PASHA Bank

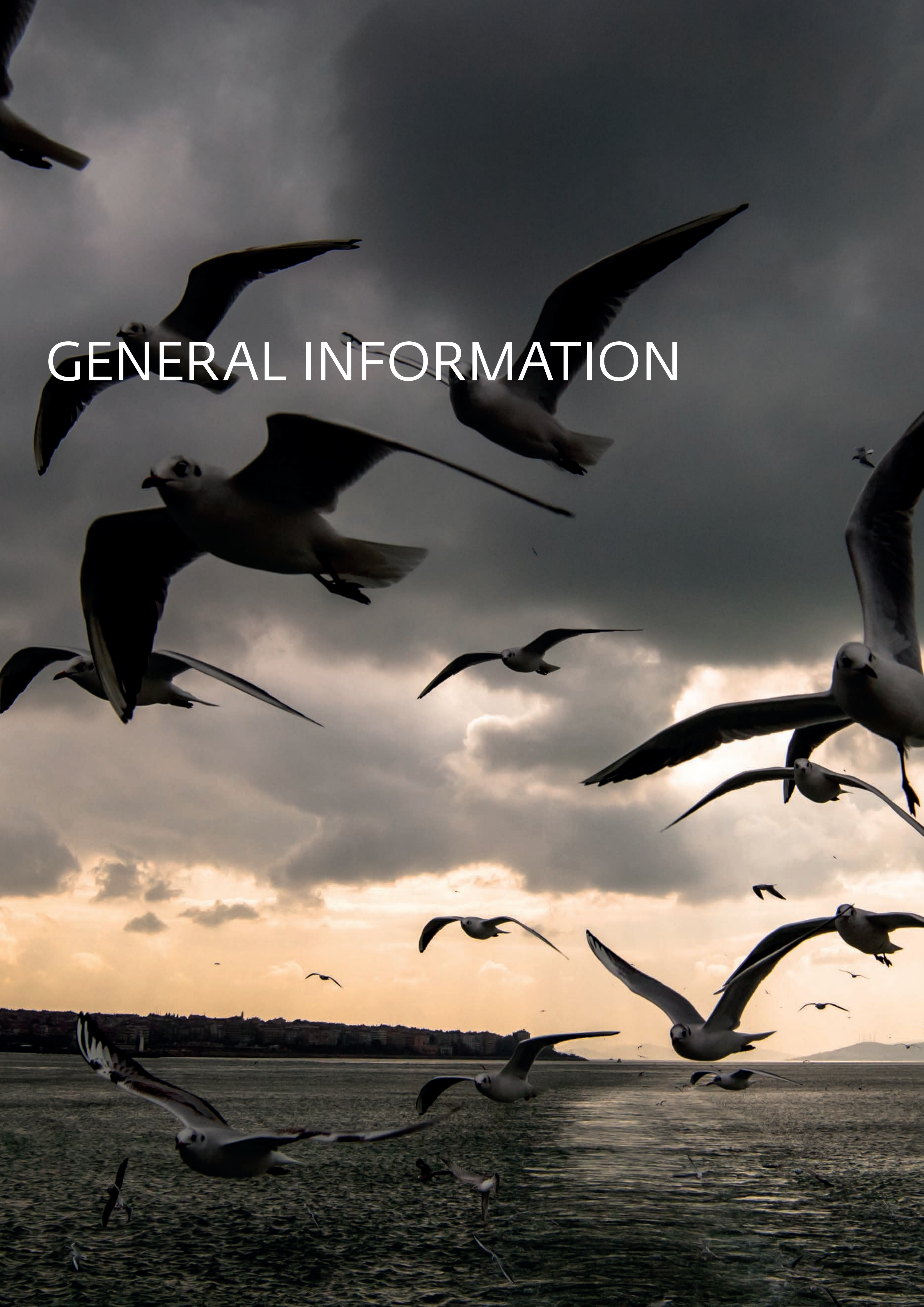
ANNUAL REPORT 2016

The photographs in this Report are from the ArTriangle 'City Stories' Photography Exhibition - an artistic bridge spanning Turkey, Azerbaijan and Georgia, formed by PASHA Bank.

Contents

PASHA Bank aims to deliver banking services at the highest international levels of transparency and service built on five core values: Integrity, Quality, Profitability, Entrepreneurship and Collaboration.

GENERAL INFORMATION



ABOUT PASHA BANK

PASHA Bank is a leading investment and corporate bank in Azerbaijan. Established in 2007, it provides a range of corporate banking services – including lending, transaction banking, capital markets services and financial advisory – to both domestic clients and foreign companies looking to do business in the region. The Bank offers an array of financial products backed by trade finance-related partnerships with international banks and financial institutions. The Bank also provides underwriting services to legal entities and is the first in the local securities market to act as a market maker. PASHA Bank has delivered private banking services to HNWIs since 2011, including deposits, loans and financial planning.

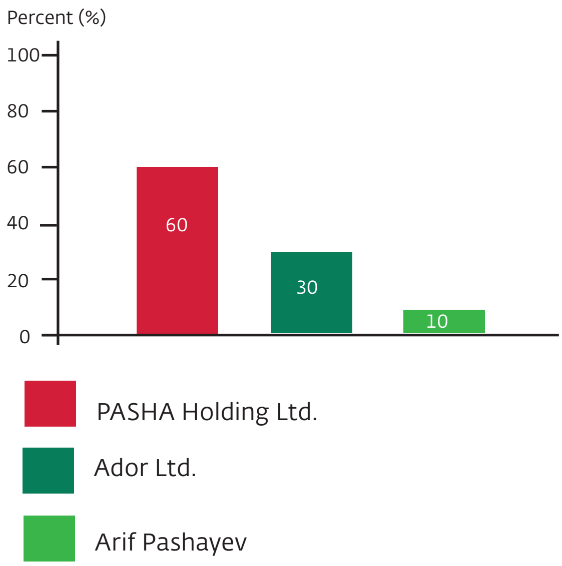
PASHA Bank's authorized capital amounts to AZN 333 million, which makes it the most capitalized privately-owned bank in Azerbaijan. PASHA Bank employs about 450 personnel at its headquarters, four branches in Baku and two regional branch locations in the cities of Ganja and Zaqatala. In February 2013, the Bank opened its first subsidiary bank – PASHA Bank Georgia. In December 2014, the Turkish regulatory authority granted PASHA Bank permission to start operations in Turkey.

In September 2016, Fitch Ratings affirmed PASHA Bank's long-term foreign currency Issuer Default Rating (IDR) as 'BB-' and short-term IDR as 'B'. In December 2016, the international rating agency Standard & Poor's reaffirmed the Long-term Issuing Bank Default Rating (IBDR) of PASHA Bank as 'BB-'. PASHA Bank also retained its 'B' Short-term IBDR rating. These ratings are among the highest of all privately-owned banks in Azerbaijan with 100% local capital.

PASHA Bank is part of PASHA Group, a major investment holding group in Azerbaijan. The Group also includes significant assets in insurance, real estate development, construction, tourism and other businesses. Kapital Bank, one of the largest retail banks in Azerbaijan, is also owned by PASHA Group.

The Bank is committed to establishing and developing long-term, supportive relationships with its growing customer base. It aims to deliver banking services at the highest international levels of transparency and service built on five core values: Integrity, Quality, Profitability, Entrepreneurship and Collaboration.

Shareholding Structure

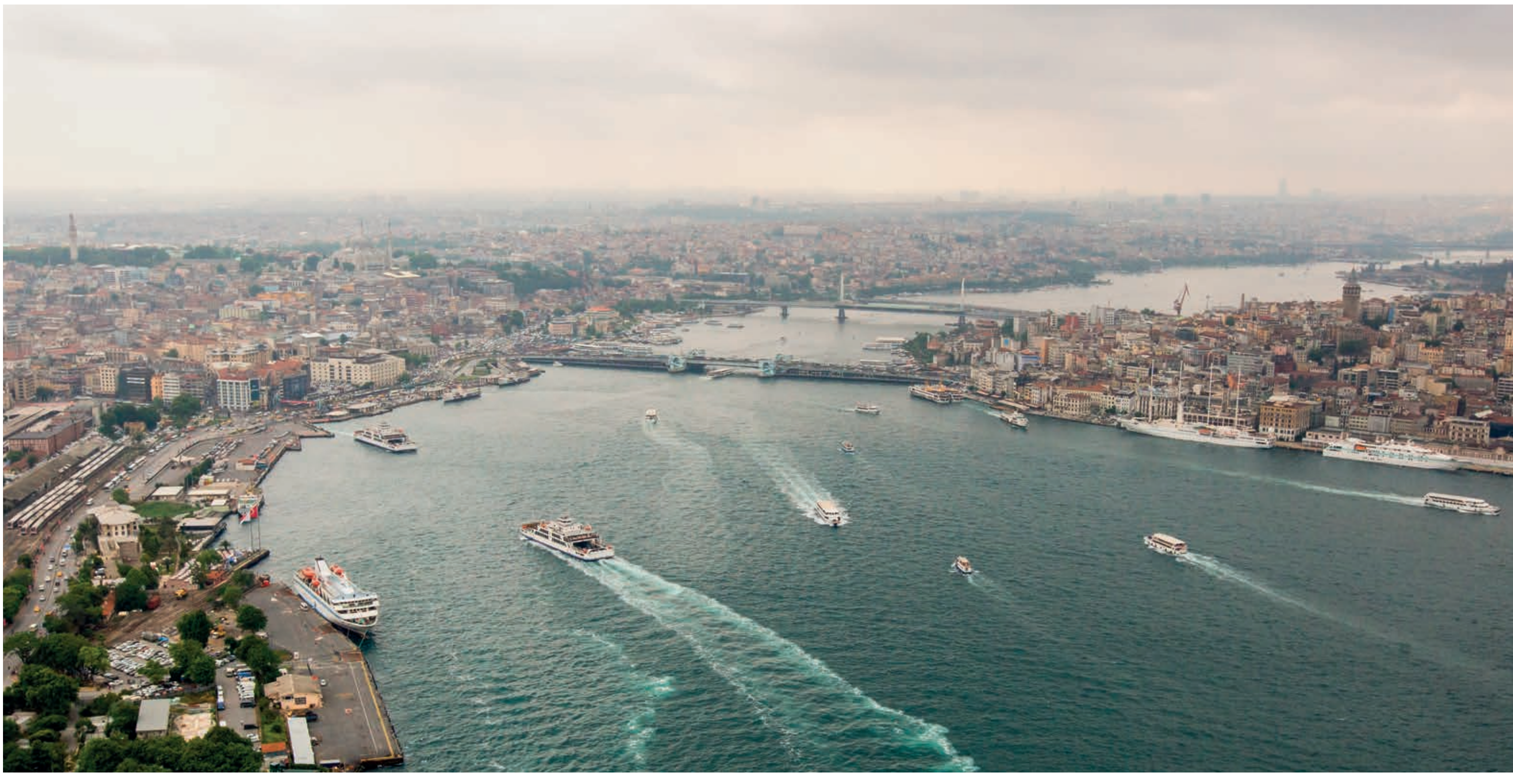


Awards

Since its establishment, PASHA Bank and its subsidiaries have received numerous awards and accolades from prestigious international and domestic platforms.

2016

"Best Bank in Azerbaijan" – Global Finance
"Best Banking Group in Azerbaijan" - World Finance
"Best Commercial Bank in Azerbaijan" - World Finance



2015
"Best Banking Group in Azerbaijan" – World Finance
"Best Private Bank in Azerbaijan" – World Finance
"Best Commercial Bank in Azerbaijan" – World Finance
"Best Bank in Azerbaijan" – World Finance
"Best Bank in Azerbaijan" – EMEA Finance
"Participant of the Year" – Azerbaijan Microfinance Association (AMFA)
"Leading Company Promoting Gender Equality" – Azerbaijan Microfinance Association

2014
"Best Bank in Azerbaijan" – EMEA Finance
"Best Bank of Azerbaijan" – International Finance Magazine
"Best Investment Bank of Azerbaijan" – International Finance Magazine
"Best SME Bank" – International Finance Magazine
"Best Investment Bank of Azerbaijan" – EMEA Finance
"Best Private Bank" – World Finance
PASHA Bank Georgia
"Bank of the Year" – Caspian Energy Forum
PASHA Capital
"Best Broker in Azerbaijan" – EMEA Finance

2012
"Best Investment Bank of Azerbaijan" – EMEA Finance
"Best Bank of Azerbaijan" – BNE Survey
"Best Corporate Social Responsibility (CSR) Program in Europe" – Europe Banking Awards

2011
"Best Investment Bank of Azerbaijan" – EMEA Finance

ABOUT PASHA HOLDING

Via its subsidiaries, PASHA Holding invests in the banking, insurance, construction, real estate development and tourism sectors – key pillars of the developing Azerbaijani economy.

TOTAL ASSETS:	*AZN 4 billion*
TOTAL EQUITY:	*AZN 800 million*
EMPLOYEES:	*2500+*

Established in 2006, PASHA Holding LLC has built its business on the solid foundation of effective management, strong corporate governance and prudent investment decisions.

Via its subsidiaries, PASHA Holding invests in the banking, insurance, construction, real estate development and tourism sectors – key pillars of the developing Azerbaijani economy.

PASHA Holding has two types of investment assets: Controlling stakes in PASHA Group companies and minority private equity investments.

PASHA Holding

PASHA Insurance

PASHA Insurance is an open joint stock company (OJSC) with issued share capital of AZN 50 million. PASHA Insurance provides 35 categories of mandatory and voluntary insurance to both corporate and individual customers.

PASHA Travel

PASHA Travel was founded in 2003 to provide premium quality travel services to companies and individuals.

PASHA Construction

PASHA Construction was established in 2006 as a full service construction and development company with issued share capital of AZN 10.4 million. The company has completed some of the most prestigious projects in Baku. It has a project portfolio totaling over 1 million sqm, with over 830 thousand sqm currently under construction.

PASHA Life

PASHA Life was founded in 2010 under the name PASHA Insurance and has AZN 40,250 million in authorized capital.

PASHA Capital

PASHA Capital was established in June 2012 to provide broker, dealer, advisory and asset management services to individual and institutional investors. The company has issued share capital of AZN 300,000 and holds an investment firm license from the Financial Market Supervisory Authority.

Kapital Bank

PASHA Holding is the controlling shareholder of Kapital Bank with 99.75% of share capital. Founded in 1874 as Azerbaijan Savings Bank, Kapital Bank is one of Azerbaijan's largest banks serving more than 3 million customers. Headquartered in Baku, Bank has a large footprint of 90 branches covering the whole country.

VISION, MISSION, VALUES AND STRATEGIC GOALS

Our Vision

Our vision is to be a leading Azerbaijani Bank committed to the highest standards of ethics, indisputable business reputation, quality of services and financial strength.

Our Mission

- Contributing to the growth of our customers by delivering high quality products and services tailored to our customers' needs
- Employing, training and cultivating highly competent and dedicated personnel
- Boosting the welfare and cultural development of society
- Maintaining a strong financial position
- Conducting our operations in a transparent and prudent manner

Our Values

- Integrity
- Quality
- Profitability
- Entrepreneurship
- Collaboration

Our Strategic Goals

- Enhancing our capital and organizational efficiency
- Strengthening core capabilities
- Expanding our market position
- Bolstering customer service
- Creating synergies with the Group

FINANCIAL AND OPERATIONAL INDICATORS

The Bank's net profit increased almost fourfold to AZN 69.3 million in 2016.

Key Financial Highlights (AZN million)

	2014	2015	2016
Total Assets	1,273.3	2,292.7	3,289.8
Loans (net)	538.9	902.2	1,107.3
Deposits	703.1	1,374.1	2,350,7
Customer Time Deposits	144.8	472.9	1,352.3
Customer Current Accounts	558.2	901.2	998.9
Shareholders' Equity	323.7	432.4	487.3
Interest Income	64.3	100.3	157.5
Fee & Commission Income	7.4	12.7	20.7
Operating Profit	60.2	116.3	186.5
Total Operating Expenses	29.3	47.4	80.6
Net Profit	-2.8	14.4	69.3

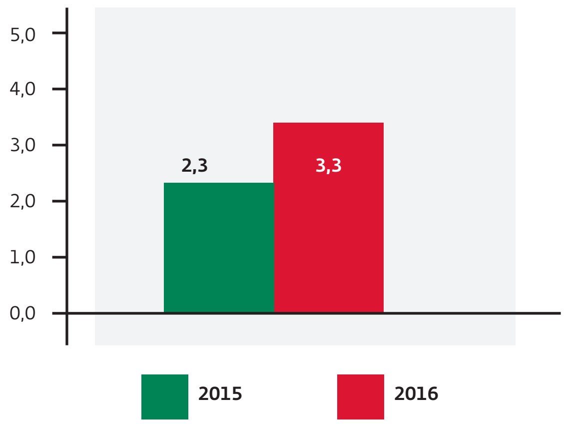
Key Financial Ratios (%)

	2014	2015	2016
Loans/Total Assets	42.3	39.4	33.7
Loans/Deposits	76.6	65.7	47.1
NPL Ratio*	10.76	3.82	8.25
Demand Deposits/ Total Deposits	79.4	65.6	42.5
Shareholders' Equity/ Total Liabilities	34.1	23.2	17.3
Capital Adequacy Ratio	33	17	20

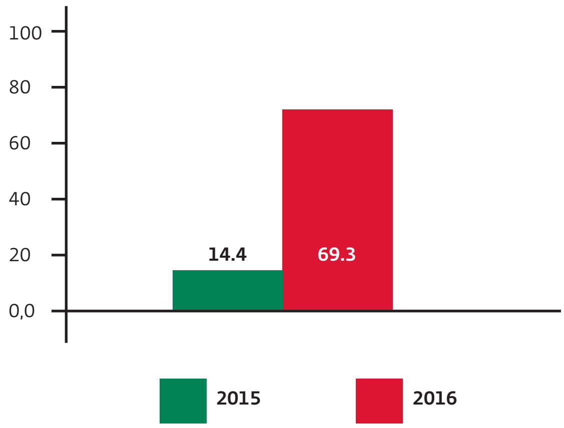
*PASHA Bank Azerbaijan only

Financial Highlights

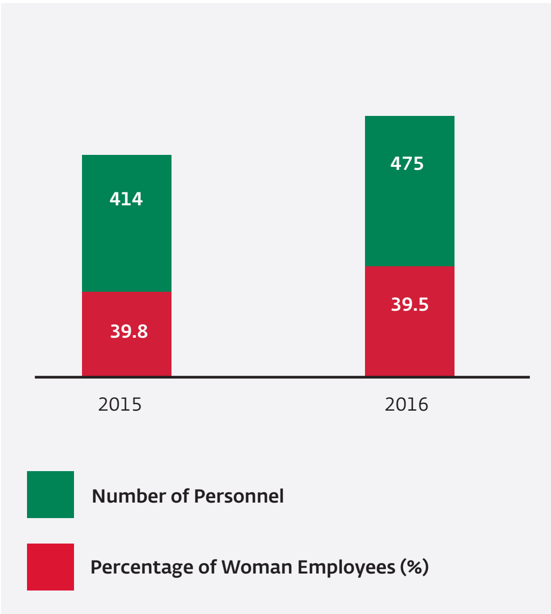
Total Assets (AZN billion)

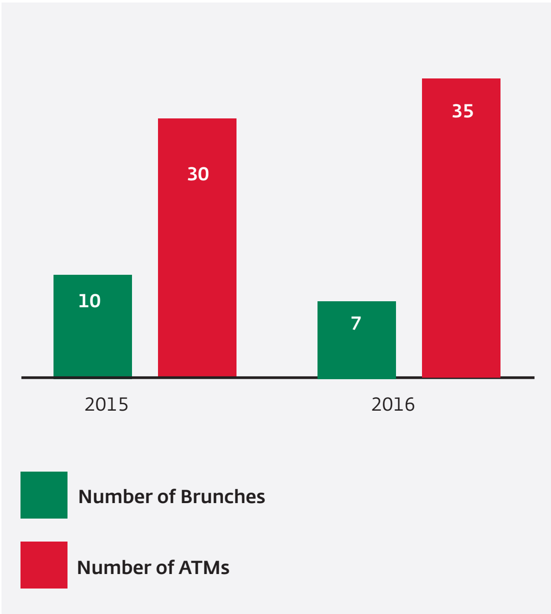


Net Profit (AZN million)

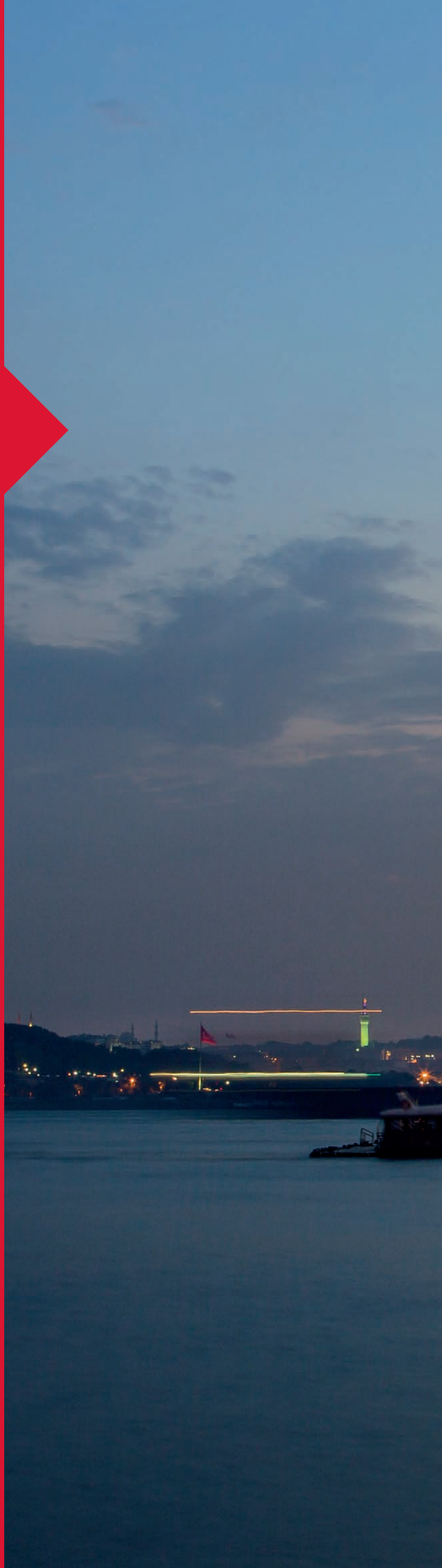


Operational Highlights





At PASHA Bank, customers are our number one priority. As such, we will ensure that our future digital services and solutions will be designed for customer comfort, ease of use and convenience at the center – to continue delivering the highest customer satisfaction during the digital transformation period.



MANAGEMENT

FOREWORD BY THE CHAIRMAN OF THE SUPERVISORY BOARD AND CHAIRMAN OF THE EXECUTIVE BOARD

Dear Colleagues, Customers and Stakeholders,

With the end of quantitative easing by the Fed in the US and the roiling of commodity markets worldwide, the global economy expanded 2.3% in 2016, underperforming its post-crisis trend of 3%. Emerging markets' economic growth largely outpaced advanced markets during the year. Developing countries recorded GDP growth of 3.4% in 2016, which is much faster than developed economies where growth was recorded at 1.6%.

Meanwhile, Azerbaijan's GDP contracted 3.8% in 2016 due to weak crude oil prices and a decline in budget revenues, which translated into weaker consumer demand. Non-oil GDP shrank 5.4% primarily due to a fall in construction activity.

The country's economy continued deleveraging on the back of economic deceleration with banking assets declining 9.9% year-on-year. The decline was exacerbated by the fact that 11 banks lost operating licenses during the 2015-2016 period, while others were forced to significantly restructure their loan portfolios. As a result, the total loan portfolio of the Azerbaijani banking system contracted 22% in 2016. By year's end, overdue loans constituted 9% of total loans. The corporate lending portfolio decreased 21.4% year-over-year. Meanwhile, the individual loan portfolio declined 28.5% year-on-year.

During the reporting year, deposits decreased 2.3%. A 14% drop in households' deposits was partially offset by a 34% jump in corporate loans, from AZN 6.8 billion to AZN 9.1 billion. Deposits from financial institutions amounted to around AZN 3 billion.

Despite the challenging environment, PASHA Bank demonstrated a solid performance in 2016. Thanks to our strategic focus on delivering maximum value to customers and continuing to improve our credit risk management, we navigated these volatile market conditions successfully.

While the local banking industry experienced shrinking portfolios and loss of profitability, PASHA Bank's total assets grew 43% and operating income jumped 60%. During the reporting year, the Bank boosted its corporate loan market share by 8%. As a result, the Bank's net profit increased almost fourfold to AZN 69.3 million. In addition – and contrary to the market – our customer deposits went up 71% year-on-year, from AZN 1,374 billion in 2015 to AZN 2,350 billion in 2016.

PASHA Bank remained committed to providing high-quality services to its corporate clients in the large corporate, commercial and SME segments. Our local market positioning remained focused on delivering solid support to corporate customers. We execute strong customer relationship management and develop tailored products to meet clients' specific needs during challenging times. PASHA Bank further bolstered its competitive position by introducing B2B services to the Bank's large and commercial clients. The upgrade allowed integration of clients' ERP systems with that of the Bank, resulting in a dramatic improvement of the speed of clients' transactions.

In 2016, PASHA Bank successfully passed established milestones on its way toward meeting its strategic objectives.

The reporting year saw our successful migration to a new core banking system, which features cutting edge technologies and supports our future growth strategy. This state-of-the-art system will allow PASHA Bank to cut operating costs, and reduce time to market for new products.

PASHA Bank also adopted Business Process Management (BPM) to introduce a new way of working. Based on a lean organization philosophy and approach, BPM lays the foundation for the Bank's continuous process improvement initiatives. These efforts aim to make our workflow more effective, more efficient and more capable of adapting to an ever-changing environment.

During the year, we developed and launched a new mobile banking application. This innovation helped the Bank increase penetration of digital services for Individual segment customers.

Understanding that human capital is its most valuable asset, PASHA Bank aligned its performance management and motivation system with the Bank's new strategic targets and organizational structure. The new system ensures that strategic goals are effectively cascaded throughout the organization.

The Bank also continued to garner accolades and awards in recognition of its excellence. In 2016, PASHA Bank received the "Best Banking Group in Azerbaijan" and "Best Commercial Bank in Azerbaijan" awards from World Finance and the "Best Bank in Azerbaijan" award from Global Finance. These prestigious honors made us all especially proud.

In addition, PASHA Bank continued efforts to develop Azerbaijani society with our social responsibility initiatives. From conducting seminars that foster entrepreneurship among young people and organizing trainings that preserve disappearing traditional crafts, to providing scholarships to students in need and promoting quality business journalism in the country, PASHA Bank strives to make a difference in the country in many key areas.

2017 is the final year of the Bank's current strategic period. During the coming year, the Bank plans to focus on meeting its strategic objectives by delivering key projects and initiatives. PASHA Bank has set new horizons for its corporate and retail businesses, raising its targets for the credit portfolio and transactional business. In 2017, the Bank will start developing a new strategic plan for the 2018-2020 period, which will focus on growing our business, bolstering our competitive position and deploying digital initiatives.

Digital technologies have become an integral part of our day-to-day life everywhere. This is also true for business, and especially banking. The transition to digital banking is not only inevitable, it is now underway on a global scale. As one of Azerbaijan's leading corporate banking institutions, PASHA Bank is currently at work on our all-encompassing digital strategy. While it is still early days to discuss specifics, we envision a complete transformation in how we will work and interact with our customers.

For some bank customers in the domestic market, these innovations and changes may at first glance appear to be outside their "comfort zone." Although the digital transformation will result in clients spending less time in queues, dealing with paperwork, and the like, they may need time to adjust to new technologies.

At PASHA Bank, customers are our number one priority. As such, we will ensure that our future digital services and solutions will be designed with customer comfort, ease of use and convenience at the center – to continue delivering the highest customer satisfaction during the digital transformation period.

Thanks to our innovative and customer-oriented approach, PASHA Bank has always been a leader in the Azerbaijan's financial industry since its founding. During these challenging times, we understand that customers need a strong partner. We have always stood by our customers, whether they face challenges or want to expand and grow. The positive feedback we receive and our strong year-end results indicate we are on the right track.

We would like to express our gratitude to our loyal customers, dedicated employees, valued shareholders and other stakeholders for their ongoing support and the respective parts they play in PASHA Bank's success. May we all achieve even greater successes in the future – together.

Respectfully yours,

Mir Jamal Pashayev
Chairman of the Supervisory Board

Taleh Kazimov
Chairman of the Executive Board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MANAGEMENT STRUCTURE

PASHA Bank Management

Supervisory Board

Mir Jamal Pashayev
Chairman of Supervisory Board

Mir Jamal Pashayev graduated from Moscow State University, Physics Department in 1993. He went on to obtain his Master of Science in Engineering from the University of California in 1996, followed by a Master of Business Administration from American University in Washington DC in 1998. He joined Mobil Corporation as a business project consultant to the company's Dallas and Washington offices in 1998. He arrived in Baku in 1999, where he assumed the position of consultant to the Central Bank of Azerbaijan. In 2000, Mir Jamal Pashayev joined the European Bank for Reconstruction and Development (EBRD) as financial analyst and was soon promoted to the position of banker on infrastructure projects. From 2005 to 2008, he was engaged in consulting activities for large-scale investment projects in the areas of infrastructure, telecommunications and financial services. Mir Jamal Pashayev has been the Managing Director at PASHA Holding since 2006. He is also the Chairman of the Board of Directors of PASHA Insurance.

Farid Akhundov
Member of Supervisory Board

Farid Akhundov graduated from the Institute of Economics of Azerbaijan in 1992. He also completed Management coursework at Nottingham Trent University. In 1994, Farid Akhundov was one of the first Azerbaijani citizens to win the Chevening Scholarship – a prestigious UK Government award administered by the British Foreign and Commonwealth Office. In 1995, he obtained an MBA degree from Salford University, Manchester, UK. He began his professional career in 1991 as an economist at a metal manufacturing facility. After a year, he moved on to the Azerbaijan Republic State Committee on Economics and Planning as a senior economist responsible for foreign economic relations. From 1996 to 2003, Farid Akhundov held several key positions at the British Bank of the Middle East (subsidiary of HSBC). There, he moved from the position of financial control manager to the head of the customer services and corporate banking departments; subsequently, he was promoted to Deputy CEO of HSBC Azerbaijan. In 2003, Farid Akhundov joined Most Bank Azerbaijan as the Chairman of the Executive Board where he had overseen the restructuring and rebranding of Most Bank Azerbaijan to Bank Standard JSC – one of the largest commercial banks of the country at that time. Farid Akhundov joined PASHA Bank in 2007 as the Chairman of the Executive Board and was appointed to the Supervisory Board on 1 July 2015.

Vadim Shneyer
Member of Supervisory Board

Vadim Shneyer graduated from Baku State University, Department of Law with an Honors Diploma in Law in 1991. From 1991 to 1997, he worked as lawyer in different Azerbaijani and foreign companies, including Baku Interbank Currency Exchange and Far East Levingston Shipbuilding. Between 1997 and 2001, he was a Managing Partner in the Baku office of Dr. Entezari & Associates law firm. In 2001, he joined the Almaty office of Michael Wilson & Partners law firm, working there until 2005. In 2005, he joined BM Law Firm Baku office and worked there until 2007. In 2007, Vadim Shneyer started work at PASHA Holding LLC as the Head of Legal Department; in 2011, he was appointed Deputy Director of PASHA Holding LLC. From 2008 to 2013, Vadim Shneyer was Chairman of the Supervisory Council of Kapital Bank OJSC.

Kamala Nuriyeva
Member of Supervisory Board

Kamala Nuriyeva graduated from Western University with a Bachelor's degree in Banking

Management in 1998, and earned a Master in Finance from Azerbaijan State Economic University in 2002. In 1996, she commenced her professional career at Postbank OJSC as IT Specialist. During her seven-year tenure there, she rose to the Head of Credit Department. In 2003, she joined Agricultural Rural Investment Fund established under TACIS program for development of the agricultural industry in regions of Azerbaijan, working as Loan Officer responsible for customer acquisition, loan origination and management. In the same year, she accepted a job offer from Unibank OJSC for the position of Treasury Control and was responsible for currency and market risk management. From 2004 to 2005, she worked at McDermott Caspian Contractors Inc. as Cost Controller on the project of fabrication and installation of Central Azeri Offshore Platforms. In 2005, she joined Bank of Baku OJSC where she served as Deputy Chief Accountant until 2007. In that position, she was responsible for accounting activities and management reporting. In 2007, she started work at PASHA Bank as Internal Auditor; in 2010, she headed the Risk Management Department.

In 2011, Kamala Nuriyeva moved to PASHA Holding as Group Internal Auditor; she was also appointed to the position of Chairman of PASHA Bank's Audit Committee. In 2013, she was appointed Head of Group Risk Management at PASHA Holding. On 11 June 2013, she became a Member of the Supervisory Board of PASHA Bank OJSC.

Nariman Sardarlı
Member of Supervisory Board

Nariman Sardarlı graduated from Brooklyn College – City University of New York with a Bachelor's degree in Business, Management and Finance in 2004. The same year, he commenced his professional career as an Audit Associate at Deloitte Azerbaijan. In 2005, he joined PwC Baku office as an Auditor. In 2007, he joined the newly established PASHA Bank as an MIS Expert in the Financial Management Department with responsibility for internal and external financial reports. In 2009, he joined PASHA Holding's Investments and Projects Department as Investment Manager responsible for developing the Holding's PE/VC financing vehicle. In March 2009, he was appointed as Chairman of the Audit Committee of PASHA Bank; in 2010, he was appointed as member of PASHA Bank's Supervisory Board. In 2012, he received a scholarship from the State Program to obtain his Master's degree in Business Administration from IE Business School (Spain). There, he participated in an exchange program with Kellogg School of Management at Northwestern University (USA). On 1 February 2015, he was appointed as Director of the Investments and Projects Department at PASHA Holding.

Executive Board

Taleh Kazimov
CEO and Chairman of the Executive Board

Taleh Kazimov joined PASHA Bank in 2007 as Risk Manager and was subsequently promoted to Treasury Director in 2009. In 2011, Mr. Kazimov was appointed Chief Investment Officer of the Bank and member of the Executive Board. He started his career in the financial sector in 2004 at CJSC Bank Standard as a Specialist in the Treasury Department. Later, he was promoted to Head of the Accounting, Budget Management and Planning Division and further to Deputy Director of the Corporate Credits Department. In 2006, Taleh Kazimov joined EY as an auditor and from 2007 worked as a General Director of "FinEco" Informational Analytical Agency. Taleh Kazimov has obtained his higher education from the Azerbaijan Technical University in 2000-2004 with major in Automation and computer engineering. Mr. Kazimov also holds an MBA from the Azerbaijan State Oil Academy and a commerce degree with a major in finance from Georgia State University. He is an alumnus of London and Harvard Business Schools.

Javid Gouliyev
Deputy Chairman of the Executive Board

Javid Gouliyev began his professional career in 1996 as Head of the Clients Department at British Bank of the Middle East, a subsidiary of HSBC; in 1999, he served as Head of the Financial Control Department of that bank. In 2003, Mr. Gouliyev joined Unibank first as Advisor to the Board; in 2004, he was appointed First Deputy Chairman of the bank. Between 2005 and 2012, Mr. Gouliyev was First Deputy Chairman of Bank Standard. In 2012, he was appointed Executive Finance Director at Capital Resources Advisors – Azerbaijan Branch. In 2014, he joined PASHA Holding as Chief Advisor. Javid Gouliyev began his career at PASHA Bank in 2015 as Business Development Advisor to the Chairman of the Board. On 22 February 2016, he was appointed as Deputy Chairman of the Executive Board of PASHA Bank. Mr. Gouliyev graduated from Azerbaijan University of Languages and Azerbaijan State Economic University majoring in Finance and Credit. In 1999, he also completed study at the Higher School of Management of the HSBC Group.

Shirin Aliyeva
Member of the Executive Board, Chief Legal Officer

Shirin Aliyeva joined PASHA Bank in 2011 as Director of the Legal Department; she was appointed as Chief Legal Officer in 2015. Previously, she held various positions at a company in the oil and gas industry, ultimately serving as Legal Advisor at Nobel Oil Limited from 2005 to 2007. Between 2007 and 2011, Mrs. Aliyeva worked in the gold mining sector as Head of Legal at Azerbaijan International Mineral Resources Operating Company (AIMROC). Shirin Aliyeva graduated from Baku State University, Department of Law in 2004. In addition, she has completed executive education programs at several leading graduate business schools; these include London Business School as well as Harvard Business School's High Potential Leadership Program.

Aydin Atakishiyev
Member of the Executive Board, Chief Strategy Officer

Aydin Atakishiyev received an undergraduate degree in Mathematical Economics from Baku State University in 2002 and a Master of Arts in Economics from Central European University of Budapest, Hungary in 2006. Mr. Atakishiyev obtained his Master of Business Administration from Rotterdam School of Management in the Netherlands in 2013. He was also an International Business Exchange scholar at the University of Chicago Booth School of Business in 2012. Mr. Atakishiyev started his professional career in sports event management in 2002 before joining the financial services industry as a loan officer in 2006. He worked at PASHA Holding LLC from 2007 to 2011 as an Investment Analyst and Project Manager. Mr. Atakishiyev joined PASHA Bank in 2013 as Head of Strategic Marketing and was appointed Chief Strategy Officer in 2015.

Hayala Naghiyeva
Member of the Executive Board, Chief Financial Officer

Hayala Naghiyeva joined PASHA Bank in 2015 as Credit Risk Assessment Director and was later appointed as Chief Financial Officer and Member of the Executive Board. Previously, she worked as Investment Manager at PASHA Holding LLC from 2009 and has served as a Member of PASHA Bank's Audit Committee since 2010. Ms. Naghiyeva started her professional career in 2003 as Auditor in the financial services industry with Deloitte CIS. Subsequently, she was promoted to Senior Advisor in Financial Advisory Services at Deloitte CIS and seconded to Almaty, Kazakhstan, where she managed numerous local and regional projects. Ms. Naghiyeva holds a degree from Azerbaijan State Economic University, where she graduated from in 2004 with distinction. She attended Slippery Rock University (Pennsylvania, USA) for part of her undergraduate education. Ms. Naghiyeva is an

alumna of Harvard Business School, London Business School, Ashridge Business School (UK) and IE Business School (Spain).

PASHA Bank Georgia

Shahin Mammadov
Chairman of PASHA Bank Georgia
Board of Directors, CEO

Shahin Mammadov graduated from Azerbaijan State Economic University in 2002 with an undergraduate degree in Accounting. In 2004, he was awarded a Master's degree from the same university and he obtained a Ph.D. in Economics in 2010. Mr. Mammadov started work at Kocbank Azerbaijan Ltd. in 2003, serving as Accountant and Deputy Chief Accountant. He joined Deloitte & Touche in 2005 as Associate Auditor and was subsequently promoted to Audit Manager. Mr. Mammadov has been ACCA certified since 2014. In 2009, Shahin Mammadov was appointed as Director of the Financial Management Department at PASHA Bank headquarters; he became a Member of the Executive Board in 2011. In 2013, he moved to PASHA Bank Georgia to hold the position of Business Development Director. Since July 2014, Shahin Mammadov has served as CEO at PASHA Bank Georgia.

Goga Japaridze
Member of PASHA Bank Georgia
Board of Directors, CCO

Goga Japaridze joined PASHA Bank as Commercial Director in January 2014. Since April 2015, Mr. Japaridze has served as a Member of the Board of Directors at PASHA Bank Georgia. Mr. Japaridze began his banking career in 2003 as an Associate at BG Capital, the investment banking subsidiary of Bank of Georgia. He went on to work as Senior Equity Banker at Bank of Georgia in 2005. Later, Mr. Japaridze served as Principal Banker at the EBRD's private equity facility in Tbilisi and London from 2006 to 2011. Subsequently, he was the Head of Corporate Banking at Bank Republic Société Générale Group. Goga Japaridze graduated from Tbilisi State University in 1996. He obtained an MBA degree from Hofstra University's Zarb Business School in 2002.

PASHA Bank Turkey

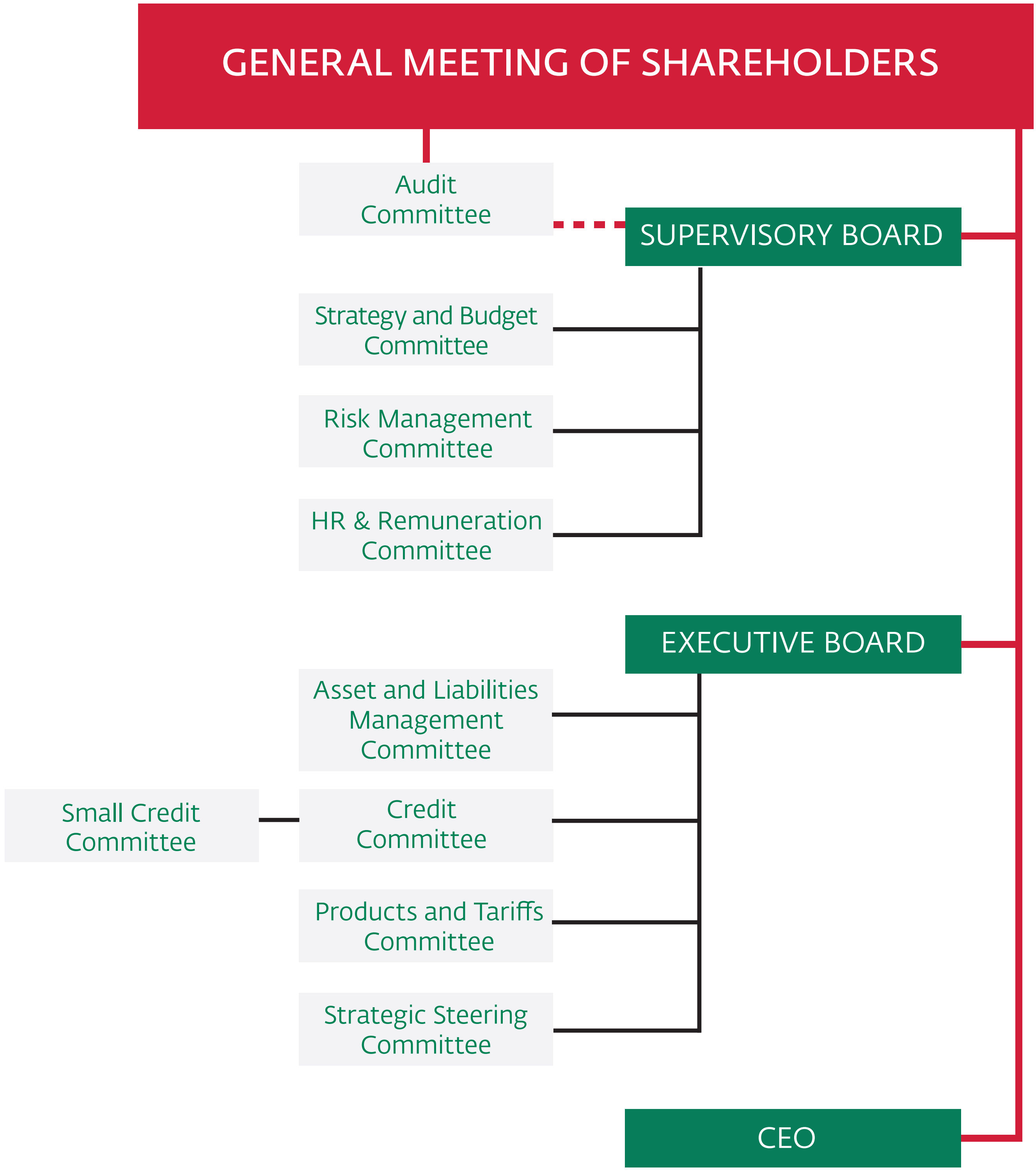
H. Cenk Eynehan
Member of PASHA Yatırım Bankası A.Ş. Board of Directors, General Manager

H. Cenk Eynehan received an Associate's degree in Economics from Erasmus University (Netherlands), a Bachelor's degree in Management from Monroe College (New York, USA), and an Executive MBA from Koç University. Between 1994 and 2013, he worked in Turkey and abroad in mid- to executive-level managerial positions with banks and other financial institutions. He joined PASHA Bank as General Manager on August 2, 2013. He has 21 years of experience in banking and business administration.

Ali İhsan Tokkuzun
Deputy General Manager of PASHA Yatırım Bankası A.Ş.

Ali İhsan Tokkuzun joined PASHA Yatırım Bankası A.Ş. as Deputy General Manager in June 2014. Previously, he served as a Member of the Executive Committee and Finance Coordinator at Istanbul Gemi İnşa San. Tic. Mr. Tokkuzun started his professional career at Esbank T.A.Ş. on the Board of Auditors; later, he moved on to Esbank AG in Vienna where held various key positions, including Deputy Chair of the Audit Committee, until 2000. From 2000 to 2002, he worked at Kentbank A.Ş. as the Financial Institutions and International Marketing Group Manager. Subsequently, he served as Deputy General Manager at DenizBank AG, Vienna until 2010. From 2010, he worked as General Manager at SK Danube AG, Vienna. Mr. Tokkuzun holds a Bachelor's degree from Gazi University, Department of Management and an MBA from Istanbul Technical University.

Governance Structure*



*C-level employees may be appointed as Executive Board members without change of the functions they perform.

The Bank's supreme management body is the General Meeting of Shareholders. Control over the Bank's management and operations is carried out by the Supervisory Board. The Audit Committee oversees the Bank's audit activities. The Bank's executive body is the Executive Board.

Board and Committee Members

Supervisory Board:
Mir Jamal Pashayev – Chairman
Farid Akhundov – Member
Vadim Shneyer – Member
Nariman Sardarly – Member
Kamala Nuriyeva – Member

Executive Board:
Taleh Kazimov – Chairman
Javid Gouliyev – Deputy Chairman
Shirin Aliyeva – Member
Aydin Atakishiyev – Member
Hayala Naghiyeva – Member

Strategy and Budget Committee:
Member of the Executive Board, Chief Financial Officer, Hayala Nagiyeva – Chairman
Director of Treasury and Asset and Liability Management Department, Bahruz Naghiyev – Member
Director of Strategy Department, Agshin Mirzazade – Member
PASHA Holding Specialist of the Banking Group, Vugar Akhundov – Independent Member
Chief Operating Officer of the Banking Group PASHA Holding, Deputy Executive Director, Agha Ali Kamalov – Independent Member
Chief Accountant of the Banking Group PASHA Holding, Akbar Ibragimov – Independent Member
Counsel of Chairman of the Executive Board, PASHA Bank, Turkhan Mahmudov – Non-voting Member

HR & Remuneration Committee:
Chairman of the Supervisory Board, Mir Jamal Pashayev – Chairman
Head of the Banking Group PASHA Holding LLC, Jalal Gasimov – Independent Member
PASHA Holding Group Director of HR and Administration, Aytan Abbasli – Member
Chairman of the Executive Board, Taleh Kazimov – Member
Chief Human Resources Officer, Chimnaz Gasimova – Member

Risk Management Committee:
Member of the Supervisory Board, Kamala Nuriyeva – Chairman
Chairman of the Executive Board, Taleh Kazimov – Member
Member of the Executive Board, Chief Financial Officer, Hayala Nagiyeva – Member
Chief Risk Officer, Mansur Mammadov – Member
Chief Information Security Officer, Natig Huseynov – Member
Chairman of the Audit Committee, Azer Sadigov – Member (non-voting member according to the "Corporate Governance Standards in Banks")

Steering Committee:
Chairman of the Executive Board, Taleh Kazimov – Chairman
Deputy Chairman of the Executive Board, Javid Gouliyev – Member
Member of the Executive Board, Chief Legal Officer, Shirin Aliyeva – Member
Member of the Executive Board, Chief Financial Officer, Hayala Nagiyeva – Member
Member of the Executive Board, Chief Strategy Officer, Aydin Atakishiyev – Member
Chief Risk Officer, Mansur Mammadov – Member
Chief Information Security Officer, Natig Huseynov – Member
Director of Treasury and Asset and Liability Management Department, Bahruz Naghiyev – Member
Chief Human Resources Officer, Chimnaz Gasimova – Member
Chief Technology Officer, Matthew Western – Member

Director of Strategy Department, Agshin Mirzazade – Member

Credit Committee:
Chairman of the Executive Board, Taleh Kazimov – Chairman
Member of the Executive Board, Chief Legal Officer, Shirin Aliyeva – Member
Deputy Chairman of the Executive Board, Javid Gouliyev – Member
Chief Commercial Officer, Melih Mengu – Member
Director of the Strategy Department, Agshin Mirzazade – Member
Chief Risk Officer, Mansur Mammadov – Member
Director of the Treasury Department and Asset and Liability Management, Bahruz Naghiyev – Member
Counsel on Credit Risks, Padikkal Abdurahiman – Non-voting Member

Small Credit Committee:
Chief Credit Underwriter of the Credit Risk Underwriting Department, Elmin Isgandarov – Chairman
Operation and Control Department Director, Rashad Mammadov – Member
Corporate and Institutional Banking, Head of the Small and Medium Enterprises Division, Heydar Suleymanov – Member
Head of the Trade Finance Division, Shota Dekanosidze – Member
Director of the Legal Department, Rugiyya Hajizade – Member

Assets and Liabilities Management Committee:
Member of the Executive Board, Chief Financial Officer, Hayala Nagiyeva – Chairman
Deputy Chairman of the Executive Board, Javid Gouliyev – Member
Chief Risk Officer, Mansur Mammadov – Member
Director of the Strategy Department, Agshin Mirzazade – Member
Director of Treasury and Asset and Liability Management Department, Bahruz Naghiyev – Member

Product and Tariff Committee:
Member of the Executive Board, Chief Strategy Officer, Aydin Atakishiyev – Chairman
Director of Marketing and Product Development Department, Anar Suleymanov – Member
Application Development and Support Department, Head of the Creation of Application Programs, Rovshan Mammadov – Member
Chief Commercial Officer, Melih Mengu – Member
Senior Project Manager of the Strategy Department, Zaur Baghirov – Member

Audit Committee:
Parvin Ahadzade – Chairman
Jamil Mammadov – Member
Ramil Heydarov – Member

The Central Bank of Azerbaijan made critical corrections to para- meters of the interest rate corridor in 2016, to reduce inflation, curb currency spec- ulation and boost confidence in the national currency in order to stimu- late savings in local currency.

GLOBAL MACROECONOMIC OUTLOOK AND AZERBAIJAN’S ECONOMY

GLOBAL MACROECONOMIC OUTLOOK AND AZERBAIJAN'S ECONOMY

Global Macroeconomic Outlook

Against the backdrop of the end of quantitative easing by the Federal Reserve in the US and volatile commodity markets worldwide, the global economy expanded 2.3% in 2016, below the long-term post-crisis trend of 3%. Advanced economies largely outperformed emerging markets during the year. Developing countries recorded GDP growth of 3.4% in 2016, which is much faster than developed economies where growth was recorded at 1.6%.

The main reasons for weak emerging market growth was the economic slowdown in China, the fall in commodity prices due to a stronger dollar in the post-quantitative easing environment and political instability around the world.

The European Central Bank and the Bank of Japan extended their quantitative easing programs to combat low inflation and subdued economic growth. Meanwhile, the Bank of England also launched a QE effort to offset the negative effects of Brexit.

Global trade growth, one of the major drivers of the world economy, has remained weak. The World Trade Organization (WTO) forecasts a 2.3% increase in global trade as of end-2016, lower than world GDP growth.

Current global economic growth rates prevent global employment from rebounding to pre-crisis levels. According to the International Labor Organization, there are 199 million unemployed in the world at present. Global unemployment is estimated at 5.8% as of year-end 2016.

According to UNCTAD, foreign direct investment is expected to decline about 15% in 2016. Relatedly, global financial and investment flows continued to return to advanced economies in 2016.

Azerbaijan's Economy

Azerbaijan's GDP decreased 3.8% in 2016 due to weak crude oil prices and a decline in budget revenues, which translated into weaker consumer demand. Non-oil GDP contracted 5.4% primarily due to a fall in construction activity.

Fixed asset investments, another significant component of domestic demand, decreased 26% year-on-year, to AZN 14.9 billion in 2016.

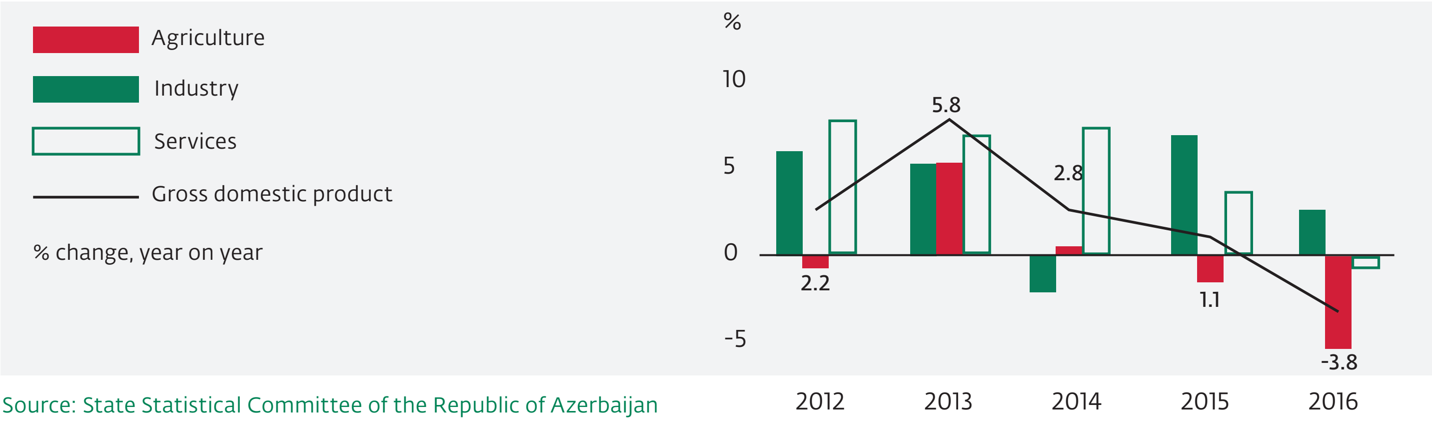
Fiscal consolidation in the form of a cut in public spending curbed growth as well.

Azerbaijan's average annual inflation reached 12.4% in 2016. Based on State Statistical Committee data, headline inflation was 12.4%, with non-food prices jumping 16.8%, service prices rising 5.6%, and food prices increasing 14.1%. The average annual producer price index rose 22.6% in 2016. Agricultural producer prices declined 3.4%, mainly driven by a 10.3% price fall in plant-growing products.

In 2016, the AZN exchange rate was defined by the balance of payment within the managed floating exchange rate regime, which was announced by the Central Bank of Azerbaijan in the prior year. The AZN depreciated 12% against the US Dollar during the reporting year.

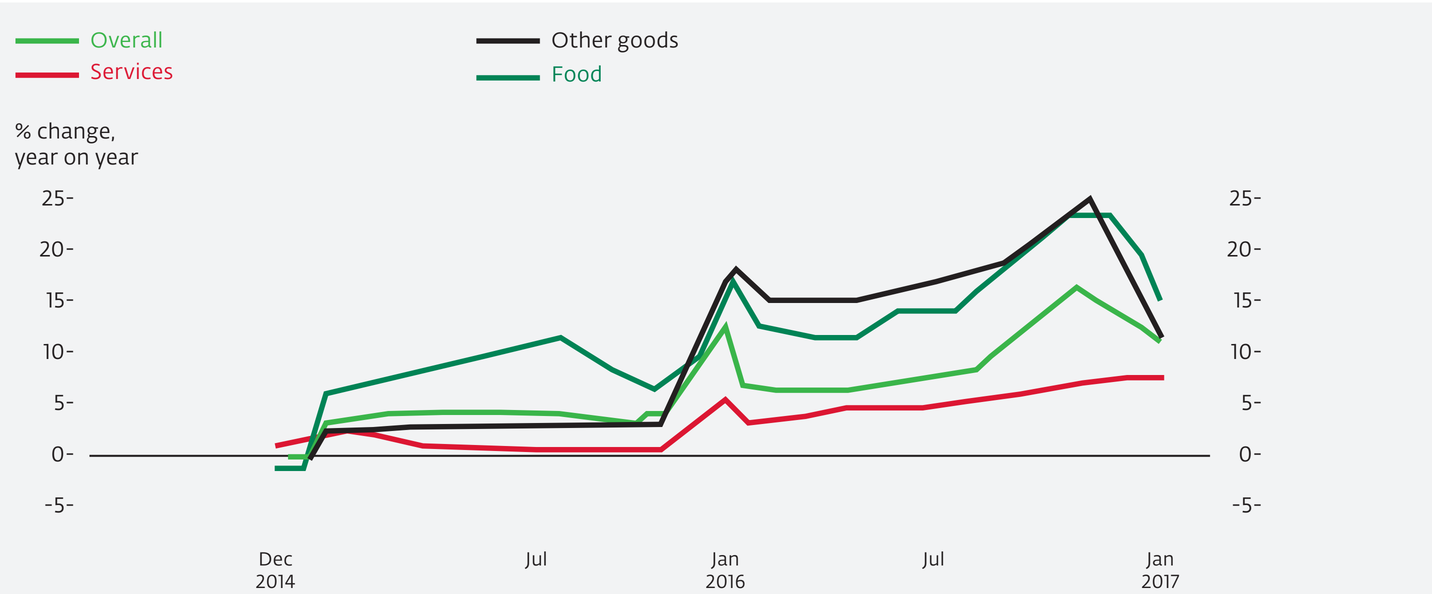
The Central Bank made critical corrections to parameters of the interest rate corridor in 2016, to reduce inflation, curb currency speculation and boost confidence in the national currency in order to stimulate savings in local currency. Thus, the refinancing rate rose to 15%, up from 3% a year earlier.

GDP growth by sector



Source: State Statistical Committee of the Republic of Azerbaijan

Monthly inflation

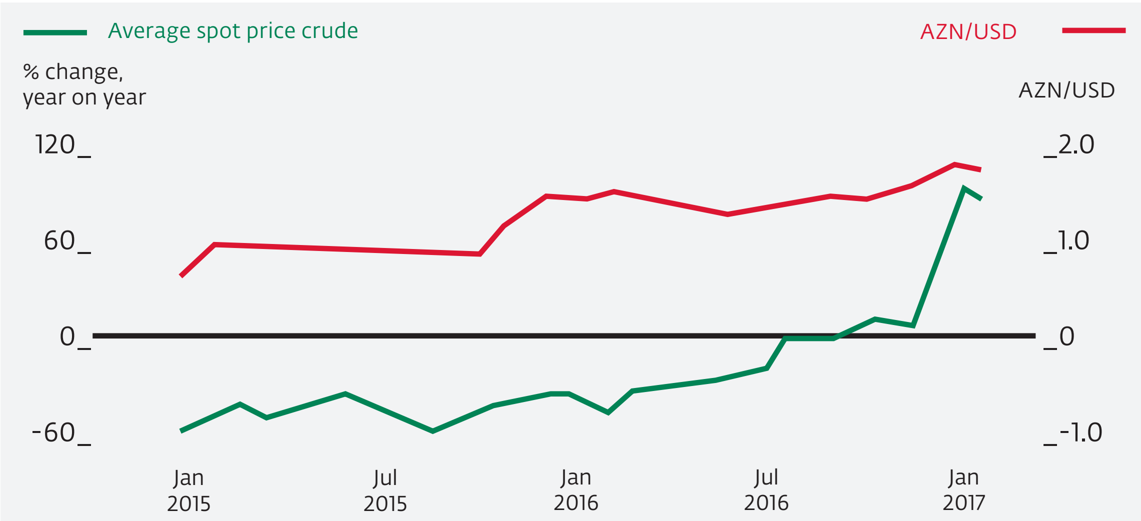


Sources: Central Bank of the Republic of Azerbaijan; Haver Analytics (accessed 13 March 2017)

Economic Indicators* (%)	2017F	2018F
Real GDP Growth	-1.0	2.0
Inflation (annual average)	10.0	8.0
Current Account Balance (Share of GDP)	1.3	3.8
Unemployment	6.0	6.0

Source: Asian Development Outlook 2016.

Exchange Rate and Average Crude Oil Price



Note: An increase in the exchange rate indicates depreciation.
Sources: Central Bank of the Republic of Azerbaijan; Haver Analytics (accessed March 13, 2017)

Banking Industry

In 2016, Azerbaijan's economy continued deleveraging on the back of economic deceleration with banking assets declining 9.9% year-on-year, from AZN 34.9 billion to AZN 31.4 billion. The decline was aggravated by the fact that nine banks lost licenses during the year, while others were forced to significantly restructure their loan portfolios. As a result, total loan portfolio of the Azerbaijani banking system shrank 22% in 2016, decreasing from AZN 21.2 billion to AZN 16.4 billion. Non-performing loans went up from AZN 1,314.6 million to AZN 1,472.6 million; by year's end, NPLs constituted 9% of total loans. The corporate lending portfolio decreased 20.5% year-over-year, from AZN 12.7 billion to AZN 10.1 billion. Meanwhile, the individual loan portfolio declined 25.4% year-over-year, from AZN 8.47 billion to AZN 6.32 billion.

During the year, deposits decreased 5.8%, falling from AZN 23.46 billion to AZN 22.09 billion. A 21% drop in households' deposits, from AZN 9.5 billion to AZN 7.4 billion, was partially compensated by a 19% jump in corporate deposits, from AZN 7.6 billion to AZN 9.1 billion. Deposits from financial institutions amounted to around AZN 5.5 billion.

2017 Projections

The IMF expects that global growth will pick up in 2017 due to a rebound in emerging market economies and some improvement in developed markets. Thus, IMF forecasts project 4.6% GDP growth for developing countries and 1.8% growth for advanced economies.

Commodity markets might see some reversals, which should help boost economic expansion rates in emerging markets and Azerbaijan.

Fitch estimates that the Azerbaijan economy will return to positive growth, at a rate of 0.2%. Meanwhile, the Azerbaijani government estimates that the nation's economy will expand by 1% in 2017. Non-oil GDP is expected to grow by 2.5%.

The proposed widespread reforms across the financial and real sectors are likely improve the outlook further.

In 2016, PASHA Bank continued efforts to enhance the quality of its digital banking services – an area of strategic focus.

2016 ACTIVITIES

CORE BANKING BUSINESS

The scalable RM skill development factory will improve customer service and enable the Bank to achieve sustainable and efficient growth over next several years.

RM Factory

During the year, PASHA Bank implemented the Relationship Manager (RM) Factory project to boost the Bank's bottom line and efficiency by identifying profitable market segments, conducting a customer profitability analysis and upgrading the Bank's business process infrastructure. The benefits of this wide-ranging project include increased revenues of an estimated AZN 5 million over a 12-month period, some 2.5 times the project cost.

This effort formulated strategic growth priorities for the Bank oriented toward market segments that promise to yield the highest net income in the coming years. In addition, the systematic review of the profitability of each client resulted in increased transparency and helped to define corrective actions. As a result, PASHA Bank's loss avoidance capability was improved.

The RM Factory project also covers building an efficient business process infrastructure over next two to three years. Design of best business practices and organizational enablers will support PASHA Bank in upgrading its business process infrastructure. These efforts include development of analytical instruments/cross-selling tools and an effective organizational and coverage model.

Vendor Finance

PASHA Bank differentiates from its competitors by not only working closely with its customers but also bolstering their business development opportunities. With this objective, the Bank launched its new Vendor Finance Program in 2015. Vendor Finance is one of the alternative lending products focused on the final users (end customers) of PASHA Bank's corporate clients. The Bank supports its valued corporate customers by financing their clients, thus strengthening the business opportunities of the Bank's customer base.

In 2016, PASHA Bank partnered on various efforts related to information technologies and the public sector, while also engaging in cooperation with local and multinational companies.

Internet Banking

2016 was a year of active digitization of transactional banking products at PASHA Bank. The Bank boosted the ratio of transactions processed via Internet Banking from 47% to 60%. Additional functionalities were added to Internet Banking products, such as tracking the acquiring product's transactions, enhancing statements, among others. The Bank increased user adoption of digital baking and met their expectations during 2016, resulting in significant growth of branchless banking channel usage.

DIRECT BANKING

As a corporate banking provider, PASHA Bank decided to focus efforts on the acquiring side of the business. In 2016, the Bank finalized project integration of cashless solutions for hotels and restaurants.

PASHA Bank's competitive strength is derived from its vision to develop innovative, world class products and services in line with global trends. Since its founding, the Bank has introduced numerous firsts to Azerbaijan's banking industry. In 2016, PASHA Bank continued efforts to enhance the quality of its digital banking services – a strategic priority area. The Bank understands that its future growth and success depend on embracing technology and innovation, to better serve an expanding, tech-savvy customer base and reduce costs. To these ends, PASHA Bank executed the following projects in 2016:

- Connection to CBAR's National Switch System

In March 2016, the Bank launched a connection to Kapitalbank OJSC and Yapı Kredi Bank Azerbaijan CJSC locally through CBAR's National Switch system. Prior, clearing and settlement with the referenced banks was made via international payment systems. After the process moved to the National Switch system, PASHA Bank's execution became more time efficient and less complicated, with significantly reduced operational costs.

- Launch of Fraud Management Acquiring System

This project granted the Bank the capability to monitor and decline suspicious transactions on the acquiring side (our POS terminal network). This innovative tool prevents the Bank and its clients from incurring potential losses from fraudulent transactions.

- Launch of Card Payments on MilliON payments terminals

In September 2016, PASHA Bank launched card payment capability on MilliON terminals. Previously, MilliON terminals received only cash; with the upgrade, it is now possible to make payment by card, too. By showing kiosk owners the benefits of non-cash payments – lower risks and higher security of payments, and no costs for encashment – PASHA Bank aims to change consumer behaviour in the market.

- Integrated Cashless Solutions for Hotels and Restaurants

As a corporate banking provider, PASHA Bank decided to focus efforts on the acquiring side of the business. In 2016, the Bank finalized project integration of cashless solutions for hotels and restaurants. Thanks to this systems integration initiative, merchant companies that use Micros Cash Desks and PASHA Bank's POS terminals will not have to initiate transactions on POS from the beginning in case the customer is willing to pay by card. The integrated solution provides ease of use, and saves time for both merchants and cardholders.

- Zero Cash Interchange with Caspian Development Bank OJSC (CDB) and VTB Bank Azerbaijan OJSC (VTB)

Banks pay each other a commission for cash withdrawal made at their ATMs by non-customer cardholders. Under the Bank's agreement with CDB and VTB, there is no fee between PASHA Bank & CDB and PASHA Bank & VTB for cash withdrawals by our cardholders. For PASHA Bank, this arrangement reduces operational costs and expands its ATM network as PASHA Bank cardholders can now use the ATMs of these banks at no charge.

- Avaya Call Management System (CMS)

Designed for enterprises with complex contact center operations and high call volume, Avaya CMS is a database, administration, and reporting application to help businesses identify operational issues and take immediate to solve them. This integrated analysis and reporting solution tracks virtually every facet of the contact center – from evaluating the performance of a single agent or group of agents to managing the entire contact center. Avaya CMS delivers real-time monitoring and historical reporting for call center solutions. Real-time reports can be updated every three seconds; with this functionality, management can make operational decisions to manage the call center effectively. Historical reports display past data for various agent, split/skill, number of ACD calls, abandoned calls, average talk time, and average speed of answer.

- NICE Interaction Management

With this project, the Bank aims to record interactions, analyze customer calls, improve quality management and ensure regulatory compliance. NICE's advantages include the following:

- Records 100% of customer interactions,

- Allows managers to listen to calls, dispute resolution, and the like with real-time capabilities,

- Features the capability to record and store interactions from thousands of channels on a single server.

- Other 2016 Developments

- Promotional campaigns were conducted for cardholders in conjunction with the Individual Banking Department.

- MChip Advance new chip certification was carried out during the year.

- All card designs were renewed.

- PASHA Bank executed an agreement with Kapital Bank relating to a lower interchange rate.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CORPORATE AND COMMERCIAL BANKING

In 2016, PASHA Bank conducted market and feasibility studies of major projects that are socially significant for the region.

PASHA Bank delivers customized corporate banking solutions to large enterprises and small businesses alike with a dedicated team of relationship managers, a comprehensive product portfolio and efficient business processes. Committed to Azerbaijan's welfare and advancement, the Bank has developed deep expertise in the country's high growth industries. By providing support to expand medium sized businesses through an extensive range of services and financial solutions, PASHA Bank also contributes to the diversification of the nation's economy.

Project Finance

In 2016, PASHA Bank conducted market and feasibility studies of major projects that are socially significant for the region. By using financial and technical analyses, these studies were aimed at stimulating development of the non-petroleum sector, expanding the local market, and achieving effective use of financial assets.

PASHA Bank is very active in financing projects that boost production, increase employment and create high added value. The Bank continued to perform marketing and feasibility studies as well as technical and fiscal analyses for a wide range of client projects. As a result of these studies, the Bank provided funding opportunities to investment projects that will contribute to Azerbaijan's industrial development.

During the year, the Bank refinanced a plant to establish a new production facility for a leading food industry player. The plant was originally commissioned in 2012; 32% of its project value was financed by PASHA Bank. The production site, which resulted in new employment opportunities, is located on a 3-hectare tract, and consists of production zones, refrigerated storage, laboratory and an office building. The project aims to boost the share of local meat and dairy products in the domestic market and reduce dependence on imports within a short period of time.

The Bank also helped to develop the construction industry by introducing a new product range to finance two major projects in 2016. PASHA Bank financed 25% of a plant project to manufacture a new product by one of the country's leading metallurgical companies. The Bank conducted a detailed market study and sensitivity analyses for the client.

Additionally, PASHA Bank financed 42% of a newly opened gypsum plant, a major project for a company operating in the building materials sector. Equipment for the plant is being imported from Turkey. This project will boost overall production of the company, expand its market share in the region and increase turnover as forecast by the Bank's technical-economic analytical studies.

Project finance will remain a significant business line at PASHA Bank in the coming period. The Bank plans to maintain a leading position in financing projects in areas that are vital to the development of the country's economy, by transferring well-needed funds to the real sector.

FACTORING

During fiscal year 2016, PASHA Bank established correspondent relations with factoring companies and banks in Russia, Italy, UAE and Lithuania to better serve its growing client base.

PASHA Bank became the only financial institution in 2015 to start offering factoring solutions in Azerbaijan. Maintaining market leadership today, the Bank provides all types of factoring products, including domestic factoring, invoice discounting, supply chain finance, export and import Factoring.

In 2015, PASHA Bank was the only bank in Azerbaijan to become a member of Factors Chain International (FCI). FCI is a global network of the world's leading factoring companies. Through the network, PASHA Bank obtains access to a wide range of more than 400 corresponding factoring providers in 90 countries.

The main requirements for factoring include:

- Contract between seller (supplier) and buyer (debtor);
- Proof of commercial relations between seller (supplier) and buyer (debtor) for a specific time period;
- Act of acceptance for the goods and services between seller (supplier) and buyer (debtor);
- All invoices and other supporting documentation required by the agreement should be delivered to the Bank.

The benefits of factoring include:

- Immediately receiving up to 90% of on credit sales
- Working capital boost with favorable financing terms
- Committed financial resources and long term payment conditions
- Improved credit control over receivables and payments
- Support of trusted relationship between supplier and buyer

As of end-2016, PASHA Bank's total domestic factoring volume amounted to AZN 106 million. The number of invoices processed totaled more than 1,000.

During fiscal year 2016, the Bank established correspondent relations with factoring companies and banks in Russia, Italy, UAE and Lithuania to better serve its growing client base.

Factoring solutions are very much suitable for small and medium enterprises in Azerbaijan, providing them with access to finance on more affordable terms than traditional collateral-based lending. PASHA Bank expects to continue growing this business line in the coming years.

INDIVIDUAL BANKING

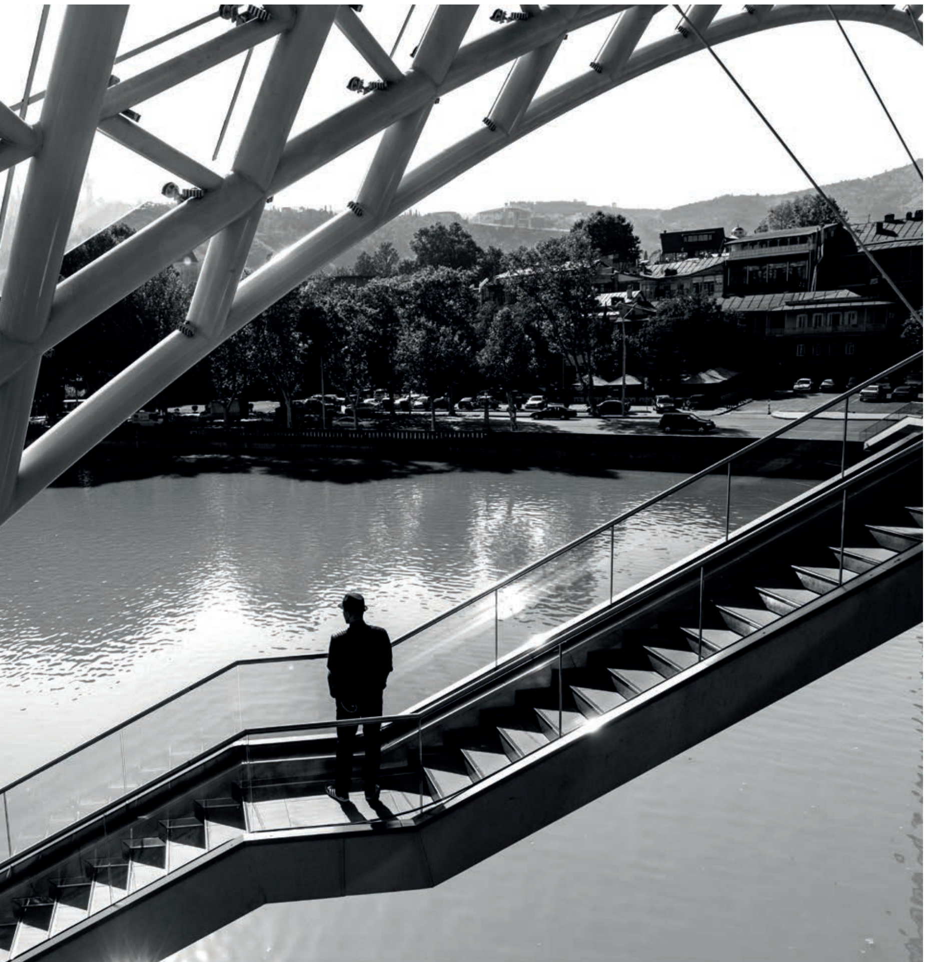
PASHA Bank Individual Banking Block achieved impressive growth in individual banking sales in 2016. IBB's cash loan portfolio increased by 9% year-on-year while the credit card portfolio expanded by 66%.

To provide comprehensive financial services to individual clients, PASHA Bank expanded Individual Banking Block (IBB) by establishing two new departments:

- Marketing & Product Management
- Personal Banking

By forming these two new departments, IBB set new goals, including:

- Establishing and developing a digital banking system;
- Automating individual banking processes;
- Boosting the contribution of Individual Banking to PASHA Bank's profitability;
- Expanding the number of PASHA Bank salary card holders via cooperations to attract new salary projects;
- Creating new products and improving existing products.



IBB recorded numerous achievements with the addition of the Marketing & Product Management and Personal Banking departments:

- New mobile application system enabling individual clients to apply for a loan, or make loan, card-to-card, and utility payments via this app;
- Launch of Individual Banking branch, which delivers a comprehensive range of services for individual clients;
- Introduction of new loan and card products;
- Redesign of bank cards;
- General Service Agreement implementation;
- Optimization and automation of individual banking processes.

PASHA Bank IBB achieved impressive growth in individual banking sales in 2016. IBB's cash loan portfolio increased by 9% year-on-year while the credit card portfolio expanded by 66%. Deposits of individual clients rose 24% for the year. In addition, personal saving product sales jumped 143% in 2016.

The Bank plans to capitalize on its strong reputation and prestige to expand in this key segment. Embracing customer satisfaction as a strategic priority, PASHA Bank plans to center its IBB activities around delivering the highest level of customer care.

INVESTMENT BANKING

During 2016, PASHA Bank participated in the largest placement of SOCAR corporate bonds and was among the biggest book builders.

Two years since its inception, the Investment Banking Department continues to carve out its niche in a challenging market environment. The Department delivers a range of products and services to local financial markets and provides services to commercial enterprises. 2016 presented the Investment Banking Department with the opportunity to deepen its experience in advisory and debt restructuring while developing new product lines.

As of end-2016, the Department's product and service offerings include:

Fixed Income Products:

- Structuring and subsequent placement of bonds in primary market locally. The Bank also acts as an intermediary in buying and selling bonds on behalf of its clients on the secondary market.

Brokerage Operations:

- Brokerage access, leverage capabilities through repo and asset based lending (ABL), account administration, transaction settlements, collections of receivables and related advisory.

Advisory:

- Private Equity Investment: PASHA Capital* advises various companies from the region in equity or debt fund raising activities.

Research:

- Team produced weekly commentary reports covering major events in global and domestic capital markets.
- Advisory Services: Advisory to institutional clients in capital structure optimization, rating advisory, equity and debt financing, among others.

During the year, PASHA Bank participated in the largest placement of SOCAR corporate bonds and was among the biggest book builders. The acquired expertise and successful track record will allow the Bank to advise on similar deals in the future.

The coming years are expected to bring unique opportunities in investment banking business in Azerbaijan as the government steps up reforms and privatization efforts. PASHA Bank's focus will be primarily on advisory, corporate finance and restructuring projects.

*The Financial Regulator of Azerbaijan prohibits banks to provide both institutional and private customers with brokerage and investment services. PASHA Bank provides customers with investment banking and advisory services via its sister company PASHA Capital.

TREASURY

In 2016, the Treasury Department generated 39% of PASHA Bank's interest income and 86% of the Bank's non-interest income.

Closely monitoring fluctuations in financial markets, PASHA Bank's Treasury Department worked to minimize risks and achieve high returns by using alternative investment instruments in 2016. By improving asset quality, the Department made a significant contribution to PASHA Bank's profitability in line with 2016 targets.

In light of recent developments in the domestic and global environment, the Treasury Department helped improve the Bank's solid balance sheet structure thanks to appropriate timing and alternative investment opportunities. By closely evaluating cost factors, the Department continued to diversify its portfolio.

The Treasury Department continued to operate effectively and proactively in very challenging and fast changing market, investing in a wide range of asset classes.

As of end-2016, assets under Treasury management totaled AZN 2,021 million. This consisted of AZN 185.68 million in the securities portfolio, AZN 1,088 million in cash and cash equivalents and AZN 746.20 million in amount due from credit institutions. Treasury generated 39% of PASHA Bank's interest income (AZN 46.8 million) and 86% of the Bank's non-interest income.

Treasury provides following solutions and services to clients:

- Corporate Foreign Exchange Desk: Access to traders on the dealing room to execute deals in real time
- Derivatives

  - Foreign exchange forward, non-deliverable forward, swaps, and options contracts

  - Commodities hedging – wide range of futures, including sugar, wheat, aluminum, gold, oil and others.

In the coming year, the Bank expects these business areas to grow as more corporate players turn to the capital markets.

INSTITUTIONAL BANKING

PASHA Bank closely monitors global trends in trade finance and continually updates its array of trade finance products to always meet generally recognized international standards.

Trade Finance

PASHA Bank delivers an extensive range of trade finance products to its clients. These specialized product offerings include local and international bank guarantees; standby LCs; documentary LCs; documentary collections; short-, medium- and long-term post-financing; and pre-export financing. The Bank also provides trade finance related consultancy and advisory services to its customers. The Bank's trade finance products are offered in both local currency and major foreign currencies.

For short-term (0-24 months) financing of foreign transactions, PASHA Bank uses the services of its international globally established partner bank network via direct net trade finance lines.

For medium- and long-term (24+ months) financing of foreign transactions that are mainly related to the import of capital goods and services, PASHA Bank has a long track record of cooperation with the world's leading export credit agencies, such as Euler Hermes, SACE and OeKB.

The Bank closely monitors global trends in trade finance and continually updates its array of trade finance products to always meet generally recognized international standards. PASHA Bank offers following trade finance products to its clients:

- All types of bank guarantees (both local and international, direct and indirect);
- All types of documentary letters of credit (both local and international, direct and confirmed);
- Short-term post-financing under documentary letters of credit;
- Long-term post-financing under documentary letters of credit (ECA covered financing);
- Import and export documentary collections;
- Advising on received bank guarantees, standby letters of credit and documentary letters of credit;

- Issuance of bank guarantees backed by counter-guarantees;
- Adding confirmation to received standby and documentary letters of credit;
- Consultancy on various trade finance related issues.

PASHA Bank is one of the leading banks in Azerbaijan in terms of trade finance. As of December 31, 2016, the Bank increased its sales volume by 15% from AZN 155.5 million to AZN 179.6 million. The Bank's transaction volume grew 94%, from 226 to 439. Thanks to this solid performance, the Bank's trade finance profit rose 15%, from AZN 3.7 million to AZN 4.3 million.

Cooperation with International Financial Institutions

In 2016, PASHA Bank actively worked to expand its correspondent banking network. For the fourth consecutive year, the Bank participated in a SIBOS conference and was successful in boosting the number of its correspondent bank relationships via that event. During the year, PASHA Bank added eight financial institutions to its network, expanding its capabilities in terms of cash management, trade finance, money market and FX products (derivatives).

Thanks to solid relationships forged with both domestic and international financial institutions, PASHA Bank secured AZN 131 million in deposits from local private & government FIs and AZN 172 million from IFIs. The Bank also maintained a USD 4 million credit line from the World Bank sponsored program which was supported by Ministry of Agriculture to develop Azerbaijan's agricultural sector. The credit line amount can be increased in case of a rise in demand

In 2016, PASHA Bank started business relationships with BayernLB, Sberbank, ICBC, ED&F Man, Univer Capital LLC – banks and investment firms that have a worldwide network. Access to these networks facilitate cash management, treasury, trade finance and factoring operations for the Bank's clients. The Bank also secured a line of credit from CaixaBank for trade finance.

Additionally, PASHA Bank extended its business relationships with Turkish Exim Bank and Hungarian Exim Bank for trade finance. Besides working with various export-import banks, PASHA Bank has credit lines from prominent international banks including Raiffeisen Bank International (RBI), CaixaBank, LBBW, UBI Banca, Ziraat Bank and Aktif Bank.

PRIVATE BANKING

With an in-depth understanding of the wants and needs of various customer segments, PASHA Bank has developed market leading financials product and a life-style service portfolio.

PASHA Private Banking is the first private banking service provider in the domestic Azerbaijani market, offering solutions designed to accommodate both financial and non-financial needs of our clients.

In keeping with the mission of providing comprehensive financial services to all customer segments, PASHA Private Banking aims to:

- Deliver customer-focused financial and non-financial services in Azerbaijan and abroad;
- Ensure that the services on offer are at the highest quality standards;
- Establish long-term, mutually beneficial customer relationships;
- Ensure long-term financial stability for our clients;
- Transform private banking into an integral part of customers' lives;
- Assist clients in growing and protecting personal wealth as well as managing the transfer of wealth to future generations;
- Find effective, customer-oriented solutions;
- Become Azerbaijan's leading bank in private capital management.

With an in-depth understanding of the wants and needs of various customer segments, PASHA Bank has developed market leading financials product and a life-style service portfolio. The Bank offers a full range of classic banking products and services delivered with a strong customer service approach. This offering includes:

- Personal banker for each customer
- Portfolio management
- Credit and debit cards
- Bank safe deposit boxes
- Securities of local companies

- International banking precious metals account
- Deposit services
- Mobile Banking
- Internet Banking
- Credit lines
- Cash secured loans
- Mortgage
- Financial advisory services
- Non-financial services, including real estate, healthcare and education related services
- Global concierge service

Globalization requires accelerated integration of Azerbaijan into international capital markets, irrespective of the relatively conservative investment instruments available in the domestic market. Thus, PASHA Bank has embraced an "open architecture" strategy. Under this approach, the Bank develops internal capabilities and an international partnership network to offer its clients worldwide reach and solutions to satisfy their global wealth management needs. In addition to onshore investment opportunities, PASHA Bank provides foreign asset management services as well.

Non-financial Services

Thanks to cooperation with numerous quality service providers, PASHA Private Banking offers an array of non-financial services to meet clients' needs in education, medical care and real estate.

PASHA Private Banking places great importance on holding regular events where the Bank's valued clients have the opportunity to enjoy, network and learn. In June 2016, PASHA Bank teamed with Julius Baer, one of the world's leading private banks based on a solid Swiss heritage, to hold the exclusive "Next Generation Dialogue," a series of business events that looked at the world from a people, planet and growth perspective. The series focused on structural changes and fundamental imbalances within the economy and society at large. PASHA Bank's expert speakers shared with the target audience their vision on emerging markets, its growing middle class and the passion for investing.

At the end of 2016, PASHA Bank welcomed current and potential Private banking clients at the AmCham "Black & White Ball" – a memorable evening that included excellent cuisine and spectacular entertainment.

INTERNATIONAL REPUTATION

As one of the country's leading financial institutions, PASHA Bank continues to attract the attention of some of the most distinguished members of the global financial community.

Credit Ratings

Despite the increased macroeconomic challenges in 2016, PASHA Bank maintained its creditworthiness, which was recognized by international ratings agencies.

In September 2016, Fitch Ratings affirmed PASHA Bank's long-term foreign currency Issuer Default Rating (IDR) as 'BB-' and short-term IDR as 'B', with a negative outlook.

In December 2016, Standard & Poor's reaffirmed the Long-term Issuing Bank Default Rating (IBDR) of PASHA Bank as 'BB-'. PASHA Bank also retained its 'B' Short-term IBDR rating. These ratings are among the highest of all private banks in Azerbaijan with 100% local capital.

Awards, Events and Sponsorships

As one of the country's leading financial institutions, PASHA Bank continues to attract the attention of some of the most distinguished members of the global financial community. In 2016, the Bank received a number of prestigious awards on international platforms in recognition of its excellence:

- PASHA Bank was selected as the "Best Bank of Azerbaijan 2016" by Global Finance magazine.
- PASHA Bank was named the "Best Bank in Azerbaijan," "Best Commercial Bank in Azerbaijan" and Best Private Bank in Azerbaijan" by World Finance.

PASHA Bank continues to sponsor major local and international events that boost its reputation and recognition globally. In 2016, these events included:

- Sponsorship and panel participation at the "Energy, Renewables and Sustainability" conference, organized by the American Chamber of Commerce in Baku, Azerbaijan – April 22, 2016
- Panel participation at the EBRD Annual meeting in London, UK – May 10-11, 2016
- Participation in the EU-Azerbaijan Business Forum, held in Baku, Azerbaijan – May 18, 2016
- Panel participation at Moody's Annual Credit Risk Conference, held in Baku, Azerbaijan – May 24, 2016
- Sponsorship of Caspian Oil & Gas International Exhibition and Conference official reception, held in Baku, Azerbaijan – June 1, 2016
- Sponsorship of Formula 1 Tournament, first time held in Baku, Azerbaijan – June 17-19, 2016
- Participation in SIBOS 2016 International exhibition, held in Geneva, Switzerland – September 26-29, 2016
- Sponsorship and panel participation at the Micro-Financing Conference, organized by the Azerbaijan Micro-Finance Association in Baku, Azerbaijan – October 6-7, 2016
- Participation in the IMF Annual Meeting, held in Washington, DC – October 7-9, 2016
- Sponsorship and panel participation at the US-Azerbaijan Business Forum, organized by the American Chamber of Commerce in Baku, Azerbaijan – December 1, 2016

RISK MANAGEMENT

Risk management at PASHA Bank aims to ensure that the outcomes of risk-taking activities are consistent with the Bank's strategies and risk appetite, and that there is an appropriate balance between risk and reward in order to maximize shareholder returns.

Effective risk management is fundamental to the success of PASHA Bank, and is widely recognized as one of the Bank's strategic priorities. PASHA Bank has a strong, disciplined risk management culture where risk management is a responsibility shared by all the Bank's employees. A key aspect of this culture is diversification across business lines, geographies, products, and industries.

Risk management at PASHA Bank aims to ensure that the outcomes of risk-taking activities are consistent with the Bank's strategies and risk appetite, and that there is an appropriate balance between risk and reward in order to maximize shareholder returns. The Bank's enterprise-wide risk management framework provides the foundation for achieving these goals. This framework is subject to constant evaluation to ensure that it meets the challenges and requirements of the local market where the Bank operates, including regulatory standards and industry best practices.

During fiscal year 2016, PASHA Bank's Risk team focused on crucial projects that significantly strengthened the Bank's risk based approach and were successfully implemented throughout the year.

These key projects included conducting detailed industry research for better portfolio management decisions; building the Bank's own econometric models; developing a credit rating model; revising the lending cycle to reflect previously achieved goals; and introducing a model to manage risks related to investments.

Industry Research Project

Under industry research project, the Bank reclassified the loan portfolio according to new Industry Classification Guidelines. The loan portfolio was back-tested based on new industry segmentation; consequently, each industry was assigned its own historical probability of default rating (PD), which was tested against Moody's global PD scale.

The new LLA (Loan Loss Analyzer) model developed by PASHA Holding was tested for applicability to the Bank. The loan portfolio was tested as of end-2015 and end-2016.

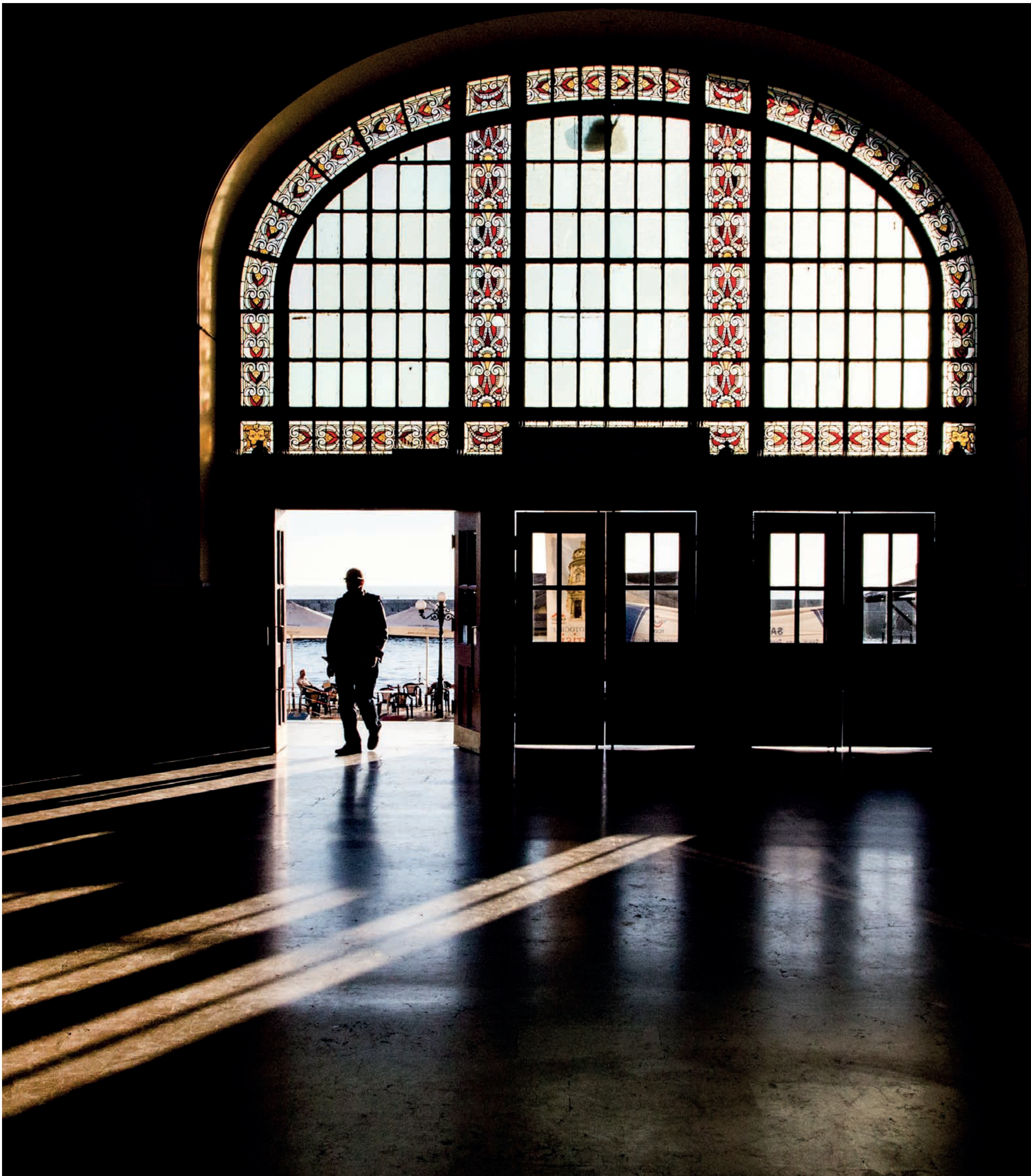
In parallel, the Risk Block built the model to hedge industry exposure. Eventually, a hedging mechanism was developed only through overweighting or underweighting strong/poor performing industries.

Additionally, the Risk MIS team was formed to produce reports (industry performance reports, reports for RMC) on behalf of the Risk team. The next step is the automatization of the process, which will be undertaken till the end of 2016.

In 2016, the Risk Block successfully performed large-scale stress testing of PASHA Bank and prepared a comprehensive Stress Test Report, which proved the sustainable liquidity/solvency and capital position of the Bank in the long run.

Macro Research Project:

As part of the macro research project, the Bank developed and implemented the initial model for forecasting of the yield curve. The current approach will be the basis for the pricing of credit products and the focal point for a more complex yield curve forecasting model. As a



result, the model was built and the Risk team successfully forecasted yield curve shift.

In addition, the Bank integrated the complex dynamic macro model. The output of the model was used in developing idiosyncratic models, the budgeting process and formulating strategy. The current stress testing approach is based on macro models.

The Risk management team prepared macro research reports for better portfolio analyses – a major achievement in 2016. These macro reports guide the management in forecasting and assessing macro trends/conditions to better analyze and minimize risky decisions.

Idiosyncratic Models

PASHA Bank's risk measurement techniques include the use of models and stress testing. The Bank uses models for a range of purposes, such as estimating the value of transactions, risk exposure, credit risk ratings and parameters, economic and regulatory capital. The use of quantitative risk methodologies and models is balanced by a strong governance framework and includes the application of sound and experienced judgment. The development, independent review, and approval of models are subject to formalized policies where applicable, including the oversight of credit committees. New approach modeling prepared by the Risk Block accounts for risk based pricing and stress test tools allowing the evaluation of different scenarios: in micro trends, micro sensitivity to various macro shocks.

Lending Cycle

In 2016, one of the Bank's core tasks included revision of the lending cycle to reflect the previously achieved goals. After specification of macro/micro modeling and framework, the Bank started revising the lending cycle to diagnose weak points based on a new modeling approach prepared and recommended by the Risk Block.

Investment Risk Management:

The Risk Block also built the investment matrix during the year. The matrix, framework and description will be able to process, define and evaluate risks for complex financial instruments, with each financial instrument broken down to its basic components to evaluate against potential risks.

Operational Risk Management:

PASHA Bank's Operational Risk Management Framework sets out an integrated approach to identify, assess, control, mitigate and report operational risks across the Bank. In 2016, the Bank's operational risk management team reviewed significant transactions and processes to identify and assess operational risks. One of the major achievements of the operational risk team during the year was the creation of a risk catalogue.

INFORMATION TECHNOLOGIES

In 2016, PASHA Bank became the country's first bank to successfully test and deploy a Real Time Data Center to ensure full continuity of its services.

PASHA Bank deploys advanced technologies that will enhance the speed and quality of service it delivers in every aspect of its operations to maximize both customer and employee satisfaction.

PASHA Bank's Information Technologies Department is responsible for the Bank's systems, communications, security and software infrastructure. The Department is also charged with the 24/7 error-free, fast, auditable, scalable and instantly observable operation of the integrated banking application that runs on the Bank's system infrastructure.

The Department's major activities that ensure the optimum use of technology within the Bank's operations include:

- Routine check-ups of IT infrastructure and software to minimize service downtime;
- Provision of training and instructions for recently introduced software or technologies;
- Easy-to-access and responsive IT Support team;
- Periodic analysis of the Bank's operations and automation of tasks to boost efficiency.

Throughout 2016, PASHA Bank continued with various efforts to upgrade and renew its technology to ensure that the Bank's business processes comply with international standards. In 2016, the Department:

- Installed a new Core Banking System that exceeds the requirements of today and enables the Bank to adapt to the industry's digitalization era;
- Deployed the latest SAP software to manage human resources more effectively;
- Installed top-of-the-line real-time monitoring systems for all running services, which also enables notifications prior to incidents;
- Implemented best practices for IT infrastructure utilizing state of the art technologies to make all services function most effectively for both internal and external customers;
- Passed full Business Continuity Planning to ensure none of the Bank's services ceases to function due to unforeseen incidents;
- Published cutting edge forward-looking Internet Banking solution that offers more functionality and visual enhancements for customers;
- Released mobile application for iOS and Android devices to further help customers meet their banking needs without leaving the comfort of their phones

Since its founding, PASHA Bank has introduced numerous firsts to Azerbaijan's banking industry, from technological breakthroughs to innovative products and services. In 2016, PASHA Bank became the country's first bank to successfully test and deploy a Real Time Data Center to ensure full continuity of its services. The Bank also commenced a Digital Banking strategy during the year.

In the coming year, PASHA Bank plans to step up its efforts in technology and innovation, as the market embraces digital and mobile banking in particular.

PASHA Bank Georgia has developed clear competitive advantages in certain product areas, such as debt capital markets operations, drawing upon PASHA Bank's significant experience gained over the years in Azerbaijan's capital market environment.

CROSS-BORDER ACTIVITIES

DOMESTIC AND INTERNATIONAL DEVELOPMENT

PASHA Bank has actively positioned itself at the forefront of the region's rising trade and investment flows, providing corporate, commercial and investment banking services with transparent business practices and an ethical approach. With increased economic activity between Azerbaijan, Turkey and Georgia, PASHA Bank's Board of Directors decided that it was in the best interest of the Bank's clients to enter these markets in order to meet their current and potential banking needs.

PASHA Bank Georgia

PASHA Bank opened its first subsidiary office in Tbilisi, Georgia in February 2013. The Bank selected Georgia as the first country in its overseas expansion for numerous reasons, including the growing volume of trade between the two countries and the joint participation of Georgia and Azerbaijan in implementing strategic regional projects. Currently, many Azerbaijani companies, including PASHA Bank clients, conduct operations in Georgia. The Bank's subsidiary office makes it easier to better serve existing customers and grow the client base as well. Another key goal with this initiative is to contribute to the development of the economies of both Georgia and Azerbaijan.

At year-end 2016, PASHA Bank Georgia recorded total assets of over GEL 282 million. As a regional bank, PASHA Bank Georgia leverages its experience in various markets to offer clients tailor-made products and services that incorporate global best practices. PASHA Bank Georgia places the respective interests of its partners at the cornerstone of its corporate strategy, aiming to achieve "New Heights Together" by contributing to mutual sustainable growth.

PASHA Bank Georgia has developed clear competitive advantages in certain product areas, such as debt capital markets operations, drawing upon PASHA Bank's significant experience gained over the years in Azerbaijan's capital market environment. PASHA Bank Georgia places special emphasis on the development of the trade finance business. PASHA Bank's presence in the region's three major economies puts the Bank in a strong position to offer a unique value proposition for its client base.

Financial highlights (GEL thousand)	
Net Profit	4,881
Gross Loans	97,210
Total Assets	282,485
Key ratios	
Cost to Income	64%
ROAE*	5%
NPL to Gross Loans	0%

*Calculated from total comprehensive income.

PASHA Bank Turkey

After careful consideration of all market entry options in Turkey – one of the world's top 20 economies – the Bank's Board of Directors resolved to acquire a majority stake in TAIB Bank and partner with Aksoy Holding. As PASHA Bank already had a long-term, trust-based working relationship with Aksoy Holding, this transaction was a natural extension of that partnership. PASHA Bank and Aksoy Holding saw a unique, one-time opportunity to leverage their trusted partnership and build upon the market know-how and capital that presently exists.

In December 2014, PASHA Bank was authorized by Turkey's Banking Regulation and Supervision Agency (BRSA) to enter the Turkish market by acquiring a majority interest in TAIB Bank from Aksoy Holding. With this acquisition, the Bank plans to target corporate clients based in Turkey.

The Turkish market also holds great potential for small and medium enterprises seeking investment opportunities in Azerbaijan, Georgia and other countries in the region. In addition, the Bank aims to bring Azerbaijani investment to Turkey to more fully realize the vast potential that local projects offer.

PASHA Bank believes that attracting new foreign direct investment, especially from Azerbaijan, to the Turkish economy, will benefit the economies of both countries. It will also create an excellent opportunity to grow and expand for its current clients as well as prospective customers.

In 2016, PASHA Bank Turkey successfully completed the sale to qualified investors of the bank's bonds amounting to TL 37.5 million – its first debt issue. PASHA Bank Turkey's bonds started to be traded in the relevant market on Borsa Istanbul. Following the bond issuance in October, Fitch Ratings affirmed PASHA Bank Turkey's long-term credit rating as A (tur).

During the year, PASHA Bank Turkey's Corporate Governance Rating was upgraded to 92.64, demonstrating the importance PASHA Bank places on corporate governance principles and its commitment to sustainable success.

Key financial highlights and ratios	(TL million)
Total Assets	510
Shareholders' Equity	245
Total Loans	404
Net Profit	14
Paid-in Capital	255
ROE	5.9%
CAR (unconsolidated)	53.85%

SUPPORT TO SUSTAINABLE ECONOMIC DEVELOPMENT

SUPPORT TO SUSTAINABLE ECONOMIC DEVELOPMENT

In support of the country's economy, PASHA Bank contributes to capacity building and the financial education of small and medium enterprises in Azerbaijan. In 2016, the Bank held various events for SMEs from different industries with the participation of other stakeholders, including the Azerbaijan Entrepreneurs Association and the Central Bank of Azerbaijan.

PASHA Bank Supports a Young Entrepreneurs' Business Forum

PASHA Bank, one of Azerbaijan's largest banks, sponsored a business forum for young entrepreneurs in Lankaran and Khachmaz. The forum saw representatives of PASHA Bank come together to speak with young entrepreneurs about how small businesses are established, and financed.

Mr. Vugar Aliyev, Senior Relationship Manager at PASHA Bank, discussed new banking products, services and credit opportunities with project participants. A representative of PASHA Bank also provided advice on writing business proposals, assessing market opportunities and identifying risks, structuring and planning start-up businesses, accessing financial resources and setting up financial accounting structures.

Seminar on Sales in a Time of Crisis (May 14, 2016)

This event was organized by PASHA Bank and Systema Consult for representatives of around 40 retail businesses to help them navigate challenging market conditions.

Moody's Annual Credit Risk Conference (May 24, 2016)

A well-attended event held each year to discuss key credit issues in Azerbaijan and the region, Moody's Annual Credit Risk Conference was held in Baku on May 24, 2016. PASHA Bank's Chief Risk Officer Mansur Mammadov was one of the speakers at the conference. Representatives of the World Bank, state owned enterprises and the banking and insurance sectors were among those who took part in the event.

During the conference, experts from Moody's gave presentations on the current macroeconomic climate, focusing on the recent changes seen in the economies of Azerbaijan and the wider region. These presentations analyzed the trends that are impacting the financial industry and explored key issues such as diversification of funding sources and the currency risks facing CIS countries.

The conference also included a separate panel discussion on global oil price volatility and the impact that the low oil price environment is having on the business climate in Azerbaijan and on the development of the banking industry. During this discussion, Mansur Mammadov highlighted the positive effect of the economic initiatives the Azerbaijani government has introduced to help stimulate business activity in the country.

Corporate Stakeholders Engagement 2016. Seminar 2: Income Comes to Changeable Business (June 8, 2016)

PASHA Bank teamed with Deloitte Azerbaijan to hold a joint conference titled "Income Comes to Changeable Business." The event was dedicated to SME development in light of changes taking place in the economies of Azerbaijan and regions.

About 70 representatives from the SME sector attended the conference, which consisted of two themed panel discussions. The first panel was dedicated to the latest legal and regulatory changes affecting SMEs and the current market environment. Entrepreneurs discussed current challenges and difficulties they faced, and shared their views on the outlook for development of small and medium businesses. The second panel discussed how to develop businesses in a sustainable manner, including adapting to new economic realities, improving corporate governance and similar issues.

Events Supported and Co-organized

PASHA Bank supports initiatives that explore economic risks and scenarios via panel discussions with industry experts. These events focus on the outlook for growth, while linking global risks and developments to strategic decisions facing business leaders in Azerbaijan and the Caspian region. In 2016, PASHA Bank partnered with various stakeholders to organize events where policymakers, investors, and non-governmental organizations from a number of countries gathered to discuss opportunities for Azerbaijan to accelerate its economic development.

Energy, Renewables and Sustainability (April 22, 2016)

PASHA Bank sponsored the "Energy, Renewables & Sustainability" conference organized by AmCham Azerbaijan in cooperation with the US Embassy in Azerbaijan, ADA University, the State Agency on Alternative and Renewable Energy Sources and other government and business organizations. The conference was held on April 22, 2016 in Baku.

The conference speakers, who included PASHA Bank's CEO and Chairman of the Executive Board Taleh Kazimov, addressed the issue of sustainability, Azerbaijan's transition to a low-carbon economy, environmental regulations and compliance, awareness and promotion of green energy objectives. The event highlighted the value of incorporating the experience of countries already applying successful renewable energy strategies, while emphasizing the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importance of research and development. The keynote speech stressed the necessity for all countries to develop a national renewable energy policy and the corresponding legislative framework, as well as the need to invest in building the relevant scientific and technical capacity to deliver on such a policy.

PASHA Bank's CEO and Chairman of the Executive Board Taleh Kazimov noted in his speech that Azerbaijan's economy needs to adapt by using innovative technologies and by applying know how and best practice expertise.

Azerbaijan Microfinance Association (AMFA) Annual Conference (October 6-7, 2016)

An international microfinance conference titled "New Opportunities on the Horizon: Let's Change Difficulties into Prospects" was held in Baku on October 6-7, 2016. PASHA Bank was the main sponsor of the event.

The conference attendees discussed a range of issues, including sound lending and responsible borrowing in the microfinance market in Azerbaijan; financial awareness for long-term savings and investments; introduction of innovative agricultural instruments to meet the needs of small farmers; optimization of the pricing policy at financial institutions; the digital revolution; and the like.

Mr. Melih Mengu, PASHA Bank's Chief Commercial Officer, was a speaker at the conference and indicated that the Bank is one of the leaders in offering a wide range of financial services to the corporate and private banking segments and complying with transparent business principles. PASHA Bank allocated AZN 70 million to microfinancing in 2016.

Some 130 representatives attended this major event. Attendees included microfinance and specialized financial experts of a number of international and domestic investments firms and service providers from Turkey, US, Germany, Russia, Kazakhstan, Ukraine, Bulgaria, and Italy.

US Azerbaijan Business Forum (December 1, 2016)

The American Chamber of Commerce in Azerbaijan (AmCham) – in cooperation with and with the financial support of PASHA Bank – hosted the first Azerbaijan-USA Business Forum. The goal of the forum was to introduce Azerbaijan, its economy, opportunities and possibilities to American companies to improve business relations between the two countries.

Representatives from government, academia and industry from Azerbaijan and the US delivered presentations about doing business in Azerbaijan, investment opportunities and privatization. The forum also witnessed the signing of a Memorandum of Understanding between AmCham and Azerbaijan's State Customs Committee on cooperation and promotion of use of the green corridor and other gating systems for the transport of goods and vehicles across the customs border for AmCham members.

The event featured sessions on Banking and Finance, Energy and Industry, Cyber Security and E-Commerce, Agricultural and Trade and Transport. The conference was followed up by B2B meetings. Representatives of well-known American companies such as Honeywell, International Development of Reinke, AGCO Corporation, John Deere, Commercial Airplanes Boeing and TERA International Group Inc. travelled to Azerbaijan to participate in this major event.

PASHA Bank organizes seminars for its small and medium enterprise clients that lack the resources to attend or send their employees to various capacity and skills building trainings.

CORPORATE SOCIAL RESPONSIBILITY

CORPORATE SOCIAL RESPONSIBILITY

Committed to being a responsible corporate citizen, PASHA Bank greatly values social responsibility and focuses on active involvement in the community where it operates. Since its founding, the Bank has played a proactive, cooperative and collaborative role in society. PASHA Bank aims to help ensure the well-being of the Azerbaijani people and make the country a better place to conduct and develop business.

In today's volatile and rapidly globalizing world, an entity and its stakeholders should follow the same path forward to ensure long-term and sustainable growth. To this end, since 2015 PASHA Bank has shifted from a traditional model of corporate social responsibility to a more contemporary approach of stakeholder engagement.

This shift will ensure that the Bank's focus remains on improving the lives of the Azerbaijani people.

Three dimensions underlie each aspect of PASHA Bank's new corporate social responsibility approach:

- We Empower Entrepreneurship.
- We Empower Human Capital.
- We Empower Capacity and Good Governance.

We Empower Entrepreneurship.

This dimension aims to support the SME sector, by effectively serving current customers and growing the customer base in this segment. PASHA Bank organizes seminars for its small and medium enterprise clients that lack the resources to attend or send their employees to various capacity and skills building trainings. The Bank's "Responsible Business: Building Local Capacity for Development" seminars are conducted by local professional trainers either in the Bank's Business Support Centers or at the BARAMA Innovation and Entrepreneurship Center's office. These efforts are also in line with PASHA Bank's brand promise of reaching "New Heights Together" with customers.

Project Portfolio

Ideya Qazandi

A reality television program and the first of its kind in the country, Ideya Qazandi is broadcast locally in Azerbaijan. The show includes 10 series where young entrepreneurs pitch their business ideas in order to secure seed capital from a panel of investors, who include representatives of large corporations, financial institutions like PASHA Bank and successful business owners. Ideya Qazandi aims to encourage the uptake of entrepreneurship, develop small-medium enterprises while improving business know-how and ethical practices among young people.

BARAMA

Since 2015, PASHA Bank has supported the BARAMA Innovation and Entrepreneurship Center, a business incubator launched by Azercell in 2009 to boost entrepreneurial activity in Azerbaijan. BARAMA provides capacity building support to small businesses during the start-up period.

Business Class

This project's main goal is to increase the entrepreneurial capacity and skills of small and medium enterprises operating in non-oil sectors via educational seminars conducted by highly experienced industry professionals.

Disappearing Crafts

PASHA Bank always strived to preserve Azerbaijan's national heritage. In 2016, the Bank implemented a project devoted to Azerbaijani handicraft. The initiative is designed to empower economic potential in several regions of the country by attracting youth's interest in vanishing crafts – such as jewelry-making, metal engraving, wood carving, carpet-making, pattern weaving, knitting and embroidery. The project aims to help young people run their own family businesses in these traditional crafts. Another positive result of this effort is reducing unemployment, by providing skills and a permanent job. The selected young people were trained by local craftsmen and the final handiwork was exhibited at a sales show, held in the capital Baku. This innovative project trained 300 young persons in ancient Azerbaijani handcrafts; 100 of whom were motivated to start an entrepreneurial venture with the skills they learned.

We Empower Human Capital.

This dimension aims to select and train the country's best students and young people in order to attract them to the Bank as interns or employees.

Project Portfolio
PASHA Bank Scholarship

Since 2012, PASHA Bank has conducted a scholarship program in partnership with the Union of Youth Student Organizations of Azerbaijan. The program is designed to foster talent and socially responsible students at local universities, and generate future leaders for both the private and public sectors. This initiative supports talented students who demonstrate academic excellence, leadership potential, and who are socially responsible.

The Bank provides scholarships for students majoring in mathematics, economics, finance, audit and related subjects. In the selection process for the scholarship program, preference is given to students who actively participate in student competitions, are engaged in social activities and strive for continuous development both as an individual and a professional. The scholarship program encourages the best students by motivating them to work harder, while simultaneously shaping more socially responsible future generations. This effort aims to raise youth awareness, while recognizing and rewarding talented individuals whose intellectual potential will serve the further development and achievement of the country.

We Empower Capacity and Good Governance.

This dimension aims to support the Bank's reputation via various awareness raising initiatives and events.

Project Portfolio
Business Journalism

This project aims to raise the standards of business news reporting in Azerbaijan, by bolstering the professional competencies and skills of the national media through a special training program tailored to meet the needs of the selected 11 journalists. The program is run in cooperation with the Thomson Foundation, one of Europe's biggest media organizations, and envisages a valuable opportunity for the journalists learn from leading media outlets like BBC, Al Jazeera and Associated Press, among others.

The program focuses on enhancing the following journalistic competencies and skills:

- Different styles of story writing
- Features writing skills
- News reporting
- News writing

- Interviewing techniques and practices

The training workshops are based on the following themes:

- Ethics, balanced and fair reporting
- Economics journalism and online media
- Business journalism

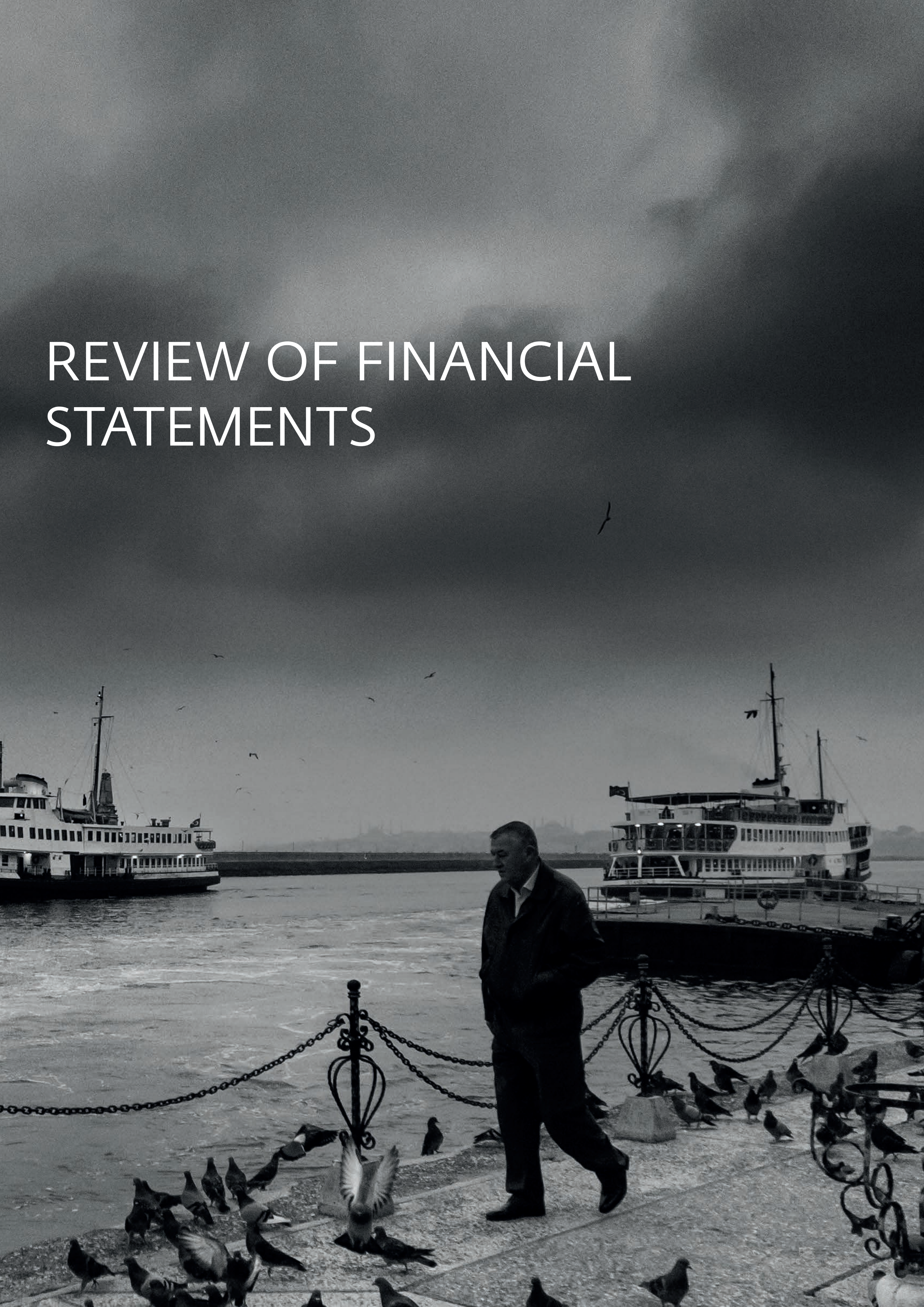
The program consists of three training workshops in Baku – 13 days in total. One of the components of the project is English language courses for the participants.

The final stage of the program is a one week UK Study Tour which includes visits and placements at well-known newspapers, magazines and other media establishments in addition to meetings with leading journalists.

PASHA Bank's envisions having a leading group of journalists who set an example of fair and quality reporting in the country while notably contributing to raising the standards of business reporting in Azerbaijan.

Maintaining high quality assets is one the main targets of the Bank in the current strategic plan period 2015-2017. The Bank has diversified its assets between highly liquid and semi liquid assets, balancing between profitability and risk.

REVIEW OF FINANCIAL STATEMENTS



REVIEW OF FINANCIAL STATEMENTS

Some of the main figures and performance evaluation ratios of PASHA Bank and its subsidiaries (PASHA Bank Georgia and PASHA Yatirim Bankasi) for the year ended 31 December 2016.

PASHA Bank is committed to expanding further in the financial sector of Azerbaijan. The Bank aims to become one of the leading financial service providers in the corporate and private banking segments, by embracing transparent business practices and enhancing the transparency of the country's banking industry. Maintaining high quality assets is one the main targets of the Bank in the current strategic plan period 2015-2017. The Bank has diversified its assets between highly liquid and semi liquid assets, balancing between profitability and risk.

The Bank maintained its position as the largest commercial bank by total equity, which amounted to AZN 487,266 thousand (2015: AZN 432,489 thousand).

As of end-2016, PASHA Bank recorded total assets of AZN 3,289,845 thousand, an increase of 43% year-on-year (2015: AZN 2,292,739 thousand).

The breakdown of Bank's assets as of 31 December 2016 is as following:

Cash and cash equivalents – 34%
Loans to customers – 34%,
Due from credit institutions – 22%
Securities portfolio – 8%
Other non-current and current assets – 2%

PASHA Bank generated strong loan growth in 2016, increasing its gross loan portfolio by 23% to AZN 1,169,607 thousand (2015: AZN 949,848 thousand).

The effective provision rate on the portfolio was 5.3% (2015: 5.0%). In 2016, the ratio of loans individually determined to be impaired to the gross portfolio rose to 8.25% (2015: 3.82%).

By remaining consistent and serving customers when the market was soft, the Bank is now benefiting from the relationships it has developed over the last several years. As a result, PASHA Bank has generated a customer deposits base totaling AZN 2,350,687 thousand in 2016, up 71% year-on-year (2015: AZN 1,374,113 thousand). Customer deposits were mainly concentrated in demand and term accounts in the proportion of 42% and 58%, respectively (2015: 66% and 34%, respectively).

The Bank reported net profit of AZN 69,288 thousand for fiscal year 2016 (2015: AZN 14,383 thousand). Total operating income for period was AZN 186,499 thousand, an increase of 60% year-on-year (2015: AZN 116,253 thousand).

The Bank's interest income totaled AZN 157,502 thousand while non-interest income amounted to AZN 82,003 thousand. As a result, the ratio of non-interest income to total operating income was 44%.

Thanks to extensive negotiations with international financial institutions, PASHA Bank was able to provide more trade finance services to its corporate clients by accessing a broader range of financial instruments. The Bank was also able to obtain better terms for financing of customers after receiving a credit rating from two global rating agencies. At the institutional level, the Bank held various seminars and workshops for clients to strengthen its capacity to provide timely professional services. In 2016, documentary operations balances (including post financing) amounted to AZN 303,727 thousand (2015: AZN 347,134 thousand).

PASHA Bank reported an estimated tier capital adequacy ratio under CBAR capital requirements of 20% (2015: 17%). The Bank remains focused on meeting the required capital levels once Basel II and BASEL III are finalized, while also returning capital to our shareholders through dividends.

*All figures have been presented as of 31 December 2016 if not indicated otherwise and are based on consolidated audited financial statements.

SUSTAINABILITY SUMMARY

SUSTAINABILITY SUMMARY

PASHA Bank is committed to integrating the best sustainability practices into every aspect of its operations. To date, PASHA Bank has issued two sustainability reports that covered the Bank's sustainability performance during 2011-2015 and laid out sustainability objectives for the upcoming strategic period.

Despite the challenging macro environment, PASHA Bank continues to base its strategic decisions and business activities on its core values: integrity, profitability, collaboration, ownership and quality.

To demonstrate our commitment to sustainability and our guiding values, below is a short summary of major sustainability-related issues and achievements during 2016.

Our Customers

Since its founding, PASHA Bank has been committed to supporting SMEs from diverse sectors. Specialized SME branches provide banking services to small and medium-sized companies across the country.

Each year, PASHA Bank has expanded its customer base, attracting a wider range of customers to the Bank. In 2016, PASHA Bank ramped up its financial advisory practice to provide more consultation for corporate and enterprise clients to navigate the turbulent economic climate. As this business line increased, we created a supply chain banking for SME customers to cooperate with corporate customers. This type of relationship helps SME customers to boost their turnover and grow their businesses. For underperforming businesses challenged by the market, PASHA Bank's advisory and financing assisted them in diversifying into other areas of activity which later proved successful. In addition, PASHA Bank's transfers to non-cash operations – POS terminals, e-commerce platforms, transfers from accounts – have increased significantly. All of these efforts demonstrate how PASHA Bank supports the development of SMEs in Azerbaijan.

Customer service is a strategic priority area for any successful enterprise today. PASHA Bank continually strives to improve its services to ensure that the Bank consistently delivers the highest rates of customer satisfaction. The Contact Center operates at maximum efficiency so customers can receive help with their queries whenever they may need it. Meanwhile, the Organizational Development and Quality Assurance worked on numerous new initiatives to boost the level of service at the Bank, such as developing a more advanced system to monitor client satisfaction. The Bank also regularly conducts customer satisfaction surveys to ensure that customers are fully satisfied and to make adjustments as needed.

PASHA Bank has developed specialized products and services to better serve the SME segment, in areas such as factoring, scoring approach and trade finance. For example, the scoring model aims to improve and expedite decision-making process by adequate review and further approval/rejection or standardized review of loan applications. Thus, SMEs receive the funds they need more quickly.

In 2016, PASHA Bank granted the highest number of Letters of Guarantee – a key product in trade finance – in the Bank's history. The Bank extended 123 Letters of Guarantee in 2016, up sharply from 19 a year earlier. In addition, the Bank's marketing efforts resulted in more active customers. Out of 1,663 SME clients, 1,643 were active customers in 2016.

During the reporting year, PASHA Bank factored more than 1,000 invoices as factoring operations.

These positive results demonstrate the extent to which PASHA Bank has expanded its service offering to better serve and meet the needs of customers in changing times and conditions.

Our People

PASHA Bank's Human Resources Management Policy was developed and adopted in 2010 in compliance with national labor requirements. The HR Management Policy aims to equip employees with essential skills that will help them in their professional development. Personnel development is a fundamental pillar of the Bank. Continuous performance improvement and regular employee training sessions are central to maintaining the quality of the Bank's services and ensuring the Bank's rapid adaptation to labor market requirements.

The Human Resources Department benchmarks the Bank's HR Management Policy against international best practices and coordinates the Bank's activity with regards to personnel.

In 2016, PASHA Bank further developed its procedures and processes regarding management of human resources, by adopting internal rules on training and development, internal guides on health, safety and environmental issues, and internal professional certification guidelines.

By end-2016, PASHA Bank's workforce totaled 475 employees with more than 100 new hires throughout the year.

Developing Our People

Our employees and their performance have a direct impact on our service quality. Investment in human capital is a major driver in our commitment to safeguarding the Bank's sustainable future. Investing in the next generation of leaders is critical to maintaining our competitive advantage and achieving growth over the long run. Our employees participate in intensive training programs both externally and in-house in a variety of disciplines, including finance and accounting, customer service and project management.

In 2016, PASHA Bank held 134 training sessions; of which, 32 were in-house trainings covering 131 participants. A further 58 internal training sessions for 927 participants were conducted during the year. Sixteen employees received 11 individual training sessions each by external service providers. Additionally, 33 employees of PASHA Bank participated in individual executive coaching sessions as part of mid-level managers capacity building efforts. PASHA Bank has continued expanding the capacity of its sales forces under a specially designed "Elite Banker" Training Program.

Engaging Our People

PASHA Bank works tirelessly to build a highly efficient team where every member shares the same values and vision. In 2016, the Bank conducted the Employee Engagement Survey which revealed a high level of loyalty of PASHA Bank employees to the brand and their adherence to the Bank's vision and values. Several areas for improvement were also identified, including further bolstering internal communication both vertically and horizontally, and empowering mid-level managers. Based on the findings of the survey, the Bank has developed a three-stage program to further boost employee engagement.

Under the first stage of this program, mid-level managers have received trainings on strengthening their leadership and communications skills to reinforce their dialogue and interaction both with their subordinates and super-

visors. The "Leadership in Banking" coursework that was developed specifically for PASHA Bank managers by the Paris-Sorbonne University Abu Dhabi included a vast range of topics, such as Coaching and Feedback, Mentoring, Performance Management and Motivation.

PASHA Bank has continued its tradition of CEO Breakfasts, where the Bank's CEO meets junior staff members for an exchange of ideas and views. Thirty-four breakfast meetings were held in 2016 both in Baku and at the Bank's regional offices. During these events, 32 suggestions on optimization and improvement of business processes put forward by junior employees were considered by various functions in the Bank and successfully implemented.

To improve both vertical and horizontal communication, the cascade communications process was developed to bolster the relationship between managers and their direct subordinates by pushing information throughout the organization – from top executives to supervisors and managers to workers on the frontlines.

The process also helps to send information up through the organizational structure, creating a dynamic, two-way information flow that drives vital information and gives employees an effective voice in the workplace.

As part of cascade communications efforts, a plan was developed for each member of the PASHA Bank executive board which included Village Halls, team building events, one-to-one formal sessions and informal meetings with key persons and heads of functions under their direct supervision.

To better equip the Board and C-level for this exercise, an international training network was designed on the Develor platform. In addition, a training program was conducted to help the top management better focus on sustainable behavior change.

PASHA Bank Rotary Club

PASHA Bank Rotary Club is managed by the Organization Committee with an aim of streamlining charity efforts of the Bank's employees outside of the general mandate of PASHA Bank corporate social responsibility. The Committee arranges regular visits of PASHA Bank employees to orphanages in attempt to meet their needs for amusement and attention. The Committee also organizes various games and championships among PASHA Bank personnel and employees of other PASHA Holding companies to raise awareness on social issues which the Rotary Club aims to address.

The most important indicator of the Committee's success is the involvement of Bank employees in new exercises and activities. Since the start of the project, the number of personnel actively involved in the activities of the Club has increased four-fold.

Contributing to Socio-economic Development

Investing in community development is an essential part of PASHA Bank's activities. Investments made locally today will yield huge benefits to society as a whole and will also promote long-term development opportunities. In 2013, PASHA Bank was recognized as having the "Best Corporate Social Responsibility (CSR) Program in Europe" by EMEA Finance for its active support of local communities.

PASHA Bank's overall corporate social responsibility objectives include empowering entrepreneurship to develop Azerbaijan's economy. Meanwhile, the Bank believes that education plays a key role in contributing to Azerbaijan's further development. This is why PASHA Bank devotes substantial resources to supporting the education of young people, improving financial literacy among the nation's youth, and educating the business community.

PASHA Bank is engaged in a number of projects that target the nation's young people and contributes to capacity building and the financial education of small and medium enterprises in Azerbaijan. These include a business journalism scheme developed in collaboration with the Thomson Foundation and support to the Young Entrepreneurs' Business Forum in partnership with Junior Achievement Azerbaijan. The "I Am a PASHA Bank Scholar" program, which is designed to encourage young talent to come work at the Bank, is another successful effort initiated by PASHA Bank to support Azerbaijan's youth.

To help improve the financial literacy and corporate governance knowledge of the country's business leaders further, PASHA Bank co-organized and participated in several events with its counterparts, including the seminar "Sales in a Time of Crisis, Moody's Annual Credit Risk Conference, Conference on Energy, Renewables and Sustainability, seminar on "Rapidly changing businesses earn more", annual conference of the Azerbaijan Microfinance Association and the US-Azerbaijan Business Forum. Nearly 1,000 representatives from public and private companies, as well as international financial institutions, took part in these varied events. The Bank sees these seminars, conferences and forums, and similar ones it will arrange in the future, as having a lasting impact on developing the skills and know-how of the business community and raising corporate governance standards in Azerbaijan.

We believe that sustainable growth is possible through building quality, long-term relationships with our customers, continually improving our products and services, boosting the efficiency of our business processes, and investing in the wider community. During the period leading up to when the next biennial Sustainability Report is published, we plan to further refine our sustainability goals to ensure they remain focused, while continuing to develop our sustainability performance and management systems.

This report details the sustainability activities that PASHA Bank undertakes to maintain its competitive advantages. In keeping with the guidelines of the GRI (Global Reporting Initiative) G4 Core option, the boundary of the report focuses on PASHA Bank's activities in Azerbaijan for fiscal year 2016.

During the process of determining the scope of the PASHA Bank Sustainability Report, the guidance of PASHA Bank senior management and recommendations of the Bank's stakeholders were taken into consideration. The report's Materiality Analysis (below) was constituted to map the contents of the report.

PASHA Bank Sustainability Report Materiality Analysis

Impact on PASHA Bank	Low	Middle	High
High		• Energy • Emissions • Employment • Diversity and Equal Opportunity	• Economic Performance • Indirect Economic Performance • Products and Services • Training and Education • Anti-Corruption • Compliance • Product Portfolio • Audit • Active Ownership • Investment
Middle		• Transport • Non Discrimination	• Product Responsibility • Equal Remuneration for Women and Men • Local Communities
Low			

Stakeholders' Priorities

Sustainability Strategy of PASHA Bank

PASHA Bank is committed to achieving sustainable growth by shifting from a classical CSR (Corporate Social Responsibility) approach to a CSE (Corporate Stakeholder Engagement) model.

CSE Dimension	Sustainability Approach
We empower entrepreneurship.	Clients for us
We empower human capital.	People for us
We empower capacity and good governance.	Reputation for us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OJSC PASHA Bank Consolidated financial statements

Year ended 31 December 2016
together with independent auditor's report


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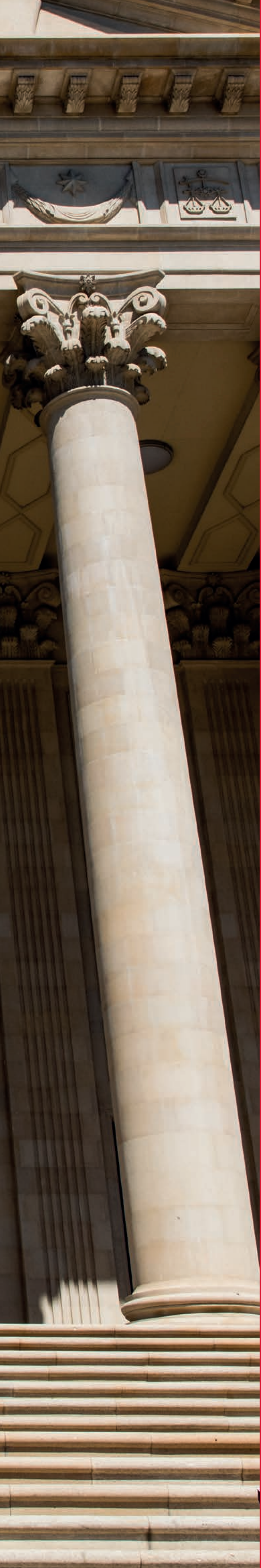

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INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Directors of OJSC PASHA Bank

Opinion

We have audited the consolidated financial statements of OJSC PASHA Bank and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at 31 December 2016, and the consolidated statement of profit or loss, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2016, and its financial performance and 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 (ISA). Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the consolidated financial statements section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of management and the Audit Committee for the consolidated financial statements

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

In preparing the consolidated financial statements, management is responsible for assessing the Group'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 Group or to cease operations, or has no realistic alternative but to do so.

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

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

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group'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 Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

17 March 2017
Baku, Azerbaijan

Building a better working world

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of OJSC PASHA Bank and its subsidiaries as at 31 December 2016, and their financial performance and cash flows for the year 2016 in accordance with International Financial Reporting Standards.

Ernst & Young Holdings (CIS) B.V.

OJSC PASHA Bank 2016 CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
As at 31 December 2016
(Figures in tables are in thousands of Azerbaijani manats)

	Notes	2016	2015
Assets			
Cash and cash equivalents	6	1,105,769	1,021,306
Trading securities	7	22,669	46,238
Amounts due from credit institutions	8	728,121	137,895
Investment securities			
- available-for-sale	9	173,329	5,696
- loans and receivables	9	61,220	87,903
Derivative financial assets	19	984	324
Loans to customers	10	1,107,274	902,150
Investment property	11	1,654	1,668
Property and equipment	12	12,809	15,851
Goodwill and other intangible assets	13	55,067	56,730
Current income tax assets		–	287
Deferred income tax assets	20	1,647	1,555
Other assets	14	19,302	15,136
Total assets		3,289,845	2,292,739
Liabilities			
Amounts due to banks and government funds	15	330,294	369,693
Amounts due to customers	16	2,350,687	1,374,113
Other borrowed funds	17	51,473	93,814
Debt securities issued	18	18,705	–
Derivative financial liabilities	19	2,468	991
Current income tax liabilities		12,436	–
Deferred income tax liabilities	20	8,446	9,688
Provision for guarantees and letters of credit	23	6,959	379
Other liabilities	14	21,111	11,572
Total liabilities		2,802,579	1,860,250

The accompanying notes on page 84 to 160 are an integral part of these consolidated financial statements.

	Notes	2016	2015
Equity			
Share capital	21	333,000	333,000
Retained earnings		83,152	19,283
Net unrealised loss on investment securities available-for-sale		(1)	(100)
Foreign currency translation reserve		71,046	80,244
Total equity attributable to shareholders of the Bank		487,197	432,427
Non-controlling interests		69	62
Total equity		487,266	432,489
Total liabilities and equity		3,289,845	2,292,739

Signed and authorised for release on behalf of the Executive Board of the Bank:

Taleh Kazimov Chairman of the Executive Board

Hayala Nagiyeva Chief Financial Officer

17 March 2017

The accompanying notes on page 84 to 160 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF PROFIT OR LOSS
For the year ended 31 December 2016
(Figures in tables are in thousands of Azerbaijani manats)

	Notes	2016	2015
Interest income			
Loans to customers		105,063	78,032
Amounts due from credit institutions		35,647	6,799
Investment securities available-for-sale		9,755	6,846
Cash and cash equivalents		2,122	3,382
Securities purchased under agreements to resell		–	61
		152,587	95,120
Trading securities		4,915	5,160
		4,915	5,160
Interest expense			
Amounts due to customers		(40,530)	(16,700)
Amounts due to banks and government funds		(10,185)	(5,401)
Other borrowed funds		(1,757)	(2,174)
Debt securities issued		(396)	–
Other		(138)	(60)
		(53,006)	(24,335)
Net interest income		104,496	75,945
Provision for impairment of interest earning assets	23	(11,447)	(52,171)
Net interest income after provision for impairment of interest bearing assets		93,049	23,774
Net fee and commission income	24	12,564	7,686
Net gains/(losses) from trading securities		109	(3,678)
Net gains/(losses) from investment securities available-for-sale		84	(145)
Net gains from foreign currencies:			
-dealing		57,810	17,635
-translation differences		8,699	12,992
- operations with foreign currency derivatives		2,304	5,467
Other income		433	351
Non-interest income		82,003	40,308

The accompanying notes on page 84 to 160 are an integral part of these consolidated financial statements.

	Notes	2016	2015
Personnel expenses	25	(35,358)	(21,835)
General and administrative expenses	25	(33,449)	(21,265)
Depreciation and amortisation	12, 13	(6,678)	(4,342)
Goodwill impairment	13	(3,642)	–
Loss on initial recognition of financial assets at fair value		(1,474)	–
(Provision)/reversal of provision for guarantees and letters of credit	23	(6,580)	2,304
Non-interest expenses		(87,181)	(45,138)
Profit before income tax expense		87,871	18,944
Income tax expense	20	(18,583)	(4,561)
Net profit for the year		69,288	14,383
Attributable to:			
- shareholders of the Bank		69,281	14,380
- non-controlling interests		7	3
		69,288	14,383

The accompanying notes on page 84 to 160 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
For the year ended 31 December 2016
(Figures in tables are in thousands of Azerbaijani manats)

	Notes	2016	2015
Net profit for the year		69,288	14,383
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods:			
Gross unrealised gains/(losses) on investment securities available-for-sale		208	(393)
Realised gains/(losses) on investment securities available-for-sale reclassified to the consolidated statement of profit or loss		(84)	145
Net unrealised gains/(losses) on investment securities availablefor-sale	21	124	(248)
Tax effect of net gains/(losses) on investment securities available-for-sale	20	(25)	50
Foreign currency translation differences	21	(9,198)	83,707
Net other comprehensive (loss)/income to be reclassified to profit or loss in subsequent periods		(9,099)	83,509
Total comprehensive income for the year		60,189	97,892
Attributable to:			
- shareholders of the Bank		60,182	97,889
- non-controlling interests		7	3
		60,189	97,892

The accompanying notes on page 84 to 160 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2016
(Figures in tables are in thousands of Azerbaijani manats)

	Attributable to shareholders of the Bank						
	Share capital	Retained earnings (accu-mulated deficit)	Net unrealised gain/(losses) on investment securities avai-lable-for-sale	Foreign currency translation difference	Total	Non-controlling interests	Total equity
As at 31 December 2014	333,000	(5,929)	98	(3,463)	323,706	–	323,706
Net profit for the year	–	14,380	–	–	14,380	3	14,383
Other comprehensive income for the year	–	–	(198)	83,707	83,509	–	83,509
Total comprehensive income for the year	–	14,380	(198)	83,707	97,889	3	97,892
Cancellation of dividends declared in 2014 (Note 21)	–	10,832	–	–	10,832	–	10,832
Acquisition of subsidiary (Note 5)	–	–	–	–	–	97	97
Decrease in non-controlling interest	–	–	–	–	–	(38)	(38)
As at 31 December 2015	333,000	19,283	(100)	80,244	432,427	62	432,489
Net profit for the year	–	69,281	–	–	69,281	7	69,288
Other comprehensive loss for the year	–	–	99	(9,198)	(9,099)	–	(9,099)
Total comprehensive income for the year	–	69,281	99	(9,198)	60,182	7	60,189
Dividends to shareholders of the Bank (Note 21)	–	(5,412)	–	–	(5,412)	–	(5,412)
31 December 2016	333,000	83,152	(1)	71,046	487,197	69	487,266

The accompanying notes on page 84 to 160 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS
For the year ended 31 December 2016
(Figures in tables are in thousands of Azerbaijani manats)

	Notes	2016	2015
Cash flows from operating activities			
Interest received		130,157	88,989
Interest paid		(38,697)	(22,444)
Fees and commissions received		20,730	12,337
Fees and commissions paid		(8,117)	(4,926)
Net realized losses on sale of investment securities available-for-sale		84	(145)
Net realized gain from trading securities		1,017	178
Realised gains less losses from dealing in foreign currencies and operations with foreign currency derivatives		60,747	23,641
Personnel expenses paid		(26,041)	(18,430)
General and administrative expenses paid		(32,262)	(18,790)
Other operating income received		382	334
Cash flows from operating activities before changes in operating assets and liabilities		108,000	60,744
Net (increase)/decrease in operating assets			
Trading securities		22,274	(28,098)
Amounts due from credit institutions		(583,565)	63,618
Loans to customers		(179,617)	(202,467)
Other assets		(1,095)	(597)
Net increase/(decrease) in operating liabilities			
Amounts due to banks and government funds		(72,062)	19,990
Amounts due to customers		874,709	342,791
Other borrowed funds		(48,120)	(6,976)
Derivative financial liabilities		1,110	–
Other liabilities		(1,497)	1,022
Net cash flows from operating activities before income tax		120,137	250,027
Income tax paid		(6,252)	(970)
Net cash from operating activities		113,885	249,057
Cash flows from investing activities			
Acquisition of a subsidiary, net of cash acquired (Note 5)		–	371
Purchase of investment securities available-for-sale		(231,358)	(539,479)
Proceeds from sale and redemption of investment securities available-for-sale		78,569	690,411

The accompanying notes on page 84 to 160 are an integral part of these consolidated financial statements.

	Notes	2016	2015
Purchase of investment securities – loans and receivables		(27,105)	–
Proceeds from sale and redemption of investment securities – loans and receivables		50,627	–
Purchase and prepayments for property and equipment		(2,356)	(3,999)
Acquisition of intangible assets		(4,526)	(4,406)
Proceeds from sale of property and equipment		34	1,410
Net cash (used in)/from investing activities		(136,115)	144,308
Cash flows from financing activities			
Proceeds from debt securities issued	18	19,258	–
Dividends paid	21	(5,412)	–
Net cash from financing activities		13,846	–
Effect of exchange rates changes on cash and cash equivalents		92,847	279,961
Net increase in cash and cash equivalents		84,463	673,326
Cash and cash equivalents, beginning	6	1,021,306	347,980
Cash and cash equivalents, ending	6	1,105,769	1,021,306

The accompanying notes on page 84 to 160 are an integral part of these consolidated financial statements.

OJSC PASHA Bank
Notes to 2016 consolidated financial statements

NOTES TO 2016 CONSOLIDATED FINANCIAL STATEMENTS

1. Principal activities

OJSC PASHA Bank ("the Bank") was established on 18 June 2007, as an open joint stock company under the laws of the Republic of Azerbaijan. The Bank operates under a banking licence No. 250 issued by the Central Bank of the Republic of Azerbaijan (the "CBAR") on 28 November 2007.

The Bank and its subsidiaries (together – "the Group") accept deposits from the public and extend credit, transfer payments, exchange currencies and provide other banking services to its commercial and private customers.

The Bank has four service points and two branches in Azerbaijan as at 31 December 2016 (31 December 2015: three service points and two branches) and two subsidiaries, JSC PASHA Bank Georgia located in the Republic of Georgia and PASHA Yatirim Bankasi A.Ş. (the "Subsidiaries") located in the Republic of Turkey.

The Bank's registered legal address is 15 Yusif Mammadaliyev Street, Baku, AZ1005, Azerbaijan.

As at 31 December 2016 and 2015, the following shareholders owned the outstanding shares of the Bank:

Shareholders	2016 (%)	2015 (%)
PASHA Holding Ltd.	60	60
Ador Ltd.	30	30
Mr. Arif Pashayev	10	10
Total	**100**	**100**

As at 31 December 2016 and 2015, the Group is ultimately owned by Mrs. Leyla Aliyeva and Mrs. Arzu Aliyeva, who exercise joint control over the Group.

PASHA Bank Georgia JSC, a wholly – owned subsidiary, is located in the Republic of Georgia, operating in the banking sector, with registered and paid up share capital of GEL 35,000 thousand as of 31 December 2013. In March 2014 share capital of subsidiary was increased and amounted to GEL 103,000 thousand as at 31 December 2016 and 2015. PASHA Bank Georgia JSC operates under a banking licence issued by the National Bank of Georgia (the "NBG") on 17 January 2013.

Legal address of the PASHA Bank Georgia JSC is 15 Rustaveli Street, Tbilisi, GE 0108, Georgia.

TAIB Yatirim Bank A.Ş. was incorporated in 1987 as an investment bank in Turkey with the permission of the Council of Ministers decision no. 6224 which allows the transfer of the banks' net profit after statutory liabilities and in case of liquidation the transfer of capital to foreign shareholders. On 27 January 2015, the Bank acquired 79.47% of the voting common shares of TAIB Yatirim Bank A.Ş. (Note 5). TAIB Yatirim Bank A.Ş. was renamed to Pasha Yatirim Bankasi A.Ş. at the registration of the Bank as shareholder. In March 2015, investment in share capital of the subsidiary was increased by TRY 175,000 thousand to TRY 255,000 thousand. As at 31 December 2016 and 2015, the Bank holds 99.92% voting common shares of PASHA Yatirim Bankasi A.Ş. with its head office located in Istanbul. The activities of the bank are regulated by the Central Bank of the Republic of Turkey (the "CBRT").

OJSC PASHA Bank and its Subsidiaries were consolidated in these financial statements.

2. Basis of preparation

General

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

The Azerbaijani manat is the functional and presentation currency of OJSC PASHA Bank as the majority of the transactions are denominated, measured, or funded in Azerbaijani manat. Transactions in other currencies are treated as transactions in foreign currencies. The Group is required to maintain its records and prepare its financial statements in Azerbaijani manat and in accordance with IFRS. These consolidated financial statements are presented in thousands of Azerbaijani manat ("AZN"), except when otherwise indicated. The consolidated financial statements have been prepared under the historical cost convention except for trading and available for sale securities and derivative financial instruments which have been measured at fair value.

3. Summary of significant accounting policies

Changes in accounting policies

The Group has adopted the following amended IFRS which are effective for annual periods beginning on or after 1 January 2016:

Amendments to IAS 1 Disclosure Initiative

- The amendments to IAS 1 clarify, rather than significantly change, existing IAS 1 requirements. The amendments clarify:
- The materiality requirements in IAS 1;
- That specific line items in the statement(s) of profit or loss and OCI and the statement of financial position may be disaggregated;
- That entities have flexibility as to the order in which they present the notes to financial statements;
- That the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss.

Furthermore, the amendments clarify the requirements that apply when additional subtotals are presented in the statement of financial position and the statements of profit or loss and OCI. These amendments are effective for annual periods beginning on or after 1 January 2016. These amendments do not have any impact on the Group.

Annual improvements 2012-2014 cycle

IFRS 7 Financial Instruments: Disclosures

The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. An entity must assess the nature of the fee and the arrangement against the guidance for continuing involvement in IFRS 7 in order to assess whether the disclosures are required. The assessment of which servicing contracts constitute continuing involvement must be done retrospectively. However, the required disclosures would not need to be provided for any period beginning before the annual period in which the entity first applies the amendments.

Basis of consolidation

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

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

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

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

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

A change in the ownership interest of a subsidiary, without a change of control, is accounted for as an equity transaction. Losses are attributed to the non-controlling interests even if that results in a deficit balance.

If the Bank loses control over a subsidiary, it derecognises the assets (including goodwill) and liabilities of the subsidiary, the carrying amount of any non-controlling interests, the cumulative translation differences, recorded in equity; recognises the fair value of the consideration received, the fair value of any investment retained and any surplus or deficit in profit or loss and reclassifies the parent's share of components previously recognised in other comprehensive income to profit or loss.

Business combinations

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interests in the acquiree. For each business combination, the acquirer measures the non-controlling interests in the acquiree that are present ownership interests either at fair value or at the proportionate share of the acquiree's identifiable net assets and other components of non-controlling interests at their acquisition date fair value. Acquisition costs incurred are expensed.

When acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value as at the acquisition date through profit or loss.

Any contingent consideration to be transferred by the acquirer is recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration which is deemed to be an asset or liability, will be recognised in accordance with IAS 39 either in profit or loss or as change to other comprehensive income. If the contingent consideration is classified as equity, it shall not be remeasured until it is finally settled within equity.

Goodwill is initially measured at cost being the excess of the consideration transferred over the acquiree's net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognised in profit or loss.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units. Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

Fair value measurement

The Group measures financial instruments, such as trading and available-for-sale securities and derivative financial instruments at fair value at each balance sheet date. Also, fair values of financial instruments measured at amortised cost are disclosed in Note 27.

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

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

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

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the consolidated financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 – quoted (unadjusted) market prices in active markets for identical assets or liabilities.
- Level 2 – valuation techniques for which the lowest level input that is significant to the

fair value measurement is directly or indirectly observable.

- Level 3 – valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

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

Financial assets

Initial recognition

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held to maturity investments, or available-for-sale financial assets, as appropriate. The Group determines the classification of its financial assets upon initial recognition, and subsequently can reclassify financial assets in certain cases as described below.

Date of recognition

All regular way purchases and sales of financial assets are recognized on the trade date i.e. the date that the Group commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the market place.

Financial assets at fair value through profit or loss

Financial assets classified as held for trading are included in the category “financial assets at fair value through profit or loss”. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of derivatives are included in Net gain/loss operations with foreign currency derivatives. In a currency swap, the Group pays a specified amount in one currency and receives a specified amount in another currency. Currency swaps are mostly gross-settled.

Held to maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held to maturity when the Group has the positive intention and ability to hold them to maturity. Investments intended to be held for an undefined period are not included in this classification. Held to maturity investments are subsequently measured at amortized cost. Gains and losses are recognized in profit or loss when the investments are impaired, as well as through the amortization process.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortized cost using the effective interest method. Gains and losses are recognized in profit or loss when the loans and receivables are derecognized or impaired, as well as through the amortization process.

The Group places deposits with banks as well as issues loans to banks. According to the terms of deposit agreements the Group is allowed to withdraw deposits before maturity while as per terms of loan agreements the Group is not allowed to do so and loans can be demanded by the Group at maturity.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial recognition available-for-sale financial assets are measured at fair value with gains or losses being recognized in other comprehensive income until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income is reclassified to the consolidated statement of profit or loss. However, interest calculated using the effective interest method is recognized in profit or loss.

Reclassification of financial assets

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit or loss category in one of the following cases:

A financial asset that would have met the definition of loans and receivables above may be reclassified to loans and receivables category if the Group has the intention and ability to hold it for the foreseeable future or until maturity;

Other financial assets may be reclassified to available for sale or held to maturity categories only in rare circumstances.

A financial asset classified as available for sale that would have met the definition of loans and receivables may be reclassified to loans and receivables category of the Group has the intention and ability to hold it for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. Any gain or loss already recognized in profit or loss is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the CBAR, NBG and CBRT, excluding obligatory reserves, and amounts due from credit institutions due on demand or within 90 days from the date of origination and that are free from contractual encumbrances.

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 consolidated statement of financial position and, in case the transferee has the right by contract or custom to sell or re-pledge them, reclassified as securities pledged under sale and repurchase agreements. The corresponding liability is presented within amounts due to credit institutions or customers. Securities purchased under agreements to resell ("reverse repo") are recorded as separate account on the consolidated statement of financial position if material or as cash and cash equivalents or loans to customers as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

Derivative financial instruments

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

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contract, and the host contract is not itself held for trading or designated at fair value through profit or loss. The embedded derivatives separated from the host are carried at fair value in the trading portfolio with changes in fair value recognised in profit or loss.

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include Amounts due to banks and government funds, other borrowed funds and amounts due to customers. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in profit or loss when the borrowings are derecognised as well as through the amortisation process.

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 into other operating expenses.

Measurement of financial instruments at initial recognition

When financial instruments are recognised initially, they are measured at fair value, adjusted, in the case of instruments not at fair value through profit or loss, for directly attributable fees and costs.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price. If the Group determines that the fair value at initial recognition differs from the transaction price, then:

- If the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e., a Level 1 input) or based on a valuation technique that uses only data from observable markets, the Group recognises the difference between the fair value at initial recognition and the transaction price as a gain or loss;
- In all other cases, the initial measurement of the financial instrument is adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the Group recognises that deferred difference as a gain or loss only when the inputs become observable, or when the instrument is derecognized.

Offsetting of financial instruments

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

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

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

Impairment of financial assets

The Group assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, 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.

Amounts due from credit institutions and loans to customers

For amounts due from credit institutions and loans to customers carried at amortized cost, the Group first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risks characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment of impairment.

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in current year profit. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. 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 Group. 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 a future write-off is later recovered, the recovery is credited to the consolidated statement of profit or loss.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Group'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 on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of 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 years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group or their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Available-for-sale financial investments

For available-for-sale financial investments, the Group assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognized in the other comprehensive income is reclassified from other comprehensive income to the consolidated statement of profit or loss. Impairment losses on equity investments are not reversed through the consolidated statement of profit or loss; increases in their fair value after impairment are recognized in other comprehensive income.

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recognized in the consolidated statement of profit or loss. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the consolidated statement of profit or loss, the impairment loss is reversed through the consolidated statement of profit or loss.

Held to maturity financial investments

For held to maturity investments the Group assesses individually whether there is objective evidence of impairment. If there is objective evidence that an impairment loss 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. The carrying amount of the asset is reduced and the amount of the loss is recognized in the consolidated statement of profit or loss.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognized, any amounts formerly charged are credited to the consolidated statement of comprehensive income.

Renegotiated loans

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

The accounting treatment of such restructuring is as follows:

- If the currency of the loan has been changed the old loan is derecognised and the new loan is recognised;
- If the loan restructuring is not caused by the financial difficulties of the borrower the Group uses the same approach as for financial liabilities described below;
- If the loan restructuring is due to the financial difficulties of the borrower and the loan is impaired after restructuring, the Group recognizes the difference between the present value of the new cash flows discounted using the original effective interest rate and the carrying amount before restructuring in the provision charges for the period. In case loan is not impaired after restructuring the Group recalculates the effective interest rate.

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 or current effective interest rate.

Derecognition of financial assets and liabilities

Financial assets

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

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

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

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

Financial liabilities

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

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

Financial guarantees

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit and guarantees. Financial guarantees are initially recognized in the consolidated financial statements at fair value, in 'Other liabilities', being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amortized premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the consolidated statement of profit or loss. The premium received is recognized in profit or loss on a straight-line basis over the life of the guarantee.

The interest rate is applied to amount of guarantees without consideration of effective interest rate method.

Taxation

The current income tax expense is calculated in accordance with the regulations of the Republic of Azerbaijan and of the countries in which the Group has offices and branches and where its subsidiaries are located.

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

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

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

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity respectively. Where current tax or deferred tax arises from the initial accounting for a business combination, the tax effect is included in the accounting for the business combination.

Property and equipment

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

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

Depreciation of an asset, including construction in progress, begins when it is ready and available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	Years
Buildings	20
Furniture and fixtures	4
Computers and other equipment	4
Vehicles	4
Other equipment	5
Leasehold improvements	6

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

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

Investment property

Investment property is land or building or a part of building held to earn rental income or for capital appreciation and which is not used by the Group or held for the sale in the ordinary course of business. Property that is being constructed or developed or redeveloped for future use as investment property is also classified as investment property.

Investment property is initially recognized at cost, including transaction costs, and subsequently is stated at cost less accumulated depreciation and any accumulated impairment losses. For disclosure purposes investment property is remeasured at fair value reflecting market conditions at the end of the reporting period. Fair value of the Group's investment property is determined on the base of various sources including reports of independent appraisers, who hold a recognized and relevant professional qualification and who have recent experience in valuation of property of similar location and category.

Earned rental income is recorded in the income statement within income arising from non-banking activities. Gains and losses resulting from changes in the fair value of investment property are recorded in the consolidated statement of profit or loss and presented within income or expense arising from non-banking activities.

Subsequent expenditure is capitalized only when it is probable that future economic benefits associated with it will flow to the Group and the cost can be measured reliably. All other repairs and maintenance costs are expensed when incurred. If an investment property becomes owner-occupied, it is reclassified to premises and equipment, and its carrying amount at the date of reclassification becomes its deemed cost.

Repossessed collateral

In certain circumstances, collateral is repossessed following the foreclosure on loans that are in default. Repossessed collateral is measured at the lower of carrying amount and net realizable value and reported within "Other assets".

Goodwill

Goodwill acquired in a business combination is initially measured at cost being the excess of the consideration transferred over the investee's net identifiable assets acquired and liabilities assumed. Goodwill on an acquisition of a subsidiary is included in goodwill and other intangible assets. Goodwill on an acquisition of an associate is included in the investments in associates. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying amount may be impaired.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated:

- Represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and
- Is not larger than the operating segment as defined in IFRS 8 Operating Segments before aggregation.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cashgenerating units) is less than the carrying amount, an impairment loss is recognised. Impairment losses relating to goodwill cannot be reversed in future periods.

Intangible assets other than goodwill

Intangible assets consist of banking license, other licenses and computer software.

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

Banking license is represented by an intangible asset acquired in a business combination and has indefinite useful life.

Intangible assets with indefinite useful lives are not amortised and assessed for impairment at least at each financial year-end whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end.

Provisions

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

Retirement and other employee benefit obligations

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

Share capital

Share capital

Ordinary shares are 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.

Dividends

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

Contingencies

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

Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Expenses are recognized when incurred. The following specific recognition criteria must also be met before revenue and expense is recognised.

Interest and similar income and expense

For all financial instruments measured at amortised cost and interest bearing securities classified as trading or available-for-sale, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense. Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the original effective interest rate applied to the new carrying amount.

Fee and commission income and expense

The Group earns fee and commission income from a diverse range of services it provides to its customers. Fee and commission income includes cash collection and withdrawal fees and customer services fees, which are recognized as revenue as the services are provided. Fee and commission expense consists of documentary operations (letters of credit and guarantees), customer, brokerage, custodian and foreign currency purchase/sale fees.

Foreign currency translation

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

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

As at the reporting date, the assets and liabilities of the Bank's subsidiaries whose functional currency is different from the presentation currency of the Bank are translated into AZN at the rate of exchange ruling at the reporting date and, their statement of profit or loss are translated at the weighted average exchange rates for the year. The exchange rate differences arising on the translation are taken to consolidated statement of comprehensive income.

The Group used the following official exchange rates at 31 December 2016 and 2015 in the preparation of these consolidated financial statements:

	2016	2015
1 US Dollar	AZN 1.7707	AZN 1.5594
1 Euro	AZN 1.8644	AZN 1.7046
1 Georgian Lari	AZN 0.6663	AZN 0.6511
1 Turkish Lira	AZN 0.5023	AZN 0.5358

Standards and interpretations issued but not yet effective

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

IFRS 9 Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments which reflects all phases of the financial instruments project and replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting.

From a classification and measurement perspective, the new standard will require 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 will be replaced by: fair value through profit or loss (FVPL), fair value through other comprehensive income (FVOCI), and amortised cost categories. IFRS 9 will also allow entities to continue to irrevocably designate instruments that qualify for amortised cost or FVOCI instruments as FVPL, if doing so eliminates or significantly reduces a measurement or recognition inconsistency. Equity instruments that are not held for trading may be irrevocably designated as FVOCI, with no subsequent reclassification of gains or losses to the income statement. The accounting for financial liabilities will largely be the same as the requirements of IAS 39.

IFRS 9 will also fundamentally change the approach to loan impairment. The standard will replace IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. The Group will be required to record an allowance for expected losses for all loans and other debt financial assets not carried at FVPL, as well as for loan commitments and financial guarantee contracts. The allowance is based on the expected credit losses associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case the allowance would be based on the probability of default over the life of the asset.

IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Retrospective application is required, but restatement of comparative information is not required; the effect on the transition date – 1 January 2018 – would be recorded in retained earnings. The adoption of IFRS 9 is expected to have an effect on the classification and measurement of the Group's financial assets, but no impact on the classification and measurement of the Group's financial liabilities. The Group expects a significant impact on its equity due to adoption of IFRS 9 impairment requirements, but it will need to perform a more detailed analysis which considers all reasonable and supportable information, including forward-looking elements to determine the extent of the impact.

IFRS 15 Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15 Revenue from Contracts with Customers, effective for periods beginning on 1 January 2018 with early adoption permitted. IFRS 15 defines principles for recognising revenue and will be applicable to all contracts with customers. However, interest and fee income integral to financial instruments and leases will continue to fall outside the scope of IFRS 15 and will be regulated by the other applicable standards (e.g., IFRS 9, and IFRS 16 Leases).

Revenue under IFRS 15 will need to be recognised as goods and services are transferred, to the extent that the transferor anticipates entitlement to goods and services. The standard will also specify a comprehensive set of disclosure requirements regarding the nature, extent and timing as well as any uncertainty of revenue and corresponding cash flows with customers.

The Group does not anticipate early adopting IFRS 15 and is currently evaluating its impact.

IFRS 16 Leases

The IASB issued the new standard for accounting for leases – IFRS 16 Leases in January 2016. The new standard does not significantly change the accounting for leases for lessors. However, it does require lessees to recognise most leases on their balance sheets as lease liabilities, with the corresponding right of-use assets. Lessees must apply a single model for all recognised leases, but will have the option not to recognise 'short-term' leases and leases of 'low-value' assets. Generally, the profit or loss recognition pattern for recognised leases will be similar to today's finance lease accounting, with interest and depreciation expense recognised separately in the statement of profit or loss.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted provided the new revenue standard, IFRS 15, is applied on the same date.

The Group does not anticipate early adopting IFRS 16 and is currently evaluating its impact.

Amendments to IAS 12 Income Taxes

In January 2016, through issuing amendments to IAS 12, the IASB clarified the accounting treatment of deferred tax assets of debt instruments measured at fair value for accounting, but measured at cost for tax purposes. The Group does not anticipate that adopting the amendments would have a material impact on its financial statements.

Amendments to IAS 7 Statement of Cash Flows

In January 2016, the IASB issued amendments to IAS 7 Statement of Cash Flows with the intention to improve disclosures of financing activities and help users to better understand the reporting entities' liquidity positions. Under the new requirements, entities will need to disclose changes in their financial liabilities as a result of financing activities such as changes from cash flows and non-cash items (e.g., gains and losses due to foreign currency movements). The amendment is effective from 1 January 2017. The Group is currently evaluating the impact.

4. Significant accounting judgments and estimates

In the process of applying the Group's accounting policies, management has made the following judgements and made estimates which have affected the amounts recognised in the consolidated financial statements:

Fair value of financial instruments

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

Allowance for loan impairment

The Group regularly reviews its loans and receivables to assess impairment. The Group uses its experienced judgement to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Group estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. The Group uses its experienced judgement to adjust observable data for a group of loans or receivables to reflect current circumstances.

The Group has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for loan impairment. The valuations of collaterals are performed based on review of similar collaterals available on the market.

As at 31 December 2016, the Group applied new methodology for determining the allowance for impairment on loans to customers. The previous applied methodology mainly based on statistical data while new methodology is the combination of statistical data and rating based model. This led to increase in provision for collective loan impairment by AZN 3,889 thousand and reversal of provision for individual loan impairment by AZN 9,056 thousand in the statements of profit or loss (Note 23). In the new methodology, probability of default for individually significant not impaired loans were assessed based on internal rating system. Also, for the purpose of individual assessment, in accordance with the new methodology the Bank used assumptions on realization of collateral based on its own statistics.

Deferred tax assets

Deferred tax assets are recognised for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits together with future tax planning strategies. If actual results differ from those estimates or if these estimates must be adjusted in future periods, the financial position, results of operations and cash flows may be negatively affected. In the event that an assessment of future utilization indicates that the carrying amount of deferred tax assets must be reduced, this reduction is recognised in the consolidated statement of profit or loss (Note 20).

Impairment of goodwill and banking license

The recoverable amount of banking license is measured annually, irrespective of whether there is any indication that it may be impaired. This requires an estimation of the value in use of the cash-generating unit. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The Group reviews and validates at the end of each reporting period its decision to classify the useful life of an intangible asset as indefinite. If events and circumstances no longer support an indefinite useful life, the change from indefinite to finite life is accounted for as a change in accounting estimate under IAS 8, which requires such changes to be recognised prospectively. Furthermore, reassessing the useful life of an intangible asset as finite rather than indefinite is an indicator that the asset may be impaired. The carrying amount of banking license at 31 December 2016 was AZN 42,228 thousand (2015: AZN 45,045 thousand). More details are provided in Note 13.

5. Business combination

Acquisition of TAIB Yatirim Bank

On 27 January 2015, the Bank completed acquisition of 79.92% of the voting common shares of TAIB Yatirim Bank A.Ş. under its business expansion strategy. The Bank also acquired a call option for purchase of 20.00% of voting shares that were held by one shareholder. This minority shareholder also acquired put option over these 20.00% voting shares. The option was exercised on 30 October 2015. The transaction was registered by the Banking Regulation and Supervision Agency ("the BRSA") of the Republic of Turkey on 23 December 2015. As at 31 December 2016 and 2015, the Bank holds 99.92% of voting common shares of PASHA Yatirim Bankasi A.Ş.

As at 31 December 2015, accounting for the business combination was completed. While making a purchase price allocation the Bank identified a banking license (the "License"), an intangible asset with indefinite useful life, for which respective fair value exercise was made which amounted to AZN 27,978 thousand (Note 13). The License is not accounted in the separate financial statements of PASHA Yatirim Bankasi A.Ş.

The fair value of the identifiable assets and liabilities acquired and goodwill arising as at the date of acquisition was:

	Fair value recognised on acquisition
Cash and cash equivalents	371
Loans to customers	15,570
Investment securities available-for-sale	587
Property and equipment (Note 12)	97
Intangible assets (Note 13)	28,042
Other assets	1,041
	45,708
Borrowings	2,194
Money markets	366
Deferred income tax liabilities (Note 20)	4,497
Other financial liabilities	45
Other liabilities and provisions	623
	7,725
Total identifiable net assets	37,983
Non-controlling interests	97
Goodwill arising on acquisition (Note 13)	2,413
Purchase consideration transferred	40,299

The goodwill of AZN 2,413 thousand comprises the value of expected synergies arising from the acquisition. None of the goodwill recognized is expected to be deductible for income tax purposes.

From the date of acquisition PASHA Yatirim Bankasi A.Ş. has contributed AZN 9,855 thousand of interest income, AZN 582 thousand of non-interest income and AZN 4,517 thousand to the net profit before tax of the Bank as at 31 December 2015.

Cash outflow on acquisition of the subsidiary

Transaction costs of the acquisition (Note 24)	(1,610)
Net cash acquired with the subsidiary (included in cash flows from investing activities)	371
Cash paid	(40,299)
Net cash outflow	(41,538)

The transaction costs of AZN 1,610 have been expensed and are included in other operating expenses. Cash consideration was prepaid in 2013.

6. Cash and cash equivalents

Cash and cash equivalents comprise:

	2016	2015
Cash on hand	114,917	116,763
Current accounts with the CBAR, the NBG and the CBRT	534,087	199,708
Current accounts with other credit institutions	91,145	335,481
Time deposits with credit institutions up to 90 days	365,620	369,354
Cash and cash equivalents	1,105,769	1,021,306

Current accounts with other credit institutions consist of interest bearing correspondent account balances with resident and non-resident banks in the amount of nil (31 December 2015 – AZN 554 thousand) and AZN 298 thousand (31 December 2015 – AZN 643 thousand), respectively, and non-interest bearing correspondent account balances with resident and non-resident banks in the amount of AZN 27,114 thousand (31 December 2015 – AZN 7,462 thousand) and AZN 63,733 thousand (31 December 2015 – AZN 326,822 thousand), respectively.

As at 31 December 2016, the Group placed AZN 363,994 thousand in time deposits with one resident bank and three non–resident banks maturing through January 2017 with interest rates ranging between 0.4% and 14.30% p.a. (31 December 2015 – AZN 369,354 thousand matured in March 2016 with interest rates ranging between 0.13% and 13.00% p.a.).

7. Trading securities

Trading securities comprise:

	2016		**2015**	
	Annual interest rate	Carrying value	Annual interest rate	Carrying value
Bonds of financial institutions	9.00%	19,431	9.00%	19,770
Corporate bonds	14.00%	3,238	9.75%-14.00%	26,468
Trading securities		22,669		46,238

As at 31 December 2016, the Bank held securities of two (31 December 2015 – three) local entities amounting to AZN 22,669 thousand (31 December 2015 – AZN 46,238 thousand).

In December 2015, the Bank's management decided to reclassify trading securities with fair value of AZN 7,609 thousand into investment securities classified as loans and receivables category due to deterioration of issuer's financial standing.

8. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2016	2015
Time deposit with the CBAR	474,994	–
Loans to banks	93,727	23,386
Time deposits with banks	74,558	92,261
Obligatory reserve with the CBAR, the NBG and the CBRT	47,007	19,196
Restricted deposits	38,742	3,832
	729,028	138,675
Less: allowance for impairment (Note 23)	(907)	(780)
Amounts due from credit institutions	728,121	137,895

As at 31 December 2016, time deposits with the CBAR represents deposit with maturity in September 2017. The deposit was placed from resources of one government entity (Note 16).

As at 31 December 2016, the Group had outstanding amount of AZN 93,727 thousand (31 December 2015 – AZN 23,386 thousand) of unsecured loans issued to six resident commercial banks (31 December 2015 – four resident commercial banks) with contractual maturity through June 2017 (31 December 2015 – May 2017) and with interest rates ranging between 3% and 22% p.a. (31 December 2015 – 7.5% and 16% p.a.).

As at 31 December 2016, time deposits with banks mature between January 2017 and December 2017 (31 December 2015 – between January 2016 and November 2017) with interest rates ranging between 0.5% and 15.00% p.a. (31 December 2015 – between 0.02% and 12.5% p.a.).

As at 31 December 2016, the Group had outstanding amount of AZN 93,727 thousand (31 December 2015 – AZN 23,386 thousand) of unsecured loans issued to six resident commercial banks (31 December 2015 – four resident commercial banks) with contractual maturity through June 2017 (31 December 2015 – May 2017) and with interest rates ranging between 3% and 22% p.a. (31 December 2015 – 7.5% and 16% p.a.).

Credit institutions in the Republic of Azerbaijan are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBAR at the level of 0.5% (2015 – 0.5%) and 1.0% (2015 – 0.5%) of the previous month average of funds attracted from customers by a credit institution in AZN and foreign currencies, respectively. Credit institutions in the Republic of Georgia are required to maintain a mandatory interest earning cash deposit with the NBG at the level of 7% (2015 – 10%) and 20% (2015 – 15%) of the average of funds attracted from customers by the credit institution for the appropriate two-week period in GEL and foreign currencies, respectively. Credit institutions in the Republic of Turkey are required to maintain a mandatory interest earning cash deposit with the CBRT at the level of 4%-10.5% for TRY deposits and other liabilities according to their maturities (2015 – 5%-11% for all liabilities) and 4.5%-24.5% for foreign currency deposits and other liabilities according to their maturities (2015 – 5%-25%).

9. Investment securities

Investment securities available-for-sale comprise:

	2016		2015	
	Carrying value	Nominal value	Carrying value	Nominal value
Bonds of the Ministry of Finance of the Republic of Azerbaijan	68,827	72,819	236	235
Notes issued by the Central Bank of Azerbaijan Republic	65,360	65,758	–	–
Corporate bonds	29,028	28,776	–	–
Bonds of financial institutions	7,002	6,988	306	300
Turkey Government Bonds	3,112	3,064	5,154	5,090
Investment securities available-for-sale	173,329	177,405	5,696	5,625

Nominal interest rates per annum and maturities of these securities are as follows:

	2016		2015	
	%	Maturity	%	Maturity
Bonds of the Ministry of Finance of the Republic of Azerbaijan	2.49%-20.88%	January 2017 – December 2017	3.59%	May 2016
Notes issued by the Central Bank of Azerbaijan Republic	14.34%-14.39%	January 2017	–	–
Corporate bonds	4.97%-10.38%	October 2021 – December 2021	–	–
Bonds of financial institutions	1.38%-11.84%	January 2017 – September 2017	8.79%	April 2016
Turkey Government Bonds	9.26%-10.64%	March 2017 – June 2017	10.80%	November 2016

Loans and receivables comprise:

	2016	2015
Treasury bonds of the Ministry of Finance of Georgia	20,674	25,209
Certificates of deposits of financial institutions	17,686	7,946
Bonds of financial institutions	14,353	23,660
Corporate bonds	8,641	5,790
Treasury bills of the Ministry of Finance of Georgia	–	15,319
Certificates of deposit of the NBG	–	9,979
	61,354	87,903
Less: allowance for impairment	(134)	–
Loans and receivables	61,220	87,903

On 1 July 2015, Asset and Liability Committee of PASHA Bank Georgia JSC decided to reclassify certain of PASHA Bank Georgia JSC's investment securities from the available-for-sale category into category of loans and receivables. The bank has no history of sale of any of its securities before maturity. The bank assessed that based on the changing market conditions it is not intending to sell the securities in future and will hold them till their contractual maturities. The fair value of available-for-sale securities at the date of reclassification was AZN 43,912 thousand.

10. Loans to customers

Loans to customers comprise:

	2016	2015
Legal entities	1,046,055	823,212
Individuals	123,552	126,636
Loans to customers (gross)	1,169,607	949,848
Less – allowance for impairment (Note 22)	(62,333)	(47,698)
Loans to customers (net)	1,107,274	902,150

A reconciliation of the allowance for impairment of loans to customers by class is as follows:

	Corporate lending	Individual lending	Total
31 December 2016			
Individual impairment	(45,339)	(341)	(45,680)
Collective impairment	(12,750)	(3,903)	(16,653)
	(58,089)	(4,244)	(62,333)
Gross amount of loans, individually determined to be impaired before deducting any individually assessed impairment allowance	93,196	3,242	96,438
31 December 2015			
Individual impairment	(23,313)	(1,893)	(25,206)
Collective impairment	(18,814)	(3,678)	(22,492)
	(42,127)	(5,571)	(47,698)
Gross amount of loans, individually determined to be impaired before deducting any individually assessed impairment allowance	31,673	4,582	36,255

Loans are made in the following industry sectors:

	2016	2015
Trade and services	469,902	327,626
Non-banking credit organizations	125,530	84,344
Individuals	123,552	126,636
Manufacturing	119,577	167,224
Construction	113,895	101,295
Mining	64,622	30,239
Agriculture and food processing	48,438	48,795
Transport and telecommunication	43,671	26,281
Energy	13,782	16,513
Leasing	6,345	14,994
Other	40,293	5,901
Total loans (gross)	1,169,607	949,848

As at 31 December 2016, loans granted to top 6 customers (31 December 2015 – 5 customers) which individually exceeded 5% of the Group's equity, amounted to AZN 299,486 thousand (31 December 2015 – AZN 215,005 thousand).

Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2016, comprised AZN 5,435 thousand (2015 – AZN 3,718 thousand).

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

The main types of collateral obtained are as follows:

- For commercial lending, charges over real estate properties, cash, securities, inventory and trade receivables;
- For retail lending, mortgages over residential properties.

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

11. Investment property

In 2011, the Bank acquired land for the amount of AZN 2,000 thousand as investment property which is held for long-term appreciation in value. As at 31 December 2016, the fair value of this investment property amounted to AZN 1,654 thousand (31 December 2015 – AZN 1,668 thousand). The Bank recognized impairment in the amount of AZN 346 thousand as of 31 December 2016 (31 December 2015 – AZN 332 thousand) due to decrease in recoverable amount.

12. Property and equipment

The movements in property and equipment were as follows:

	Land	Buildings	Furniture and fixtures	Computers and other equipment	Vehicles	Other equipment	Leasehold improvements	Construction in progress	Total
31 December 2014	415	5,571	5,963	4,791	937	482	1,491	3,851	23,501
Acquisition through business combinations	–	–	97	–	–	–	–	–	97
Additions	–	–	634	2,861	311	28	2	–	3,836
Disposals	–	(1,464)	(164)	(930)	(174)	(9)	–	–	(2,741)
Foreign currency translation difference	–	–	509	539	53	102	433	–	1,636
Transfers			2,139	770			942	(3,851)	–
31 December 2015	415	4,107	9,178	8,031	1,127	603	2,868	–	26,329
Additions	–	–	901	749	127	35	210	–	2,022
Disposals	–	–	(23)	(124)	(119)	–	–	–	(266)
Foreign currency translation difference	–	–	21	3	3	5	27	–	59
31 December 2016	415	4,107	10,077	8,659	1,138	643	3,105	–	28,144
Accumulated depreciation									
31 December 2014	–	(596)	(3,036)	(2,208)	(618)	(199)	(600)	–	(7,257)
Depreciation charge	–	(253)	(1,461)	(1,148)	(175)	(97)	(311)	–	(3,445)
Disposals	–	113	155	671	174	7	–	–	1,120
Foreign currency translation difference	–	–	(254)	(312)	(22)	(48)	(260)	–	(896)
31 December 2015	–	(736)	(4,596)	(2,997)	(641)	(337)	(1,171)	–	(10,478)
Depreciation charge	–	(206)	(1,889)	(2,100)	(216)	(123)	(544)	–	(5,078)
Disposals	–	–	21	116	108	–	–	–	245
Foreign currency translation difference	–	–	(10)	2	(1)	(1)	(14)	–	(24)
31 December 2016	–	(942)	(6,474)	(4,979)	(750)	(461)	(1,729)	–	(15,335)
Net book value									
31 December 2016	415	3,165	3,603	3,680	388	182	1,376	–	12,809
31 December 2015	415	3,371	4,582	5,034	486	266	1,697	–	15,851
31 December 2014	415	4,975	2,927	2,583	319	283	891	3,851	16,244

13. Goodwill and other intangible assets

The movements in goodwill and other intangible assets were as follows:

	Goodwill	Banking license	Licenses	Computer software	Total
Cost					
31 December 2014	–	–	2,678	2,994	5,672
Acquisition through business combination (Note 5)	2,413	27,978	–	64	30,455
Additions	–	–	2,085	2,302	4,387
Disposals	–	–	(389)	(429)	(818)
Transfers	–	–	990	(990)	–
Foreign currency translation difference	1,472	17,067	111	639	19,289
31 December 2015	3,885	45,045	5,475	4,580	58,985
Additions	–	–	3,374	3,326	6,700
Disposals	–	–	(11)	(394)	(405)
Foreign currency translation difference	(243)	(2,817)	4	(23)	(3,079)
31 December 2016	3,642	42,228	8,842	7,489	62,201
Accumulated amortization					
31 December 2014	–	–	(660)	(886)	(1,546)
Amortisation charge	–	–	(457)	(440)	(897)
Disposals	–	–	222	198	420
Transfers	–	–	(455)	455	–
Foreign currency translation difference	–	–	(23)	(209)	(232)
31 December 2015	–	–	(1,373)	(882)	(2,255)
Amortisation charge	–	–	(1,018)	(582)	(1,600)
Disposals	–	–	9	334	343
Impairment	(3,642)	–	–	–	(3,642)
Foreign currency translation difference	–	–	–	20	20
31 December 2016	(3,642)	–	(2,382)	(1,110)	(7,134)
Net book value					
31 December 2016	–	42,228	6,460	6,379	55,067
31 December 2015	3,885	45,045	4,102	3,698	56,730
31 December 2014	–	–	2,018	2,108	4,126

Impairment testing of goodwill and other intangible assets with indefinite lives

Goodwill and banking license acquired through business combination with indefinite lives have been allocated to one individual cash-generating unit for impairment testing which is PASHA Yatirim Bankasi A.Ş.

The carrying amount of goodwill and value of the banking license acquired allocated to the cash-generating units is nil (2015: AZN 3,885 thousand) and AZN 42,228 thousand (2015: AZN 45,045 thousand), respectively.

Key assumptions used in fair value calculation

As at 31 December 2016, recoverable amount of cash generating unit have been determined based on fair value less cost to sell calculated through application Income and Market approaches (Level 3) by an independent appraiser for impairment testing purposes. Under the income approach, Warranted Equity Method has been applied. Similar methodology was used for the purpose of valuation of the cash generating unit in prior year.

The calculation of fair value less cost to sell is most sensitive to the following assumptions:

- Price/book multiple calculated on the basis of peer group banks;
- Cost of equity;
- Return on equity of the global banking sector;
- Weights allocated to Market and Income approaches during reconciliation of the results under these approaches and making of the value conclusion;
- Amount of cash contribution required to be made when applying for the banking license in Turkey.

The following rates are used by the Bank for fair value calculation:

Risk free rate	Rf	11.1%
Market premium	Rm-Rf	6.0%
Beta	β	0.88
Company specific risk premium	Rs	1.8%
Cost of equity (discount rate)	Ke	18.2%
Terminal growth rate		5.0%

As a result of the valuation, recoverable amount of cash generating unit amounted to AZN 158,903 thousand. Accordingly goodwill in the amount of AZN 3,642 thousand was determined to be impaired and written-off. The impairment loss was mainly due to decrease in return on equity.

Sensitivity for reasonably possible increase in discount rate by 1% would result in additional impairment of AZN 2,812 thousand.

14. Other assets and liabilities

Other assets comprise:

	2016	2015
Other financial assets		
Clearance cheque accounts	2,048	2,263
Settlements on money transfers	5,598	2,071
Accrued interest receivable on guarantees and letters of credit	338	430
Other	101	–
Other non-financial assets	8,085	4,764
Deferred expenses	3,394	4,848
Prepayments for acquisition of property, equipment and intangible assets	1,362	3,142
Repossessed collateral	5,280	1,537
Other prepayments	1,017	802
Taxes, other than income tax	164	43
	11,217	**10,372**
Other assets	**19,302**	**15,136**

As at 31 December 2016, clearance cheque accounts consist of receivables from other banks for which cheques stand as collateral.

As at 31 December 2016, deferred expenses of AZN 816 thousand (31 December 2015 – AZN 2,036 thousand), related to the prepayment for the rent of the service points located in Baku and AZN 1,487 thousand (31 December 2015 – AZN 1,101 thousand) related to long term software support.

Other liabilities comprise:

	2016	2015
Other financial liabilities		
Settlements on money transfer	3,464	3,310
Clearance cheque accounts	2,048	2,263
Accrued expenses	535	172
Financial lease liabilities	–	596
Other	175	72
	6,222	6,413

	2016	2015
Other non-financial liabilities		
Payable to employees	13,715	4,415
Deferred income	731	234
Other provision	132	165
Taxes, other than income tax	94	291
Other	217	54
	14,889	5,159
Other liabilities	21,111	11,572

15. Amounts due to banks and government funds

Amounts due to banks and government funds comprise:

	2016	2015
Loans from the National Fund for Support of Entrepreneurship	99,906	67,436
Short-term deposits from banks	90,136	246,210
Long-term deposits from banks	67,287	–
Loans from the CBAR and NBG	41,676	48,383
Amount due to IT Development Fund	5,013	2,400
Amount due to Azerbaijan Mortgage Fund	4,826	4,667
Correspondent accounts with other banks	21,450	597
Amounts due to banks and government funds	330,294	369,693

As at 31 December 2016, the Group received short-term funds from five non-resident commercial banks (31 December 2015 – six) comprising AZN 90,136 thousand (31 December 2015 – AZN 246,210 thousand) and none from resident commercial banks (31 December 2015 – one) maturing on August 2017 (31 December 2015 – 18 November 2016) and with interest rates ranging between 1.60% and 12.00% p.a. (31 December 2015 – 1%-3% p.a.).

As at 31 December 2016, the Group had loans received from the National Fund for Support of Entrepreneurship amounting to AZN 99,906 thousand (31 December 2015 – AZN 67,436 thousand), maturing through August 2026 (31 December 2015 – through September 2025), and bearing interest rate of 1.0% p.a. The loans were acquired for the purposes of assistance in gradually improving entrepreneurship environment in Azerbaijan under the government program. The loans have been granted to local entrepreneurs at interest rate of 6% p.a. (31 December 2015 – 6% p.a.).

As at 31 December 2016, the Group received long-term funds from one resident commercial bank (31 December 2015 – nil) comprising AZN 67,287 thousand maturing on 2 February 2018 with interest rate 2.00%.

As at 31 December 2016, the Group had loans received from the CBAR and NBG amounting to AZN 41,676 thousand (31 December 2015 – 48,383 thousand), maturing through November 2017 (31 December 2015 – through November 2017) with interest rates ranging between 3.5% and 7% p.a. (31 December 2015 – 3.5% and 9.11% p.a.).

As at 31 December 2016, the Group had loans refinanced from the IT Development Fund amounting to AZN 5,013 thousand (31 December 2015 – AZN 2,400 thousand), maturing through December 2021 (31 December 2015 – through December 2,021) and bearing interest rate of 1.0% p.a.

As at 31 December 2016, the Group had loans refinanced from the Azerbaijan Mortgage Fund amounting to AZN 4,826 thousand (31 December 2015 – AZN 4,667 thousand), maturing through December 2040 (31 December 2015 – through May 2040) and bearing interest rate of 4.0% p.a.

16. Amounts due to customers

The amounts due to customers include the following:

Included in time deposits is a deposit attracted at market rate from one government entity of AZN 470,006 thousand maturing through September 2017.

	2016	2015
Demand deposits	998,925	901,216
Time deposits	1,351,762	472,897
Amounts due to customers	2,350,687	1,374,113
Held as security against guarantees issued (Note 21)	8,123	8,090

An analysis of customer accounts by economic sector follows:

	2016	2015
Manufacturing	542,550	56,207
Individuals	532,932	367,234
Investment holding companies	449,016	481,678
Trade and services	372,380	184,048
Construction	166,766	66,385
Transport and communication	90,276	82,876
Insurance	46,254	58,299
Hotel business	42,478	17,904
Public organizations	25,474	17,863
Mining	25,238	11,859
Non banking credit organizations	22,315	18,256
Agriculture	10,454	207
Energy	3,232	844
Other	21,322	10,453
Amounts due to customers	**2,350,687**	**1,374,113**

As at 31 December 2016, customer deposits included balances with five (31 December 2015 – five) largest customers comprised AZN 1,100,919 thousand or 47% of the total customer deposits portfolio (31 December 2015 – AZN 623,366 thousand or 45% of the total customer deposits portfolio).

17. Other borrowed funds

As at 31 December 2016, other borrowed funds included balances with four (31 December 2015 – five) foreign banks amounting to AZN 51,473 thousand (31 December 2015 – AZN 93,814 thousand), maturing through April 2021 (31 December 2015 – through April 2021) and bearing interest rates ranging between 1.48% and 3.75% p.a. (31 December 2015 – between 1.67% and 6.35% p.a.). These unsecured borrowings are for trade finance of import operations (letters of credit) of the customers of the Group.

18. Debt securities issued

PASHA Yatirim Bankasi A.S. had issued a fixed rate bond on 26 October 2016, with nominal amount of AZN 18,836 thousand with the term of 90 days maturing at 24 January 2017. The carrying amount of the bond is AZN 18,705 thousand as at 31 December 2016 (31 December 2015 – none).

19. Derivative financial instruments

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

Foreign and domestic in the table above stand for counterparties where foreign means non-Azerbaijani entities and domestic means Azerbaijani entities.

As at 31 December 2016 and 2015, the Group has positions in the following types of derivatives:

	2016			2015		
	Notional amount	Fair values		**Notional amount**	Fair values	
		Asset	Liability		Asset	Liability
Interest rate contracts						
Options – domestic	–	–	–	3,350	–	(22)
Foreign exchange contracts						
Forwards and swaps – foreign	26,441	320	(983)	38,158	324	(26)
Forwards and swaps – domestic	37,316	664	(495)	–	–	–
Options – domestic	2,162	–	(990)	3,283	–	(943)
Total derivative assets/(liabilities)		984	(2,468)		324	(991)

Foreign and domestic in the table above stand for counterparties where foreign means non-Azerbaijani entities and domestic means Azerbaijani entities.

Forwards

Forwards and futures contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market.

Swaps

Swaps are contractual agreements between two parties to exchange movements in interest and foreign currency rates and equity indices, and (in the case of credit default swaps) to make payments with respect to defined credit events based on specified notional amounts.

Options

Options are contractual agreements that convey the right, but not the obligation, for the purchaser either to buy or sell a specific amount of a financial instrument at a fixed price, either at a fixed future date or at any time within a specified period.

20. Taxation

The corporate income tax expense comprises:

	2016	2015
Current tax charge	(19,377)	(2,708)
Deferred tax credit/(charge) – origination and reversal of temporary differences	769	(1,803)
Less: deferred tax recognised in other comprehensive income	25	(50)
Income tax expense	(18,583)	(4,561)

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

	2016	2015
Net (gains)/losses on investment securities available-for-sale	(25)	50
Income tax credited/(charged) to other comprehensive income	(25)	50

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

	2016	2015
Profit before income tax expense	87,871	18,944
Statutory tax rate	20%	20%
Theoretical tax expense at the statutory rate	(17,574)	(3,789)
Tax effect of non-deductible expenses	(1,218)	(1,350)
Change in unrecognized deferred tax assets	–	498
Utilised tax losses carried forward, not recognized previously	–	151
Prior year tax actualization	(302)	–
Tax effect of tax-exempt income	165	199
Effect of difference in tax rate in foreign country	185	15
Other	161	(285)
Income tax expense	(18,583)	(4,561)

Deferred tax assets and liabilities as at 31 December 2016 and 2015 and their movements for the respective years comprise:

		Origination and reversal of temporary differences					Origination and reversal of temporary differences			
	2014	In the statement of profit or loss	In other comprehen-sive income	Effect of business combination (Note 5)	Translation difference	2015	In the statement of profit or loss	In other comprehen-sive income	Translation difference	2016
Tax effect of deductible temporary differences										
Tax losses carried forward	954	(1,244)	–	1,052	554	1,316	(815)	–	35	536
Trading securities	–	572	–	–	–	572	1	–	–	573
Amounts due from credit institutions	–	–	–	–	–	–	4,024	–	–	4,024
Loans to customers	1,271	(52)	–	–	27	1,246	(841)	–	(10)	395
Investment securities	–		–	–	–	–	–	15	–	15
Investment property	–	66	–	–	–	66	3	–	–	69
Property and equipment	55	43	–	–	(50)	48	103	–	–	151
Intangible assets	12	(12)	–	–	–	–	–	–	–	–
Derivative financial liabilities	–	193	–	–	–	193	140	–	–	333
Provision for guarantees and letters of credit	185	(185)	–	–	–	–	318	–	–	318
Other liabilities	211	704	–	50	(63)	902	2,098	–	(85)	2,915
Gross deferred tax assets	2,688	85	–	1,102	468	4,343	5,031	15	(60)	9,329
Unrecognised deferred tax asset	(651)	664	–	–	(13)	–	–	–	–	–
Deferred tax asset	2,037	749	–	1,102	455	4,343	5,031	15	(60)	9,329
Tax effect of taxable temporary differences										
Trading securities	(47)	47	–	–	–	–	–	–	–	–
Amounts due from credit institutions	(222)	(1,797)	–	–	–	(2,019)	2,019	–	–	–
Derivative financial assets	–	–	–	–	–	–	(169)	–		(169)
Investment securities	(24)	–	50	(3)	(36)	(13)	–	(40)	44	(9)
Loans to customers	(711)	286	–	–	168	(257)	146	–	(7)	(118)
Property and equipment	(20)	(394)	–	–	–	(414)	176	–	1	(237)
Intangible assets	–	(72)	–	–	(20)	(92)	25	–	(1)	(68)
Other assets	–	–	–	–	–	–	(350)	–	25	(325)
Amounts due to banks and government funds	–	–	–	–	–	–	(222)	–	–	(222)
Amounts due to customers	–	–	–	–	–	–	(6,534)	–	–	(6,534)
Provision for guarantees and letters of credit	–	(672)	–	–	–	(672)	672	–	–	–
Banking license	–	–	–	(5,596)	–	(9,009)	–	–	563	(8,446)
Deferred tax liabilities	(1,024)	(2,602)	50	(5,599)	(3,413)	(12,476)	(4,237)	(40)	625	(16,128)
Net deferred tax assets/ (liabilities)	1,013	(1,853)	50	(4,497)	(3,301)	(8,133)	794	(25)	565	(6,799)

The temporary differences associated with investments in subsidiaries arising from consolidation for which a deferred tax liability aggregate to AZN 302 thousand (2015 – AZN 16,186 thousand).

Deferred taxes in the consolidated statement of financial position as at 31 December 2016 and 2015 can be reconciled as follows:

	2016	2015
Deferred tax assets	1,647	1,555
Deferred tax liabilities	(8,446)	(9,688)
Net deferred tax liabilities	(6,799)	(8,133)

21. Equity

As at 31 December 2016 and 2016, the Bank's authorized, issued and fully paid capital amounted to AZN 333,000 thousand comprising of 10,000 ordinary shares with a par value of AZN 33,300.00 per ordinary share. Each ordinary share entitles one vote to the shareholder.

On 25 June 2015, General Shareholders Meeting cancelled its decision to pay dividends dated 25 December 2014 of AZN 10,832 thousand.

On 23 May 2016 Shareholders of the Bank declared dividends totalling AZN 5,412 thousand on ordinary shares (AZN 541 per share) which was paid as at 31 December 2016.

Foreign currency translation reserve

Foreign currency translation reserve is used to record exchange difference arising from the translation of the financial statements of foreign subsidiaries. Loss in the amount of AZN 9,198 thousand (2015 – gain in the amount of AZN 83,707 thousand) occurred due to the change of exchange rates throughout the year (Note 3).

Unrealised gains (losses) on investment securities available-for-sale

This reserve records fair value changes on available-for-sale investments.

22. Commitments and contingencies

Operating environment

Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks as required by the market economy. The future stability of the Azerbaijan economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

In 2015 as a result of significant drop in crude oil prices, Azerbaijani Manat devalued against the US dollar from AZN 0.7862 to AZN 1.5500 for 1 USD. Following this devaluation, the Central Bank of the Republic of Azerbaijan announced floating exchange rate. During 2016 the exchange rate of Azerbaijani Manat against US dollar continued to fluctuate in the range between AZN 1.4900 and AZN 1.7707.

These events resulted in worsening of liquidity in the banking system and much tighter credit conditions. There continues to be uncertainty regarding economic growth, access to capital and cost of capital which could adversely affect the Group's financial position and business prospects.

Azerbaijani government announced plans to accelerate reforms and support to banking system in response to current economic challenges.

The Group's Management is monitoring these developments in the current environment and taking precautionary measures it considered necessary in order to support the sustainability and development of the Group's business in the foreseeable future.

Legal

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

Taxation

Azerbaijani tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant authorities. Recent events within the Azerbaijan suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and, as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years proceeding the year of review.

Management believes that its interpretation of the relevant legislation as at 31 December 2016 is appropriate and that the Group's tax, currency and customs positions will be sustained.

Insurance

The Bank has not currently obtained insurance coverage related to liabilities arising from errors or omissions. Liability insurance is generally not available in Azerbaijan at present.

Compliance with the CBAR ratios

CBAR requires banks to maintain certain prudential ratios computed based on statutory financial statements. As at 31 December 2016 and 2015, the Bank was in compliance with these ratios except for the followings:

a) Ratio of maximum credit exposure of a bank per a single borrower or a group of related borrowers that should not exceed 7 percent of the Bank's total capital when the market value of the collateral of credit exposures is less than 100 percent of such credit exposures, or the market value of real estate collateral of loans is below 150% of the loan value. As at 31 December 2016 the Bank's ratio was 18.94% (2015: 22.42%);

b) Ratio of maximum credit exposure of a bank per a single borrower or a group of related borrowers that should not exceed 20 percent of the Bank's total capital when the market value of the collateral of credit exposures is more than 100 percent of such credit exposures, or the market value of real estate collateral of loans is above 150% of the loan value. As at 31 December 2016 the Bank's ratio was 24.25% (2015: the Bank was in compliance);

c) Ratio of the share in one legal entity which should not exceed 10% of total capital. As at 31 December 2016 the Bank's ratio was 39.55% (2015: 49.21%);

d) Ratio of the total share in other legal entities which should not exceed 40% of total capital. As at 31 December 2016 the Bank's ratio was 58.05% (2015: 72.23%).

Throughout the year the Bank submitted information regarding these breaches to the Financial Markets Supervision Chamber (the "FMSC") on a monthly basis and no sanctions were imposed on the Bank. Management believes that the Bank will not face any sanctions against the Bank in the future.

Financial commitments and contingencies

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

Financial commitments and contingencies comprise:

	2016	2015
Credit-related commitments		
Guarantees issued	239,314	232,587
Unused credit lines	86,545	44,184
Letters of credit	12,940	20,733
	338,799	297,504
Operating lease commitments		
Not later than 1 year	4,197	2,593
Later than 1 year but not later than 5 years	16,699	5,936
Later than 5 years	4,780	3,280
	25,676	11,809
Less – provisions (Note 23)	(6,959)	(379)
Commitments and contingencies (before deducting collateral)	357,516	308,934
Less – cash held as security against guarantees issued (Note 16)	(8,123)	(8,090)
Commitments and contingencies	349,393	300,844

23. Impairment losses on interest bearing assets, and provision for guarantees and letters of credit

The movements in allowance for impairment losses on interest bearing assets, and provision for guarantees and letters of credit were as follows:

2016	Corporate lending	Individual lending	Total loans to customers	Amounts due from credit institutions	Investment securities - loans and receivables	Total	Guarantees and letters of credit
At 1 January	(42,127)	(5,571)	(47,698)	(780)	–	(48,478)	(379)
(Charge)/recovery for the year	(13,036)	1,852	(11,184)	(127)	(136)	(11,447)	(6,580)
Amounts written off	1,362	36	1,398	–	–	1,398	–
Recovery	(4,339)	(561)	(4,900)	–	–	(4,900)	–
Exchange difference	51	–	51	–	2	53	–
At 31 December	(58,089)	(4,244)	(62,333)	(907)	(134)	(63,374)	(6,959)

2015	Corporate lending	Individual lending	Total loans to customers	Amounts due from credit institutions	Investment securities - loans and receivables	Total	Guarantees and letters of credit
At 1 January	(34,401)	(366)	(34,767)	–	–	(34,767)	(2,683)
(Charge)/recovery for the year	(45,337)	(6,054)	(51,391)	(780)	–	(52,171)	2,304
Amounts written off	37,038	849	37,887	–	–	37,887	–
Acquisition of subsidiary	(181)	–	(181)	–	–	(181)	–
Exchange difference	754	–	754	–	–	754	–
At 31 December	(42,127)	(5,571)	(47,698)	(780)	–	(48,478)	(379)

Allowance for impairment of assets is deducted from the carrying amount of the related assets. Provision for guarantees and letters of credit is recorded in liabilities.

24. Net fee and commission income

Net fee and commission income comprise:

	2016	2015
Guarantees and letters of credit	5,874	4,686
Settlements operations	5,140	2,857
Servicing plastic card operations	4,569	2,493
Cash operations	3,105	1,609
Securities operations	1,127	645
Other	850	364
Fee and commission income	20,665	12,654
Servicing plastic card operations	(4,607)	(2,799)
Settlements operations	(1,706)	(778)
Guarantees and letters of credit	(850)	(856)
Cash operations	(495)	(172)
Securities operations	(8)	(145)
Other	(435)	(218)
Fee and commission expense	(8,101)	(4,968)
Net fee and commission income	12,564	7,686

25. Personnel, general and administrative expenses

Personnel expenses comprise:

	2016	2015
Salaries and bonuses	(27,986)	(16,682)
Social security costs	(5,013)	(2,963)
Other employee related expenses	(2,359)	(2,190)
Total personnel expenses	(35,358)	(21,835)

General and administrative expenses comprise:

	2016	2015
Charity and sponsorship	(8,806)	(719)
Professional services	(7,552)	(3,463)
Operating leases	(6,883)	(4,863)
Software cost	(2,291)	(948)
Advertising costs	(1,943)	(2,006)

	2016	2015
Insurance	(896)	(443)
Repair and maintenance	(851)	(411)
Utilities	(641)	(482)
Transportation and business trip expenses	(505)	(378)
Taxes, other than income tax	(505)	(331)
Communications	(486)	(278)
Entertainment	(404)	(443)
Security expenses	(400)	(344)
Membership fees	(290)	(272)
Stationery	(258)	(442)
Printing expenses	(65)	(86)
Impairment of investment property	(14)	(332)
Penalties incurred	–	(168)
Transaction costs of the acquisition (Note 5)	–	(1,610)
Registration fee	–	(1,165)
Loss on disposal of property and equipment	–	(683)
Other expenses	(659)	(1,398)
Total general and administrative expenses	(33,449)	(21,265)

26. Risk management

Introduction

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

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 Group's strategic planning process.

Board of Directors

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

Audit Committee

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

Management Board

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

Risk Committee

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

Risk Management

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

Bank Treasury

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

Internal Audit

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

Risk measurement and reporting systems

The Group'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 Group also runs worse case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

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

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

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

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

Risk mitigation

Bank actively uses collateral to reduce its credit risks.

Excessive risk concentration

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

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

Credit risk

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

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

Credit-related commitments risks

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

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

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

For more details on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes.

Credit quality per class of financial assets

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

The Group classifies its loan related assets as follows:

	Notes	Neither past due nor impaired			Past due but not impaired	Individually impaired	Total
		High grade	Standard grade	Sub-standard grade			
31 December 2016							
Cash and cash equivalents (excluding cash on hand)	6	534,087	456,765	–	–	–	990,852
Trading securities	7	–	22,669	–	–	–	22,669
Amounts due from credit institutions	8	73,295	647,954	–	6,872	907	729,028
Investment securities – available-for-sale	9	162,975	10,354	–	–	–	173,329
Loans and receivables	9	59,334	2,020	–	–	–	61,354
Derivative financial assets	19	–	984	–	–	–	984
Loans to customers	10						
Corporate lending		–	804,378	133,371	15,110	93,196	1,046,055
Individual lending		–	103,282	11,861	5,167	3,242	123,552
Other financial assets	14	–	8,085	–	–	–	8,085
Total		829,691	2,056,491	145,232	27,149	97,345	3,155,908

	Notes	Neither past due nor impaired			Past due but not impaired	Individually impaired	Total
		High grade	Standard grade	Sub-standard grade			
31 December 2015							
Cash and cash equivalents (excluding cash on hand)	6	199,708	704,835	–	–	–	904,543
Trading securities	7	–	46,238	–	–	–	46,238
Amounts due from credit institutions	8	19,196	113,092	–	5,607	780	138,675
Investment securities – available-for-sale	9	5,390	306	–	–	–	5,696
Loans and receivables	9	76,247	11,656	–	–	–	87,903
Derivative financial assets	19	–	324	–	–	–	324
Loans to customers	10						
Corporate lending		–	693,412	21,942	76,185	31,673	823,212
Individual lending		–	119,737	1,617	700	4,582	126,636
Other financial assets	14	–	4,764	–	–	–	4,764
Total		300,541	1,694,364	23,559	82,492	37,035	2,137,991

High grade – counterparties with excellent financial performance or sovereign risk, having no changes in the terms and conditions of loan agreements and no overdue in principal and interest.

Standard grade – counterparties with stable financial performance, having no changes in the terms and conditions of loan agreements and overdue in principal and interest up to 30 days.

Sub-Standard grade – counterparties with satisfactory financial performance, having changes in the terms and conditions of loan agreements and no overdue in principal and interest.

Past due but not impaired – counterparties with satisfactory financial performance, having changes in the terms and conditions of loan agreements and overdue in principal and interest. This also includes all past due collectively assessed loans. An analysis of past due loans, by age, is provided below. The majority of the past due loans are not considered to be impaired.

Individually impaired – counterparties with satisfactory and unsatisfactory financial performance, having changes in the terms and conditions of loan agreements and overdue in principal and interest.

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business, geographic regions and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Group's rating policy. The attributable risk ratings are assessed and updated regularly.

Aging analysis of past due but not impaired loans per class of financial assets

	Less than 30 days	31 to 60 days	61 to 90 days	More than 90 days	Total
31 December 2016					
Amounts due from credit institutions	–	–	–	6,872	6,872
Loans to customers					
Corporate lending	3,281	15	1,268	10,546	15,110
Individual lending	517	–	–	4,650	5,167
Total	3,798	15	1,268	22,068	27,149
31 December 2015					
Amounts due from credit institutions	–	–	–	5,607	5,607
Loans to customers					
Corporate lending	–	32,496	17,785	25,904	76,185
Individual lending	–	–	–	700	700
Total	–	32,496	17,785	32,211	82,492

Impairment assessment

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, restructuring, customer's payment behaviour, or infringement of the original terms of the contract. The Group addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

The Group determines the allowances appropriate for each individually significant loan 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 pay-out should bankruptcy ensue, the availability of other financial support and the realisable 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 to customers that are not individually significant (including credit cards, residential mortgages and unsecured consumer lending) and for individually significant loans 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 no 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, credit rating of customers, the appropriate 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. Local management is responsible for deciding the length of this period which can extend for as long as one year. The impairment allowance is then reviewed by credit management to ensure alignment with the Group's overall policy.

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

The geographical concentration of the Group's monetary assets and liabilities is set out below:

	2016				2015			
	The Republic of Azerbaijan	OECD countries	CIS and other non-OECD countries	Total	The Republic of Azerbaijan	OECD countries	CIS and other non-OECD countries	Total
Financial assets								
Cash and cash equivalents	692,775	403,189	9,805	1,105,769	330,824	671,580	18,902	1,021,306
Trading securities	22,669	–	–	22,669	46,238	–	–	46,238
Amounts due from credit institutions	627,610	48,206	52,305	728,121	109,336	14,787	13,772	137,895

	2016				2015			
	The Republic of Azerbaijan	OECD countries	CIS and other non-OECD countries	Total	The Republic of Azerbaijan	OECD countries	CIS and other non-OECD countries	Total
Investment securities	161,876	10,114	62,559	234,549	8,151	5,154	80,294	93,599
Derivative financial assets	984	–	–	984	–	324	–	324
Loans to customers	841,806	202,110	63,358	1,107,274	700,911	130,528	70,711	902,150
Other financial assets	6,037	2,048	–	8,085	2,501	2,263	–	4,764
	2,353,757	665,667	188,027	3,207,451	1,197,961	824,636	183,679	2,206,276
Financial liabilities								
Amounts due to banks and government funds	251,159	50,782	28,353	330,294	309,002	1,785	58,906	369,693
Amounts due to customers	2,317,515	2,506	30,666	2,350,687	1,360,252	–	13,861	1,374,113
Other borrowed funds	–	51,473	–	51,473	–	93,814	–	93,814
Derivative financial liabilities	1,663	805	–	2,468	965	26	–	991
Debt securities issued	–	18,705	–	18,705	–	–	–	–
Other financial liabilities	4,025	2,048	149	6,222	3,454	2,900	59	6,413
	2,574,362	126,319	59,168	2,759,849	1,673,673	98,525	72,826	1,845,024
Net assets/ (liabilities)	(220,605)	539,348	128,859	447,602	(475,712)	726,111	110,853	361,252

Liquidity risk and funding management

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

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

The liquidity position is assessed and managed by the Bank based on certain liquidity ratios established by the CBAR. As at 31 December 2016 and 2015, these ratios were as follows:

	2016 (%)	2015 (%)
Instant Liquidity Ratio (30% is the minimum required by the CBAR) (assets receivable or realisable within one day/liabilities repayable on demand)	82	63

As at 31 December 2016, liquidity ratio of PASHA Bank Georgia JSC (average volume of liquid assets/average volume of liabilities) based on requirements established by the NBG was 39%

(2015 – 34%). Minimum required level of liquidity by NBG is 30%.

As at 31 December 2016, liquidity ratio of PASHA Yatirim Bankasi A.S. based on requirements established by the CBRT was 295% (2015 – 322%). Minimum required level of liquidity by CBRT is 100%.

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2016 and 2015 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

Financial liabilities	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total 2016
As at 31 December 2016					
Amounts due to banks and government funds	106,767	60,102	129,782	46,335	342,986
Amounts due to customers	1,140,316	801,066	504,349	–	2,445,731
Other borrowed funds	3,150	12,381	38,014	–	53,545
Gross settled financial liabilities					
- Contractual amounts payable	27,612	25,145	–	–	52,757
- Contractual amounts receivable	(27,122)	(24,000)	–	–	(51,122)
Net settled derivative financial liabilities	16	974	–	–	990
Debt securities issued	18,836	–	–	–	18,836
Other financial liabilities	6,222	–	–	–	6,222
Total undiscounted financial liabilities	1,275,797	875,668	672,145	46,335	2,869,945
As at 31 December 2015					
Amounts due to banks and government funds	199,791	105,121	52,716	37,127	394,755
Amounts due to customers	1,030,542	278,887	90,475	–	1,399,904
Other borrowed funds	5,944	16,481	80,934	2,204	105,563
Gross settled financial liabilities					
- Contractual amounts payable	23,433	–	–	–	23,433
- Contractual amounts receivable	(23,786)	–	–	–	(23,786)
Net settled derivative financial liabilities	22	–	943	–	965
Other financial liabilities	5,967	446	–	–	6,413
Total undiscounted financial liabilities	1,241,913	400,935	225,068	39,331	1,907,247

The table below shows the contractual expiry by maturity of the Group's financial commitments and contingencies.

	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Maturity undefined	Total
As at 31 December 2016	135,990	123,340	7,651	26,170	45,648	**338,799**
As at 31 December 2015	86,597	57,550	71,717	–	81,640	**297,504**

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

The Group's capability to repay its liabilities relies on its ability to realise an equivalent amount of assets within the same period of time. There is a significant concentration of deposits from organizations of related parties in the period of one year. Any significant withdrawal of these funds would have an adverse impact on the operations of the Group. Management believes that this level of funding will remain with the Group for the foreseeable future and that in the event of withdrawal of funds, the Group would be given sufficient notice so as to realise its liquid assets to enable repayment.

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

Operational risk

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

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchanges, and equity prices. The Group manages exposures to market risk based of sensitivity analysis. The Group has no significant concentration of market risk.

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 sensitivity of current year profit 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 2016. The Group does not have substantial amount of floating rate non-trading financial instruments as at 31 December 2016 and 2015.

Currency risk

Currency risk is defined as the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its statement of financial position and statement of cash flows.

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

As at 31 December 2016, the Group had the following exposure to foreign currency exchange rate risk:

	AZN	USD	EURO	GEL	TRY	Other	Total 2016
Financial assets							
Cash and cash equivalents	161,555	551,692	357,842	2,225	24,668	7,787	1,105,769
Trading securities	22,669	–	–	–	–	–	22,669
Amounts due from credit institutions	554,056	118,017	56,043	5	–	–	728,121
Investment securities	115,981	69,406	–	42,198	6,964	–	234,549
Derivative financial assets	842	–	–	–	142	–	984
Loans to customers	456,381	318,099	155,210	44,575	133,009	–	1,107,274
Other financial assets	4,719	358	959	–	2,048	1	8,085
Total financial assets	1,316,203	1,057,572	570,054	89,003	166,831	7,788	3,207,451
The effect of derivatives	36,962	1,767	–	–	10,342	–	49,071
Financial liabilities							
Amounts due to banks and government funds	132,731	106,020	34,421	25,681	15,731	15,710	330,294
Amounts due to customers	1,005,650	858,007	474,800	1,805	2,500	7,925	2,350,687
Other borrowed funds	–	9,533	41,940	–	–	–	51,473
Derivative financial liabilities	1,663	–	–	–	805	–	2,468
Debt securities issued	–	–	–	–	18,705	–	18,705
Other financial liabilities	3,452	1,114	137	133	1,332	54	6,222
Total financial liabilities	1,143,496	974,674	551,298	27,619	39,073	23,689	2,759,849
The effect of derivatives	–	41,606	7,454	–	1,646	–	50,706
Net position after the effect of derivatives	209,669	43,059	11,302	61,384	136,454	(15,901)	445,967

As at 31 December 2015 the Group had the following exposure to foreign currency exchange rate risk:

	AZN	USD	EURO	GEL	TRY	Other	Total 2015
Financial assets							
Cash and cash equivalents	170,087	486,535	348,590	554	14,379	1,161	1,021,306
Trading securities	46,238	–	–	–	–	–	46,238
Amounts due from credit institutions	58,545	50,647	22,104	6,599	–	–	137,895
Investment securities	12,198	10,311	–	65,936	5,154	–	93,599
Derivative financial assets	–	–	–	–	324	–	324
Loans to customers	443,904	182,833	137,516	50,658	86,913	326	902,150
Other financial assets	848	660	1,013	–	2,243	–	4,764
Total financial assets	731,820	730,986	509,223	123,747	109,013	1,487	2,206,276
The effect of derivatives	–	–	4,521	–	19,266	–	23,787
Financial liabilities							
Amounts due to banks and government funds	77,517	236,238	20	55,608	2	308	369,693
Amounts due to customers	492,029	429,583	450,338	1,244	26	893	1,374,113
Other borrowed funds	–	39,451	54,024	–	–	339	93,814
Derivative financial liabilities	965	–	–	–	26	–	991
Other financial liabilities	2,723	249	417	62	2,860	102	6,413
Total financial liabilities	573,234	705,521	504,799	56,914	2,914	1,642	1,845,024
The effect of derivatives	–	9,851	9,041	–	4,541	–	23,433
Net position after the effect of derivatives	158,586	15,614	(96)	66,833	120,824	(155)	361,606

Currency risk sensitivity

The following table details the Group's sensitivity to increase and decrease in the USD, EUR, GEL and TRY against the AZN. These are the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the possible change in foreign currency exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for specified changes in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations within the Group where the denomination of the loan is in a currency other than the currency of the lender or the borrower.

Impact on profit before tax based on assets value as at 31 December 2016 and 2015:

	2016		2015	
	AZN/USD +20%	AZN/USD -20%	AZN/USD +15%	AZN/USD -60%
Impact on profit before tax	(8,612)	8,612	(2,342)	9,368

	2016		2015	
	AZN/EUR +20%	AZN/EUR -20%	AZN/EUR +15%	AZN/EUR -60%
Impact on profit before tax	(2,260)	2,260	14	(58)

	2016		2015	
	AZN/GEL +15%	AZN/GEL -15%	AZN/GEL +15%	AZN/GEL -15%
Impact on profit before tax	(9,208)	9,208	(10,025)	10,025

	2016		2015	
	AZN/TRY +10%	AZN/TRY -10%	AZN/TRY +10%	AZN/TRY -10%
Impact on profit before tax	(13,645)	13,645	(12,082)	12,082

27. Fair values of financial instruments

Fair value hierarchy

For the purpose of fair value disclosures, the Group's has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy:

		Fair value measurement using			
	Date of valuation	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Assets measured at fair value					
Trading securities	31 December 2016	–	22,669	–	22,669
Investment securities – available for sale	31 December 2016	35,790	134,187	3,352	173,329
Derivative financial assets	31 December 2016	–	984	–	984

	Date of valuation	Fair value measurement using			
		Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant un-observable inputs (Level 3)	Total
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2016	1,105,769	–	–	1,105,769
Amounts due from credit institutions	31 December 2016	–	–	728,121	728,121
Investment securities – loans and receivables	31 December 2016	–	2,074	61,027	63,101
Loans to customers	31 December 2016	–	–	1,088,091	1,088,091
Investment property	31 December 2016	–	–	1,654	1,654
Liabilities measured at fair value					
Derivative financial liabilities	31 December 2016	–	2,468	–	2,468
Liabilities for which fair values are disclosed					
Amounts due to banks and government funds	31 December 2016	–	–	330,294	330,294
Amounts due to customers	31 December 2016	–	–	2,354,701	2,354,701
Other borrowed funds	31 December 2016	–	–	51,473	51,473
Debt securities issued	31 December 2016	–	–	18,690	18,690
Assets measured at fair value					
Trading securities	31 December 2015	–	46,238	–	46,238
Investment securities – available for sale	31 December 2015	5,390	306	–	5,696
Derivative financial assets	31 December 2015	–	324	–	324
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2015	1,021,306	–	–	1,021,306
Amounts due from credit institutions	31 December 2015	–	–	137,895	137,895
Investment securities – loans and receivables	31 December 2015	–	4,370	82,348	86,718
Loans to customers	31 December 2015	–	–	884,654	884,654
Investment property	31 December 2015	–	–	1,668	1,668

	Date of valuation	Fair value measurement using			
		Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Liabilities measured at fair value					
Derivative financial liabilities	31 December 2015	–	991	–	991
Liabilities for which fair values are disclosed					
Amounts due to banks and government funds	31 December 2015	–	–	369,693	369,693
Amounts due to customers	31 December 2015	–	–	1,373,943	1,373,943
Other borrowed funds	31 December 2015	–	–	93,814	93,814

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

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

	Carrying value 2016	Fair value 2016	Unrecognized gain/(loss) 2016	Carrying value 2015	Fair value 2015	Unrecognized gain/(loss) 2015
Financial assets						
Cash and cash equivalents	1,105,769	1,105,769	–	1,021,306	1,021,306	–
Amounts due from credit institutions	728,121	728,121	–	137,895	137,895	–
Investment securities – loans and receivables	61,220	63,101	1,881	87,903	86,718	(1,185)
Loans to customers	1,107,274	1,088,091	(19,183)	902,150	884,654	(17,496)
Financial liabilities						
Amounts due to banks and government funds	330,294	330,294	–	369,693	369,693	–
Amounts due to customers	2,350,687	2,354,701	(4,014)	1,374,113	1,373,943	170
Other borrowed funds	51,473	51,473	–	93,814	93,814	–
Debt securities issued	18,705	18,690	15	–	–	–
Total unrecognised change in unrealised fair value			(21,301)			(18,511)

The following is a description of the determination of fair value for financial instruments which are recorded at fair value using valuation techniques. These incorporate the Group's estimate of assumptions that a market participant would make when valuing the instruments.

Fixed rate financial instruments

The fair value of fixed rate financial assets and liabilities carried at amortised cost are estimated by comparing market interest rates when they were first recognized with current market rates offered for similar financial instruments. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and maturity. For quoted debt issued the fair values are calculated based on quoted market prices. For those notes issued where quoted market prices are not available, a discounted cash flow model is used based on a current interest rate yield curve appropriate for the remaining term to maturity.

Assets for which fair value approximates carrying value

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

Fixed and variable rate financial instruments

For quoted debt instruments the fair values are determined based on quoted market prices. The fair values of unquoted debt instruments are estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

Movements in level 3 assets and liabilities at fair value

Securities determined as Level 3 assets which are recorded at fair value were purchased closed to reporting period end. Management believes that there were not any movements and their fair value approximates carrying value as of 31 December 2016.

28. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled See Note 25 "Risk management" for the Group's contractual undiscounted repayment obligations.

	2016			2015		
	Within one year	More than one year	Total	Within one year	More than one year	Total
Cash and cash equivalents	1,105,769	–	1,105,769	1,021,306	–	1,021,306
Trading securities	19,479	3,190	22,669	23,862	22,376	46,238
Amounts due from credit institutions	728,121	–	728,121	133,607	4,288	137,895
Investment securities	186,387	48,162	234,549	53,857	39,742	93,599
Derivative financial assets	984	–	984	324	–	324

	2016			2015		
	Within one year	More than one year	Total	Within one year	More than one year	Total
Loans to customers	512,518	594,756	1,107,274	438,100	464,050	902,150
Investment property	–	1,654	1,654	–	1,668	1,668
Property and equipment	–	12,809	12,809	–	15,851	15,851
Goodwill and other intangible assets	–	55,067	55,067	–	56,730	56,730
Current income tax assets	–	–	–	287	–	287
Deferred income tax assets	–	1,647	1,647	–	1,555	1,555
Other assets	17,431	1,871	19,302	12,056	3,080	15,136
Total assets	2,570,689	719,156	3,289,845	1,683,399	609,340	2,292,739
Amounts due to banks and government funds	161,616	168,678	330,294	297,897	71,796	369,693
Amounts due to customers	1,876,555	474,132	2,350,687	1,293,886	80,227	1,374,113
Other borrowed funds	14,796	36,677	51,473	18,539	75,275	93,814
Debt securities issued	18,705	–	18,705	–	–	–
Derivative financial liabilities	2,468	–	2,468	–	991	991
Current income tax liability	12,436	–	12,436			
Deferred income tax liabilities	–	8,446	8,446	–	9,688	9,688
Provision for guarantees and letters of credit	6,959	–	6,959	379	–	379
Other liabilities	18,880	2,231	21,111	11,236	336	11,572
Total liabilities	2,112,415	690,164	2,802,579	1,621,937	238,313	1,860,250
Net assets	458,274	28,992	487,266	61,462	371,027	432,489

29. Related party disclosures

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

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

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

	2016					2015				
	Parent	Entities under common control	Key management personnel	Other	Total	Parent	Entities under common control	Key management personnel	Other	Total
Cash and cash equivalents	–	18,203	–	–	18,203	–	–	–	–	–
Amounts due from credit institutions	–	34,487	–	–	34,487	–	25,558	–	–	25,558
Loans outstanding at 1 January, gross	–	31,128	2,690	–	33,818	10	19,803	1,644	–	21,457
Loans issued during the year	–	172,952	4,057	291	177,300	–	47,733	6,745	–	54,478
Loan repayments during the year	–	(88,591)	(3,598)	(97)	(92,286)	(10)	(39,067)	(6,555)	–	(45,632)
Interest accrual	–	2,115	63	8	2,186	–	244	28	–	272
Foreign currency translation difference	–	6,908	81	12	7,001	–	2,415	828	–	3,243
Loans outstanding at 31 December, gross	–	124,512	3,293	214	128,019	–	31,128	2,690	–	33,818
Less: allowance for impairment at 31 December	–	(1,097)	(9)	–	(1,106)	–	(945)	(280)	–	(1,225)
Loans outstanding at 31 December, net	–	123,415	3,284	214	126,913	–	30,183	2,410	–	32,593
Interest income on loans	–	6,434	258	13	6,705	–	3,487	137	–	3,624
Deposit at 1 January	25,605	135,220	557	85,873	247,255	5,062	26,239	289	57,516	89,106
Deposits received during the year	–	405,758	5,650	81,268	492,676	18,812	123,874	121	58,937	201,744
Deposits repaid during the year	(26,740)	(93,555)	(616)	(114,906)	(235,817)	(4,200)	(15,700)	(99)	(58,726)	(78,725)
Interest accrual	–	136	–	–	136	9	522	6	125	662
Foreign currency translation difference	1,135	6,875	209	6,571	14,790	5,922	285	240	28,021	34,468
Deposits at 31 December	–	454,434	5,800	58,806	519,040	25,605	135,220	557	85,873	247,255
Amounts due to banks and government funds	–	48,317	–	–	48,317	–	289	–	–	289
Current accounts at 31 December	29,564	240,425	1,712	248,151	519,852	10,955	513,550	393	173,911	698,809

	2016					2015				
	Parent	Entities under common control	Key management personnel	Other	Total	Parent	Entities under common control	Key management personnel	Other	Total
Interest expense on deposits	(467)	(12,859)	(123)	(3,176)	(16,625)	(480)	(8,133)	(8)	(3,035)	(11,656)
Guarantees issued	–	12,146	–	–	12,146	–	4,564	–	–	4,564
Letters of credit issued	–	6,465	–	–	6,465	–	2,026	–	–	2,026
Unused credit lines	182	1,787	801	231	3,001	163	558	269	34	1,024
Fee and commission income	55	3,537	8	5	3,605	14	1,426	1	1	1,442
Net gains/(losses) from foreign currencies: dealing	437	14,722	122	3,180	18,461	103	3,585	8	1,584	5,280
Other operating expenses	–	(4,810)	–	–	(4,810)	–	(4,037)	–	–	(4,037)

The Bank has guarantee from its parent received as a collateral in respect of deposits placed in local banks in the amount of AZN 6,872 thousand as at 31 December 2016 (2015 – AZN 21,219 thousand).

Compensation to members of key management personnel was comprised of the following:

	2016	2015
Salaries and other benefits	(6,291)	(3,043)
Social security costs	(550)	(480)
Total key management compensation	(6,841)	(3,523)

30. 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 ratios established by the CBAR.

During the past year, the Bank had complied in full with all its externally imposed capital requirements.

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, policies and processes from the previous years.

CBAR capital adequacy ratio

The CBAR requires banks to maintain a minimum capital adequacy ratio of 10% (2015: 10%) of risk-weighted assets for regulatory capital. As at 31 December 2016 and 2015 the Bank's capital adequacy ratio on this basis was as follows:

	2016	2015
Tier 1 capital	330,438	339,059
Tier 2 capital	75,195	16,206
Less: deductions from capital	(148,987)	(148,987)
Total regulatory capital	256,646	206,278
Risk-weighted assets	1,136,889	1,199,711
Capital adequacy ratio	23%	17%

NBG capital adequacy ratio

The NBG requires banks to maintain a minimum total capital adequacy ratio of 11.4% (2015 – 11.4%) of risk-weighted assets for regulatory capital. As at 31 December 2016, capital adequacy ratio of PASHA Bank Georgia was 34% (31 December 2015 – 44%).

The BRSA requires banks to maintain a minimum total capital adequacy ratio of 8% (2015 – 8%) of risk-weighted assets for regulatory capital. Capital Adequacy Standard Ratio of PASHA Yatirim is calculated in accordance with BRSA. As at 31 December 2016 the bank's capital adequacy ratio was 54% (31 December 2015: 92%).

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