with underwriting criteria being revised accordingly. This approach enabled the Bank to keep credit risks within acceptable limits despite an unstable macro environment.

Proactive Restructuring Offered to FX Borrowers Weakened by GEL Depreciation

- The Bank offered restructuring to borrowers with foreign currency denominated exposures which were affected by the currency depreciation. The purpose of this restructuring process was to enable customers with increased debt burden to meet their credit obligations. Either loan maturity lengthening or conversion to local currency options was exercised by borrowers. Restructuring packages were tailor made to individual borrower needs especially in case of large borrowers.

NPL and LLP Methodology Updates

- The Bank updated its NPL methodology to harmonise it with international best practice so that it appropriately reflects portfolio quality, also resulting in better comparability of TBC's NPL ratio with that of peers. In past years TBC Bank disclosed the share of 90 days past due and restructured loans in the total portfolio. From December 2015, TBC Bank applied an updated definition of Non-Performing Loans which incorporates loans with principal or interest overdue by more than 90 days and those with identified underlying well-defined weaknesses regardless of the amount or days in arrears. The Management believes that the updated definition results in a more accurate and sound classification of non-performing exposures.
- As of 31 December 2015, TBC Bank reports (IFRS) loan loss provisions based on a revised methodology. The methodology was developed in 2015 with the support of Deloitte. It increased the sophistication of assessment of impairment allowances resulting in enhanced accuracy. In particular, more granular segmentation of the portfolio was undertaken and various sophisticated risk parameters were applied for a more comprehensive assessment of losses. TBC Bank has also enhanced its assessment methodology for individually "significant" borrowers through the introduction of a scenario analysis. The updated provisioning methodology did not result in a material impact on the overall impairment allowances of the Bank. For more details, please refer to Note 9 of Audited Financial Statements of TBC Group.

Structural & Functional Review in 2015

- The Bank is focused on continuous enhancement of its risk management practices in line with industry best practices adopted internationally. As a result the Bank undertook a comprehensive structural and functional review of risk management in 2015. The four month comprehensive review was supported by leading risk management consulting firm Oliver Wyman.
- The Bank validated its current practice efficiency and established risk strategic priorities across a three-year time horizon. Implementation of key priorities are aimed at promoting prudent and informed risk-taking, risk analysis sophistication advancements, modelling and validation capabilities further development, increasing process automation, etc.
- The Enterprise Risk Management (ERM) team was mandated with the responsibility to coordinate the implementation of strategic projects.

Updated Organisational Structure and Team	• All risk management functions were consolidated under a centralised risk management umbrella. The resulting organisational structure is sufficient to serve the current scale of Bank activities as well as future strategic developments. • An ERM function in charge of cross-risk analytics was established, driving the risk appetite framework as well as accomplishment of the risk strategy. • Restructuring and collection activities across all workout phases and business segments were consolidated under one umbrella. • The collateral management function was enhanced and centralised. • The financial risk management function joined the risk organisation structure. The team subordinated to CRO drives the financial risk management strategy, defines methodologies and sets limits, while the execution function rests with teams subordinated to CFO. • The Constanta risk team was fully integrated within the risk management team. • The risk management team was further expanded through internal promotions and recruitment of new members. The current team is a combination of TBC Bank's incumbent team, Bank Constanta team and new external additions. The team is equipped with a wealth of Georgian and international banking, regulatory and Big Four audit experience (including at Intesa Sanpaolo, SocGen Group, JPMorgan, and Barclays). This is coupled with world class MBAs and Master degrees from Insead, London Business School, Oxford, Imperial College London, Bocconi University, Grenoble and others.
Further Enhancement of Risk Role in Strategic Planning	• Risk and business planning processes were further harmonised. A structured planning process with interactive development of the business and risk plans, increases the feasibility of achievement of targets and alignment of the two by solving risk-return trade-offs in the process.
Advancement and Automation of Risk Management Tools	• As part of business as usual improvements, the risk teams focused on improving the efficiency of the risk analysis process. For that purpose several software tools were launched that increase the efficiency of the credit granting decision-making process, collections process and borrowers financial ratio calculations.
Subsidiaries Risk Management Harmonisation within the Group	• TBC Bank's risk teams increased their involvement in subsidiary risk management, especially in the areas of credit and operational risks. Despite the insignificant size of subsidiaries, the Bank tries to maximise the synergies achievable through Group-wide risk management and risk planning harmonisation.

RISK MANAGEMENT
CONTINUED

Risk Management Framework

All of the components necessary for comprehensive risk governance are embedded in the risk management framework, which is comprised of enterprise risk management, credit, financial and non-financial risk management, risk reporting and the supporting IT infrastructure, cross-risk analytical tools and techniques such as capital adequacy management and stress-testing. The following "figure 1" depicts the risk management framework building blocks.

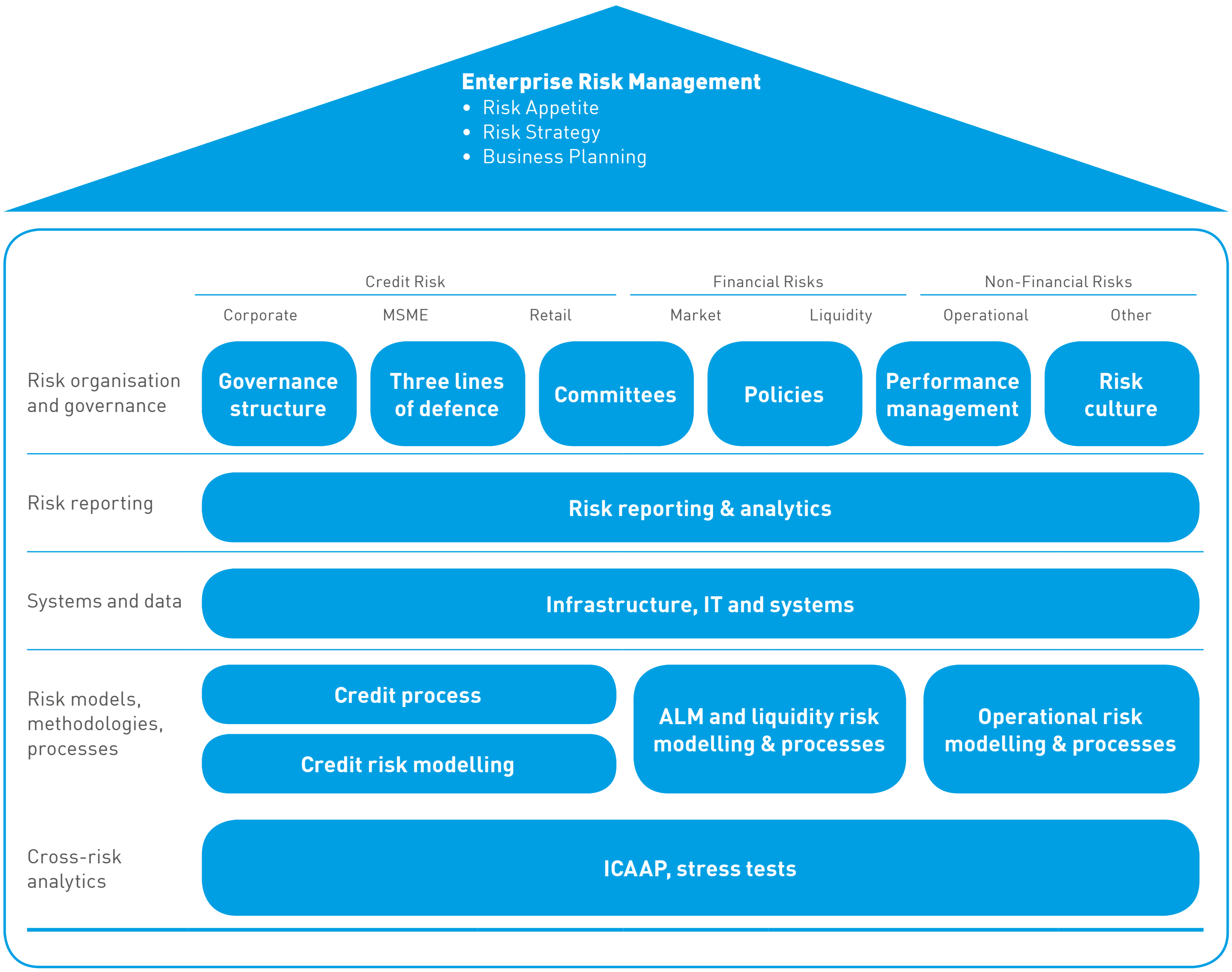

Figure 1 TBC Bank's Risk Management Framework

Risk Organisation and Governance

TBC conducts its risk management activities within the framework of its unified risk management system. Involvement of all governance levels in risk management, clear segregation of authorities and effective communications between different structures, facilitates clarity regarding TBC's strategic and risk objectives, adherence to TBC's risk appetite and sound risk management. TBC's governance structure ensures adequate oversight and accountability, as well as clear segregation of duties. Figure 2 on Risk Governance Structure depicts the major risk governance bodies at various levels: Supervisory Board, Management Board, Risk Management Organisation.

The Supervisory Board has the overall responsibility to set the tone at the top and monitor compliance with established objectives, while the Management Board governs and directs TBC Bank's daily activities.

Both the Supervisory Board and the Management Board have established dedicated risk committees. The Risk, Ethics and Compliance Committee of the Supervisory Board supervises the risk profile and risk governance practice within TBC Bank while the Audit Committee is responsible for the implementation of key accounting policies and the facilitation of internal and external auditor activities. The Management Board Risk Committee was established to guide bank-wide risk management activities and monitor major risk trends to ensure the risk profile complies with TBC's established risk appetite. The Operational Risk Committee makes decisions related to operational risk governance while the Assets and Liabilities Management Committee ("ALCO") is responsible for the implementation of asset-liability management policies.

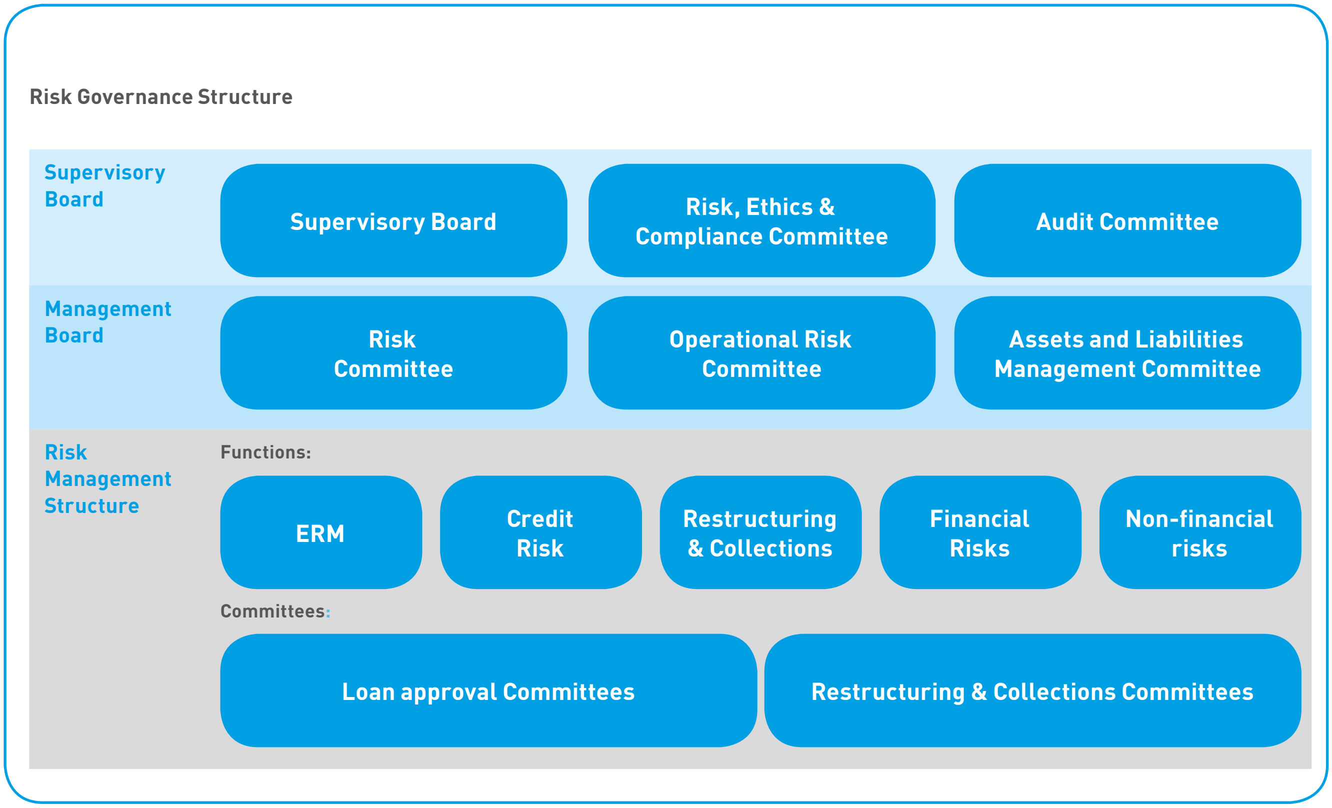

Figure 2 Risk Governance Structure

RISK MANAGEMENT
CONTINUED

The Supervisory Board and the senior management of TBC Bank govern risk objectives through the Risk Appetite Statement ("RAS"), which establishes the desired risk profile and risk limits for different economic environments. RAS also establishes monitoring and reporting responsibilities, as well as escalation paths for different trigger events and limit breaches which prompt risk teams to establish and implement established mitigation actions. In order to effectively implement TBC's risk appetite into TBC's day-to-day operations, RAS metrics are cascaded into more granular limits at the business unit level, establishing risk allocation across different segments and activities. That way all employees play their part in the achievement of the Group's risk results. The process of risk appetite setting and cascading is undertaken in parallel to the business planning process. The interactive development of business and risk plans aligns the plans by solving risk-return trade-offs in the process and increases the feasibility of achieving the targets.

Board level oversight, coupled with the permanent involvement of senior management in TBC's risk management, and the exercise of top down risk allocation by the enterprise risk management function, ensures clarity regarding risk objectives, intense monitoring of the risk profile against the risk appetite, the prompt escalation of risk-related concerns and the establishment of remediation actions.

The daily management of individual risks is based on the three lines of defence principle. While business lines are primary owners of risks, risk teams assume the function of second line of defence. This is performed through multiple processes, tools and techniques for risk identification, analysis, measurement, sanctioning, monitoring and reporting. Committees established at operational levels are in charge of making transaction-level decisions as part of a framework comprised of clear and sophisticated delegations of authority based on the "four eyes principle". All new products and projects pass through risk teams to ensure risks are comprehensively analysed. These control arrangements are aimed at making informed decisions that remain within the predefined risk appetite. Credit, liquidity, market, operational and other non-financial risks are each managed by dedicated teams.

TBC's strong and independent risk management structure enables the fulfilment of all required risk management functions within the second line of defence by highly skilled professionals, with a balanced mix of credentials in banking and real sectors, in local and international markets.

Detailed descriptions of various functions performed within the risk management function are provided below.

Enterprise Risk Management
The core areas of the enterprise risk management framework are risk strategy and risk appetite setting and monitoring facilitation. The centralised ERM efficiently supports cross-risk activities such as cross-risk reporting, aggregation and analytics, capital adequacy and stress-testing. The ERM function also drives the Bank's risk culture.

Credit Risk Management
A strong credit risk management function is critical for maintenance of a balanced loan portfolio and delivering sustainable returns. For that purpose, a prudent credit risk environment has been established focusing on maintenance of efficient processes for credit risk identification, measurement, and monitoring. Credit risk management by risk teams is performed both on a transaction level and portfolio level. As part of credit risk management, the underwriting unit is involved in transaction level analysis and approval, putting in place checks and controls over borrower analysis performed by business units. Credit risk management by a separate dedicated team is aimed at portfolio oversight and quality monitoring, and development and maintenance of the credit risk management framework including modelling and collateral valuations.

Restructuring and Collections Management
In order to minimise losses from delinquent and non-performing loans, the Bank has a centralised restructuring and collections management framework within the risk organisation. A comprehensive portfolio supervision system has been set up to identify weakened credit exposures in a timely manner and take early remedial actions. Separate dedicated professionals focus on restructuring, collections and recoveries of large corporates, SME, micro, unsecured retail and secured retail loans. The teams' efforts are based on a comprehensive framework of strategy selection for borrowers based on their credit quality profile and outlook. Strategies are tailor made to the type and size of exposure. For smaller retail and micro loans, a special collection system is in place to effectively manage overdue loans in a more automated manner. Efficient management of collections, recoveries and repossessed assets supports achievement of the desired portfolio quality and cost parameters.

Financial Risk Management
Liquidity risk, interest rate risk and FX risk are managed through defining and maintaining policies and procedures, models and forecasts and conducting stress-tests. Based on the analysis of the emerging risks, the Bank initiates mitigating actions. The financial risk management team under the CRO monitors the strategy and limits compliance which is executed by the Asset-Liability management team subordinated to the CFO. This distribution of functions between CRO and CFO was put in place at the end of 2015. Prior to that, financial risks were managed by a team subordinated to the CFO.

Operational Risk Management (ORM)
The main objective of operational risk management is to implement and enforce an appropriate framework for identification, assessment, monitoring and reporting of operational risks. ORM enables TBC Bank to identify and assess operational risk categories across the Bank's different processes and operations; to detect critical risk areas or groups of operations with an increased risk level, to develop response actions; and suggest restrictions in critical risk zones to mitigate identified risks. The ORM ensures that operational risk exposure remains within TBC's risk appetite.

Additional Layers of Defence
In addition to the risk teams that are subordinate to the CRO, the Compliance Department is in charge of anti-money laundering ("AML") and compliance risk management. The Internal Audit Department as a third line of defence is in charge of providing independent and objective assurance and recommendations to TBC Bank and its shareholders to facilitate further improvement of operations and risk management.

Compliance is managed by a function subordinated directly to the CEO in charge of improving the entire compliance system. It is responsible for coordinating the identification, assessment and documentation of compliance risks associated with TBC's activities, including the development of new products and business practices, establishment of new types of business or customer relationships, or material changes in the nature of such relationships, and other related measures. The function administers TBC's overall compliance systems, performs compliance-related direction and supervision, and instructs on corrective actions for branches, offices, divisions, headquarters, subsidiaries and affiliates, both in and out of Georgia, upon the occurrence of violations of compliance, all in an integrated fashion. Anti-money laundering is one of the Compliance Department's main functions, established according to Georgian legislation and recommendations of competent international organisations.

The independent internal audit function represents a third line of defence in all areas of the Bank's risk-taking activities. The Internal Audit Department discusses the results of all assessments with management and reports its findings and recommendations to the Audit Committee.

The soundness of internal controls and risk management practices are subject to periodic reviews by an external auditor as well as intense supervision by National Bank of Georgia, effectively representing additional external layers of defence.

Risk Reporting and Systems

Sound risk reporting systems and IT infrastructure are important tools for the efficient risk management of TBC Bank, in particular for early identification and monitoring of risks and decision-making. Thus, TBC Bank invests in and places significant emphasis on constantly driving the development of required software solutions. In order to ensure availability and fast flow of information, TBC Bank has established a dedicated risk reporting unit. Risk reporting enables senior managers to exercise their oversight role. This is accomplished through delivery of comprehensive information and analysis with adequate frequency for each recipient such as the Supervisory Board, Management Board, various risk management and other units. Risk reports balance a mixture of risk data, analysis, interpretations and qualitative explanations.

Credit Risk Management
Credit granting is the major income-generating activity of TBC Bank as well as the major source of risk. Thus, the Bank dedicates significant resources to its management. Credit risk arises from lending to large Corporate clients, SME, Micro and Retail customers. Key significant components of credit risk are currency induced credit risk due to the high dollarisation level of the economy, as well as concentration risk. Major objectives of credit risk management are to put in place sound credit approval processes for informed risk-taking and procedures for effective risk identification, monitoring and measurement. The Bank adopts segment and product specific approaches for prudent and efficient credit risk management.

Credit Approval
TBC Bank strives to ensure a sound credit-granting process by establishing well-defined credit granting criteria and building up an efficient process for assessment of a borrower's risk profile. A comprehensive credit risk assessment framework is in place with clear segregation of duties among parties involved in the credit analysis and approval process.

The credit assessment process differs across segments, being further differentiated across various product types reflecting different natures of these asset classes. Corporate, SME and larger retail and micro loans are assessed on an individual basis with thorough analysis of the borrower's creditworthiness and structure of the loan. The decision making process for smaller retail and micro loans is largely automated, with borrowers receiving a credit score that reflects the outcome of the borrower's risk profile assessment based on the dedicated scorecard models and credit bureau grading.

Different Loan Approval Committees are in place for the approval of credit exposures to Corporate, SME, Retail and Micro customers. Credit analysts and loan officers from Business Units are primarily responsible for borrower analysis, structuring credit facility and suggesting exposure approval to the loan approval committee. Credit risk managers (as members of Loan Approval Committees) ensure that the borrower and proposed credit exposure risks are thoroughly analysed.

RISK MANAGEMENT
CONTINUED

The Bank puts in place sophisticated delegations of authorities for loan approval that are based on the four eyes principle and require higher seniority levels of approval authorities with increasing sizes of exposures. In particular, different tiers of Loan Approval Committees are responsible to review credit applications and approve exposures considering the borrower's aggregated liabilities and risk profile. A large or higher risk loan would be reviewed by a Loan Approval Committee with a higher approval level, such as one including the Chief Executive Officer, Corporate Business Director and Chief Risk Officer. A loan to the top 20 largest borrowers or exceeding 5% of TBC Bank's regulatory capital would require the review and approval of the Risk, Ethics and Compliance Committee.

Such a structure is a sound platform for risk teams to facilitate continuous ehancement and sophistication of borrower analysis by business unit managers, introduce on line controls for risk-taking and ensure that credit approval decisions are in compliance with Bank's established risk appetite.

Currency Induced Credit Risks (CICR)
TBC Bank faces currency-induced credit risk given that a large part of its exposures are denominated in foreign currency in line with the dollarisation level of the economy. However, limits are established within the risk appetite framework to ensure the Bank continues its efforts toward minimising the portfolio dollarisation level. Various management tools and techniques are applied to mitigate the inherent CICR risk in the loan book encompassing all phases of credit risk management.

The Bank applies more conservative lending standards to unhedged borrowers with FX denominated exposures in order to ensure that they can withstand a certain amount of FX depreciation without credit quality deterioration. Currency fluctuation is one of the stress scenarios applied throughout analysis of corporate borrowers' risk profile in order to assess the potential impact of the currency depreciation on the borrower's financial standing and thus appropriately structure the loan. As a result, FX denominated loans can withstand certain levels of currency shocks without quality deterioration.

Apart from the measures in place throughout the underwriting process, the Bank actively monitors and assesses the quality of FX denominated loans through stress-testing exercises and holds sufficient capital buffers against unexpected losses.

In the event of material currency depreciation, the Bank has tools in place to accelerate its monitoring efforts, identify customers with potential weaknesses, and introduce prompt mitigation. In response to GEL devaluation in 2015 by approximately 30%, the Bank focused on intense portfolio quality monitoring throughout the year. During the monitoring process, the Bank assessed the impact of currency depreciation on the overall portfolio as well as the risk profile, and the estimated outlook for individual exposures. Based on the monitoring results the Bank undertook proactive restructuring, adjusted underwriting standards and ran a continuous follow-up monitoring process limiting potential impact of the devaluation on the Bank's risk profile.

Credit Concentration Risk
TBC Bank is exposed to concentration risk defined as potential deterioration in portfolio quality due to large exposures or individual industries. Management tools are established by the Bank in order to efficiently manage concentration risk. In particular, name concentration, sectoral concentration and unsecured lending limits are defined as part of the Bank's risk appetite framework. The Bank is subject to single name as well as TOP 20 borrowers' concentration limits and focuses on optimisation of the structure and quality of the latter portfolio. Unsecured lending is capped by the regulatory requirements. In addition, the Bank imposes limits on individual sectors with more conservative caps applied for high-risk sectors, which are defined based on comprehensive analysis of industry cycles and outlook.

Credit concentrations are monitored by Enterprise Risk Management and Credit Risk Management departments on a monthly basis. Trends in the risk positions are analysed in details and corrective actions are recommended should new sources of risk or positive developments emerge. Throughout the underwriting process, risk teams analyse the impact of disbursing large exposures on the Bank's risk position to make sure that decisions are compatible with the Bank's risk appetite.

Along with managing concentration levels in the portfolio, the Bank estimates unexpected losses and respective economic capital for single name concentration and sectoral concentration using the Herfindahl-Hirschman Index (HHI) thus ensuring that sufficient capital is held against concentration risk.

Collateral Policies
Collateral represents the most significant credit risk mitigation tool for TBC Bank, thus, effective collateral management is one of the key risk management components. Collateral on loans extended by TBC may include, but is not limited to, real estate, cash deposit, vehicles, equipment, inventory, precious metals, securities and third party guarantees. The collateral accepted against a loan depends on the type of credit product and on the credit risk of the borrower. The Bank has a largely collateralised portfolio on all of its segments with real estate representing a major share of collateral.

A centralised unit for collateral management is in place governing the Bank's view and strategy in relation to collateral management and ensuring that collateral serves as an adequate mitigating factor for credit risk management purposes. The collateral management framework comprises of a sound independent appraisal process, haircuts system throughout the underwriting process, monitoring and revaluations.

Throughout the underwriting process provided collateral is appraised by TBC Bank's Internal Appraisal Group in accordance with TBC's internal policies. In specific instances such as insider lending and material transactions the Bank uses external appraisers to validate appraisals. The Internal Appraisal Group is part of the collateral management unit and is independent from the loan granting process in order to ensure that adequate appraisals are obtained and proper appraisal procedures are followed. When appraising collateral, TBC Bank applies haircuts to the asset's market value based on the property type and its location.

Loan officers and/or appraisers perform on-site visits to check the quality and condition of the provided collateral. Collateral of significant value (defined as cases in which the value of both the loan and the collateral exceeds US$300,000) is re-evaluated annually through on-site visits by internal appraisers. Statistical methods are used to monitor the value of collateral of non-significant value. Collateral may require more frequent re-evaluation as a result of changes in the borrower's standing or market fluctuations. In case of repossession, any collateral is also re-evaluated within three months prior to repossession. Requirements relating to the frequency of re-evaluations are determined in accordance with TBC Bank's collateral appraisal policy.

Credit Monitoring

TBC Bank's risk management policies and processes are designed to identify and analyse risk in a timely manner, and monitor adherence to predefined limits by means of reliable and timely data. TBC Bank dedicates considerable resources to gain a clear and accurate understanding of the credit risk faced across various business segments. The Bank uses a robust monitoring system to react timely to macro and micro developments, identify weaknesses in the credit portfolio and outline solutions to make informed risk management decisions. Monitoring processes are tailored to the specifics of individual segments. Monitoring processes encompass individual credit exposures, overall portfolio performance and external trends that may impact the portfolio's risk profile. Early warning signals serve as an important early alert system for the detection of credit deteriorations, leading to mitigating actions.

For corporate and SME loans, monitoring is conducted by a credit analyst (for corporate loans) and loan officer (for SME loans) and is reviewed by underwriting risk managers/credit sanctioners. Regular oversight of monitoring and selective reviews are conducted by the credit risk management team. Debt repayments are monitored on a daily basis. Retail borrowers are monitored for timely debt repayment on a daily basis. Statistical techniques are applied to the monitoring of the overall performance of the portfolio, with a deeper analysis performed for specific sub-segments in the event of signs of performance deterioration. Along with the daily monitoring of debt repayments and a monthly analysis of the portfolio's performance, a dedicated unit is in place for on-site monitoring of micro loans considering the specifics of this segment and given that it is mostly represented by borrowers residing in rural areas. The monitoring group undertakes site visits to the borrower's business to perform its analysis. This process enables TBC Bank to promptly identify any inconsistencies with TBC Bank's lending policy and undertake corresponding actions.

The Credit Risk Management Department analyses trends of the portfolio on a regular basis, including total credit portfolio exposure, portfolio quality, vintage analysis, concentrations, maturities, volumes and performance of Non-performing Loans, write-offs and recoveries, and presents its findings to the Management Board Risk Committee. Furthermore, reports relating to the credit quality of the credit portfolio are presented to the Supervisory Board's Risk, Ethics and Compliance Committee on a quarterly basis. By comparing current data with historical figures, and by analysing forecasts Management believes it is able to identify risks and respond to them by amending its policies in a timely fashion.

Restructuring and Collections

TBC Bank uses a comprehensive portfolio supervision system to identify weakened credit exposures in a timely manner and take early remedial actions. Collections and recoveries processes are invoked when the borrower does not meet the agreed payments or the borrower's financial standing is weakened, potentially jeopardising the repayment of the credit.

Dedicated restructuring and recovery units are in place to manage weakened borrowers across all business segments, with collection and recovery strategies tailored for business segments and individual exposure categories.

The primary goal of restructuring units is to rehabilitate the borrower and transfer the exposure back to the performing category. The sophistication and complexity of the rehabilitation process differs based on the type and size of the exposure. Corporate and SME borrowers are transferred to the restructuring units when there is a deterioration in the borrower's financial standing, jeopardising the repayment of the credit. However, the main source of the repayment remains the borrower's cash flow. A restructuring manager assesses the customer relationship strategy and creates the turnaround plan, which considers the specifics of the circumstances and may involve a restructuring of the exposure, a decrease in the borrower's leverage (by spinning off part of the borrower's assets), raising equity, the sale of the exposures to the third parties, taking control of the borrowers' cash flows and limiting its management's business decisions.

Corporate and SME borrowers are transferred to the recovery unit when there is a strong probability that a material portion of the principal amount will not be paid and the main stream of recovery is no longer the borrower's cash flow. Loan recovery plans consider all available sources of loan recovery, such as selling the borrower's assets, realising collateral or payments under guarantees. TBC Bank's goal in the recovery process is to negotiate with the borrower a loan recovery strategy and secure cash recoveries to the extent possible or negotiate repayment through the sale or repossession of collateral.

Collection functions for retail and micro loans provide support to customers who are experiencing difficulties in meeting their obligations. Such customers may miss payments, or notify TBC Bank about their difficulty with loan repayments. A centralised monitoring team monitors retail and micro borrowers in delinquency, which coupled with branches' efforts are aimed at collection maximisation. Collection strategies are defined considering the size and type of exposure. Specific strategies are tailored for different sub-groups of customers, reflecting respective risk levels, so that greater effort is dedicated to customers with a higher risk profile.

Retail and micro loans are generally transferred to the recovery unit at 90 days past due. Collateralised loans are transferred to the internal recovery unit, whereas TBC Bank collaborates with external collection agencies for unsecured loans. For recovery of collateralised loans, the recovery plan is outlined considering specifics of the individual borrower and may involve loan repayments under revised schedules or the sale of collateral. Collection agencies generally negotiate with the borrowers the full repayment of the loan or loans can be rescheduled and repaid accordingly.

RISK MANAGEMENT
CONTINUED

Once the exposure is transferred to the recovery unit, if TBC Bank is unable to negotiate acceptable terms with the borrower, the Bank may initiate collateral repossession, which is usually standard and quite a fast process with limited legal complications, and may include court, arbitration or notary procedures. Restructuring and recovery units are supported by qualified incumbent lawyers for efficient accomplishment of litigation and repossession processes.

Provisioning Guidelines
According to TBC Bank's policy, loan loss reserves must be maintained at a level that is adequate to absorb all estimated inherent losses in TBC Bank's credit portfolio at any given point in time.

The credit portfolio is assessed for impairment on an individual and collective basis. For provisioning purposes, borrowers or groups of borrowers are classified as "significant" or "non-significant". Borrowers with total liabilities of GEL 2 million or more are regarded as significant.

To assess impairment with respect to individually "significant" borrowers, TBC Bank outlines trigger events, which include the deterioration of the borrower's financial standing, delinquencies in loan repayments, bankruptcy proceedings, or other events that may affect the borrower's creditworthiness. If there is evidence that an impairment loss event with respect to a significant credit exposure has occurred, TBC Bank assesses the borrower on an individual basis and measures the amount of the loss as the difference between the asset's carrying amount and the present value of estimated future cash flows. TBC Bank estimates future recoveries by applying a scenario analysis and taking into account all relevant information available at the reporting date, including adverse changes in the general macroeconomic environment or the industry the borrower operates in.

If TBC Bank determines that no objective evidence exists that an individually assessed financial asset has been impaired, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. For collective assessment purposes, financial assets are grouped into homogenous risk pools based on similar credit risk characteristics, including the type of counterparty (individual or business), the type of product, the past-due status of the financial asset, the restructuring status and the type of collateral.

In order to calculate the impairment allowance for collectively assessed loan pools, TBC Bank estimates certain risk parameters, which include the probability of default, cure rate, recovery rate, survival rate and loss given default, based on historical experience. Probabilities of defaults are calculated based on migration matrices for different overdue buckets within the portfolio and increase based on the number of payments missed, thus raising the associated impairment requirement. For recovery rate estimation purposes, the impaired portfolio is segmented based on the number of months in default and the amounts to be recovered are estimated, which decrease as the number of months in default increase. Cure rates estimate the extent to which defaulted exposures can be cured by the borrower repaying the overdue amounts in full. Exposures with a longer time in default have lower cure rates compared to newly defaulted exposures. For cured exposures, TBC Bank also estimates survival rate, which represents the probability that the exposure will be repaid or survive the one-year quarantine period and become a performing portfolio. In case there is change in the internal or external environment and historical data no longer reflects current conditions, TBC Bank adjusts the risk parameters on the basis of current observable data to reflect the effects of current conditions that did not affect past periods, and to remove the effects of past conditions that do not exist currently.

TBC Bank will reverse a previously recognised impairment loss if, after the impairment was recognised, the amount of the impairment loss decreases and the decrease is related to an objective event. The previously recognised impairment loss is reversed by adjusting the allowance account through profit or loss. In order to reverse provisions for individually significant borrowers, there should be objective evidence that the borrower's financial standing has improved or there is an improvement in collateral coverage. For collectively assessed loans, the exposure should survive the quarantine period to be reclassified as a performing loans pool.

Liquidity Risk Management
Liquidity risk is the risk that TBC either does not have sufficient financial resources available to meet all of its obligations and commitments as they fall due, or can access those resources only at a high cost. Liquidity risk is managed by the Financial Risk Management and Treasury Departments and is monitored by the ALCO.

The principal objectives of TBC's liquidity risk management policy are to:
(i) ensure the availability of funds in order to meet claims arising from total liabilities and off-balance sheet commitments, both actual and contingent, at an economic price;
(ii) recognise any structural mismatch existing within TBC's statement of financial position and set monitoring ratios to manage funding in line with the Bank's well-balanced growth; and
(iii) monitor liquidity and funding on an ongoing basis to ensure that approved business targets are met without compromising TBC's risk profile.

The Liquidity risk management Policy is reviewed by the Management Board prior to approval by the Supervisory Board.

Liquidity risk is categorised into two risk types: funding liquidity risk and market liquidity risk.

Funding liquidity risk is the risk that TBC will not be able to efficiently meet both expected and unexpected current and future cash flow without affecting either its daily operations or its financial condition under both normal conditions and during a crisis situation. To manage funding liquidity risk, TBC internally developed a Liquidity Coverage Ratio (LCR) and a Net Stable Funding Ratio (NSFR) model both under Basel III liquidity guidelines. In addition, TBC also applies stress tests and "what-if" scenario analyses, and monitors NBG minimum liquidity ratio.

LCR (calculated by reference to the sum of qualified liquid assets and 30-day cash inflows divided by 30-day cash outflows) is used to help manage short-term liquidity risks. TBC's liquidity risk management framework is designed to comprehensively project cash flows arising from assets, liabilities and off-balance sheet items over certain time bands and ensure that liquidity coverage ratio limits are put in place. TBC also stress tests the results of liquidity through large shock scenarios set by the NBG. TBC calculates its internal liquidity coverage ratio and conducts stress tests on a weekly basis. TBC Bank's liquidity coverage ratios were 288%, 254% and 344% for the years ended 31 December 2015, 2014 and 2013, respectively.

NSFR (calculated by dividing available stable by required stable funding) is used for long-term liquidity risk management to promote resilience over a longer time horizon by creating additional incentives for TBC to rely on more stable sources of funding on a continuing basis.

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

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

Funding and Maturity Analysis
TBC's principal sources of liquidity include customer deposits and customer accounts, borrowings from local and international banks and financial institutions, subordinated loans from IFI Investors, local inter-bank short-term term deposits and loans, proceeds from sales of investment securities, principal repayments on loans, interest income, and fee and commission income.

We believe that a strong and diversified funding structure is one of TBC's differentiators. TBC relies on relatively stable deposits from Georgia as the main source of funding. In order to maintain and further enhance its liability structure TBC sets targets for retail deposits in the strategy and sets gross loan to deposit ratio limits. TBC's gross loan to deposit ratio (defined as total value of gross loans divided by total value of deposits) was 111.0%, 111.6% and 102.5% as at 31 December 2015, 2014 and 2013, respectively.

TBC also sets deposit concentration limits for large deposits and deposits of non-Georgian residents in its deposit portfolio.

We believe that TBC has sufficient liquidity to meet its current on and off-balance sheet obligations.

For further information on management of liquidity risk, please refer to Note 35 to the Audited Consolidated Financial Statements.

Market Risk
TBC follows the Basel Committee's definition of market risk as the risk of losses in on and off-balance-sheet positions arising from movements in market prices. These risks are principally (a) risks pertaining to interest rate related instruments and equities in the "trading book" (financial instruments or commodities held for trading purposes); and (b) foreign exchange risk and commodities risk throughout TBC. TBC's strategy is not to be involved in trading financial instruments or investments in commodities. Accordingly, TBC's only exposure to market risk is foreign exchange risk in its "structural book," comprising its regular commercial banking activities having no trading, arbitrage or speculative intent.

Foreign Exchange Risk Management
TBC is exposed to currency risk that arises from potential change in foreign currency exchange rates, which can affect the value of a financial instrument. This risk stems from the open currency positions created due to mismatches in foreign currency assets and liabilities. The NBG requires TBC Bank to monitor both balance sheet and total aggregate balance (including off-balance sheet) open currency positions and to maintain the latter within 20% of TBC Bank's regulatory capital. For the year ended 31 December 2015, TBC Bank maintained an aggregate balance open currency position of 1.56%.
In addition, the Supervisory Board sets further limits on open currency positions. The ALCO has set limits on the level of exposure by currency and for total aggregate position which are more conservative than those set by the NBG and the Supervisory Board. TBC Bank's compliance with these limits is monitored daily by the heads of the Treasury and Financial Risk Management Departments and is reported periodically to the Management Board, the Supervisory Board and the Risk, Ethics and Compliance Committee.

Open currency positions are used to assess TBC Bank's minimum capital requirements under the ICAAP framework on a monthly basis. In addition, the Financial Risk Management Department performs stress testing on a monthly basis.

Interest Rate Risk Management
Interest rate risk arises from potential changes in market interest rates that can adversely affect the value of TBC's financial assets and liabilities. This risk can arise from maturity mismatches of assets and liabilities, as well as from the repricing characteristics of such assets and liabilities. The deposits and 80% of the loans offered by TBC are at fixed interest rates, while a portion of TBC's borrowing is based on a floating rate of interest. TBC's floating rate borrowings are, to a certain extent, hedged as a result of the NBG paying a floating rate of interest on the minimum reserves that TBC holds with the NBG. Furthermore, many of TBC's loans to and deposits from customers contain a clause allowing TBC to adjust the interest rate on the loan/deposit in case of adverse interest rate movements, thereby limiting TBC's exposure to interest rate risk. Management also believes that TBC's interest rate margins provide a reasonable buffer in order to mitigate the effect of possible adverse interest rate movement.

TBC Bank employs an advanced framework for the management of interest rate risk. In order to manage interest rate risk, TBC Bank establishes appropriate limits, monitors compliance with the limits and prepares forecasts. Interest rate risk is managed by the Financial Risk Management Department and is monitored by the ALCO. The ALCO decides on actions that are necessary for effective interest rate risk management and follows up on their implementation. The major aspects of interest rate risk management development and the respective reporting are periodically provided to the Management Board, the Supervisory Board and the Risk, Ethics and Compliance Committee.

RISK MANAGEMENT
CONTINUED

TBC Bank measures four types of interest rate risk based on the source of the risk: (i) repricing risk, (ii) yield curve risk, (iii) basis risk and (iv) optionality (embedded option risk).

TBC Bank considers a number of stress scenarios, including different yield curve shift scenarios and behavioural adjustments to cash flows (such as deposit withdrawals or loan prepayments), to calculate the impact on one-year profitability and enterprise value. Appropriate limits are set by the Supervisory Board and by the ALCO.

Under the ICAAP framework, TBC Bank reserves capital in the amount of the adverse effect of possible parallel yield curve shift scenarios on net interest income over a one-year period for Basel II Pillar 2 capital calculation purposes. As at 31 December 2015 the impact of the downward parallel shift of a yield curve of (4.8)% in GEL and a downward parallel shift of 2.4% in USD on net interest income over a one-year period was equivalent to GEL 35.7 million. In addition, TBC has developed stress tests in accordance with Basel II requirements to ensure that the Bank can withstand severe but probable stress scenarios.

Operational Risk Management

One of the main risks TBC Bank is exposed to is operational risk, which is the risk of loss resulting from inadequate or failed processes, people and systems or from external events. It includes legal risk, but excludes strategic and reputational risk. However, reputational risk management is also given high importance and priority and is an integral part of the overall risk culture in the organisation.

In order to oversee and mitigate operational risk, TBC Bank has established an operational risk management framework that outlines the general principles for effective operational risk management and defines the roles and responsibilities of various parties involved in the process. Policies and procedures enabling effective management of operational risks are an integral part of the framework.

The Management Board ensures a strong internal control culture within the Bank where control activities are an integral part of TBC Bank's operations. The Supervisory Board sets TBC Bank's operational risk appetite and the Operational Risks Committee oversees compliance with the limits set therein. The Operational Risks Committee discusses TBC Bank's operational risk profile and risk minimisation recommendations on a regular basis.
The Operational Risk Management Department is responsible for the implementation of appropriate policies and procedures enabling the Bank to manage operational risks. The ORM department is also responsible for the day-to-day management of operational risks using various techniques that include but are not limited to the running of risk and control self-assessment aimed at detecting possible gaps in operations and processes with the purpose of suggesting appropriate corrective actions; internal risk event database formation for further quantitative and qualitative analysis; performing internal control for detecting systematic errors in banking operations, internal fraud events and monitoring key risk indicators; scenario and root cause analysis; business advisory with regard to nonstandard cases as well as new products and procedures assessment; IT incident occurrence monitoring and overseeing activities targeted at solving identified problems; and insurance policies to transfer the risk of losses from operational risk events. The ORM department reports to the Chief Risk Officer.

For the purpose of measuring potential (both expected and unexpected) operational risk losses and appropriate capital, the Bank uses quantitative tool such as the Advanced Measurement Model (AMA) that incorporates internal and external loss data as well as a scenario analysis of possible events.

There are various policies, processes and procedures in place to control and mitigate material operational risks. These include:
- outsourcing risk management policy which enables TBC Bank to control outsourcing (vendor) risk arising from adverse events and risk concentrations due to failures in vendor selection, insufficient controls and oversight over a vendor and/or services provided by a vendor and other impacts to the vendor;
- implementation of procedures to analyse system flaws and take corrective measures to prevent the re-occurrence of significant losses;
- involvement of the Operational Risk Department in the approval process of new products and services to minimise risks relating thereto; and
- development of a special Operational Risk Awareness program for TBC Bank employees and provision of regular training to further strengthen TBC's internal risk culture.

An Information Security Steering Committee has been established in charge of continuous improvement of information security and business continuity management processes and minimising information security risks. The Committee has been formed to centralise the information security function including physical security, HR security, data security, IT security and business continuity. The Bank invests in effective information security risk management, incident management and awareness programs, which are enhanced with automated tools that ensure acceptable levels of information security risk within the organisation. Whenever preventive controls are not applicable, comprehensive business continuity and incident response plans ensure TBC Bank's ability to operate on an ongoing basis and limit losses in the event of a severe business disruption.

Reputational Risk Management

TBC's business model is built on public trust and therefore aims to ensure that no activities are undertaken which may result in an adverse reputational impact. Management believes that one of TBC's key strengths is its well-known and trusted brand, and is consequently very protective of the strong reputation that TBC has developed on the market. Hence the maintenance of a strong reputation is considered to be a goal of highest priority and importance and reputation risk awareness and management is embedded throughout the Bank including all business units and responsibility levels.

TBC's reputation risk management efforts include:

- monitoring TBC's reputation, addressing matters damaging that reputation and using the feedback from external stakeholders to gain insights or receive early warning signals of potential concerns;
- identifying and reporting reputational risk-related matters by both business units and risk staff in their daily interactions with clients as well as through the process of project and product development; and
- restricting activities that may cause reputational damage to TBC Bank, such as projects and activities having negative environmental or social impacts.

Strategic Risk Management

Strategic risk is the current or prospective risk to earnings and capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to changes in the business environment, both internal and external. This risk is a function of the compatibility of TBC's strategic goals, the business strategies developed and resources employed to achieve strategic goals, and the quality of implementation of those goals.

The aim of strategic risk management efforts is to maintain TBC's strategic risk at defined levels in accordance with its strategic objectives. The strategic risk management system consists of the following main stages: (i) identification, (ii) measurement, (iii) monitoring and (iv) control and mitigation.

The Management Board has overall responsibility for TBC's strategic objectives and key principles of the strategic risk management framework. The primarily responsibility for strategic risk assessment, management, monitoring and control lies with the Strategic Planning and Budgeting Department and TBC's business segments.

An analysis of TBC Bank's actual performance compared to its stated goals is reported to the Management Board on a regular basis. This report includes the level of strategic risk for the period and its dynamic, mitigating actions undertaken to address these risks, potential strategic risks for future periods and recommendations.

Compliance and AML Risk Management

TBC Bank has established a compliance function that is represented by a three-level structure consisting of the Compliance Department, the CEO and the Risk, Ethics and Compliance Committee. The Compliance Department is responsible for, *but not limited to*, assisting with the identification and assessment of compliance risk in all business activities; advising on compliance policy, processes, rules and standards; assessing the impact of new laws, regulations and guidelines; assessing the adequacy of internal compliance processes; helping with the coordination of responses to requests from external regulators and ensuring that TBC follows appropriate procedures including in relation to anti-money laundering, conflicts of interest, protection of non-public customer information and insider trading. The Compliance Department is accountable to the Risk, Ethics and Compliance Committee and the Supervisory Board, and acts independently within TBC Bank.

TBC's anti-money laundering programme, established in accordance with Georgian law, is a part of TBC's compliance framework. The anti-money laundering unit of the Compliance Department (AML Unit) is responsible for anti-money laundering issues. The anti-money laundering policy and complementary internal standards and procedures include Georgian law requirements, as well as measures based on recommendations from international bodies, such as the Financial Action Task Force, Basel, United Nations and the Office of Foreign Assets Control, and contain "Know Your Customer" procedures, methods for the assessment of correspondent banks, processing and retaining documentation, maintaining and updating client databases, operational standards, risk-based assessment of customers, due diligence procedures, and the identification of suspicious transactions and transactions that are subject to mandatory reporting to the Financial Monitoring Service of Georgia (FMS). The anti-money laundering policy (and any amendments thereto) is approved by the Management and the Supervisory Board. TBC Bank's anti-money laundering policy and all related internal instructions and standards are available to all employees through TBC Bank's intranet.

To adhere to anti-money laundering policy requirements, TBC Bank has implemented automated solutions for (i) client screening against sanctioned lists during the on-boarding process and international money transfers, (ii) anti-money laundering risk assessment of clients, products and services, and (iii) revealing suspicious behaviour on client's accounts. An automated process is performed through Siron products provided by FICO-Tonbeller.

The Compliance Department delivers face-to-face training in anti-money laundering and compliance topics which are tailored for different target groups, including new employees. Training in anti-money laundering and other compliance issues is conducted annually and is followed by staff testing on an annual basis.

TBC's anti-money laundering compliance activities are reviewed annually by its Internal Audit Department. Since the previous report, TBC Bank and its subsidiaries have not been inspected by the National Bank of Georgia regarding abidance of the anti-money laundering law. As of the date of this report, no TBC Group Company has been accused, named or cited in connection with any occurrence of money laundering, financing of terrorist activity, fraud, or other corrupt or illegal purpose transactions or breaches of Georgian laws prohibiting such activities.

RISK MANAGEMENT
CONTINUED

Internal Capital Adequacy Assessment Process

The level of capital that TBC Bank is choosing to hold is impacted by the following factors:

- minimum regulatory requirements (Pillar 1);
- ICAPP (Pillar 2);
- regulatory add-ons (Pillar 2, SREP); and
- business expectations.

Currently, TBC must comply with two regulatory capital adequacy requirements imposed by the NBG in line with the Basel Committee's standards. The new Basel II/III framework, introduced by the NBG in 2013, replaces the previous Basel I based requirements, which are gradually being phased out and will be fully removed by the end of 2017. The NBG version of the Basel II/III requirements is a more conservative version of the original Basel II/III framework, with the main difference being an additional 75% risk weight for foreign currency denominated loans.

For Pillar 2 purposes, TBC has implemented an Internal Capital Adequacy Assessment Process (ICAAP), whereby TBC Bank assesses all material risks that it faces and reserves capital for each. TBC Bank's ICAAP is subject to a Supervisory Review and Evaluation Process and it engages in active dialogue with the regulator to demonstrate that the Bank adequately measures its unexpected losses and holds sufficient capital against it.

The key components of TBC's ICAAP process include risk identification and assessment and capital allocation.

The table below summarises the material risks TBC Bank faces and the approaches used to calculate capital charges for each identified risk.

Summary of Risks Considered per Basel Pillar 1 and 2

Key areas	Pillar 1	Pillar 2
Credit Risk	Standardised approach	Standardised approach
Currency Induced Credit Risk (CICR)	NBG assessment	Bank assessment
Market Risk	Standardised approach	Standardised approach
Operational Risk	Basic indicator approach	Advanced measurement approach
Interest Rate Risk in the Banking Book	—	Advanced approach
Reputation Risk	—	Benchmarking
Strategic Risk	—	Benchmarking
Concentration Risk	—	Bank assessment

Stress Testing

TBC Bank performs regular stress testing exercises which represent a significant management decision making component. The Bank has developed a comprehensive, Enterprise-Wide Stress Testing (EWST) framework that is actively used for capital management and risk assessment purposes. The stress parameters used in EWST are negative trends of GDP, exchange rates, unemployment, interest rates, CPI levels and real estate price levels. The results of EWST are expressed as the amount of capital needed (per risk type) in order to withstand the full potential losses resulting from the specified stress events.

Two severity levels are considered for performing enterprise-wide stress tests. A mild stress scenario is considered to be a stress that might occur during the normal business cycle (once in seven years). A severe stress scenario is based on the assumption of occurrence once in 100 years.

The Bank has introduced an internal capital buffer that is equal to the losses under a mild stress scenario. Additionally the Bank maintains a level of equity that covers losses under a severe stress scenario.