

Independent auditor's report
on the financial statements of
Joint Stock Company RN Bank
for the year ended 31 December 2018

March 2019

Translation of the original Russian version

**Independent auditor's report
on the financial statements of
Joint Stock Company RN Bank**

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Independent auditor's report

Translation of the original Russian version

To the Shareholder and Board of Directors of
Joint Stock Company RN Bank

Report on the audit of the financial statements

Opinion

We have audited the financial statements of Joint Stock Company RN Bank (hereinafter, the "Bank"), which comprise the statement of financial position as at 31 December 2018, and the statement of profit and loss and comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2018 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

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

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Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying financial statements.

| Key audit matter | How our audit addressed the key audit matter |
|---|--|
| <i>Allowance for impairment of loans to customers</i> | |
| Estimation of the allowance for impairment of loans to customers is a key area of judgement for the Bank's management. | Our audit procedures included an analysis of the methodology for estimating expected credit losses on loans to customers. |
| The identification of indicators of a significant increase in credit risk, assessment of the probability of a borrower's default and estimation of the allowance require the significant use of professional judgement, assumptions and analysis of various factors. | In testing the impairment of loans, we engaged our experts in this field and analyzed the underlying statistical models, key inputs and assumptions, as well as forward-looking information used in to calculate expected credit losses. |
| The use of different models and assumptions can significantly affect the allowance for impairment of loans to customers. Due to the significant amount of loans issued, and because the allowance estimation process involves an extensive use of judgment that is subjective, estimation of the assessment of the allowance for impairment was a key audit matter. | For the selected substantial loans to legal entities, we tested their classification by stage, credit risk factors and internal credit ratings assigned. |
| The information on the allowance for expected credit losses on loans to customers, and the Bank's management approach to assessing and managing credit risk is provided in Notes 7 and 17 to the financial statements. | For loans to individuals, we analyzed their classification by stage, the probability of default calculated on the basis of the migration model, loss given default, including the value of collateral, information on any overdue debts. |
| | We performed procedures in respect of the information on expected credit losses on loans to customers disclosed in the notes to the financial statements. |

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Other information included in the Bank's 2018 Annual report

Other information consists of the information included in the Bank's 2018 Annual report, other than the financial statements and our auditor's report thereon. Management is responsible for the other information.

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

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of management and Board of Directors for the financial statements

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

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

Board of Directors are responsible for overseeing the Bank's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

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

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

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

We communicate with Board of Directors 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.

We also provide Board of Directors with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with Board of Directors, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

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Report in accordance with the requirements of Article 42 of the Federal Law of the Russian Federation No. 395-1 Concerning Banks and Banking Activities of 2 December 1990

Management of the Bank is responsible for the compliance of the Bank with the mandatory prudential ratios established by the Central Bank of the Russian Federation (hereinafter, the “Bank of Russia”) and for the conformity of internal control and organization of the risk management systems of the Bank with the requirements set forth by the Bank of Russia in respect of such systems.

In accordance with the requirements of Article 42 of the Federal Law of the Russian Federation No. 395-1 *Concerning Banks and Banking Activities* of 2 December 1990 (hereinafter, the “Federal Law”), during the audit of the Bank’s financial statements for the year ended 31 December 2018, we determined:

- 1) Whether the Bank complied as at 1 January 2019 with the obligatory ratios established by the Bank of Russia;
- 2) Whether internal control and organization of the risk management systems of the Bank conformed to the requirements set forth by the Bank of Russia for such systems in respect of the following:
 - ▶ subordination of the risk management departments;
 - ▶ the existence of methodologies, approved by the Bank’s respective authorized bodies, for detecting and managing risks that are significant to the Bank and for performing stress-testing; the existence of a reporting system at the Bank pertaining to its significant risks and capital;
 - ▶ consistency in applying and assessing the effectiveness of methodologies for managing risks that are significant to the Bank;
 - ▶ oversight performed by the Board of Directors and executive management of the Bank in respect of the Bank’s compliance with risk limits and capital adequacy requirements set forth in the Bank’s internal documents, and effectiveness and consistency of the application of the Bank’s risk management procedures.

This work included procedures selected based on our judgment, such as inquiries, analysis, reading of documents, comparison of the requirements, procedures and methodologies approved by the Bank with the requirements set forth by the Bank of Russia, and the recalculation, comparison and reconciliation of numerical values and other information.

The findings from our work are provided below.

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Compliance by the Bank with the obligatory ratios established by the Bank of Russia

We found that the values of the obligatory ratios of the Bank as of 1 January 2019 were within the limits established by the Bank of Russia.

We have not performed any procedures in respect of accounting data of the Bank, except for those procedures we considered necessary to express our opinion on the fair presentation of the Bank's financial statements.

Conformity of internal control and organization of the risk management systems of the Bank with the requirements set forth by the Bank of Russia in respect of such systems

- ▶ We found that, in accordance with the legal acts and recommendations issued by the Bank of Russia, as at 31 December 2018 the Bank's internal audit division was subordinated and accountable to the Board of Directors, and the Bank's risk management departments were not subordinated or accountable to the departments that take the relevant risks.
- ▶ We found that the Bank's internal documents effective as at 31 December 2018 that establish the methodologies for detecting and managing credit, market, operational and liquidity risks that are significant to the Bank and stress-testing have been approved by the Bank's authorized bodies in accordance with the legal acts and recommendations issued by the Bank of Russia. We also found that, as at 31 December 2018, the Bank had a reporting system pertaining to credit, market, operational and liquidity risks that were significant to the Bank and pertaining to its capital.
- ▶ We found that the frequency and consistency of reports prepared by the Bank's risk management departments and internal audit division during the year ended 31 December 2018 with regard to the management of credit, market, operational and liquidity risks of the Bank complied with the Bank's internal documents, and that those reports included observations made by the Bank's risk management departments and internal audit division in respect of the effectiveness of relevant risk management methodologies.
- ▶ We found that, as at 31 December 2018, the authority of the Board of Directors and executive management bodies of the Bank included control over compliance of the Bank with internally established risk limits and capital adequacy requirements. For the purpose of control over the effectiveness and consistency of the risk management procedures applied by the Bank during the year ended 31 December 2018, the Board of Directors and executive management bodies of the Bank regularly reviewed the reports prepared by the Bank's risk management departments and internal audit division.

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The procedures pertaining to the internal control and organization of the risk management systems were conducted by us solely for the purpose of determining the conformity of certain elements of the internal control and organization of the risk management systems of the Bank, as listed in the Federal Law and described above, with the requirements set forth by the Bank of Russia.

The partner in charge of the audit resulting in this independent auditor's report is A.F. Lapina.

A.F. LAPINA
Partner
Ernst & Young LLC

19 March 2019

Details of the audited entity

Name: Joint Stock Company RN Bank
Record made in the State Register of Legal Entities on 6 November 2002, State Registration Number 1025500003737.
Address: Russia 109028, Moscow, Serebryanicheskaya naberezhnaya, 29.

Details of the auditor

Name: Ernst & Young LLC
Record made in the State Register of Legal Entities on 5 December 2002, State Registration Number 1027739707203.
Address: Russia 115035, Moscow, Sadovnicheskaya naberezhnaya, 77, building 1.
Ernst & Young LLC is a member of Self-regulated organization of auditors "Russian Union of auditors" (Association) ("SRO RUA"). Ernst & Young LLC is included in the control copy of the register of auditors and audit organizations, main registration number 11603050648.

Statement of financial position
as at 31 December 2018

(thousands of Russian rubles)

Translation of the original Russian version

| | Notes | 31 December 2018 | 31 December 2017 |
|--|-------|---------------------|---------------------|
| Assets | | | |
| Cash and cash equivalents | 5 | 9,593,279 | 7,513,681 |
| Obligatory reserve with the Bank of Russia | | 318,510 | 390,249 |
| Derivative financial assets | 6 | 1,082,686 | 205,946 |
| Loans to customers | 7 | 79,088,188 | 66,619,003 |
| Investment securities | 8 | 439,648 | 595,935 |
| Property and equipment | | 60,892 | 15,973 |
| Intangible assets | | 148,867 | 271,825 |
| Current income tax asset | | — | 22,008 |
| Deferred income tax assets | 9 | 1,008,353 | 1,130,974 |
| Other assets | 10 | 111,106 | 98,433 |
| Total assets | | 91,851,529 | 76,864,027 |
| Liabilities | | | |
| Amounts due to credit institutions | 11 | 42,686,949 | 34,859,623 |
| Debt securities issued | 13 | 18,685,486 | 15,447,150 |
| Derivative financial liabilities | 6 | 279,679 | 1,582,363 |
| Amounts due to customers | 12 | 11,898,945 | 12,703,434 |
| Current income tax liability | | 41,426 | — |
| Other liabilities | 10 | 2,027,780 | 1,724,034 |
| Total liabilities | | 75,620,265 | 66,316,604 |
| Equity | | | |
| Share capital | 14 | 6,133,091 | 3,333,091 |
| Share premium | | 5,780,800 | 5,580,800 |
| Retained earnings/(accumulated deficit) | | 4,323,404 | 1,716,561 |
| Unrealized gain/(loss) on revaluation of investment securities — debt securities at FVOCI | | (703) | 2,323 |
| Unrealized loss on cash flow hedges | | (5,328) | (85,352) |
| Total equity | | 16,231,264 | 10,547,423 |
| Total equity and liabilities | | 91,851,529 | 76,864,027 |

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


 Chairman of the Management Board
 Xavier Gerard Derot




 Chief Accountant
 Darya Dolgorukova

19 March 2019

**Statement of profit or loss and comprehensive income
for the year ended 31 December 2018**

(thousands of Russian rubles)

Translation of the original Russian version

| | Notes | 2018 | 2017 |
|---|-------|--------------------|--------------------|
| Interest income calculated using the EIR method | | | |
| Loans to customers | | 10,884,576 | 10,036,715 |
| Amounts due from credit institutions | | 460,580 | 424,881 |
| Investment securities | | 32,800 | 16,867 |
| Total interest income | | 11,377,956 | 10,478,463 |
| Interest expense | | | |
| Amounts due to customers | | (478,462) | (467,722) |
| Amounts due to credit institutions | | (3,615,589) | (4,077,390) |
| Debt securities issued | | (1,239,923) | (977,662) |
| Total interest expense | | (5,333,974) | (5,522,774) |
| Net interest income | | 6,043,982 | 4,955,689 |
| Allowance for loan impairment | 7 | (736,224) | (969,709) |
| Net interest income after allowance for loan impairment | | 5,307,758 | 3,985,980 |
| Fee and commission income | | 119,244 | 132,518 |
| Fee and commission expense | | (190,977) | (170,938) |
| Net fee and commission expense | | (71,733) | (38,420) |
| Net losses from financial instruments at fair value through profit or loss | | 206,678 | (503,847) |
| Net gains from foreign currencies: | | (565,237) | 6,525 |
| - dealing | | 76 | 243 |
| - translation differences | | (565,313) | 6,282 |
| Other income | | 3,065 | 297,657 |
| Non-interest expense | | (355,494) | (199,665) |
| Personnel expenses | 16 | (566,444) | (392,463) |
| Other administrative expenses | 16 | (768,380) | (858,839) |
| Depreciation of property and equipment | | (27,962) | (17,113) |
| Depreciation of intangible assets | | (222,631) | (203,378) |
| Operating expense | | (1,585,417) | (1,471,793) |
| Profit before income tax expense | | 3,295,114 | 2,276,102 |
| Income tax expense | 9 | (688,271) | (528,306) |
| Total net profit for the year | | 2,606,843 | 1,747,796 |
| Other comprehensive income/(loss) | | | |
| <i>Items which may be reclassified to profit or loss in subsequent periods:</i> | | | |
| Revaluation reserve for investment securities — debt securities at FVOCI | | (3,026) | 1,777 |
| Unrealized gain/(loss) on cash flow hedges | 6 | 80,024 | 73,592 |
| Other comprehensive income/(loss), net of tax | | 76,998 | 75,369 |
| Total comprehensive income | | 2,683,841 | 1,823,165 |

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

Chairman of the Management Board
Xavier Gerard Derot

19 March 2019



Chief Accountant
Darya Dolgorukova

Statement of changes in equity
for the year ended 31 December 2018

(thousands of Russian rubles)

Translation of the original Russian version


| | <i>Share capital</i> | <i>Share premium</i> | <i>Retained earnings (accumulated deficit)</i> | <i>Unrealized gain on securities revaluation</i> | <i>Provision for hedges</i> | <i>Total equity</i> |
|---|----------------------|----------------------|--|--|-----------------------------|---------------------|
| 31 December 2016 | 3,333,091 | 5,580,800 | (31,235) | 546 | (158,944) | 8,724,258 |
| Profit for the year | – | – | 1,747,796 | – | – | 1,747,796 |
| Other comprehensive income/(loss) | – | – | – | 1,777 | 73,592 | 75,369 |
| Total comprehensive income/(loss) for the year | – | – | 1,747,796 | 1,777 | 73,592 | 1,823,165 |
| Effect of applying IFRS 9 | – | – | – | – | – | – |
| 31 December 2017 | 3,333,091 | 5,580,800 | 1,716,561 | 2,323 | (85,352) | 10,547,423 |
| Profit for the year | – | – | 2,606,843 | – | – | 2,606,843 |
| Other comprehensive income | – | – | – | (3,026) | 80,024 | 76,998 |
| Total comprehensive income for the year | – | – | 2,606,843 | (3,026) | 80,024 | 2,683,841 |
| Capital contribution from shareholder | 2,800,000 | 200,000 | – | – | – | 3,000,000 |
| 31 December 2018 | 6,133,091 | 5,780,800 | 4,323,404 | (703) | (5,328) | 16,231,264 |

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


Chairman of the Management Board
Xavier Gerard Derot

19 March 2019




Chief Accountant
Darya Dolgorukova

Statement of cash flows
for the year ended 31 December 2018

(thousands of Russian rubles)

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| | Notes | 31 December 2018 | 31 December 2017 |
|--|-------|---------------------|---------------------|
| Cash flows from operating activities | | | |
| Interest received | | 11,749,401 | 10,449,313 |
| Interest paid | | (4,536,359) | (3,731,612) |
| Fees and commissions received | | 116,435 | 137,416 |
| Fees and commissions paid | | (191,131) | (173,470) |
| Results of operations with financial instruments at fair value | | (828,127) | (2,837,460) |
| Realized gains less losses from dealing in foreign currencies | | 76 | 243 |
| Other income received | | 3,064 | 3,352 |
| Personnel expenses paid | | (535,519) | (500,147) |
| Other operating expenses paid | | (692,189) | (756,362) |
| Cash flows from operating activities before changes in operating assets and liabilities | | 5,085,651 | 2,591,273 |
| <i>Net (increase)/decrease in operating assets</i> | | | |
| Obligatory reserve with the Bank of Russia | | 71,739 | (360,852) |
| Amounts due from credit institutions | | – | 3,001,790 |
| Loans to customers | | (13,619,790) | (14,141,752) |
| Other assets | | (186,568) | 228,739 |
| <i>Net increase/(decrease) in operating liabilities</i> | | | |
| Amounts due to the Bank of Russia | | – | – |
| Amounts due to credit institutions | | 6,413,832 | 6,137,108 |
| Amounts due to customers | | (1,925,561) | (726,810) |
| Other liabilities | | 470,583 | (27,042) |
| Net cash used in operating activities before income tax | | (3,690,114) | (3,297,546) |
| Income tax expense | | (521,990) | (714,775) |
| Net cash used in operating activities | | (4,212,104) | (4,012,321) |
| Cash flows from investing activities | | | |
| Purchase of property and equipment, intangible assets | | (182,260) | (134,610) |
| Purchase of securities available for sale | | – | (441,434) |
| Proceeds from sale and redemption of securities and other financial assets available for sale | | 153,031 | 49,896 |
| Net cash used in investing activities | | (29,229) | (526,148) |
| Cash flows from financing activities | | | |
| Proceeds from increase in share capital | 14 | 3,000,000 | – |
| Debt securities issued | | 3,308,535 | 10,000,000 |
| Net cash from financing activities | | 6,308,535 | 10,000,000 |
| Effect of exchange rates changes on cash and cash equivalents | | 12,396 | (915) |
| Net increase/(decrease) in cash and cash equivalents | | 2,079,598 | 5,460,616 |
| Cash and cash equivalents, beginning | | 7,513,681 | 2,053,065 |
| Cash and cash equivalents, ending | 5 | 9,593,279 | 7,513,681 |

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


Chairman of the Management Board
Xavier Gerard Derot

19 March 2019




Chief Accountant
Darya Dolgorukova

Translation of the original Russian version

JSC RN Bank

Notes to the 2018 financial statements

(thousands of Russian rubles)

1. Principal activities

These are the financial statements of JSC RN Bank (hereinafter, the "Bank").

The Bank (former CJSC Bank Sibir) was formed in the Russian Federation (the city of Omsk) on 9 March 1989. In 1998, in order to align the legal structure with the legislation, the Bank was reorganized into a limited liability company – LLC OCB Sibir. In 2002, the Bank changed its legal form to a closed joint stock company. Since May 2013, the Bank has been registered and located in Moscow. On 5 September 2013, following the decision of the sole shareholder (Decision No. 1 of 5 September 2013), the Bank changed its name as follows:

Full corporate name of the Bank: Closed Joint Stock Company RN Bank.

Short name: CJSC RN Bank.

Location (legal address): Russia 109028, Moscow, Serebryanicheskaya naberezhnaya, 29.

Main State Registration Number: 1025500003737.

The record concerning the establishment was made in the Uniform State Register of Legal Entities on 6 November 2002.

Bank's identification code (BIC): 044583105.

Taxpayer identification number (TIN): 5503067018.

Contact telephone number: + 7 (495) 775-40-68.

Contact fax number: + 7 (495) 775-40-67.

Email address: help@rn-bank.ru.

Web-site: www.rn-bank.ru.

In 2014, the Bank changed its legal form from a closed joint stock company to a joint stock company. The decision was approved by the shareholders on 31 October 2014. The change was made to the Uniform State Register of Legal Entities on 9 December 2014.

The Bank carries out its activities based on the following licenses:

- ▶ License No. 170 issued on 6 November 2013 to carry out banking operations in rubles and foreign currencies (without the right to accept deposits from individuals);
- ▶ License No. 170 issued on 6 November 2013 to accept deposits from individuals denominated in rubles and foreign currencies.

The Bank is a member of the deposit insurance system and was included in the register of banks participating in the obligatory insurance system on 3 February 2005 (Certificate No. 551). The system operates under the federal laws and regulations and is governed by the State Corporation "Agency for Deposits Insurance." Insurance covers the Bank's liabilities to individual depositors in the amount up to RUB 1,400 thousand both in 2018 and 2017 per each individual in case of a business failure or revocation of the banking license issued by the Bank of Russia.

As at 1 January 2019, the Bank:

- ▶ Is not a member of a banking group;
- ▶ Is not a professional participant of the securities market;
- ▶ Has no branches or representative offices in the Russian Federation;
- ▶ Has no subsidiaries or associates.

On 1 March 2018, Analytical Credit Rating Agency (ACRA) upgraded the national credit rating of the Bank to AA+(RU) with a stable outlook. The ratings of exchange-traded bond issues of the Bank were also upgraded to AA+(RU).

On 8 March 2018, International Credit Rating Agency S&P Global Ratings confirmed the Bank's long-term credit rating at BB+ with a stable outlook.

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JSC RN Bank

Notes to the 2018 financial statements

(thousands of Russian rubles)

1. Principal activities (continued)

As at 1 January 2019, the average headcount of the Bank was 195 employees (1 January 2018: 186 employees).

As at 31 December 2018 and 2017, Limited Liability Company BARN B.V., the Netherlands, is the sole shareholder of the Bank. Its ownership in the share capital of the Bank is 100.00%.

The executive body as represented by the Chairman of the Management Board of JSC RN Bank approves the annual financial statements for issue. The IFRS financial statements of the Bank are published in full on the Bank's official website (www.rn-bank.ru/about/investors/отчетность).

2. Basis of preparation

Statement of compliance with International Financial Reporting Standards

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

The Bank is required to maintain its records and prepare its financial statements for regulatory purposes in accordance with Russian accounting and banking legislation and related instructions (RAL). These financial statements are based on RAL, as adjusted and reclassified in order to comply with IFRS.

Basis of measurement

These financial statements have been prepared under the historical cost convention except for financial instruments at fair value. For example, derivative financial instruments have been measured by the Bank at fair value. The historical cost is generally estimated based on the fair value of consideration transferred in exchange of goods and services.

Presentation currency

These financial statements are presented in thousands of Russian rubles (RUB).

Inflation accounting

The Russian economy was considered hyperinflationary until 31 December 2002. As such, the Bank applied IAS 29 *Financial Reporting in Hyperinflationary Economies*. The effect of applying IAS 29 is that non-monetary items, including components of equity, were restated to the measuring units current at 31 December 2002 by applying the relevant inflation indices to the historical cost, and that these restated values were used as a basis for accounting in subsequent periods.

The application of this standard resulted in an increase in the share capital by RUB 64,091 thousand and a decrease in retained earnings/(accumulated deficit) by the same amount.

3. Summary of accounting policies

Changes in accounting policies

The Bank applied for the first time certain amendments to the standards, which are effective for annual periods beginning on or after 1 January 2018. The Bank has not adopted early standards, interpretations or amendments that have been issued but are not yet effective. The nature and the impact of each new amendment are described below:

(thousands of Russian rubles)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement* for annual periods beginning on or after 1 January 2018. The Bank has not restated comparative information for 2017 for financial instruments in the scope of IFRS 9. Therefore, the comparative information for 2017 is reported under IAS 39 and is not comparable to the information presented for 2018. Differences arising from the adoption of IFRS 9 have been recognized directly in equity as at 1 January 2018 and are disclosed below.

(a) *Classification and measurement*

Under IFRS 9, all debt financial assets that do not meet the “solely payments of principal and interest” (SPPI) criterion, are classified at initial recognition as financial assets at fair value through profit or loss (FVPL). Under this criterion, debt instruments that do not correspond to a “basic lending arrangement” are measured at FVPL. Debt financial instruments that meet the SPPI criterion are classified at initial recognition based on the business model, under which these instruments are managed:

- ▶ Instruments that are managed on a “hold to collect” basis are measured at amortized cost;
- ▶ Instruments that are managed on a “hold to collect and for sale” basis are measured at fair value through other comprehensive income (FVOCI);
- ▶ Instruments that are managed on other basis will be measured at FVPL.

The classification and measurement of financial liabilities remain largely unchanged from the current IAS 39 requirements. Derivatives will continue to be measured at FVPL. Embedded derivatives are no longer separated from a host financial asset.

Business model assessment

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

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

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

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

“Solely payments of principal and interest on the principal amount outstanding” test (SPPI test)

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

(thousands of Russian rubles)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

(b) Impairment

The adoption of IFRS 9 changes the Bank's accounting for allowances for expected credit losses by replacing the IAS 39 incurred credit loss approach with a forward-looking expected credit loss (ECL) approach. Since 1 January 2018, the Bank has been recording the allowance for ECL for all loans, including loans to individuals, factoring dealer financing and interbank loans, interest accrued and other debt financial instruments not measured at FVPL, together with loan and financing commitments, which are collectively referred to as financial instruments in this section. Equity instruments are not subject to impairment under IFRS 9.

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

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

| | |
|---------|--|
| Stage 1 | At initial recognition of a loan, the Bank recognizes an impairment allowance in the amount equal to 12-month ECL. Stage 1 also includes loans and other credit facilities for which credit risk decreased to the extent that they have been reclassified from Stage 2. |
| Stage 2 | When a loan has shown a significant increase in credit risk since initial recognition, the Bank records an allowance for impairment equal to lifetime ECL. Stage 2 also includes loans and other credit facilities for which credit risk decreased to the extent that they have been reclassified from Stage 3. |
| Stage 3 | Loans considered credit-impaired. The Bank records an impairment allowance equal to lifetime ECL. |
| POCI | Purchased or originated credit-impaired (POCI) financial assets are assets that are credit-impaired on initial recognition. POCI assets are recorded at fair value at initial recognition and interest revenue is subsequently recognized based on a credit-adjusted EIR. The allowance for ECL is only recognized or derecognized to the extent that there is a change in expected credit losses. |

In the Bank does not have reasonable expectations regarding the recoverability of the financial asset in full or in part, the gross carrying amount of the asset should be decreased. Such a decrease is considered (a partial) derecognition of the financial asset.

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

| | |
|-----------------------------|--|
| Probability of default (PD) | The <i>Probability of Default (PD)</i> is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the asset has not been previously derecognized and is still in the portfolio. |
| Exposure at default (EAD) | The <i>Exposure at Default (EAD)</i> is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest scheduled by contract. |
| Loss given default (LGD) | The <i>Loss Given Default (LGD)</i> is an estimate of the loss arising in the case where a default occurs at a given time. |

The Bank considers a credit exposure to have significantly increased since initial recognition if credit risk monitoring revealed a deterioration of a borrower's credit grade, or when asset restructuring has taken place. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

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Notes to the 2018 financial statements

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3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

The Bank considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes more than 90 days past due on its contractual payments.

Loans may be transferred from Stage 3 to Stage 2 in the absence of any impairment indicators and provided the borrower has fully settled the overdue amounts. Loans may be transferred to Stage 1 in the absence of any impairment indicators and provided the borrower has not delayed any payments at the reporting date and no amounts have been overdue by more than 30 days within a 12-month period.

The IFRS 9 methodology incorporates a prospective provisioning element (forward-looking adjustment), which is meant to cover the risks of the mono-sector portfolio exposed to the risks and implications of any macroeconomic changes.

The Bank calculates ECL on an individual basis for the following assets: all Stage 3 assets, the factoring portfolio, accounts receivable, treasury and interbank transactions (amounts due from banks, debt instruments at FVOCI). The Bank calculates ECL on a collective basis for all other classes of assets which it groups into smaller homogeneous portfolios, based on a combination of internal and external characteristics of the loans.

(c) Effect of transition to IFRS 9

The following sets out the impact of adopting IFRS 9 on the statement of financial position and retained earnings as at 1 January 2018, including the effect of replacing the IAS 39 incurred credit loss model with the IFRS 9 ECL model.

A reconciliation of the carrying amounts under IAS 39 and the balances reported under IFRS 9 as at 1 January 2018 is as follows:

| | IAS 39 measurement | | Reclassification | IFRS 9 measurement | |
|--|--------------------|-------------------|------------------|--------------------|----------------------------|
| | Category | Amount | | Amount | Category |
| Financial assets | | | | | |
| Cash and cash equivalents | L&R* | 7,513,681 | - | 7,513,681 | AC** |
| Obligatory reserve with the Bank of Russia | L&R | 390,249 | - | 390,249 | AC |
| Amounts due from credit institutions | L&R | - | - | - | AC |
| Derivative financial assets | FVPL | 205,946 | - | 205,946 | FVPL |
| Loans to customers | L&R | 66,619,003 | - | 66,619,003 | AC |
| Investment securities available for sale | AFS*** | 595,935 | - | 595,935 | FVOCI (equity instruments) |
| Other assets | L&R | 98,433 | - | 98,433 | AC |
| Non-financial assets | | | | | |
| Property and equipment | n/a | 15,973 | - | 15,973 | n/a |
| Intangible assets | n/a | 271,825 | - | 271,825 | n/a |
| Income tax | n/a | 22,008 | - | 22,008 | n/a |
| Deferred income tax assets | n/a | 1,130,974 | - | 1,130,974 | n/a |
| Total assets | | 76,864,026 | - | 76,864,026 | |
| Financial liabilities | | | | | |
| Amounts due to credit institutions | AC | 34,859,623 | - | 34,859,623 | AC |
| Debt securities issued | AC | 15,447,150 | - | 15,447,150 | AC |
| Derivative financial liabilities | FVPL | 1,582,363 | - | 1,582,363 | FVPL |
| Amounts due to customers | AC | 12,703,434 | - | 12,703,434 | AC |
| Other liabilities | AC | 1,724,034 | - | 1,724,034 | AC |
| Total liabilities | | 66,316,604 | - | 66,316,604 | |

* L&R: loans and receivables

** AC: amortized cost

*** AFS: available for sale

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Notes to the 2018 financial statements

(thousands of Russian rubles)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

The impact of transition to IFRS 9 on retained earnings is as follows:

| | Reserves and retained earnings |
|--|---------------------------------------|
| Closing balance under IAS 39 (31 December 2017) | 1,716,561 |
| Remeasurement on reclassifying financial assets at amortized cost to FVPL | - |
| Recognition of IFRS 9 ECL including those on instruments measured at FVOCI | - |
| Related deferred tax | - |
| | 1,716,561 |
| Opening balance under IFRS 9 (1 January 2018) | 1,716,561 |
| Total change in equity due to adopting IFRS 9 | - |

The following table reconciles the aggregate opening loss allowances for loans and securities under IAS 39 to the ECL allowances under IFRS 9.

| | Allowance for loan impairment under IAS 39 / IAS 37 at 31 December 2017 | Remeasurement | ECL under IFRS 9 at 1 January 2018 |
|--------------------------------------|--|----------------------|---|
| Allowance for impairment | | | |
| Loans to customers at amortized cost | 2,573,267 | - | 2,573,267 |
| | 2,573,267 | - | 2,573,267 |

IFRS 15 Revenue from Contracts with Customers

IFRS 15, issued in May 2014 and amended in April 2016, establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. However, the standard does not apply to revenue associated with financial instruments and leases, and therefore, does not impact the Bank's revenue such as interest revenue, net gains/(losses) on operations with investment securities or lease income, which are covered by IFRS 9 *Financial Instruments* and IAS 17 *Leases*. As a result, the Bank's income is not materially impacted by the adoption of this standard,

Prior to the adoption of IFRS 15, variable consideration was assessed based on historical information. In accordance with IFRS 15, revenue can only be recognized to the extent that it is highly probable that a significant reversal will not occur when the uncertainty associated with the variable consideration is subsequently resolved. The Bank applied the above requirement in estimating variable consideration compared to the amount previously included in the transaction price. The Bank analyzed the effect of this standard and identified no material effect from the application of IFRS 15 on retained earnings as at 1 January 2018.

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration

The Interpretation clarifies that, in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognizes the non-monetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, the entity shall determine a date of the transaction for each payment or receipt of the advance consideration. The Interpretation had no impact on the Bank's financial statements.

(thousands of Russian rubles)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

Amendments to IAS 40 Transfers of Investment Property

The amendments clarify when an entity should transfer property, including property under construction or development, into or out of investment property. The amendments state that a change in use occurs when property begins or ceases to comply with the definition of investment property and there is evidence of a change in use. Any change in management's intentions regarding the use of the property itself does not indicate a change in its use. The amendments had no impact on the Bank's financial statements.

IAS 28 Investments in Associates and Joint Ventures – clarification that measuring investees at fair value through profit or loss is an investment-by-investment choice

The amendments clarify that an entity that is a venture capital organization, or another qualifying entity, may elect to measure its investments in associates and joint ventures at fair value through profit or loss. This election is made separately for each investment at initial recognition. If the entity that is not an investment entity itself has an interest in an associate or joint venture that are investment entities, when applying the equity method, such an entity can retain the fair value measurement applied by its investment entity associate or joint venture to its interests in subsidiaries. This election is made separately for each investment entity associate or joint venture, at the later of the date on which: (a) the investment entity associate or joint venture is initially recognized; (b) the associate or joint venture becomes an investment entity; and (c) the investment entity associate or joint venture first becomes a parent. The amendments had no impact on the Bank's financial statements.

Financial assets

Initial recognition

The Bank recognizes an asset in its statement of financial position when it becomes party to the contractual provisions of the financial instrument.

The Bank classifies its financial assets at initial recognition.

Classification of financial assets

The Bank classifies its financial assets as subsequently measured at amortized cost, at fair value through other comprehensive income or at fair value through profit or loss, based on the following:

- (a) The Bank's business model for managing the financial assets, and
- (b) The financial asset's contractual cash flow characteristics (SPPI test).

The Bank measures a financial asset at amortized cost if both of the following conditions are met:

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

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

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

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

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

(thousands of Russian rubles)

3. Summary of accounting policies (continued)

Financial assets (continued)

Included in this category are the Bank's loans to individuals and legal entities, as the Bank does not expect its loan portfolios to be regularly sold without any deterioration in their credit quality. Gains and losses on such assets are recognized in profit or loss.

Debt instruments at FVOCI

Since 1 January 2018, the Bank has applied the new category under IFRS 9 of debt instruments measured at FVOCI when both of the following conditions are met:

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

The Bank includes its issued securities classified as available for sale within the FVOCI category, since the Bank plans to hold these assets not only to collect contractual cash flows, but also for the purpose of relatively frequent significant sales. After initial recognition, the Bank measures the securities at fair value recording the revaluation gains and losses in other comprehensive income until the investment is derecognized or until the investment is determined to be impaired. However, interest calculated using the effective interest rate method is recognized in profit or loss.

The Bank measures financial assets at fair value through profit or loss unless they are measured at amortized cost or FVOCI. For financial assets at fair value through profit or loss, the business model does not meet the SPPI criterion.

Financial instruments at fair value through profit or loss represent financial assets and liabilities, which are:

- ▶ Acquired principally for the purpose of reselling or repurchasing in the near term;
- ▶ Part of a portfolio of identified financial instruments that are managed as a single portfolio and for which there is evidence of a recent actual pattern of near-term profit-taking;
- ▶ Derivative financial instruments (except for derivative financial instruments designated as a hedging instrument in an effective hedge), or
- ▶ Classified by the Bank as financial instruments at fair value through profit or loss at initial recognition.

Financial assets and liabilities are classified by the Bank as financial assets and liabilities at fair value through profit or loss if:

- ▶ These assets or liabilities are managed and evaluated on a fair value basis;
- ▶ Designation of these assets and liabilities into the category of assets and liabilities at fair value through profit or loss eliminates or significantly reduces the mismatch which otherwise would arise, or
- ▶ The corresponding asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

Gains or losses on financial assets not held for trading are recognized in profit or loss.

Disposal of financial assets

The Bank derecognizes a financial asset in the statement of financial position where:

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

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

(thousands of Russian rubles)

3. Summary of accounting policies (continued)

Financial assets (continued)

Fair value measurement

The Bank measures financial instruments, which are recorded at FVPL and FVOCI, at fair value at each reporting date.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

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

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

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

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

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

For assets and liabilities that are recognized in the financial statements on a recurring basis, the Bank determines whether transfers should occur 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.

Reclassification of financial assets

Starting 1 January 2018, the Bank does not reclassify financial assets after their initial recognition, apart from exceptional cases when the Bank changes the business model for managing the financial assets (2017: the Bank did not reclassify financial assets).

Cash and cash equivalents

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

Obligatory cash balances with the Central Bank of the Russian Federation

The Bank cannot use obligatory cash balances with the Bank of Russia to finance its day-to-day operating activities.

(thousands of Russian rubles)

3. Summary of accounting policies (continued)

Financial assets (continued)

Derivative financial instruments

In the normal course of business, the Bank enters into various derivative financial instruments, including interest rate and cross-currency interest rate swaps. Such financial instruments are not held for trading and are entered into to hedge the Bank's liabilities denominated in foreign currency and fixed-rate liabilities, and 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 statement of profit or loss as net gains/(losses) from financial instruments at fair value through profit or loss for the period.

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

Under IAS 39, derivatives embedded in financial assets, liabilities and non-financial host contracts were treated as separate derivatives and recorded at fair value if they met the definition of a derivative (as defined above), their economic characteristics and risks were not closely related to those of the host contract, and the host contract was not itself held for trading or designated at FVPL. The embedded derivatives separated from the host contract were carried at fair value in the trading portfolio with changes in fair value recognized in the statement of profit or loss.

Since 1 January 2018, with the introduction of IFRS 9, the Bank has accounted in this way for derivatives embedded in financial liabilities and non-financial host contracts. Financial assets are classified based on the business model and SPPI assessments.

Hedge accounting

The objective of hedge accounting is to represent, in the financial statements, the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss (or other comprehensive income).

At its discretion, the Bank designates a hedging relationship between a hedging instrument and a hedged item.

Hedging instruments

The standard does not limit the circumstances in which the derivative may be designated as a hedging instrument, provided the hedge criteria are met.

Hedged items

A hedged item may be:

- (a) A separate asset, liability, firm commitment, highly probable forecast transaction or net investment in a foreign operation;
- (b) A group of assets, liabilities, firm commitments, highly probable forecast transactions or net investments in foreign operations with similar risk characteristics, or
- (c) For a portfolio hedge of interest rate risk only, a component of the portfolio of financial assets or financial liabilities with the same hedged risk.

(thousands of Russian rubles)

3. Summary of accounting policies (continued)

Financial assets (continued)

Hedge accounting

Two types of hedging relationships are determined:

- (a) Fair value hedge: a hedge of the exposure to changes in fair value of a recognized asset or liability or an unrecognized firm commitment, or an identified component of any such item, that is attributable to a particular risk and could affect profit or loss.
- (b) Cash flow hedge: a hedge of the exposure to variability in cash flows that:
 - (i) Is attributable to a particular risk associated with a recognized asset or liability (such as all or some future interest payments on variable-rate debt), or
 - (ii) Could affect profit or loss.

A hedging relationship qualifies for hedge accounting if, and only if, all of the following criteria are met:

- (a) At the inception of the hedging relationship, there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge. That documentation shall include the identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedge effectiveness to compensate for the exposure to changes in the fair value of the hedged item or cash flows associated with the risk being hedged.
- (b) Hedges are expected to compensate for changes in the fair value or cash flows associated with the risk being hedged in accordance with the originally documented risk management strategy for the related hedging relationship.
- (c) For cash flow hedges, future transactions being hedged must be highly probable, and such transactions must give rise to the exposure to variability in cash flows that could affect profit or loss.
- (d) The effectiveness of the hedge can be reliably measured, i.e. the fair value or cash flows of the hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured.
- (e) The hedge is assessed on an ongoing basis, and the effectiveness of the hedge is assessed for all reporting periods for which the hedge is designated.

Fair value hedges

As long as a fair value hedge meets the qualifying criteria (see above) during the period, it should be accounted for as follows:

- ▶ The gain or loss on the fair value revaluation of the hedging instrument is recognized in profit or loss.
- ▶ The gain or loss on the hedged item associated with the risk being hedged adjusts the carrying amount of the hedged item and is recognized in profit or loss. This method is applied where the hedged item is measured at cost.

A fair value hedge is discontinued when the following criteria are met:

- (a) A hedging instrument expires or is terminated, sold or exercised.

For this purpose, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such a replacement or rollover is part of the entity's documented hedging strategy.

- (b) The hedge ceases to meet the criteria for hedge accounting.
- (c) The entity revokes its previous designation of a hedge relationship.

Cash flow hedges

As long as a cash flow hedge meets the qualifying criteria (see above) during the period, it should be accounted for as follows:

- (a) The portion of the gain or loss on the hedging instrument that was determined to be an effective hedge should be recognized in other comprehensive income.
- (b) The ineffective portion of the gain or loss on the hedging instrument is recognized in profit or loss.

(thousands of Russian rubles)

3. Summary of accounting policies (continued)

Financial assets (continued)

In greater detail, cash flow hedges are accounted for as follows:

- (a) Separate components of equity associated with the hedged item are adjusted to the lower of the following (in absolute amounts):
 - (i) The cumulative gain or loss on the hedging instrument from inception of the hedge; and
 - (ii) The cumulative change in fair value (present value) of the hedged expected future cash flows from inception of the hedge.
- (b) Any remaining gain or loss on the hedging instrument or certain component of the hedging instrument (that is not an effective hedge) is recognized in profit or loss.

If a hedged forecast transaction subsequently results in the recognition of a financial asset or financial liability, the respective gain or loss recognized in other comprehensive income shall be removed from equity and recognized in profit or loss as a reclassification adjustment in the same period or periods during which the hedged expected future cash flows affect profit or loss (for example, in the periods when interest income or interest expense is recognized). However, if the entity expects that all or a portion of the loss recorded within other comprehensive income will not be recovered in one or more future periods, it shall reclassify the amount that is not expected to be recovered into profit or loss as a reclassification adjustment.

If a hedged forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, or a hedged forecast transaction for a non-financial asset or non-financial liability becomes a firm commitment to which fair value hedge accounting is applied, the entity shall:

- (a) Reclassify the related gain or loss recorded in other comprehensive income into profit or loss as a reclassification adjustment in the same period or periods during which the asset acquired or liability assumed affects profit or loss (for example, in the periods when the depreciation or cost or sales was recognized). However, if the entity expects that all or a portion of the loss recorded within other comprehensive income will not be recovered in one or more future periods, it shall transfer the amount that is not expected to be recovered from equity into profit or loss as a reclassification adjustment.
- (b) Remove the associated gain or loss recognized in other comprehensive income and include it in the initial cost or other carrying amount of the asset or liability.

A cash flow hedge is discontinued when the following criteria are met:

- (a) A hedging instrument expires or is terminated, sold or exercised. In this case, the cumulative gain or loss on the hedging instrument recorded in other comprehensive income from the period during which the hedge was effective shall continue to be recognized in equity as a separate item until the forecast transaction is completed. For the purpose of this paragraph, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such a replacement or rollover is part of the entity's documented hedging strategy.
- (b) The hedge ceases to meet the criteria for hedge accounting listed above. In this case, the cumulative gain or loss on the hedging instrument recorded in other comprehensive income from the period during which the hedge was effective shall continue to be recognized in equity as a separate item until the forecast transaction occurs.
- (c) The transaction is no longer expected to occur, in which case the cumulative gain or loss on the hedging instrument recorded in other comprehensive income from the period during which the hedge was effective shall be removed from equity and recognized in profit or loss as a reclassification adjustment. A future transaction that is no longer highly probable to occur may still be expected to occur.
- (d) The entity revokes its previous designation of a hedge relationship. For a hedged future transaction, the cumulative gain or loss on the hedging instrument recorded in other comprehensive income from the period during which the hedge was effective shall continue to be recognized in equity as a separate item until the transaction occurs or is no longer expected to occur. If the transaction is no longer expected to occur, the cumulative gain or loss recorded in other comprehensive income shall be removed from equity and recognized in profit or loss as a reclassification adjustment.

(thousands of Russian rubles)

3. Summary of accounting policies (continued)

Financial assets (continued)

Hedge effectiveness calculations

Hedge effectiveness assessment is based on the hypothetical derivative method (a variety of the dollar compensation method in IAS 39 IG F5.5).

Under this method, an ideal hypothetical derivative is determined that would be an ideal hedging instrument to hedge against particular risks. The fair value of the ideal hypothetical instrument shall be used instead of the net discounted value of future cash flows being hedged. It is that fair value that is compared to fair value changes in the actual hedging instrument.

The actual hedge effectiveness ratio shall be within the range of 80% to 125%.

Hedge effectiveness shall be assessed monthly at each reporting date.

IFRS 9 gives a choice to continue applying the hedge accounting requirements of IAS 39 instead of the new requirements set out in IFRS 9. The Bank decided not to apply IFRS 9 for hedge accounting when IFRS 9 becomes effective.

Offsetting

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to set off the recognized amounts and there is an intention to realize the asset and settle the liabilities simultaneously.

The right to set-off must not be contingent on a future event and should be enforceable in all the following circumstances:

- ▶ In the normal course of business;
- ▶ In the event of default, and
- ▶ In the event of insolvency or bankruptcy of an entity or any of its counterparties.

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

Restructured loans

Provided that an income source is available to the borrower, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions.

From 1 January 2018, the Bank derecognizes a financial asset, such as a loan to a customer, when the terms and conditions have been revised to the extent that, substantially, it becomes a new loan, with the difference recognized as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognized loans are classified as Stage 1 for ECL measurement purposes, unless the new loan is deemed to be POCI. When assessing whether or not to derecognize a loan to a customer, amongst others, the Bank considers the following factors:

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

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

For modifications not resulting in derecognition, the Bank also reassesses whether there has been a significant increase in credit risk or whether the assets should be classified as credit-impaired. In order for the restructured loan to be reclassified out of Stage 3, regular payments of more than an insignificant amount of principal or interest have been made during at least half of the probation period in accordance with the modified payment schedule.

(thousands of Russian rubles)

3. Summary of accounting policies (continued)

Financial assets (continued)

Impairment of financial assets under IAS 39

Before 1 January 2018, the Bank assessed at each reporting date whether there was any objective evidence that a financial asset or a group of financial assets was impaired. A financial asset or a group of financial assets was deemed to be impaired if, and only if, there was objective evidence of impairment as a result of one or more events that had occurred after the initial recognition of the asset (an incurred "loss event") and that loss event (or events) had an impact on the estimated future cash flows of the financial asset or the group of financial assets that could be reliably estimated. Evidence of impairment may have included indications that the borrower or a group of borrowers was experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they would enter bankruptcy or other financial reorganization and where observable data indicated that there was a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlated with defaults.

The Bank assessed whether objective evidence of impairment existed individually for financial assets that were individually significant, or collectively for financial assets that were not individually significant.

If there was objective evidence that an impairment loss had been incurred, the amount of the loss was measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that had not yet been incurred) discounted using the original effective interest rate, or, for financial assets available for sale, as the difference between the cost of the investment and its fair value. The carrying amount of the asset was reduced and the amount of the loss was recognized in profit or loss. Interest revenue continued to be accrued on the reduced carrying amount based on the original effective interest rate of the asset, or, for financial assets available for sale, using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. Assets together with the associated allowance were written off when there was no realistic prospect of future recovery and all collateral had been realized or transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss decreased because of an event occurring after the impairment had been recognized, the previously recognized impairment loss was reversed in the statement of profit or loss, except for equity investments available for sale, for which the increase in their fair value after impairment was recognized in other comprehensive income.

For the purpose of a collective evaluation of impairment, financial assets were grouped on the basis of the Bank's internal credit grading system that considered 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 were collectively evaluated for impairment were estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. The historical loss experience was adjusted on the basis of current observable data to reflect the effects of current conditions that had not affected the years on which the historical loss experience was based and to remove the effects of conditions in the historical periods that did not exist currently. Estimates of changes in future cash flows reflected changes in observable data from period to period (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that were indicative of incurred losses or their magnitude). The methodology and assumptions used to estimate future cash flows were reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Information on impairment assessment under IFRS 9 is presented in Note 17.

Non-financial assets

Other non-financial assets, excluding deferred taxes, are assessed for any indications of impairment at each reporting date.

The recoverable amount of non-financial assets is the greater of their fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Impairment losses in respect of non-financial assets are recognized in profit or loss and reversed only if there has been a change in the estimates used to determine the recoverable amount. Any impairment loss is only reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

(thousands of Russian rubles)

3. Summary of accounting policies (continued)

Financial liabilities

Financial liabilities are recorded in the Bank's statement of financial position when the Bank becomes a party to the contract for the respective financial instrument.

Initial recognition

The Bank classifies all financial liabilities as subsequently measured at amortized cost, except:

- (a) Financial liabilities at fair value through profit or loss (the Bank includes derivative financial instruments in this category);
- (b) Financial liabilities arising when the transfer of a financial asset does not qualify for derecognition or the principle of accounting for continuing involvement is applied (not applicable to the Bank);
- (c) Financial guarantee contracts (not applicable to the Bank);
- (d) Loan commitments at below-market interest rates (not applicable to the Bank);
- (e) Contingent consideration recorded by the acquirer upon the business combination (not applicable to the Bank).

Included in the Bank's financial liabilities at amortized cost are amounts due to credit institutions, amounts due to customers, subordinated debt and debt securities issued. After initial recognition, borrowings are subsequently recorded at amortized cost using the effective interest rate method. Gains and losses are recognized in profit or loss when the liabilities are derecognized, as well as through the amortization process.

Included in the Bank's financial liabilities at amortized cost are debt securities issued, i.e. bonds. Pursuant to Article 2 of Federal Law No. 39-FZ *On the Securities Market* of 22 April 1996, circulation of securities shall mean the conclusion of civil transactions which entail the transfer of ownership rights to securities. Thus, securities mature within a period from the moment they originate as objects of civil rights, during which parties to civil transactions may conclude transactions or perform other legal acts therewith. Debt securities issued by the Bank are recorded at their nominal cost, whether upon the initial placement or sale in the secondary market.

Reclassification of liabilities

Financial liabilities are not reclassified (the Bank did not reclassify its financial liabilities in 2017).

Disposal of financial liabilities

A financial liability is derecognized when it is discharged or canceled or expires.

Where an existing financial liability is replaced with 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 profit or loss.

Operating leases

Where the Bank is a lessee under lease agreements where the lessor retains substantially all the risks and benefits of ownership of the assets, such leases are classified as operating leases. Leased assets are not recognized in the financial statements and lease expenses are recognized in profit or loss on a straight-line basis over the lease period.

Where the operating lease terminates prior to the expiration of the lease term, any fines and forfeits due to the lessor are expensed in the period when such an operating lease was terminated.

Translation of the original Russian version

(thousands of Russian rubles)

3. Summary of accounting policies (continued)

Taxation

The current income tax expense is calculated in accordance with the regulations of the Russian Federation.

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 amounts 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.

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

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Russia also has various operating taxes that are assessed on the Bank's activities. These taxes are recorded as a component of other operating expenses.

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 equipment when that cost is incurred if the recognition criteria are met.

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

Depreciation of property and equipment begins when they become available for use. Depreciation is accrued on a straight-line basis over the following estimated useful lives:

| <i>Property and equipment</i> | <i>Depreciation period</i> |
|--|----------------------------|
| Furniture | 5-7 years |
| Equipment | 2-5 years |
| Computer equipment | 2 years |
| Capital investments in leased property and equipment | 3-6 years |
| Light vehicles | 3 years |
| Other property and equipment | 3-5 years |

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

Costs related to current and capital repairs are charged when incurred and included in other operating expenses unless they qualify for capitalization.

An item of property and equipment is derecognized upon sale or when no future economic benefits are expected from its continuing use. Gains or losses on sale or other disposal of property and equipment are determined as the difference between the sale price and the carrying amount of property and equipment and are recognized in profit or loss.

(thousands of Russian rubles)

3. Summary of accounting policies (continued)

Intangible assets and goodwill

Intangible assets other than goodwill include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses. Amortization is accrued on a straight-line basis over the useful life of an intangible asset. The useful lives of intangible assets are assessed to be either finite or indefinite. At present, the useful life of intangible assets with finite useful lives is estimated as not exceeding 5 years.

An intangible asset is derecognized upon sale or when no future economic benefits are expected from its use or disposal. Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognized in profit or loss when the asset is derecognized.

Collateral

The Bank obtains collateral against customers' obligations where necessary. Collateral is generally the pledge of the customer's assets entitling the Bank to claim such assets with regard to the customers' current and future obligations.

Other provisions

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

Pension obligations and other employee benefits

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

Share capital

Share capital

Ordinary shares are classified as equity. External costs directly attributable to the issue of new shares 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 recognized as share premium (additional paid-in capital).

Dividends

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

Contingencies

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

(thousands of Russian rubles)

3. Summary of accounting policies (continued)

Recognition of income and expenses

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

Interest and similar income and expense

From 1 January 2018, the Bank calculates interest revenue on debt financial assets measured at amortized cost or at FVOCI by applying the effective interest rate to the gross carrying amount of financial assets other than credit-impaired assets (before 1 January 2018: by applying the effective interest rate to the amortized cost of financial assets). The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in the carrying amount is recorded as interest revenue 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 recognized using the original effective interest rate applied to the new carrying amount.

Fee and commission income

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

Fee and commission income earned from services that are provided over a certain period of time

Fees earned for the provision of services over a period of time are accrued over that period as respective performance obligations are satisfied. These fees include commission income and asset management, custody and other management and advisory fees. Loan commitment fees for loans that are likely to be drawn down and other credit-related fees are deferred (together with any incremental costs) and recognized as an adjustment to the effective interest rate on the loan.

Fee and commission income from providing transaction services

Fees arising from negotiating or participating in the negotiation of a transaction for a third party – such as where the Bank's performance obligation is the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses – are recognized on completion of the underlying transaction. Fees or components of fees that are linked to certain performance obligations are recognized after fulfilling the corresponding criteria. When the contract provides for a variable consideration, fee and commission income is only recognized to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur until the uncertainty associated with the variable consideration is subsequently resolved.

Foreign currency translation

The financial statements are presented in Russian rubles, which are the Bank's functional and presentation currency. Transactions in foreign currencies are translated into the functional currency at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the presentation currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation are recognized in profit or loss as gains/losses from translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the rate of exchange ruling at the date of the initial transaction. Differences between the contractual exchange rate of a transaction in a foreign currency and the exchange rate of the Bank of Russia on the date of the transaction are included in profit or loss.

The official exchange rates of the Bank of Russia at 31 December 2018 and 31 December 2017 were RUB 69.4706 and RUB 57.6002 to 1 USD, respectively.

The official exchange rates of the Bank of Russia at 31 December 2018 and 31 December 2017 were RUB 79.4605 and RUB 68.8668 to 1 EUR, respectively.

The official exchange rates of the Bank of Russia at 31 December 2018 and 31 December 2017 were RUB 62.9976 and RUB 51.1479 to 100 JPY, respectively.

(thousands of Russian rubles)

3. Summary of accounting policies (continued)

Government grants

Since 2013, the Bank has participated in a government-sponsored program launched on 3 December 2012 by the Government of the Russian Federation for a partial reimbursement of interest income on loans issued to individuals for the purchase of Russian-produced cars.

Since 2017, the Bank has participated in government lending programs (My First Car, Family Car) providing for an additional discount for the initial installment of 10% of the cost of the purchased car.

All the government grant programs were closed as at 31 December 2018. Income for 2013-18 from government lending programs for subsidizing loan interest rates was recorded within interest income.

Standards issued but not yet effective

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

IFRS 16 Leases

IFRS 16 was issued in January 2016 and replaces IAS 17 *Leases*, IFRIC 4 *Determining Whether an Arrangement Contains a Lease*, SIC 15 *Operating Leases – Incentives* and SIC 27 *Evaluating the Substance of Transactions in the Legal Form of a Lease*. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard provides for two types of disclosure exemptions for lessees: for leases of 'low-value' assets (for example, personal computers) and 'short-term' leases (e.g. leases expiring in 12 months or less). At the inception of the lease, the lessee will recognize a liability to make lease payments (i.e. a lease liability) and an asset granting the right to use an underlying asset over the lease term (i.e. a right-of-use asset). The lessees will recognize the interest expense related to the lease liability separately from the amortization expense related to the right-of-use asset.

The lessees will also remeasure the lease liability on occurrence of a certain event (e.g. a change in lease terms or future lease payments resulting from a change in the index or rate used to determine those payments). In most cases, a lessee will account for the amount of the remeasured lease liability as an adjustment to the right-of-use asset.

The accounting treatment for the lessor under IFRS 16 remains almost unchanged from the existing requirements of IAS 17. Lessors will continue to classify all leases using the same classification principles as in IAS 17 and distinguish between two types of leases: operating and finance leases.

IFRS 16, which becomes effective for annual periods beginning on 1 January 2019, also requires lessees and lessors to make more extensive disclosures than under IAS 17.

The Bank plans to adopt IFRS 16 retrospectively with the cumulative effect of initially applying IFRS 16 recognized at the date of initial application. The Bank will apply the standard to contracts that were previously identified as leases applying IAS 17 and IFRIC 4. The Bank will therefore not apply the standard to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4.

The Bank will use the exemptions proposed by the standard for lease contracts that expire within 12 months from the date of initial application, and lease contracts for which the underlying asset is of low value. The Bank has leases of certain office equipment (i.e., personal computers, printing and photocopying machines) that are considered of low value.

The Bank plans to adopt the new standard on 1 January 2019 and is now in the process of quantifying the effect of adopting IFRS 16; however, no reasonable estimate of this effect is yet available.

(thousands of Russian rubles)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

IFRS 17 Insurance Contracts

In May 2017, the IASB issued IFRS 17 *Insurance Contracts* (IFRS 17), a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, IFRS 17 will replace IFRS 4 *Insurance Contracts* (IFRS 4) that was issued in 2005. IFRS 17 applies to all types of insurance contracts (i.e., life, non-life, direct insurance and reinsurance), regardless of the type of entity that issues them, as well as to certain guarantees and financial instruments with discretionary participation features. A few scope exceptions will apply. The overall objective of IFRS 17 is to provide an accounting model for insurance contracts that is more useful and consistent for insurers. In contrast to the requirements in IFRS 4, which are largely based on grandfathering local accounting policies, IFRS 17 provides a comprehensive model for insurance contracts, covering all relevant accounting aspects. The core of IFRS 17 is the general model, supplemented by:

- ▶ A specific adaptation for contracts with direct participation features (the variable fee approach);
- ▶ A simplified approach (the premium allocation approach) mainly for short-duration contracts.

IFRS 17 is effective for reporting periods beginning on or after 1 January 2021, with comparative figures required. Early application is permitted provided the entity also applies IFRS 9 and IFRS 15 on or before the date it first applies IFRS 17. This standard is not applicable to the Bank.

IFRIC Interpretation 23 Uncertainty over Income Tax Treatments

The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12 and does not apply to taxes or levies outside the scope of IAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments. The Interpretation specifically addresses the following:

- ▶ Whether an entity considers uncertain tax treatments separately;
- ▶ The assumptions an entity makes about the examination of tax treatments by taxation authorities;
- ▶ How an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates;
- ▶ How an entity considers changes in facts and circumstances.

An entity must determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed. The Interpretation is effective for annual periods beginning on or after 1 January 2019. The Bank intends to adopt this Interpretation when it becomes effective. Since the Bank operates in a complex tax environment, applying the Interpretation may affect its financial statements. In addition, the Bank may need to establish processes and procedures to obtain information that is necessary to apply the Interpretation on a timely basis.

Amendments to IFRS 9: Prepayment Features with Negative Compensation

Under IFRS 9, a debt instrument can be measured at amortized cost or at fair value through other comprehensive income provided that the contractual cash flows are 'solely payments of principal and interest on the principal amount outstanding' (the SPPI criterion) and the instrument is held within the appropriate business model for that classification. The amendments to IFRS 9 clarify that a financial asset passes the SPPI criterion regardless of the event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract.

The amendments should be applied retrospectively and are effective for annual periods beginning on 1 January 2019, with early application permitted. These amendments have no impact on the financial statements of the Bank.

Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The amendments address the inconsistency between the requirements in IFRS 10 and IAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or a joint venture. The amendments clarify that gains or losses arising as a result of the sale or contribution of assets that constitute a business, as defined in IFRS 3, in a transaction between an investor and its associate or joint venture are recognized in full. However, any gain or loss resulting from the sale or contribution of assets that do not constitute a business is recognized only to the extent of unrelated investors' interests in the associate or joint venture. The IASB has deferred the effective date of these amendments indefinitely, but an entity that early adopts the amendments must apply them prospectively. The Bank will apply these amendments when they become effective.

(thousands of Russian rubles)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

Amendments to IAS 19: Plan Amendment, Curtailment or Settlement

The amendments to IAS 19 address the accounting when a plan amendment, curtailment or settlement occurs during a reporting period. The amendments specify that when a plan amendment, curtailment or settlement occurs during the annual reporting period, an entity is required to:

- ▶ Determine current service cost for the remainder of the period after the plan amendment, curtailment or settlement using the actuarial assumptions used to remeasure the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event.
- ▶ Determine net interest for the remainder of the period after the plan amendment, curtailment or settlement using the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event, and the discount rate used to remeasure that net defined benefit liability (asset).

The amendments also clarify that an entity first determines any past service cost, or a gain or loss on settlement, without considering the effect of the asset ceiling. This amount is recognized in profit or loss. An entity then determines the effect of the asset ceiling after the plan amendment, curtailment or settlement. Any change in that effect, excluding amounts included in the net interest, is recognized in other comprehensive income.

The amendments apply to plan amendments, curtailments, or settlements occurring on or after the beginning of the first annual reporting period that begins on or after 1 January 2019, with early application permitted. These amendments will apply only to any future plan amendments, curtailments, or settlements of the Bank.

Amendments to IAS 28: Long-Term Interests in Associates and Joint Ventures

The amendments clarify that an entity applies IFRS 9 to long-term interests in an associate or joint venture to which the equity method is not applied but that, in substance, form part of the net investment in the associate or joint venture (long-term interests). This clarification is relevant because it implies that the expected credit loss model in IFRS 9 applies to such long-term interests.

The amendments also clarify that, in applying IFRS 9, an entity does not take account of any losses of the associate or joint venture, or any impairment losses on the net investment recognized as adjustments to the net investment in the associate or joint venture that arise from applying IAS 28 *Investments in Associates and Joint Ventures*.

The amendments should be applied retrospectively and are effective for annual periods beginning on or after 1 January 2019, with early application permitted. Since the Bank does not have such long-term interests in its associates or joint ventures, the amendments will not have any impact on its financial statements.

Annual improvements 2015-2017 cycle (issued in December 2017)

These improvements include:

IFRS 3 Business Combinations

The amendments clarify that, when an entity obtains control of a business that is a joint operation, it should apply the requirements for a business combination achieved in stages, including remeasuring previously held interests in the assets and liabilities of the joint operation at fair value. In doing so, the acquirer should remeasure its entire previously held interest in the joint operation.

An entity should apply those amendments to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2019, with early application permitted. Currently, these amendments are not applicable to the Bank; however, they can be applicable to future transactions.

IFRS 11 Joint Arrangements

A party that participates in, but does not have joint control of, a joint operation might obtain joint control of the joint operation in which the activity of the joint operation constitutes a business as defined in IFRS 3. The amendments clarify that the previously held interests in that joint operation are not remeasured.

An entity should apply those amendments to transactions in which it obtains joint control on or after the beginning of the first annual reporting period beginning on or after 1 January 2019, with early application permitted. Currently, these amendments are not applicable to the Bank; however, they can be applicable to future transactions.

(thousands of Russian rubles)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

IAS 12 Income Taxes

The amendments clarify that the income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, an entity should recognize the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognized those past transactions or events.

An entity should apply those amendments to annual reporting periods beginning on or after 1 January 2019, with early application permitted. When an entity first applies those amendments, it should apply them to the income tax consequences of dividends recognized on or after the beginning of the earliest comparative period. Since the Bank's current practice is in line with these amendments, the Bank does not expect any effect on its financial statements.

IAS 23 Borrowing Costs

The amendments clarify that an entity should treat as part of general borrowings any borrowing originally made to develop a qualifying asset when substantially all of the activities necessary to prepare that asset for its intended use or sale are complete.

An entity should apply those amendments to borrowing costs incurred on or after the beginning of the annual reporting period in which the entity first applies those amendments. An entity should apply those amendments to annual reporting periods beginning on or after 1 January 2019, with early application permitted. Since the Bank's current practice is in line with these amendments, the Bank does not expect any effect on its financial statements.

4. Significant accounting judgments and estimates

Estimation uncertainty

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

Fair values of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. More details are provided in Note 20.

Expected credit losses/impairment losses on financial assets

The measurement of impairment losses both under IFRS 9 and IAS 39 across all categories of financial assets requires judgment, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining ECL/impairment losses and assessing a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances. The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgments and estimates include:

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

The amount of the allowance recognized in the statement of financial position at 31 December 2018 was RUB 3,273,741 thousand (2017: RUB 2,573,267). More details are provided in Notes 7 and 17.

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4. Significant accounting judgments and estimates (continued)

Deferred income tax asset recognition

The recognized deferred income tax asset represents income taxes recoverable through future deductions from taxable profits, and is recorded in the statement of financial position.

The deferred income tax asset is recorded to the extent that the realization of the related tax benefit is probable. The future taxable profits and the amount of tax benefits that are forecast probable in the future are based on management's estimates.

The Bank recognized a tax asset equal to its estimated sufficient taxable profit available in the foreseeable future to realize the deferred tax asset in accordance with the Bank's business plan which is adjusted for expected adverse economic changes in the market where the Bank operates.

5. Cash and cash equivalents

Cash and cash equivalents comprise:

| | 31 December 2018 | 31 December 2017 |
|--|-----------------------------|-----------------------------|
| Cash on hand | 10 | 10 |
| Current accounts with the Bank of Russia | 1,141,839 | 1,901,740 |
| Balances on nostro accounts with other credit institutions | 47,129 | 109,657 |
| Term deposits (up to 90 days) with the Bank of Russia | 6,403,710 | 5,002,082 |
| Term deposits (up to 90 days) with other banks | 2,000,591 | 500,192 |
| Total cash and cash equivalents | 9,593,279 | 7,513,681 |

Cash and cash equivalents are neither impaired nor past due.

As at 31 December 2018, the Bank had balances with two counterparties (2017: two counterparties).

As at 31 December 2018, total balances of deposits placed with each counterparty comprised 66.75% and 20.86% of the total cash and cash equivalents, respectively (2017: 66.57% and 6.66% of the total cash and cash equivalents, respectively).

6. Derivative financial instruments

The Bank does not enter into derivative financial instruments for trading purposes. Derivative financial instruments represent hedges. The table below shows the fair values of derivative financial instruments recorded in the financial statements as assets or liabilities.

The Bank measures derivative financial instruments using valuation techniques based on market interest rates. Significant changes in the specified variables may produce materially different estimates of fair values.

Below are the fair values of derivative financial instruments recognized in assets or liabilities and their nominal values as at 31 December 2018:

| | 31 December 2018 | | | |
|---|-------------------------|---------------------|-------------------|--------------------|
| | Nominal value | | Fair value | |
| | Assets | Liabilities | Assets | Liabilities |
| Cross-currency contracts | | | | |
| Swaps | - | - | - | - |
| Cross-currency interest rate contracts | | | | |
| Swaps | 13,111,414 | (14,691,431) | 1,082,686 | (164,191) |
| Interest rate contracts | | | | |
| Swaps | 1,813,348 | (556,132) | - | (115,488) |
| | 14,924,762 | (15,247,563) | 1,082,686 | (279,679) |

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6. Derivative financial instruments (continued)

Below are the fair values of derivative financial instruments recognized in assets or liabilities and their nominal values as at 31 December 2017:

| | 31 December 2017 | | | |
|---|-------------------------|---------------------|-------------------|--------------------|
| | Nominal value | | Fair value | |
| | Assets | Liabilities | Assets | Liabilities |
| Cross-currency contracts | | | | |
| Swaps | 522,271 | (757,607) | - | (221,701) |
| Cross-currency interest rate contracts | | | | |
| Swaps | 15,680,140 | (17,569,532) | 191,073 | (1,360,662) |
| Interest rate contracts | | | | |
| Swaps | 635,032 | (698,160) | 14,873 | - |
| | 16,837,443 | (19,025,299) | 205,946 | (1,582,363) |

As at 31 December 2018, the Bank had positions in cross-currency interest rate swaps, which are contractual agreements stipulating that on a fixed date a party shall pay a fixed or floating interest on a certain amount in RUB to the other party and shall receive a payment of the interest at a floating or fixed rate in foreign currency, and non-deliverable interest rate swaps, which are contractual agreements that on a fixed date a party shall pay a fixed interest on a certain amount in RUB to the other party and shall receive a payment of the interest at a floating rate in RUB.

As at 31 December 2018, the Bank entered into derivative transactions with four counterparties. As at 31 December 2018, total balances with all counterparties were as follows: 4% with a non-resident counterparty and 96% with resident counterparties.

As at 31 December 2017, the Bank entered into derivative transactions with five counterparties. As at 31 December 2017, total balances with all counterparties were as follows: 50% with non-resident counterparties and 50% with a resident counterparty.

To manage exposure to currency and interest rate risks, the Bank continued to apply hedge accounting in 2018 in relation to all derivative transactions that were concluded after 1 January 2015 and passed the hedge effectiveness test.

The table below shows non-trading derivative financial instruments, by hedge, included in assets or liabilities as at 31 December 2018 and 2017, respectively.

| | 31 December 2018 | |
|---|-------------------------|--------------------|
| | Assets | Liabilities |
| Hedging instruments | | |
| Cross-currency contracts | - | - |
| Fair value hedges | - | - |
| Cash flow hedges | - | - |
| Cross-currency interest rate contracts | 875,558 | (164,191) |
| Fair value hedges | - | (164,191) |
| Cash flow hedges | 875,558 | - |
| Interest rate contracts | - | (115,488) |
| Fair value hedges | - | (115,488) |
| Cash flow hedges | - | - |
| Non-hedging derivatives | 207,128 | - |
| Total | 1,082,686 | (279,679) |

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6. Derivative financial instruments (continued)

| | 31 December 2017 | |
|---|-------------------------|--------------------|
| | Assets | Liabilities |
| Hedging instruments | | |
| Cross-currency contracts | - | (221,701) |
| Fair value hedges | - | - |
| Cash flow hedges | - | (221,701) |
| Cross-currency interest rate contracts | 191,073 | (1,353,932) |
| Fair value hedges | - | (400,287) |
| Cash flow hedges | 191,073 | (953,645) |
| Interest rate contracts | 14,873 | - |
| Fair value hedges | - | - |
| Cash flow hedges | 14,873 | - |
| Non-hedging derivatives | - | (6,730) |
| Total | 205,946 | (1,582,363) |

Non-hedging derivatives comprise derivative transactions that have not passed the hedge effectiveness test.

Cash flow hedges:

- ▶ The expected period of cash flow movements, including when they are expected to affect profit or loss, is from January 2018 through March 2019.
- ▶ During 2018, RUB 381,526 thousand were recognized in other comprehensive income, RUB 281,496 thousand were reclassified to profit or loss with RUB (409,788) thousand included in interest expense on amounts due to banks. Translation differences amounted to RUB 691,286 thousand.
- ▶ During 2017, RUB (482,853) thousand were recognized in other comprehensive income, RUB (574,843) thousand were reclassified to profit or loss with RUB (1,589,407) thousand included in interest expense on amounts due to banks. Translation differences amounted to RUB 1,014,564 thousand.

Fair value hedges:

- ▶ During 2018, RUB 632,118 thousand were recognized in profit or loss, including RUB 1,180,578 thousand of translation differences, RUB (417,972) thousand of interest expense on amounts due to banks and RUB (130,488) thousand of the ineffective portion.
- ▶ During 2017, RUB (243,127) thousand were recognized in profit or loss, including RUB (27,380) thousand of translation differences, RUB (239,512) thousand of interest expense on amounts due to banks and RUB 23,765 thousand of the ineffective portion.

7. Loans to customers

Loans to customers comprise:

| | 31 December 2018 | 31 December 2017 |
|--|-----------------------------|-----------------------------|
| Loans to legal entities | | |
| Factoring | 32,512,088 | 21,574,836 |
| Total gross loans to legal entities | 32,512,088 | 21,574,836 |
| Loans to individuals | | |
| Car loans | 49,849,841 | 47,617,434 |
| Total gross loans to individuals | 49,849,841 | 47,617,434 |
| Allowance for impairment | (3,273,741) | (2,573,267) |
| Total loans to customers | 79,088,188 | 66,619,003 |

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7. Loans to customers (continued)

Movements in the gross carrying amount of loans to legal entities measured at amortized cost for the year ended 31 December 2018 are provided below.

| Loans to legal entities | Stage 1 | Stage 2 | Stage 3 | Total |
|---|-------------------|------------------|----------------|----------------------|
| Balance at 1 January 2018 | 18,804,576 | 2,286,702 | 483,559 | 21,574,836 |
| Transfers to Stage 1 | 1,995 | (1,647) | (348) | - |
| Transfers to Stage 2 | (1,868) | 1,868 | - | - |
| Transfers to Stage 3 | - | (1,570) | 1,570 | - |
| Assets recognized during the period | 214,702,949 | 49,046,436 | - | 263,749,386 |
| Assets disposed or redeemed (except for write-offs) | (205,342,071) | (46,989,423) | (489,293) | (252,819,787) |
| Write-offs | - | - | (7,653) | (7,653) |
| Balance at 31 December 2018 | 28,165,582 | 4,346,506 | - | 32,512,088 |

Movements in the gross carrying amount of loans to individuals measured at amortized cost for the year ended 31 December 2018 are provided below.

| Loans to individuals | Stage 1 | Stage 2 | Stage 3 | Total |
|---|-------------------|------------------|----------------|---------------------|
| Balance at 1 January 2018 | 45,757,821 | 1,154,408 | 705,205 | 47,617,434 |
| Transfers to Stage 1 | 5,874 | (5,874) | - | - |
| Transfers to Stage 2 | (15,003) | 15,003 | - | - |
| Transfers to Stage 3 | (262,257) | (214,647) | 476,904 | - |
| Assets recognized during the period | 29,040,123 | 33,171 | - | 29,073,293 |
| Assets disposed or redeemed (except for write-offs) | (26,609,294) | (22,096) | (281,185) | (29,868,383) |
| Write-offs | - | - | (27,497) | (27,497) |
| Balance at 31 December 2018 | 47,917,263 | 1,004,157 | 928,421 | 49,849,840 |

Loans to individuals are carried with the discounted value of future cash flows from Minpromtorg related to loans of RUB 988,274 thousand issued under state programs in 2015-18 (2015-17: RUB 2,142,349 thousand).

Movements in ECL (expected credit losses) on loans to legal entities measured at amortized cost for the year ended 31 December 2018 are provided below.

| Loans to legal entities | Stage 1 | Stage 2 | Stage 3 | Total |
|--|----------------|----------------|----------------|------------------|
| Balance at 1 January 2018 | 738,139 | 472,364 | 151,781 | 1,362,284 |
| Transfers to Stage 1 | 36,224 | (35,276) | (948) | - |
| Transfers to Stage 2 | (121,030) | 121,030 | - | - |
| Transfers to Stage 3 | - | - | - | - |
| Charge/(reversal) for the period of expected credit losses | 98,995 | 292,730 | (143,180) | 248,545 |
| Write-offs | - | - | (7,653) | (7,653) |
| Balance at 31 December 2018 | 752,328 | 850,548 | - | 1,603,176 |

Movements in ECL (expected credit losses) on loans to individuals measured at amortized cost for the year ended 31 December 2018 are provided below.

| Loans to individuals | Stage 1 | Stage 2 | Stage 3 | Total |
|--|----------------|----------------|----------------|------------------|
| Balance at 1 January 2018 | 239,906 | 315,088 | 655,989 | 1,210,983 |
| Transfers to Stage 1 | 33 | (33) | - | - |
| Transfers to Stage 2 | (7,347) | 7,347 | - | - |
| Transfers to Stage 3 | (2,029) | - | 2,029 | - |
| Charge/(reversal) for the period of expected credit losses | 348,422 | (28,348) | 157,605 | 487,679 |
| Write-offs | - | - | (27,497) | (27,497) |
| Balance at 31 December 2018 | 578,985 | 294,054 | 798,126 | 1,671,165 |

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7. Loans to customers (continued)

A reconciliation of the allowance for impairment of loans, by class, for the year ended 31 December 2017 is provided below.

| | <i>Loans to legal entities</i> | <i>Loans to individuals</i> | <i>Total</i> |
|---|------------------------------------|---------------------------------|------------------|
| 1 January 2017 | 819,988 | 761,887 | 1,581,875 |
| Charge | 542,296 | 457,682 | 999,978 |
| Write-off against allowance | - | (8,586) | (8,586) |
| 31 December 2017 | 1,362,284 | 1,210,983 | 2,573,267 |
| Allowance for impairment on a collective basis | 1,343,025 | 622,918 | 1,965,943 |
| Allowance for impairment on an individual basis | 19,259 | 588,065 | 607,324 |

Key assumptions and judgments in loan impairment assessment

A loan is impaired as a result of one or more events that occurred after the initial recognition of a loan and had an impact on the estimated future cash flows from the loan that can be reliably estimated. There is no direct objective evidence of impairment for loans not individually impaired.

Objective evidence of impairment of loans to legal entities and individuals is in particular associated with the following:

- ▶ At least one of the loan-related payments is over 90 days overdue (fully or partially).
- ▶ The Client is subject to legal actions and complaints as a defendant in cases related to unsettled loans with the Bank.
- ▶ The loans of the Client were written off from the Bank's balance sheet.
- ▶ The Client's debt was restructured and the outstanding amount was reduced through forgiving or postponement of the principle amount and/or interest and/or commission payment (as appropriate).
- ▶ The Client is subject to the insolvency procedure (liquidation/bankruptcy).

The Bank determines the impairment allowance for loans to legal entities based on the following major assumptions:

- ▶ Financial position of the client and its ability to fulfill its obligations to the Bank.
- ▶ Whether the collateral considered in the future cash flows assessment may be sold on the market.

Modified and restructured loans

As at 31 December 2018 and during the year then ended, no significant modifications occurred to loans to customers, as restructured loans did not result in any material movements in cash flows and the net loss/gain on loans restructuring was insignificant. Loans restructured by the Bank are not material to the total portfolio of loans to individuals.

As at 31 December 2018, 117 restructured loans to individuals, with a carrying amount of RUB 38,900 thousand, are recognized on the balance sheet.

As at 31 December 2017, 88 restructured loans to individuals, with a carrying amount of RUB 33,485 thousand, are recognized on the balance sheet.

Collateral and other credit enhancements

The amount and type of collateral required by the Bank 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:

- ▶ Corporate lending: charges over vehicles, charges over spare parts, bank guarantees, corporate or personal sureties, the rights of claim under corporate deposits.
- ▶ Retail lending: charges over vehicles, personal sureties.

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7. Loans to customers (continued)

Collateral and other credit enhancements (continued)

The main purpose of collateral agreements is to reduce possible loan losses when settling obligations under credit agreements.

For loans secured by several types of collateral, all types of collateral at their contractual value are listed.

Below are the total values of collateral, by group of loans to customers and type of collateral, as at 31 December 2018 and 31 December 2017, respectively.

| | <i>Contractual amount of collateral (as at the reporting date)</i> | <i>Carrying amount of loans to customers</i> | <i>Contractual amount of collateral (as at the reporting date)</i> | <i>Carrying amount of loans to customers</i> |
|--------------------------------------|--|--|--|--|
| | 31 December 2018 | | 31 December 2017 | |
| Loans to legal entities | | | | |
| - Vehicles | 30,689,943 | - | 20,091,017 | - |
| - Guarantees of credit institutions | 1,912,280 | - | 899,936 | - |
| - Pledge of goods in turnover | 212,200 | - | 108,000 | - |
| - Corporate sureties | 68,176,198 | - | 49,723,894 | - |
| - Personal sureties | 38,724,404 | - | 19,089,385 | - |
| Total loans to legal entities | 139,715,025 | 32,512,088 | 89,854,152 | 21,574,836 |
| Loans to individuals | | | | |
| - Vehicles | 105,772,648 | - | 105,209,092 | - |
| - Personal sureties | 18,516 | - | 69,408 | - |
| Total loans to individuals | 105,791,164 | 49,849,841 | 105,278,500 | 47,617,434 |
| Total loans to customers | 245,506,189 | 82,361,929 | 195,132,652 | 69,192,270 |

Concentration of loans to customers

As at 31 December 2018, the concentration of loans issued to the ten largest groups of interrelated parties amounted to RUB 13,218,099 thousand (16.05% of the total loan portfolio). An allowance of RUB 661,903 thousand was charged against these loans.

As at 31 December 2017, the concentration of loans issued to the ten largest groups of interrelated parties amounted to RUB 10,534,412 thousand (15.22% of the total loan portfolio). An allowance of RUB 369,151 thousand was charged against these loans.

8. Investment securities

Investment securities comprise:

| | 31 December 2018 | 31 December 2017 |
|---|-----------------------------|-----------------------------|
| Debt securities at FVOCI | | |
| Treasury bills of the Russian Ministry of Finance | 439,648 | X |
| Corporate bonds | - | X |
| Total debt securities at FVOCI | 439,648 | X |
| Securities available for sale | | |
| Treasury bills of the Russian Ministry of Finance | X | 495,562 |
| Corporate bonds | X | 100,373 |
| Total securities available for sale | X | 595,935 |

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9. Taxation

The corporate income tax expense comprises:

| | 2018 | 2017 |
|--|------------------|------------------|
| Current income tax expense | (584,900) | (813,518) |
| Deferred tax expense – (origination)/reversal of temporary differences | (103,371) | 285,212 |
| Income tax expense | (688,271) | (528,306) |

Russian legal entities must file income tax declarations. The standard income tax rate for companies (including banks) was 20% for 2018 and 2017.

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

| | 2018 | 2017 |
|---|------------------|------------------|
| Profit before tax | 3,295,114 | 2,276,102 |
| Statutory tax rate | 20% | 20% |
| Income tax at the applicable income tax rate | (659,023) | (455,220) |
| Non-deductible expenditures and non-taxable income | (20,655) | (71,506) |
| Unrecognized deferred tax asset movement | – | – |
| Other | (10,104) | (1,580) |
| Income taxed at a lower rate | 1,511 | – |
| Income tax expense | (688,271) | (528,306) |

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

| | 1 January 2018 | Recognized in profit or loss | Recognized in other comprehensive income | 31 December 2018 |
|--|---------------------------|---|---|-----------------------------|
| Allowance for impairment | 128,345 | (35,893) | – | 92,452 |
| Derivative financial instruments | 306,857 | (204,678) | (20,007) | 82,172 |
| Loans to customers | 706,376 | (122,916) | – | 583,460 |
| Other assets | (5,290) | 6,258 | – | 968 |
| Other liabilities | (5,314) | 254,615 | – | 249,301 |
| Total deferred tax assets/(liabilities) | 1,130,974 | (102,614) | (20,007) | 1,008,353 |

| | 1 January 2017 | Recognized in profit or loss | Recognized in other comprehensive income | 31 December 2017 |
|--|---------------------------|---|---|-----------------------------|
| Allowance for impairment | 29,506 | 98,839 | – | 128,345 |
| Derivative financial instruments | 266,866 | 58,832 | (18,841) | 306,857 |
| Loans to customers | 597,657 | 108,719 | – | 706,376 |
| Other assets | (75,454) | 70,164 | – | (5,290) |
| Other liabilities | 46,028 | (51,342) | – | (5,314) |
| Total deferred tax assets/(liabilities) | 864,603 | 285,212 | (18,841) | 1,130,974 |

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10. Other assets and liabilities

Other assets comprise:

| | 31 December 2018 | 31 December 2017 |
|---|-----------------------------|-----------------------------|
| Prepayments under business contracts | 50,114 | 52,919 |
| Prepaid income tax/other taxes | 39,597 | 26,353 |
| Guarantee deposits under lease agreements | 4,379 | 4,379 |
| Other | 17,016 | 14,782 |
| Other assets | 111,106 | 98,433 |

Other liabilities comprise:

| | 31 December 2018 | 31 December 2017 |
|--|-----------------------------|-----------------------------|
| Payroll payable | 197,394 | 166,469 |
| Trade payables | 358,227 | 392,011 |
| Agency fees under insurance agreements | 442,323 | 371,896 |
| Taxes payable | 329,479 | 223,857 |
| Provision for contingent liabilities | 700,357 | 569,801 |
| Other liabilities | 2,027,780 | 1,724,034 |

11. Amounts due to credit institutions

Amounts due to credit institutions comprise:

| | 31 December 2018 | 31 December 2017 |
|---|-----------------------------|-----------------------------|
| Deposits received from banks and maturing within 1 year | 41,181,740 | 28,331,722 |
| Deposits received from banks and maturing after 1 year | 1,505,209 | 6,527,901 |
| Amounts due to credit institutions | 42,686,949 | 34,859,623 |

As at 31 December 2018, the Bank raised RUB 36,317,389 thousand (2017: RUB 24,509,772 thousand) as deposits of resident banks and RUB 6,369,560 thousand (2017: RUB 10,349,851 thousand) as deposits of non-resident banks.

As at 31 December 2018, the Bank had balances on short-term and long-term deposits with eight counterparties. As at 31 December 2018, total balances with all counterparties were as follows: 85.08% with resident banks and 14.92% with a non-resident bank.

As at 31 December 2017, the Bank had balances on short-term and long-term deposits with six counterparties. As at 31 December 2017, total balances with all counterparties were as follows: 70.31% with resident banks and 29.69% with a non-resident bank.

12. Amounts due to customers

Amounts due to customers comprise:

| | 31 December 2018 | 31 December 2017 |
|---|-----------------------------|-----------------------------|
| Current accounts and demand deposits | | |
| - Corporate customers | 10,875 | 35,445 |
| - Retail customers | 2,135,735 | 1,854,059 |
| Assigned rights of claim for factoring transactions | 44,453 | 385,506 |
| Deposits of legal entities maturing within 1 year | 2,734,670 | 10,428,424 |
| Deposits of legal entities maturing after 1 year | 6,973,211 | - |
| Amounts due to customers | 11,898,945 | 12,703,434 |

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12. Amounts due to customers (continued)

As at 31 December 2018, the Bank raised RUB 3,348,403 thousand (2017: RUB 3,138,396 thousand) as deposits of resident legal entities and RUB 6,359,478 thousand (2017: RUB 7,290,028 thousand) as deposits of non-resident legal entities.

As at 31 December 2018, the Bank had balances on short-term deposits with multiple counterparties. As at 31 December 2018, total balances with all counterparties were as follows: 65.44% and 34.56% of total short-term deposits for non-resident and resident legal entities, respectively.

As at 31 December 2017, the Bank had balances on short-term deposits with multiple counterparties. As at 31 December 2017, total balances with all counterparties were as follows: 69.91% and 30.09% of total short-term deposits for non-resident and resident legal entities, respectively.

13. Debt securities issued

| | 31 December 2018 | 31 December 2017 |
|-------------------------------|-----------------------------|-----------------------------|
| Domestic bonds | 18,685,486 | 15,447,150 |
| Debt securities issued | 18,685,486 | 15,447,150 |

The table below presents the structure of securities issued as at 31 December 2018:

| Bonds Series | Number | Placement date | Maturity date | Annual coupon rate, % | Principal | Interest accrued/ discounts | Total |
|-------------------------|------------------|---------------------------|--------------------------------------|--------------------------------------|------------------|--|------------------|
| 1 | 40100170B | 5 July 2016 | 9 July 2021, offer on 7 July 2020 | 7.9 | 3,431,228 | 131,450 | 3,562,678 |
| BO-001R-01 | 4B020100170B001P | 14 April 2017 | 16 April 2020 | 9.45 | 5,000,000 | 100,950 | 5,100,950 |
| BO-001R-02 | 4B020200170B001P | 12 October 2017 | 14 October 2020 | 8.45 | 5,000,000 | 12,280 | 5,012,280 |
| BO-001R-03 | 4B020300170B001P | 20 November 2018 | 22 November 2021 | 9.25 | 5,000,000 | 9,578 | 5,009,578 |

In 2018, changes in liabilities arising from financing activities and disclosed in the statement of cash flows in Cash flows from financing activities result only from cash flows from debt securities issued, payments on securities and accrued interest.

14. Equity

The authorized, issued and fully paid share capital comprises:

| | 2018 | | | 2017 | | |
|----------------------------|-----------------------------|--------------------------|---|-----------------------------|--------------------------|---|
| | Number of shares | Nominal value | Inflation- adjusted amount | Number of shares | Nominal value | Inflation- adjusted amount |
| Ordinary shares | 4,335,000 | 6,069,000 | 6,133,091 | 2,335,000 | 3,269,000 | 3,333,091 |
| Total share capital | 4,335,000 | 6,069,000 | 6,133,091 | 2,335,000 | 3,269,000 | 3,333,091 |

The sole shareholder of JSC RN Bank made a decision on 14 March 2018 to increase the share capital of the Bank by placing an additional issue of ordinary registered non-documentary shares for a total amount of RUB 3 billion through a private subscription in favor of BARN B.V., a private limited liability company that owns all voting shares of JSC RN Bank.

JSC RN Bank completed the procedure for increasing its share capital in the second quarter of 2018. The report on the issue of additional shares by JSC RN Bank was registered with the Corporate Affairs Department of the Bank of Russia on 9 June 2018; the additional issue was registered under No. 10200170B005D.

The additional issue through a private placement includes 2,000,000 ordinary registered non-documentary shares with a nominal value of RUB 1,400 each (the placement price of one share was RUB 1,500).

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14. Equity (continued)

As a result of the additional issue of shares, the share capital of JSC RN Bank amounted to RUB 6,069,000 thousand.

Share premium represents the excess of contributions to the share capital over the nominal value of shares issued. As at 31 December 2018, the share premium amounted to RUB 5,780,800 thousand (2017: RUB 5,580,800 thousand).

In 2018 and 2017, the Bank neither declared nor paid any dividends to its shareholders.

15. Commitments and contingencies

Operating environment

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

The Russian economy is influenced by dropping oil prices and sanctions imposed against Russia by a number of countries. The ruble interest rates remain high. The combination of the above resulted in reduced access to capital, a higher cost of capital, and increased uncertainty regarding economic growth, which could negatively affect the Bank's future financial position, results of operations and business prospects. Management believes it is taking appropriate measures to support the sustainability of the Bank's business in the current circumstances.

Legal

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

Taxation

A significant part of the Bank's business activity is carried out in the Russian Federation. Russian tax, currency and customs legislation as currently in effect is not clear and unambiguous enough, which often results in varying interpretations, selective and inconsistent application, as well as frequent and, at times, highly unpredictable changes, which may apply retrospectively. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant regional and federal authorities. The tax authorities may be taking a more assertive position in their interpretation and application of the legislation and in performing tax reviews. As a result, the Bank's approaches to tax liability calculations that have not been challenged in the past may be challenged during future tax audits. As such, significant additional taxes, penalties and interest may be assessed by the relevant authorities.

The Russian transfer pricing tax legislation allows the Russian tax authorities to apply transfer pricing adjustments and impose additional income tax and value added tax liabilities in respect of all controlled transactions if the transaction price differs from the market price and unless the Bank is able to demonstrate the use of market prices with respect to the controlled transactions. Transactions with securities and derivatives are subject to special transfer pricing rules. In 2018, the Bank determined its tax liabilities arising from controlled transactions using actual transaction prices. Management believes that the Bank complies with the requirements of the Russian transfer pricing legislation with regard to controlled transactions, including proper preparation and presentation of notifications and, if necessary, transfer pricing documentation to the tax authorities, confirming that the Bank used market prices in performing controlled transactions.

Tax legislation introduced special rules for recognizing income and expenses arising from hedging transactions. In accordance with the existing Russian tax legislation, the Bank may classify derivative transactions as hedging transactions on condition that the proper documentation is in place to confirm, inter alia, the nature and rationale for hedging transactions. Management believes that the Bank has sufficient evidence to recognize hedging transactions for taxation purposes.

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15. Commitments and contingencies (continued)

Taxation (continued)

Currently, the Russian tax legislation requires compliance with the taxation rules for controlled foreign companies and the concept of tax residency of legal entities; in addition, foreign entities receiving income from Russian sources must have an actual right to such income. Overall, the adoption of these concepts should increase the administrative and, in some cases, tax burden on Russian taxpayers that form part of an international group and/or conduct transactions with foreign companies. In some cases, the Bank paid income to foreign entities using reduced rates of the Russian withholding tax based on the provisions of international tax treaties concluded by the Russian Federation. Given that the above new rules have not been applied consistently with regard to the confirmation of the foreign entities' actual right to income, there is uncertainty regarding the procedure for the application of these rules and their possible interpretation by the Russian tax authorities and the effect on the amount of tax liabilities. Management believes it possible that with the evolution of these rules and changes in the approach of the Russian tax authorities and/or courts to their interpretation and enforcement, additional taxes and related fines and penalties may be assessed, which could negatively impact the financial position of the Bank.

The introduction of these regulations and the interpretation of some other provisions of Russian tax legislation together with the latest trends in the application and interpretation of certain provisions of Russian tax legislation suggest that the tax authorities may take a more assertive position in their interpretation and application of the legislation, conducting tax audits and imposing additional tax requirements. At the same time, it is impossible to evaluate the potential impact the adoption of these norms will have and the probability of negative outcome of litigations if challenged by the Russian tax authorities. Consequently, the tax authorities may challenge the transactions and methods of accounting which have not been challenged before. As a result, significant additional taxes, penalties and fines may be assessed. Tax field audits of the accuracy of tax calculation and payments conducted by tax authorities may cover three calendar years preceding the year during which the tax audit decision was made. Under certain circumstances, tax reviews may cover longer periods.

As at 31 December 2018, the Bank's management holds a conservative position when interpreting applicable legislation and creates a provision for undetermined tax liabilities.

Commitments and contingencies

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

| | 31 December 2018 | 31 December 2017 |
|------------------------------------|-----------------------------|-----------------------------|
| Less than 1 year | 100,156 | 102,106 |
| From 1 to 5 years | 304,770 | 313,527 |
| Operating lease commitments | 404,926 | 415,633 |

In 2017, the Bank re-entered into an operating lease agreement for the office premises that are the Bank's location and business address. In accordance with the agreement, the total lease period is 5 years with the options of renewal upon expiry and early termination. Lease payments increase annually in line with the market trends.

The Bank also entered into operating lease agreements for cars used by the Bank in carrying out its core activities. The term of the agreements is 2 years.

In 2018, RUB 70,249 thousand are recognized as operating lease expenses in profit or loss (2017: RUB 67,551 thousand) (Note 17).

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16. Personnel and other administrative expenses

Personnel and other operating expenses comprise:

Personnel expenses

| | 2018 | 2017 |
|-----------------------------------|----------------|----------------|
| Personnel benefits | 482,056 | 309,423 |
| Payroll related taxes and charges | 84,388 | 83,040 |
| Total personnel expenses | 566,444 | 392,463 |

Other general and administrative expenses

| | 2018 | 2017 |
|---|----------------|----------------|
| Promotion expenses | 195,710 | 390,411 |
| Communications and information services | 95,460 | 89,293 |
| State duties and taxes other than income tax | 88,338 | 92,044 |
| Lease expenses (Note 15) | 70,249 | 67,551 |
| Professional services | 71,596 | 58,580 |
| Telecommunication services | 52,110 | 44,550 |
| Other personnel expenses | 48,280 | 33,284 |
| Advertising, marketing and entertainment expenses | 39,632 | 6,148 |
| Advisory services | 31,464 | 2,661 |
| Business travel | 22,652 | 26,913 |
| Repair and maintenance of property and equipment | 21,126 | 19,146 |
| Audit | 17,331 | 17,592 |
| Other | 7,090 | 3,849 |
| Low-value items, expenses on materials for administrative and other needs | 5,760 | 5,475 |
| Security | 1,582 | 1,342 |
| Total general and administrative expenses | 768,380 | 858,839 |

17. Risk management

Introduction

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

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

17.1 Internal control

The Bank has established internal control that is harmonized with the nature and scale of transactions and the level and combination of the risks assumed.

Internal control is aimed at, among other things, ensuring the following:

- ▶ Appropriate and comprehensive risk assessment and management process, effectiveness of financial and operating activities, efficiency of asset and liability management;
- ▶ Appropriate reliability, security and stability of the Bank in line with the nature and scale of transactions, protection of the rights of shareholders, customers and creditors of the Bank;
- ▶ Accuracy, completeness and objectivity as well as timely preparation and presentation of (statutory) financial statements, statistical and other reports and safeguarding information security;
- ▶ Compliance with statutory regulations, as well as the Bank's founding and internal documents;
- ▶ Noninvolvement of the Bank and its personnel in illegal activities, including money laundering and terrorism financing, as well as ensuring timeliness of data submitted to the state agencies and the Bank of Russia.

(thousands of Russian rubles)

17. Risk management (continued)

17.1 Internal control (continued)

Internal control management is performed by the following bodies within the scope of their powers as set forth in the Bank's founding and internal documents:

- ▶ General Shareholders' Meeting;
- ▶ Board of Directors;
- ▶ Risks and Control Committee of the Board of Directors;
- ▶ Credit Committee of the Board of Directors;
- ▶ Management Board;
- ▶ Chairman of the Management Board;
- ▶ Audit Commission (Auditor);
- ▶ Chief Accountant / Deputy Chief Accountant;
- ▶ Committees of the Management Board:
 - a) Management Committee of the Management Board;
 - b) Credit Risk Committee of the Management Board;
 - c) Finance Committee;
 - d) Credit Committee;
 - e) Internal Control, Operational Risks and Compliance Committee;
 - f) Operational Committee of the Bank;
 - g) Information Security Committee;
- ▶ Department for Legal Support, Compliance Control and Financial Monitoring (the DLSCCFM);
- ▶ Risk Management Department;
- ▶ Other personnel or divisions responsible for internal control within their scope of activities.

The Bank's internal control system includes the following areas of focus:

- ▶ Control over organization of the Bank's operations performed by the management bodies;
- ▶ Control over the functioning of the banking risk management system and banking risk assessment;
- ▶ Control over the distribution of powers with respect to banking operations and other transactions;
- ▶ Control over data flow management (information provision and transmission) and information security assurance;
- ▶ Control over anti-money laundering and counter-terrorism financing;
- ▶ Ongoing monitoring of the internal control system to assess its compliance with the Bank's operating objectives, detection of deficiencies, proposal development, and control over the enhancement of the Bank's internal control system ("monitoring of the internal control system").

Control and monitoring over the system of banking risk management and internal control are performed by the Bank on a regular basis as provided in its internal regulations.

The Bank takes appropriate measures to enhance internal control aimed at ensuring its effectiveness, taking into account changing internal and external factors that affect the Bank's activities.

Monitoring of the internal control system is performed by the management and personnel of various business units, including departments responsible for banking operations and other transactions and their recognition in accounting and reporting as well as the Internal Audit Function and DLSCCFM responsible for internal control function and auditors engaged by the Bank's shareholders.

Frequency of monitoring of various types of banking activities is defined taking into account associated banking risks, frequency and nature of changes in the areas of the Bank's activities. Audit plans of the Internal Audit Function are annually approved by the Bank's Board of Directors.

(thousands of Russian rubles)

17. Risk management (continued)

17.1 Internal control (continued)

The Bank's Internal Audit Function was formed to perform the audit and assist the Bank's management bodies in ensuring the Bank's effective operation, protecting interests of the Bank's shareholders and customers and continuously monitoring and assessing the effectiveness and adequacy of internal control, including:

- ▶ The effectiveness of financial and operating activities;
- ▶ The fairness of accounting records, accuracy, completeness and objectivity of financial statements;
- ▶ The effectiveness of the risk management system;
- ▶ Compliance with Russian statutory regulations, as well as the Bank's founding and internal documents;
- ▶ The effectiveness of asset and liability management, including physical asset security.

The Bank has ensured consistency, independence and objectivity of the Internal Audit Function, professional qualification of its head and personnel; in addition, an environment has been created for the Internal Audit Function to comply with its duties efficiently and smoothly. The Internal Audit Function operates under the direct control of the Board of Directors.

The Bank has established the procedures of:

- ▶ Control (including additional audits) over measures taken to eliminate violations identified by the Internal Audit Function;
- ▶ Reporting by the Internal Audit Function at least semiannually on the measures taken to follow the recommendations and to eliminate the identified violations to the Board of Directors.

Department for Legal Support, Compliance Control and Financial Monitoring (DLSCCFM)

DLSCCFM is responsible for ensuring the compliance of the Bank's activities with the current legislation of the Russian Federation, the Bank's internal regulations and standards for self-regulating organizations. DLSCCFM also reviews the Bank's documentation, performs assessment of regulatory risks, provides recommendations on risk mitigation and ensures the Bank's compliance with the Russian legislation and standards and taking measures aimed at the protection of the Bank's business reputation.

DLSCCFM reports on the work performed to the Chairman of the Management Board and to the Management Board at least once a year and communicates the performance results during meetings of the Internal Control, Operational Risks and Compliance Committee.

Internal Control, Operational Risks and Compliance Committee

The Internal Control, Operational Risks and Compliance Committee reviews the information on the activities of the Internal Audit Function and DLSCCFM, the results of external audits and first level control procedures. The Committee also deals with the issues related to operational risk, development of internal control rules on anti-money laundering and counter-terrorism financing, results of business continuity and/or disaster recovery plans ('BC/DR plans') and other issues.

Risk management system

The Bank's risk management system is based on the following components:

- ▶ Strategy;
- ▶ Methodology;
- ▶ Procedures;
- ▶ Control;
- ▶ Updating.

The goal of the risk management system is to maintain the overall risk accepted by the Bank at the level defined by the Bank subject to its strategic objectives. The priority is to ensure the maximum safety of assets and equity by mitigation of risk exposures which might lead to unexpected losses.

(thousands of Russian rubles)

17. Risk management (continued)

17.1 Internal control (continued)

The goal of the risk management system is achieved through the use of a systemic and complex approach that focuses on the following:

- ▶ Identification and analysis of all risks arising in the course of the Bank's activities;
- ▶ Interpretation of the approach to various risk types;
- ▶ Quantitative and qualitative assessment (measurement) of specific risk types;
- ▶ Establishing correlation among individual risks in order to assess the impact of the actions planned to be taken to limit a particular type of risk on the increase or decrease in the level of other risks;
- ▶ Performing full risk level analysis of operations planned and completed by the Bank to determine the total amount of banking risks;
- ▶ Assessment of whether the total amount of risk is acceptable and reasonable;
- ▶ Establishing a subsystem of risk monitoring at the origination of a negative tendency and a subsystem of swift and adequate response aimed at preventing or mitigating risks.

Each risk faced by the Bank must be identified and recognized. Risks are classified into internal and external as well as controlled or not controlled by the Bank. Risks are identified on a regular basis due to the fast-evolving internal and external environment.

Management of the Bank determines its approach to all the risks identified. A part of the risks which the Bank is not ready to assume must be totally excluded, with the related activities totally terminated. With regard to the risks assumed, the Bank defines the maximum acceptable risk exposure. The Bank's strategy governs its risk approach.

The Bank's management strategy is based on the break-even principle and focuses on achieving a healthy ratio of the profitability of the Bank's business activities and the level of assumed risks.

The Bank's risk management strategy involves:

- ▶ Compliance with the Bank's strategic goals set by the Board of Directors;
- ▶ Lending schemes as a priority area;
- ▶ Effective capital management with the aim to maintain its adequate level.

The risk management strategy implies using a whole range of risk mitigation instruments and choosing each particular instrument depending on the risk type.

Evaluation of various risk types involves various methodologies which are set out in the Bank's internal documents.

The Bank complies with the requirements set by the Bank of Russia to risk and capital management systems and internal control.

The Customer Business Development and Risk Management Director, Deputy Chairman of the Management Board, the Head of the Internal Audit Function, and the Head of DLSCCFM comply with the qualification criteria established by Regulation of the Bank of Russia No. 3223-U and the business reputation requirements set forth by Federal Law No. 395-1.

Risk reporting

Information on various risks relevant to the Bank is analyzed with the aim of control and early identification of risks, and subsequent communication to the Bank's management.

Risk reporting with various level of detail and different time intervals is performed by the Bank's departments, including the Risk Management Department and Treasury in order to provide the personnel and management of the Bank with up-to-date and necessary information on the level of risks relevant to the Bank.

Daily reports include information on the Bank's open currency position, gap analysis of the assets and liabilities maturity gap to assess the liquidity risk, calculation of statutory liquidity ratios, calculation of the maximum risk attributable to one borrower or a group of borrowers, and calculation of the Bank's capital adequacy ratios. Liquidity risk reports are submitted to the Finance Committee of the Bank's Management Board on a monthly basis.

(thousands of Russian rubles)

17. Risk management (continued)

17.1 Internal control (continued)

Monthly reports on interest rate risk testing are reviewed by the Finance Committee of the Bank's Management Board and include the gap analysis of the assets and liabilities maturity gap, as well as the results of testing the basic scenario (change in the interest rate by 100 b.p.), results of the stress testing (change in the interest rate by 300-500 b.p.), analysis of changes in the Bank's external environment driven by macroeconomic trends, and the financial markets analysis.

Monthly reports on credit risk testing are reviewed by the Risk Committee of the Bank's Management Board and provide information on the quality of the Bank's loan portfolio in aggregate and broken down by interbank loans, financing to car dealers (factoring), retail lending (car loans), major quality indicators and their changes, overdue debts, their amount, dynamics, structure and timing, the amount of created provisions, collateral quality and credit risk concentration.

DLSCCFM provides regular reports to the Internal Control, Operational Risks and Compliance Committee on operational and/or regulatory risks identified. Reports on significant risks are regularly submitted to the Bank's Board of Directors.

17.2 Credit risk

Credit risk is the risk that the Bank will incur a loss because its borrowers or counterparties failed to discharge their obligations to the Bank.

The Bank has developed credit policies and procedures to finance end consumers and dealers, which provide guidelines on the evaluation of the borrower's financial performance, procedure for lending decision-making, and control over timely repayment of loans.

Credit risk management is performed through:

- ▶ Monitoring;
- ▶ Setting limits;
- ▶ Diversification;
- ▶ Scenario analysis.

In accordance with the requirements of the Bank of Russia, the Bank limits risk concentrations per borrower or group of related borrowers, maximal large credit risk, aggregate risk on the Bank's insiders, maximum amount of loans, bank guarantees and sureties provided by the Bank to its participants (shareholders). Actual exposures against limits are monitored by the Accounting and Reporting Department on a daily basis.

Additionally, the Bank limits risk concentrations by customer, counterparty and group of related customers depending on the level of the accepted credit risk.

Derivative financial instruments

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

Classification and measurement

The Bank adopted IFRS 9 on 1 January 2018. Under IFRS 9, all debt financial assets that do not meet the "solely payments of principal and interest" (SPPI) criterion, are classified at initial recognition as financial assets at fair value through profit or loss (FVPL). Under this criterion, debt instruments that do not correspond to a "basic lending arrangement," such as instruments containing embedded conversion options or "non-recourse" loans, are measured at FVPL. Debt financial instruments that meet the SPPI criterion are classified at initial recognition based on the business model, under which these instruments are managed:

- ▶ Instruments that are managed on a "hold to collect" basis are measured at amortized cost.
- ▶ Instruments that are managed on a "hold to collect and for sale" basis are measured at fair value through other comprehensive income (FVOCI).
- ▶ Instruments that are managed on other basis will be measured at FVPL.

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17. Risk management (continued)

17.2 Credit risk (continued)

The classification and measurement of financial liabilities remain largely unchanged from the current IAS 39 requirements. Derivatives will continue to be measured at FVPL.

The Bank expects to continue measuring at fair value all financial assets currently measured at fair value.

Debt securities currently classified as available for sale are expected to be measured at FVOCI under IFRS 9, as the Bank expects to hold these assets not only to collect contractual cash flows but also to sell significant amounts on a relatively frequent basis. The vast majority of loans are expected to satisfy the SPPI criterion and will continue to be measured at amortized cost; however, some of the loans will be reclassified as measured at FVPL.

Impairment assessment

IFRS 9 requires the Bank to record an allowance for expected credit losses (ECL) on all of its debt financial assets at amortized cost or FVOCI, as well as on loan commitments and financial guarantee contracts. The allowance is based on the ECL 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 is based on the lifetime ECL. If the financial asset meets the definition of purchased or originated credit-impaired, the allowance is based on the change in the lifetime ECL.

a) *Corporate dealers*

In accordance with IFRS 9, the Bank designed and implemented (from 1 January 2018) a model to assess expected credit losses related to corporate dealers.

ECL calculation mechanics

ECL calculations are based on the following key elements:

| | |
|-----------------------------|---|
| Probability of default (PD) | The <i>Probability of Default</i> is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the asset has not been previously derecognized and is still in the portfolio. |
| Exposure at default (EAD) | The <i>Exposure at Default</i> is an estimate of the amount exposed to default. |
| Loss given default (LGD) | The <i>Loss Given Default</i> is an estimate of the loss arising in case a default occurs at a given time. |

b) *Individual borrowers*

In accordance with IFRS 9, the Bank designed and implemented (from 1 January 2018) a model to assess expected credit losses related to individuals. The key element of ECL calculations is the calculation of transition matrices, which help determine the probability of default.

c) *Classification of loans*

The Bank has established policies to assess the level of risk at the end of each reporting period, including to assess whether a financial instrument's credit risk has changed significantly, by considering the change in the risk of default occurring over the remaining life of the financial instrument. Based on the assessment, the Bank classified loans as described below:

| | |
|---------|--|
| Stage 1 | Standard assets that have not shown any significant increase in credit risk since origination. Stage 1 loans also include facilities where the credit risk has improved and the loans have been reclassified from Stage 2. |
| Stage 2 | Standard assets that have shown a significant increase in credit risk since origination. Stage 2 loans also include facilities where the credit risk has improved and the loans have been reclassified from Stage 3. |
| Stage 3 | Doubtful assets considered credit-impaired. |

d) *Allowance for expected credit losses*

Under IFRS 9, where a loan has been included in Stage 1, the allowance for expected credit losses related to borrowers is equal to 12-month expected credit losses. For Stage 2 and Stage 3 loans, the allowance for expected credit losses is equal to expected credit losses over the life of the asset.

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17. Risk management (continued)

17.2 Credit risk (continued)

Credit quality per class of financial assets

The Bank manages the credit quality of financial assets through its internal credit rating system. The table below shows the credit quality by class of assets for loan-related lines in the statement of financial position, based on the Bank's credit rating system.

In the table below, high-grade loans to banks are those having a minimal level of credit risk, normally with a credit rating on or close to the sovereign level or very well collateralized. Other borrowers with good financial position and good debt service are included in the standard grade. The sub-standard grade comprises loans below the standard grade but not individually impaired.

The gross carrying amounts calculated as at 31 December 2018 are provided in the table below.

| | <i>Notes</i> | <i>Stage</i> | <i>High grade</i> | <i>Standard grade</i> | <i>Sub-standard grade</i> | <i>Impaired</i> | <i>Total</i> |
|--|--------------|--------------|-------------------|-----------------------|---------------------------|-----------------|-------------------|
| Cash and cash equivalents, except for cash on hand | 5 | Stage 1 | 7,545,559 | 2,047,720 | - | - | 9,593,279 |
| Loans to customers at amortized cost | 8 | | | | | | |
| Loans to individuals | | Stage 1 | - | 47,917,263 | - | - | 47,917,263 |
| | | Stage 2 | - | 1,004,157 | - | - | 1,004,157 |
| | | Stage 3 | - | - | - | 928,421 | 928,421 |
| Loans to legal entities | | Stage 1 | - | 28,170,682 | - | - | 28,170,682 |
| | | Stage 2 | - | 4,341,406 | - | - | 4,341,406 |
| | | Stage 3 | - | - | - | - | - |
| Debt investment securities - Measured at FVOCI | | Stage 1 | - | 439,648 | - | - | 439,648 |
| | | Stage 2 | - | - | - | - | - |
| | | Stage 3 | - | - | - | - | - |
| Total | | | 7,545,559 | 83,920,876 | - | 928,421 | 92,394,856 |

Cash and cash equivalents, high-grade loans to banks and customers are those having a minimal level of credit risk, normally with a credit rating on or close to the sovereign level or very well collateralized. Other borrowers with good financial position and good debt service are included in the standard grade. The sub-standard grade comprises loans below the standard grade but not individually impaired.

The Bank classifies liabilities of individuals and legal entities other than banks into two main categories: standard loans, including those past due but not impaired, and individually impaired loans.

The gross carrying amounts calculated under IAS 39 as at 31 December 2017 are provided in the table below.

| | <i>Notes</i> | <i>Neither past due nor impaired</i> | | | <i>Individually impaired</i> | | <i>Total</i> |
|--|--------------|--------------------------------------|-----------------------|---------------------------|------------------------------|----------------|-------------------|
| | | <i>High grade</i> | <i>Standard grade</i> | <i>Sub-standard grade</i> | <i>Standard loans</i> | <i>loans</i> | |
| | | <i>2017</i> | <i>2017</i> | <i>2017</i> | <i>2017</i> | <i>2017</i> | <i>2017</i> |
| Cash and cash equivalents | 5 | 6,903,822 | 609,849 | - | - | - | 7,513,671 |
| Loans to customers | 8 | | | | | | |
| Individuals | | - | - | - | 46,955,846 | 661,588 | 47,617,434 |
| Legal entities | | - | - | - | 21,555,577 | 19,259 | 21,574,836 |
| Investment securities available for sale | | - | 595,935 | - | - | - | 595,935 |
| Total | | 6,903,822 | 1,205,784 | - | 68,511,423 | 680,847 | 77,301,876 |

An analysis of past due loans, by age, is provided below. The majority of the past due loans are not considered to be impaired.

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17. Risk management (continued)

17.2 Credit risk (continued)

Aging analysis of past due but not impaired loans per class of financial assets as at 31 December 2017

| | <i>Notes</i> | <i>Less than 30 days 2017</i> | <i>31 to 90 days 2017</i> | <i>Total 2017</i> |
|--------------------------------------|--------------|-----------------------------------|-------------------------------|-----------------------|
| Amounts due from credit institutions | | - | - | - |
| Loans to customers | 8 | - | - | - |
| Individuals | | 485,397 | 246,233 | 731,630 |
| Legal entities | | 4,340 | - | 4,340 |
| Total | | 489,737 | 246,233 | 735,970 |

See Note 8 for more detailed information on the allowance for impairment of loans to customers.

17.3 Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises currency risk, interest rate risk and other price risks. Market risk arises from open positions in interest rate and equity financial instruments exposed to general and specific market movements and changes in the level of volatility of market prices and currency exchange rates.

The purpose of market risk management is to maintain the risk accepted by the Bank at the appropriate level defined by the Bank subject to its business strategy. The priority is to ensure maximum safety of assets and equity by reducing (excluding) the possibility of loss incurred on the Bank's operations in financial markets, as well as other operations of the Bank involving the acceptance of risk exposure.

The Bank manages its market risk by setting open position limits in relation to interest rate repricing and currency positions and stop-loss limits which are monitored on a monthly basis and reviewed and approved by the Management Board.

Currency risk

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

As at 31 December 2018, a change in the value of the Russian ruble to other currencies would have caused an increase (reduction) in equity and profit or loss as indicated in the following table. This analysis was performed net of tax and is based on the expected change in currency exchange rates. The analysis assumes that all other variables, in particular interest rates, remain constant.

| | 2018 Increase in the currency exchange rate | 2018 Decrease in the currency exchange rate |
|--|--|--|
| Change in USD to RUB exchange rate (+14%/-14%) | 462 | (462) |
| Change in EUR to RUB exchange rate (+14%/-14%) | 11,977 | (11,977) |
| Change in JPY to RUB exchange rate (+15%/-15%) | 63,479 | (63,479) |
| | 2017 Increase in the currency exchange rate | 2017 Decrease in the currency exchange rate |
| Change in USD to RUB exchange rate (+11%/-11%) | 664 | (664) |
| Change in EUR to RUB exchange rate (+12.5%/-12.5%) | 20,598 | (20,598) |
| Change in JPY to RUB exchange rate (+12.7%/-12.7%) | 7,866 | (7,866) |

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17. Risk management (continued)

17.3 Market risk (continued)

The table below discloses the Bank's currency risk exposure as at 31 December 2018 and 2017. The Bank does not intend to heavily engage in currency exchange transactions; therefore, currency risk is limited and controlled based on the ratio of the open currency position and the Bank's equity. This ratio cannot exceed 10% for each foreign currency and 20% of the total amount of open positions.

| | <i>2018</i> | | | | <i>Total</i> | <i>2017</i> | | | | <i>Total</i> |
|--|-------------------|-----------------------------|-----------------------------|-----------------------------|-------------------|-------------------|-----------------------------|-----------------------------|-----------------------------|-------------------|
| | <i>RUB</i> | <i>USD (RUB equivalent)</i> | <i>EUR (RUB equivalent)</i> | <i>JPY (RUB equivalent)</i> | | <i>RUB</i> | <i>USD (RUB equivalent)</i> | <i>EUR (RUB equivalent)</i> | <i>JPY (RUB equivalent)</i> | |
| Assets | | | | | | | | | | |
| Cash and cash equivalents | 9,548,820 | 3,299 | 4,961 | 36,199 | 9,593,279 | 7,406,831 | 6,035 | 4,610 | 96,205 | 7,513,681 |
| Obligatory reserve with the Bank of Russia | 318,510 | - | - | - | 318,510 | 390,249 | - | - | - | 390,249 |
| Amounts due from credit institutions | - | - | - | - | - | - | - | - | - | - |
| Derivative financial assets | (10,516,048) | - | 4,852,259 | 6,746,475 | 1,082,686 | (4,683,127) | - | 4,889,073 | - | 205,946 |
| Loans to customers | 79,088,188 | - | - | - | 79,088,188 | 66,619,003 | - | - | - | 66,619,003 |
| Investment securities | 439,648 | - | - | - | 439,648 | 595,935 | - | - | - | 595,935 |
| Other assets | 63,497 | - | - | - | 63,497 | 71,727 | - | - | - | 71,727 |
| Total assets | 78,942,615 | 3,299 | 4,857,220 | 6,782,674 | 90,585,808 | 70,400,618 | 6,035 | 4,893,683 | 96,205 | 75,396,541 |
| Liabilities | | | | | | | | | | |
| Amounts due to credit institutions | 36,317,389 | - | 6,369,560 | - | 42,686,949 | 24,509,772 | - | 10,349,851 | - | 34,859,623 |
| Derivative financial liabilities | 1,877,570 | - | (1,597,891) | - | 279,679 | 12,944,991 | - | (5,620,950) | (5,741,678) | 1,582,363 |
| Debt securities issued | 18,685,486 | - | - | - | 18,685,486 | 15,447,150 | - | - | - | 15,447,150 |
| Amounts due to customers | 5,539,467 | - | - | 6,359,478 | 11,898,945 | 6,927,491 | - | - | 5,775,943 | 12,703,434 |
| Other liabilities | 447,416 | - | - | - | 447,416 | 396,838 | - | - | - | 396,838 |
| Total liabilities | 62,867,328 | - | 4,771,669 | 6,359,478 | 73,998,475 | 60,226,242 | - | 4,728,901 | 34,265 | 64,989,408 |
| Net balance sheet position | 16,075,287 | 3,299 | 85,551 | 423,196 | 16,587,333 | 10,174,376 | 6,035 | 164,782 | 61,940 | 10,407,133 |

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17. Risk management (continued)

17.4 Interest risk

Interest rate risk is the risk of financial losses due to unfavorable changes in interest rates. The Bank's net interest income and the market value of assets and liabilities that are sensitive to changes in interest rates may be subject to interest rate risk.

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or fair values of financial instruments. The following table demonstrates the sensitivity of the Bank's statement of profit or loss to a possible change in interest rates.

To measure interest rate risk quantitatively, the Bank calculates the sensitivity to interest rate risk on the basis of the moving monthly average gap between assets and liabilities in each currency.

The Bank measures the sensitivity of balance sheet cash flows to changes in market interest rates. The overall sensitivity is in line with changes in the market values of balance sheet cash flows resulting from an even 1% change in interest rates for the entire yield curve.

The tables below summarize the impact on the statement of profit or loss and equity of stress-testing scenarios assuming a possible increase or decrease in interest rates by 100 basis points. Negative amounts in the table reflect a potential net decrease in the statement of profit or loss or equity, while positive amounts reflect a potential net increase.

| Currency | Increase in basis points | Sensitivity of net interest income | Sensitivity of equity |
|-----------------|-------------------------------------|---|----------------------------------|
| | 2018 | 2018 | 2018 |
| RUB | 100 | 8,658 | 6,926 |
| EUR | 100 | - | - |
| JPY | 100 | - | - |

| Currency | Decrease in basis points | Sensitivity of net interest income | Sensitivity of equity |
|-----------------|-------------------------------------|---|----------------------------------|
| | 2018 | 2018 | 2018 |
| RUB | 100 | (8,658) | (6,926) |
| EUR | 100 | - | - |
| JPY | 100 | - | - |

| Currency | Increase in basis points | Sensitivity of net interest income | Sensitivity of equity |
|-----------------|-------------------------------------|---|----------------------------------|
| | 2017 | 2017 | 2017 |
| RUB | 100 | 27,400 | 21,920 |
| EUR | 100 | - | - |
| JPY | 100 | 409 | 327 |

| Currency | Decrease in basis points | Sensitivity of net interest income | Sensitivity of equity |
|-----------------|-------------------------------------|---|----------------------------------|
| | 2017 | 2017 | 2017 |
| RUB | 100 | (27,400) | (21,920) |
| EUR | 100 | - | - |
| JPY | 100 | (409) | (327) |

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17. Risk management (continued)

17.5 Operational risk

Operational risk is one of the significant risks inherent to the Bank's operations. Operational risk is the risk of losses resulting from inconsistency with the nature and scope of the Bank's business and/or non-compliance with applicable legislation of internal practices and procedures of banking and other transactions, their breach by the employees of the Bank and/or other persons (through inadvertent or deliberate actions or omission to act), inappropriate (insufficient) functionalities (specifications) of IT and other systems applied by the Bank and/or their failures (malfunctions), or ensuing from the effect of external events.

The Bank's regulation for operational risk management and control involves prevention of operational risk and identification of new operational risks arising in the course of the Bank's activities and also develops procedures to identify, evaluate and prevent these risks.

The Bank manages its operational risk in accordance with Letter No. 76-T of the Bank of Russia *On Organizing Management of Operational Risks in Credit Institutions* of 24 May 2005 and recommendations of the Basel Committee on Banking Supervision.

The operational risk management system is based on the principle of segregating powers and duties among all levels of the Bank's management.

The Bank assesses operational risk in accordance with Regulation No. 652-P of the Bank of Russia *On the Procedure for Calculating Operational Risk Exposure* of 3 September 2018.

The Internal Control, Operational Risks and Compliance Committee analyzes reports on the level of operational risk on a quarterly basis, including operational risk management reviews, first level control results, identified operational risk events, results of the BC/DR plan testing, an action plan developed based on the results of the BC/DR plan testing, incidents in the Bank's information systems, and other issues.

Information on the identified instances of external fraud, respective measures taken, a number of fraud instances prevented by the Bank, statistics on customer requests, their reasons and respective measures taken are considered at the meetings of the Operational Committee of the Bank's Management Board on a monthly basis.

The operational risk management strategy selected by the Bank determines that the Internal Control, Operational Risks and Compliance Committee and the Operational Committee of the Management Board should take primary responsibility for the timely management of operational risks.

Compliance with prudential ratios

In 2018 and 2017, the Bank complied with prudential ratios set by the Bank of Russia.

17.6 Liquidity risk

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations or make current payments on instructions of its customers unless it restructures its assets and/or urgently mobilizes adequate funds to make such payments. Liquidity risk arises when the maturities of assets and liabilities do not match.

The liquidity management policy was developed by the Bank to ensure control over liquidity and meet its payment obligations in full and on a timely basis. The liquidity management policy is reviewed and approved by the Management Board.

The liquidity management policy requires:

- ▶ Projecting cash flows by major currency and calculating the level of liquid assets necessary in relation thereto;
- ▶ Maintaining a diverse range of funding sources;
- ▶ Managing the concentration and profile of debts;
- ▶ Development of fund-raising plans using borrowed funds;
- ▶ Maintaining liquidity and funding contingency plans;
- ▶ Monitoring liquidity ratios against regulatory requirements.

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17. Risk management (continued)

17.6 Liquidity risk (continued)

The Treasury receives information from business units on the liquidity of their financial assets and liabilities and projected cash flows arising from projected future business. Then it provides for an adequate portfolio of short-term liquid assets to be maintained, largely made up of short-term funds with credit institutions and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Bank as a whole.

The daily liquidity position is monitored and regular liquidity stress testing under a variety of scenarios covering both normal and more severe market conditions is performed by the Treasury. Under normal market conditions, reports covering the liquidity position are presented to senior management on a weekly basis. Any decisions on the liquidity management policy are taken by the Finance Committee and implemented by the Treasury. A summary of the report prepared by the Treasury is communicated to the management of the Bank and the Board of Directors.

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on the ratios of net liquid assets and liabilities established by the Bank of Russia. As at 31 December, these ratios were as follows:

| | 2018, % | 2017, % |
|--|------------|------------|
| N2 "Instant Liquidity Ratio" (assets receivable or realizable within one day / liabilities repayable on demand; statutory ratio $\geq 15\%$) | 229.4 | 304.8 |
| N3 "Current Liquidity Ratio" (assets receivable or realizable within 30 days / liabilities repayable within 30 days; statutory ratio $\geq 50\%$) | 234.2 | 220.6 |
| N4 "Long-term Liquidity Ratio" (assets receivable in more than one year / sum of capital and liabilities repayable in more than one year; statutory ratio $\leq 120\%$) | 72.1 | 87.6 |

Analysis of financial liabilities by remaining contractual maturity

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

| 31 December 2018 | <i>On demand and less than 1 month</i> | <i>1 to 3 months</i> | <i>3 to 12 months</i> | <i>1 to 5 years</i> | <i>Later than 5 years</i> | <i>No maturity</i> | <i>Total</i> |
|--|--|--------------------------|---------------------------|-------------------------|-------------------------------|--------------------|---------------------|
| Liabilities | | | | | | | |
| Debt securities issued | 135,905 | - | 1,374,431 | 20,562,936 | - | - | 22,073,273 |
| Amounts due to credit institutions | 4,193,550 | 9,227,836 | 28,942,957 | 1,719,575 | - | - | 44,083,918 |
| Deliverable derivative financial instruments | - | - | - | - | - | - | - |
| - Cash inflow | - | (1,596,956) | (674,438) | (8,638,909) | - | - | (10,910,304) |
| - Cash outflow | 55,597 | 1,788,088 | 647,485 | 8,718,232 | - | - | 11,209,403 |
| Amounts due to customers | 2,809,069 | 3,412 | 2,200,254 | 7,388,729 | - | - | 12,401,464 |
| Other financial liabilities | 120,713 | 326,573 | 130 | - | - | - | 447,416 |
| Total financial liabilities | 7,314,834 | 9,748,953 | 32,490,819 | 29,750,563 | - | - | 79,305,169 |
| | | | | | | | |
| 31 December 2017 | <i>On demand and less than 1 month</i> | <i>1 to 3 months</i> | <i>3 to 12 months</i> | <i>1 to 5 years</i> | <i>Later than 5 years</i> | <i>No maturity</i> | <i>Total</i> |
| Liabilities | | | | | | | |
| Debt securities issued | 260,712 | - | 1,158,164 | 18,122,281 | - | - | 19,541,157 |
| Amounts due to credit institutions | 4,638,117 | 6,150,582 | 18,592,466 | 6,764,140 | - | - | 36,145,305 |
| Deliverable derivative financial instruments | - | - | - | - | - | - | - |
| - Cash inflow | (2,784,494) | (6,804) | (5,757,215) | (2,783,604) | - | - | (11,332,117) |
| - Cash outflow | 3,140,374 | 198,864 | 6,824,760 | 3,264,496 | - | - | 13,428,495 |
| Amounts due to customers | 2,469,535 | 40,223 | 10,693,363 | - | - | - | 13,203,121 |
| Other financial liabilities | 18,710 | 378,128 | - | - | - | - | 396,838 |
| Total financial liabilities | 7,742,954 | 6,760,993 | 31,511,538 | 25,367,314 | - | - | 71,382,799 |

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17. Risk management (continued)

17.6 Liquidity risk (continued)

Risks assumed by the Bank

As at 31 December 2018, the Bank had the following liquidity level:

| | <i>On demand and less than 1 month</i> | <i>1 to 3 months</i> | <i>3 to 12 months</i> | <i>1 to 5 years</i> | <i>Later than 5 years</i> | <i>No maturity</i> | <i>Total</i> |
|--|--|--------------------------|---------------------------|-------------------------|-------------------------------|--------------------|-------------------|
| Assets | | | | | | | |
| Cash and cash equivalents | 9,593,279 | - | - | - | - | - | 9,593,279 |
| Obligatory reserve with the Bank of Russia | - | - | - | - | - | 318,510 | 318,510 |
| Derivative financial assets | (280,077) | - | 388,912 | 1,023,851 | - | - | 1,082,686 |
| Loans to customers | 2,225,219 | 27,172,344 | 20,482,009 | 28,928,527 | 280,089 | - | 79,088,188 |
| Investment securities – debt securities at FVOCI | - | - | 439,648 | - | - | - | 439,648 |
| Property and equipment | - | - | - | - | - | 60,892 | 60,892 |
| Intangible assets | - | - | - | - | - | 148,867 | 148,867 |
| Income tax | - | - | - | - | - | - | - |
| Deferred income tax assets | - | - | - | 1,008,353 | - | - | 1,008,353 |
| Other assets | 14,499 | 56,179 | 36,049 | 4,379 | - | - | 111,106 |
| Total assets | 11,552,920 | 27,228,523 | 21,296,618 | 30,965,110 | 280,089 | 528,269 | 91,851,529 |
| Liabilities | | | | | | | |
| Debt securities issued | 131,450 | - | 122,807 | 18,431,228 | - | - | 18,685,486 |
| Amounts due to credit institutions | 4,176,306 | 9,120,706 | 27,884,728 | 1,505,209 | - | - | 42,686,949 |
| Derivative financial liabilities | 55,506 | 164,191 | (19,378) | 79,359 | - | - | 279,679 |
| Amounts due to customers | 2,806,664 | 3,394 | 2,115,675 | 6,973,211 | - | - | 11,898,945 |
| Current income tax liability | - | - | 41,429 | - | - | - | 41,429 |
| Other liabilities | 119,996 | 1,085,850 | 738,524 | 83,410 | - | - | 2,027,780 |
| Total liabilities | 7,289,922 | 10,374,141 | 30,883,785 | 27,072,420 | - | - | 75,620,265 |
| Net position | 4,262,998 | 16,854,382 | (9,587,167) | 3,892,690 | 280,089 | 528,269 | 16,231,264 |
| Accumulated net position | 4,262,998 | 21,117,380 | 11,530,213 | 15,422,903 | 15,702,992 | 16,231,261 | |

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17. Risk management (continued)

17.6 Liquidity risk (continued)

As at 31 December 2017, the Bank had the following liquidity level:

| | <i>On demand and less than 1 month</i> | <i>1 to 3 months</i> | <i>3 to 12 months</i> | <i>1 to 5 years</i> | <i>Later than 5 years</i> | <i>No maturity</i> | <i>Total</i> |
|--|--|--------------------------|---------------------------|-------------------------|-------------------------------|--------------------|-------------------|
| Assets | | | | | | | |
| Cash and cash equivalents | 7,513,681 | - | - | - | - | - | 7,513,681 |
| Obligatory reserve with the Bank of Russia | - | - | - | - | - | 390,249 | 390,249 |
| Derivative financial assets | (50,295) | (51,711) | 288,498 | 19,454 | - | - | 205,946 |
| Loans to customers | 5,004,477 | 18,388,856 | 16,264,150 | 26,788,162 | 173,358 | - | 66,619,003 |
| Investment securities available for sale | 53,344 | - | - | 100,373 | 442,218 | - | 595,935 |
| Property and equipment | - | - | - | - | - | 15,973 | 15,973 |
| Intangible assets | - | - | - | - | - | 271,825 | 271,825 |
| Income tax | - | - | - | - | - | 22,008 | 22,008 |
| Deferred income tax assets | - | - | - | - | - | 1,130,974 | 1,130,974 |
| Other assets | 1,884 | 71,864 | 20,306 | 4,379 | - | - | 98,433 |
| Total assets | 12,523,091 | 18,409,009 | 16,572,954 | 26,912,368 | 615,576 | 1,831,029 | 76,864,027 |
| Liabilities | | | | | | | |
| Debt securities issued | 253,600 | - | 193,550 | 15,000,000 | - | - | 15,447,150 |
| Amounts due to credit institutions | 4,613,684 | 5,935,206 | 17,782,832 | 6,527,901 | - | - | 34,859,623 |
| Derivative financial liabilities | 336,971 | 189,349 | 887,656 | 168,387 | - | - | 1,582,363 |
| Amounts due to customers | 2,471,620 | 39,698 | 10,192,116 | - | - | - | 12,703,434 |
| Other liabilities | 19,224 | 870,348 | 791,989 | 42,473 | - | - | 1,724,034 |
| Total liabilities | 7,695,099 | 7,034,601 | 29,848,143 | 21,738,761 | - | - | 66,316,604 |
| Net position | 4,827,992 | 11,374,408 | (13,275,188) | 5,173,607 | 615,576 | 1,831,029 | 10,547,423 |
| Accumulated net position | 4,827,992 | 16,202,400 | 2,927,211 | 8,100,819 | 8,716,395 | 10,547,423 | |

17.7 Legal risk

Legal risk relates to the possibility that the Bank will incur financial losses or unbudgeted expenses or to the possibility that the budgeted income will be reduced as a result of the following:

- ▶ Non-compliance of organizational and administrative documentation of the Bank with laws, regulations and law enforcement practice;
- ▶ Ignorance of judicial and law enforcement practices;
- ▶ Weaknesses of the legal system (contradictory legislation, lack of regulation for certain issues arising in the course of the Bank's activities);
- ▶ Legal errors in operations (incorrect legal advice, improperly prepared internal documentation or agreements).

Legal risks inherent to the Bank's activities are as follows:

- ▶ Risks to perform transactions that are considered invalid in accordance with the applicable legislation of the Russian Federation;
- ▶ Risks to conclude agreements that may cause significant impairment of assets or growing liabilities of the Bank;
- ▶ Risks of unfavorable outcome of litigations involving the Bank;
- ▶ Risks arising from changes in applicable legislation and judicial practices pertaining to key business issues of the Bank.

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17. Risk management (continued)

17.7 Legal risk (continued)

The objective of legal risk management is to ensure sustainable growth of the Bank under its development strategy and compliance of its activities and products with legislative requirements and law enforcement practice.

Key factors/events that can increase the influence and scope of the legal risk are as follows:

- ▶ Changes in legislation, regulators' requirements, judicial and law enforcement practices;
- ▶ Contradictory judicial and law enforcement practices, conflict of regulations;
- ▶ More complex financial instruments and strategies and/or adoption of new products and technologies.

In order to support the decision-making process and ensure timely response to changes in the level of legal risk, the Bank prepares standard reports on a timely basis on losses related to the legal risk, the level of legal risk management and the current status of activities to mitigate legal risk.

The level of legal risk is compared with the relevant data for previous reporting periods. Any significant deviations are analyzed to determine the reason for a sharp increase or decrease in the relevant indicator, and proposals to change bank processes are prepared, if necessary.

To manage legal risk, the Bank applies internal rules for the approval and sign-off of legally significant documents. As regards its core activities, the Bank develops and uses standard contract templates, as well as regularly monitors the effective legislation and promptly communicates key changes that are significant to the Bank to its management and personnel of the business units involved. The Bank has internal rules for the approval and sign-off of the Bank's responses to certain claims (complaints) made by its customers and requests submitted by state authorities. Moreover, the Bank has a process in place ensuring that new contracts that are significant to the Bank comply with effective legislation and that counterparties that are legal entities have due legal capacity. The overall law enforcement practice applicable to the Bank's operations is being established.

Current and potential claims against the Bank

The Bank makes a provision for potential litigation costs for non-credit-related contingent liabilities, if the analysis of all circumstances and conditions shows a likelihood of more than 50% that claims will be raised against the Bank for non-fulfillment or improper fulfillment of its obligations, including mandatory payments (such as litigation costs).

In 2018, the Bank filed 557 legal suits against individual borrowers demanding the repayment of amounts due under loan agreements and the foreclosure on property pledged as collateral. As at 1 January 2019, those claims against individual borrowers totaled RUB 276,194 thousand.

In 2018, the Bank filed 152 legal suits against individual borrowers without demanding foreclosure on property pledged as collateral. As at 1 January 2019, those claims totaled RUB 64,004 thousand.

As at 1 January 2019, the Bank made a provision of RUB 11.2 million for litigations with individuals (1 January 2018: RUB 11.9 million). The Bank regards the amount as insignificant and does not think it is probable that future litigations with individuals will affect the Bank's financing or operating activities.

17.8 Strategic risk

Strategic risk is a risk of losses which the Bank may incur as a result of mistakes (deficiencies) in making decisions defining the Bank's strategy due to lacking or inadequate accounting for potential threats to the Bank's operations, insufficiently reasoned or incorrect determination of priority areas where the Bank can achieve competitive advantages, lacking or insufficient resources required (financial, material, technical, etc.).

The Management Board formulates the development strategy of the Bank for a period from three to five years, as well as a business plan for the current financial year, which are approved by the Board of Directors. The Management Board is informed on the business plan implementation for the current financial year on a monthly basis and the development strategy implementation on an annual basis. The Management Board makes amendments to the strategy and the business plan, if necessary, which are subsequently approved by the Board of Directors.

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17. Risk management (continued)

17.9 Reputational risk

The Bank has a solid business reputation, promotes a positive image of the Bank, quality of its services and nature of its business in general, based on the actual operating results. The risk that the Bank may incur losses as a result of business reputation deterioration is assessed by the Management of the Bank as minimal.

17.10 Country risk

Country risk (including non-payment risk) is a risk that the Bank may incur losses as a result of foreign counterparties (legal entities or individuals) failing to meet their obligations or doing that improperly due to economic, political or social changes or because the currency of a monetary liability may be inaccessible to a counterparty due to the specifics of the national legislation (irrespective of the counterparty's financial position).

The Bank is a resident of the Russian Federation and operates in the Russian Federation.

The Bank engages in transactions with non-resident counterparties registered in the EU, the USA and Japan.

18. Fair value measurements

Fair value hierarchy

The Bank uses the following hierarchy to determine and disclose the fair value of financial instruments by valuation technique:

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

As at 31 December 2018, fair value hierarchy disclosures are as follows:

| | <i>Quoted prices in active markets (Level 1)</i> | <i>Significant observable inputs (Level 2)</i> | <i>Significant unobservable inputs (Level 3)</i> | <i>Total</i> |
|--|--|--|--|-------------------|
| Assets measured at fair value | | | | |
| Investment securities – debt securities at FVOCI | 439,648 | – | – | 439,648 |
| Derivative financial instruments | – | 1,082,686 | – | 1,082,686 |
| Total assets measured at fair value | 439,648 | 1,082,686 | – | 1,522,334 |
| Assets for which fair values are disclosed | | | | |
| Cash and cash equivalents | – | 9,593,279 | – | 9,593,279 |
| Amounts due from credit institutions | – | – | – | – |
| Loans to customers | – | – | 76,221,528 | 76,221,528 |
| Other assets | – | – | 63,497 | 63,497 |
| Total assets for which fair values are disclosed | – | 9,593,279 | 76,285,025 | 85,878,304 |
| Liabilities measured at fair value | | | | |
| Derivative financial instruments | – | 279,679 | – | 279,679 |
| Total liabilities measured at fair value | – | 279,679 | – | 279,679 |
| Liabilities for which fair values are disclosed | | | | |
| Debt securities issued | – | 18,639,407 | – | 18,639,407 |
| Amounts due to credit institutions | – | – | 42,668,231 | 42,668,231 |
| Amounts due to customers | – | – | 12,190,973 | 12,190,973 |
| Other liabilities | – | – | 447,415 | 447,415 |
| Total liabilities for which fair values are disclosed | – | 18,639,407 | 55,306,619 | 73,946,026 |

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18. Fair value measurements (continued)

Fair value hierarchy (continued)

As at 31 December 2017, fair value hierarchy disclosures are as follows:

| | <i>Quoted prices in active markets (Level 1)</i> | <i>Significant observable inputs (Level 2)</i> | <i>Significant unobservable inputs (Level 3)</i> | <i>Total</i> |
|--|--|--|--|-------------------|
| Assets measured at fair value | | | | |
| Investment securities available for sale | 595,935 | – | – | 595,935 |
| Derivative financial instruments | – | 205,946 | – | 205,946 |
| Total assets measured at fair value | 595,935 | 205,946 | – | 801,881 |
| Assets for which fair values are disclosed | | | | |
| Cash and cash equivalents | – | 7,513,681 | – | 7,513,681 |
| Amounts due from credit institutions | – | – | – | – |
| Loans to customers | – | – | 62,952,128 | 62,952,128 |
| Other assets | – | – | 71,727 | 71,727 |
| Total assets for which fair values are disclosed | – | 7,513,681 | 63,023,855 | 70,537,536 |
| Liabilities measured at fair value | | | | |
| Derivative financial instruments | – | 1,582,363 | – | 1,582,363 |
| Total liabilities measured at fair value | – | 1,582,363 | – | 1,582,363 |
| Liabilities for which fair values are disclosed | | | | |
| Debt securities issued | – | 15,198,518 | – | 15,198,518 |
| Amounts due to credit institutions | – | – | 34,847,081 | 34,847,081 |
| Amounts due to customers | – | – | 12,703,434 | 12,703,434 |
| Other liabilities | – | – | 396,838 | 396,838 |
| Total liabilities for which fair values are disclosed | – | 15,198,518 | 47,947,353 | 63,145,871 |

Financial instruments not recorded at fair value in the statement of financial position

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

| | 31 December 2018 | | | 31 December 2017 | | |
|--|----------------------------|-----------------------|-------------------------------------|----------------------------|-----------------------|-------------------------------------|
| | <i>Carrying amount</i> | <i>Fair value</i> | <i>Unrecognized gain/(loss)</i> | <i>Carrying amount</i> | <i>Fair value</i> | <i>Unrecognized gain/(loss)</i> |
| Financial assets | | | | | | |
| Cash and cash equivalents | 9,593,279 | 9,593,279 | – | 7,513,681 | 7,513,681 | – |
| Amounts due from credit institutions | – | – | – | – | – | – |
| Loans to customers | 79,088,188 | 76,221,528 | (2,866,660) | 66,619,003 | 62,952,128 | (3,666,875) |
| Other assets | 63,497 | 63,497 | – | 71,727 | 71,727 | – |
| Total financial assets | 88,744,964 | 85,878,304 | (2,866,660) | 74,204,411 | 70,537,536 | (3,666,875) |
| Financial liabilities | | | | | | |
| Amounts due to credit institutions | 42,686,949 | 42,668,231 | 18,718 | 34,859,623 | 34,847,081 | 12,542 |
| Amounts due to customers | 11,898,945 | 12,190,973 | (292,028) | 12,703,434 | 12,703,434 | – |
| Debt securities issued | 18,685,486 | 18,639,407 | 46,079 | 15,447,150 | 15,198,518 | 248,632 |
| Other liabilities | 447,415 | 447,415 | – | 396,838 | 396,838 | – |
| Total financial liabilities | 73,718,795 | 73,946,026 | (227,231) | 63,407,045 | 63,145,871 | 261,174 |
| Total unrecognized change in fair value | | | (3,093,891) | | | (3,405,701) |

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18. Fair value measurements (continued)

Valuation techniques and assumptions

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

Assets for which fair value approximates carrying amount

For financial assets and financial liabilities that are liquid or have a short-term maturity (less than one year), it is assumed that their carrying amounts approximate their fair values. This assumption is also applied to demand deposits and savings accounts without a specific maturity.

Financial assets and financial liabilities carried at amortized cost

The fair value of instruments that have been unquoted for over a year, loans to customers, customer deposits, amounts due from credit institutions and amounts due to the Bank of Russia and other credit institutions, other financial assets and liabilities, obligations under finance leases is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

19. Segment reporting

The Bank has determined operating segments based on its organizational structure. Information on operating segments is presented in the same manner as internal reports presented to the Management Board.

For the purposes of this disclosure, "operating segments" are determined by the Bank based on the definition specified in IFRS 8 *Operating Segments*.

For the management purposes, the Bank's activities are divided into three business segments:

- ▶ Corporate banking – provision of financing to car dealers, maintenance of term deposits placed by corporate customers;
- ▶ Retail banking – provision of loans to retail customers (car loans) and rendering related financial services;
- ▶ In-house activities – interbank lending, trading with securities, foreign currencies and derivative financial instruments, and other internal transactions.

Management monitors operating results separately for each business unit for the purpose of making decisions on the resource allocation and performance assessment. Transfer prices for transactions between operating segments are set on an arm's length basis in a manner similar to transactions with third parties.

Information on each segment is reviewed using the methods similar to those applied in making decisions on the resource allocation between segments and performance assessment.

The breakdown of the Bank's assets and liabilities by operating segment in 2018 and 2017 is shown in the table below.

| | 31 December 2018 | 31 December 2017 |
|--------------------------|-----------------------------|-----------------------------|
| Assets | | |
| Retail banking | 48,178,976 | 46,406,450 |
| Corporate banking | 30,909,212 | 20,212,552 |
| In-house activities | 12,763,342 | 10,245,023 |
| Total assets | 91,851,530 | 76,864,025 |
| Liabilities | | |
| Retail banking | 2,136,507 | 1,854,831 |
| Corporate banking | 1,121,726 | 1,208,082 |
| In-house activities | 72,362,033 | 63,253,692 |
| Total liabilities | 75,620,266 | 66,316,605 |

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19. Segment reporting (continued)

The analysis of the Bank's income and expenses by segment for the year ended 31 December 2018 and 2017 is shown in the table below.

| | 2018 | | | | | 2017 | | | | |
|--|--------------------|--------------------|---------------------|-----------------|--------------------|--------------------|--------------------|---------------------|-----------------|--------------------|
| | Retail banking | Corporate banking | In-house activities | Reconciliation* | Total | Retail banking | Corporate banking | In-house activities | Reconciliation* | Total |
| Revenue | | | | | | | | | | |
| Interest income | 8,229,615 | 2,695,481 | 452,860 | - | 11,377,956 | 7,660,927 | 2,383,212 | 434,324 | - | 10,478,463 |
| Fee and commission income | - | 119,244 | - | - | 119,244 | - | 132,518 | - | - | 132,518 |
| Total revenue | 8,229,615 | 2,814,725 | 452,860 | - | 11,497,200 | 7,660,927 | 2,515,730 | 434,324 | - | 10,610,981 |
| Expenses | | | | | | | | | | |
| Interest expense | (3,997,967) | (1,151,672) | (431,709) | 247,374 | (5,333,974) | (4,072,104) | (1,216,023) | (735,682) | 501,035 | (5,522,774) |
| Fee and commission expense | (190,977) | - | - | - | (190,977) | (170,938) | - | - | - | (170,938) |
| Allowance for impairment | (487,379) | (248,245) | (600) | - | (736,224) | (457,454) | (542,296) | 30,041 | - | (969,709) |
| Non-interest expense/(income) | - | - | (108,120) | (247,374) | (355,494) | - | - | 301,370 | (501,035) | (199,665) |
| Other administrative expenses | (1,200,355) | (385,061) | - | - | (1,585,416) | (1,099,295) | (372,499) | - | - | (1,471,794) |
| Total expenses | (5,876,678) | (1,784,978) | (540,429) | - | (8,202,085) | (5,799,791) | (2,130,818) | (404,271) | - | (8,334,880) |
| Profit/(loss) before income tax expense | 2,352,937 | 1,029,747 | (87,569) | - | 3,295,115 | 1,861,136 | 384,912 | 30,053 | - | 2,276,101 |
| Income tax expense | (464,041) | (224,230) | - | - | (688,271) | (381,655) | (146,651) | - | - | (528,306) |
| Total net profit for the year | 1,888,896 | 805,517 | (87,569) | - | 2,606,844 | 1,479,481 | 238,261 | 30,053 | - | 1,747,795 |

* The differences relate to the effect of hedging transactions that did not pass the hedge effectiveness test.

In 2018 and 2017, the Bank had no revenue from transactions with a single external customer or counterparty that would amount to 10% or more of its total revenue.

20. 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.

20.1 Transactions with the members of the Board of Directors and the Management Board

The total compensations to the members of the Board of Directors and the Management Board included in personnel expenses in 2018 and 2017 amounted to RUB 98,792 thousand and RUB 88,699 thousand, respectively.

20.2 Transactions with related parties

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, is under common control or can exercise significant influence over the other party in making financial or operational decisions.

The Bank entered into transactions with related parties as part of its normal business. There is no increased risk of arrears or other unfavorable events resulting from such transactions.

The Bank's related parties are as follows:

As a result of a share sale and purchase transaction, BARN B.V., a private limited liability company (the Kingdom of the Netherlands) became the Bank's sole shareholder on 29 August 2013. The ownership interest in the Bank's share capital is 100.00%.

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20. Related party disclosures (continued)

20.2 Transactions with related parties (continued)

The ultimate owners of the Bank's shareholder are:

- ▶ UniCredit S.p.A., Italy – 40%;
- ▶ Renault S.A., France – 30%;
- ▶ Nissan Motor Co., Ltd., Japan – 30%.

The shares above do not include the ownership of Renault S.A., France, in the share capital of Nissan Motor Co., Ltd., Japan, which was 43% as at 31 December 2018.

| Shareholders | 31 December 2018 BARN B.V. | 31 December 2017 BARN B.V. |
|---|--|---|
| Transactions with other related parties | JSC UniCredit Bank RCI Banque S.A. Nissan Financial Services Co, Ltd. Renault Finance S.A. RNGM S.A. LLC Nissan Manufacturing RUS LLC RN Finance RUS Nissan Motor Acceptance Corporation CJSC Renault Russia DIAC | JSC UniCredit Bank RCI Banque S.A. Nissan Financial Services Co, Ltd. Renault Finance S.A. RNGM S.A. LLC Nissan Manufacturing RUS LLC RN Finance RUS Nissan Motor Acceptance Corporation CJSC Renault Russia DIAC JSC NPF AVTOVAZ |

The outstanding balances of, and gains and losses resulting from, transactions with related parties are presented below:

| | 31 December 2018 | | 31 December 2017 | |
|--|-------------------------|------------------------------|-------------------------|------------------------------|
| | Shareholder | Other related parties | Shareholder | Other related parties |
| Assets | | | | |
| Cash and cash equivalents | – | 10,918 | – | 13,447 |
| Loans to customers | – | 493,162 | – | 292,602 |
| Financial assets at fair value through profit or loss | – | 207,129 | – | 14,872 |
| Total assets | – | 711,209 | – | 320,921 |
| Liabilities | | | | |
| Amounts due to credit institutions | – | 29,066,121 | – | 24,806,570 |
| Financial liabilities at fair value through profit or loss | – | 279,679 | – | 1,182,076 |
| Amounts due to customers | – | 6,362,500 | – | 7,958,969 |
| Other liabilities | – | 2,851 | – | 6,008 |
| Total liabilities | – | 35,711,151 | – | 33,953,623 |
| Commitments and guarantees received | – | 296,620 | – | 268,145 |

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20. Related party disclosures (continued)

20.2 Transactions with related parties (continued)

| | 2018 | 2017 |
|---|---------------|---------------|
| Interest income | – 3,043,893 | – 2,012,453 |
| Interest expense | – (1,965,860) | – (1,670,136) |
| Fee and commission income | – 103,730 | – 107,025 |
| Fee and commission expense | – (56,585) | – (67,259) |
| Result of operations with financial instruments | – (458,609) | – (1,467,876) |
| Other operating income | – 595 | – 1,498 |
| Other operating expenses | – (63,746) | – (398,772) |
| Net gains/(losses) from foreign currencies | – (576,168) | – (400,291) |

21. Capital management

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

The primary objective of capital management is monitoring compliance of the Bank's capital with external requirements and maintenance of robust credit ratings and capital ratios to ensure the Bank's operation and maximize shareholder value.

In 2018, the Bank adhered to the same capital management policies as in 2017.

Capital adequacy ratio set by the Bank of Russia

Under the requirements set by the Bank of Russia, banks have to maintain a capital adequacy ratio of at least 8% of risk-weighted assets (the ratio is calculated in the statutory financial statements prepared in accordance with Russian accounting legislation).

| | 31 December 2018 | 31 December 2017 |
|--|---------------------|---------------------|
| Core capital, main capital | 15,622,147 | 9,599,375 |
| Additional capital | 1,037,081 | 1,399,645 |
| Total equity (capital) | 16,659,228 | 10,999,020 |
| Risk-weighted assets (to determine core capital adequacy) | 107,724,357 | 88,937,078 |
| Risk-weighted assets (to determine main capital adequacy) | 107,724,357 | 88,937,078 |
| Risk-weighted assets | 107,724,357 | 88,937,013 |
| Core capital adequacy ratio, % (N1.1) (minimum is set at 4.5%) | 14.5% | 10.8% |
| Main capital adequacy ratio, % (N1.2) (minimum is set at 6.0%) | 14.5% | 10.8% |
| Equity (capital) adequacy ratio, % (N1.0) (minimum is set at 8.0%) | 15.5% | 12.4% |

In 2018 and 2017, the Bank's operations complied with all externally imposed capital requirements.

A capital buffer was set in Regulation No. 180-I of the Bank of Russia *On Prudential Ratios of Banks* of 28 June 2017 (hereinafter, "Instruction No. 180-I"). The buffer amounted to 1.875% in the reporting period. During the reporting period, the Bank's actual capital adequacy ratios were in line with the established limits, subject to the capital buffers.

In the event a bank does not comply with the prudential ratio for a minimum of six business days, in aggregate, within any 30 consecutive business days, the Bank of Russia may take measures stipulated in Article 74 of the Federal Law *On the Central Bank of the Russian Federation (the Bank of Russia)*.

When planning its future activities, the Bank assesses its capital adequacy by monitoring compliance with the prudential ratios N1.0, N1.1 and N1.2 of the planned ratios as adjusted for the scope of the Bank's activities and the level of risk assumed on the planned lending transactions in accordance with Basel III regulations.

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22. Events after the reporting date

On 14 February 2019, the Bank placed three-year exchange-traded bonds of the fifth issue in the amount of RUB 5 billion with a coupon rate of 9.15%.

On 28 February 2019, Analytical Credit Rating Agency (ACRA) upgraded the national credit rating of the Bank to the maximum of AAA(RU) with a stable outlook. The ratings of exchange-traded bond issues of the Bank were also upgraded to AAA(RU).