“HSBC Bank Armenia” CJSC

Annual Report and Accounts 2017

HSBC

The HSBC Group

HSBC Bank Armenia is a member of HSBC Group, one of the largest banking and financial services organisations in the world.
HSBC Group international network comprises around 3,900 offices over 67 countries and territories.

HSBC Bank Armenia CJSC
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Statement of management's responsibilities

The management of HSBC Bank Armenia CJSC (the "Bank") is responsible for the preparation of financial statements which give a true and fair view of the financial position and financial performance of the Bank, in all material respects. In preparing these financial statements, the directors are required to:

- select appropriate accounting policies, present them for the Board's approval and apply them consistently;
- make reasonable judgments and estimates;
- keep proper accounting records;
- comply with the requirements of International Financial Reporting Standards and, in case discrepancies exist, disclose them in the notes to the financial statements;
- prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the Bank will continue in business;
- design, implement and maintain an effective and reliable internal control system relevant to the internal control minimum requirements specified by the Central Bank of the Republic of Armenia;
- set up an effective accounting system complying with the requirements of the Republic of Armenia legislation and International Financial Reporting Standards, as well providing timely and accurate information on the Bank's financial position;
- take such steps within its authorities to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

Paul Edgar Chief Executive Officer	Astghik Drambyan Chief Financial Officer / Deputy CEO

Statement of compliance

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

The financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2017, and its financial performance and its cash flows for the year then ended.

Opinion on compliance with the requirements of the Central Bank of Armenia on internal controls

This opinion is prepared based on the results of internal audits and continuing monitoring completed by the Internal Audit function during 2017. It is confirmed that the function had appropriate resources for this activity.

Based on the above, in our opinion, the Bank's activity during 2017 was generally in compliance with legislative and regulatory requirements. Any identified issues with this regard have been escalated to the Board and management through internal audit reports. Appropriate management remediating actions have been agreed and either completed or are in progress.

Internal Audit Department

Business review and financial analysis

HSBC Bank Armenia CJSC (the "Bank") continues to actively play its part in the Armenian financial sector, improve its risk management and control framework and reinforces its standards of business conduct. The Bank has also retained a strong capital position and market share in target areas.

We provide banking and financial services to our customers and continuously strive to enhance the quality of the products we offer in Armenia. Throughout 2017 we continued to serve the needs of our customers through three of HSBC's global businesses: Retail Banking and Wealth Management, Commercial Banking and Global Banking and Markets through our branches/offices and direct channels.

The market is characterised by socio-economic challenges, driven by mixed macro-economic climate, predominately as a result of the past shock in the Russian economy and the wider CIS region. There are signs of improvement in the economic environment and in investment sentiment and GDP growth is robust. Competition in the market tightened following the introduction of new requirements on the minimum level of capital prescribed by the regulator from 2017, which led to capital injections and generated liquidity for many of the banks in Armenia.

Against this background, the Bank's performance in 2017 did not meet management's expectations; we closed the year with a loss. Our 2017 financial results are largely explained by higher than desired impairment charges against our corporate loan portfolio, mainly due to more conservative valuation of real estate collateral and our prudent approach to restructured loans. Operating in a competitive environment with reduced interest margins was another factor contributing to the Bank's financial results.

Encouragingly, all business lines continued to pursue growth targets and generate strong revenues. Individual customers responded positively to the marketing campaigns and activities. In 2017 we launched a highly successful personal lending campaign and an attractive mortgage financing initiative. On the corporate side, we remained focused on internationally minded businesses - helping customers benefit from our network and expertise and connecting customers to opportunities. In 2017 we introduced a highly competitive offer for equipment financing that will enable new opportunities for growth for both the economy and the Bank in 2018. We remain one of the country's leading international banks for trade finance and international cash management.

During the year we remained committed to our strategy of supporting foreign investments into Armenia, by referring lending opportunities to HSBC Bank plc, UK for direct lending to Armenian businesses. The loan portfolio of HSBC Bank plc, UK to Armenian businesses grew from USD 170 million as at 31 December 2016 to USD 197 million as at 31 December 2017, or by 16%. These balances and related interest income are not part of the financial statements of the Bank, however this lending clearly demonstrates HSBC Group's continued support and interest in Armenia's economy. In 2017 we provided one of the largest ever loans in our history, EUR 55 million, to Electric Networks of Armenia (ENA) marking ten years of successful cooperation between ENA and HSBC. The deal shows the Bank's commitment to contribute to investments for developing a sustainable and secure energy sector in Armenia.

We are continuing to take concerted action to improve anti-money laundering and sanctions compliance controls and to implement HSBC Group's Global Standards programme. We are safer today and better protected from the threat of financial crime because of the investments we have been making in this programme. In 2017 we delivered a fully functioning financial crime management model, deployed enhanced systems that will allow us to automate customer screening and anti-money laundering transaction monitoring in Armenia setting the highest standards in the market for fighting financial crime. We remain absolutely committed to ensuring financial crime risk is clearly understood and addressed throughout our network.

We continued investing in innovation and technology to serve our customers better as well as enhance security around financial transactions and customer data. In 2017 we were the first bank in Armenia to issue Mastercard with innovative contactless technology allowing our customers to pay for low value items with a simple tap. Further, since the usage of digital channels, including mobile banking continued to increase, we commenced a project to further improve our customers' banking experience through introducing biometric authentication. By using the new iOS Face ID and Touch ID, our customers can now authenticate their identity and access digital banking in mere seconds without entering their username, password or any additional information. At the same time, we initiated an upgrade of our Automatic Teller Machines (ATM) and related software, which aims to effectively meet our customers' evolving needs, align customer data collection to best international standards and provide best possible service in this sphere.

How we do business is as important as what we do. At HSBC Sustainability means building our business for the long term by balancing social, environmental and economic considerations in the decisions we make. We contributed just over USD250,000 to local community projects from both local and Group budgets. Our main charity delivery partners for 2017 were Junior Achievement of Armenia, Orran BNGO, SOS Children Village Armenia, Foundation for the Preservation of Wildlife and Cultural Assets, British Council Armenian Branch, WWF Armenia, and Children of Armenian Fund. HSBC Armenia continued active contribution to its Global Reduce programme (a 10 point sustainability strategy to reduce our annual carbon emission by about a third per employee by 2020) through sustainable and responsible operations. In terms of our new Corporate Sustainability strategic focus on Sustainable Finance, the key objective for HSBC will be to provide financing to enable the transition to a low-carbon economy and to help clients manage transition risk. Despite time and work pressures, 165 of HSBC Armenia employees have been active volunteers supporting the communities in which we operate. There was a four-fold increase in HSBC Armenia staff volunteering hours from some 200 hours in 2016 to over 800 hours this year.

On behalf of the Management and Board, we want to thank our thirty thousand customers for their trust and commitment. None of this would have been possible without their commercial success, loyalty and support. We also owe a huge thanks to our 407 colleagues who have delivered all of the above mentioned activities at the same time as working tirelessly to meet the expectations of our customers.

Financial review

The Bank's net loss after tax for the year was AMD 7,941 million. This is explained by higher impairment charges against loan portfolio mainly due to more conservative valuation of real estate collateral. Another big driver of higher impairment charges is the more prudent approach in assessing its impairment charges against restructured loans.

Operating income before impairment losses decreased to AMD 12,303 million, a 27% decrease from the previous year. This is mainly driven by lower net loan portfolio due to impairments and de-risking initiatives, as well as reduced margins.

Impairment charges were AMD 14,186 million versus AMD 16,887 million in 2016. Personnel and other administrative expenses were AMD 8,239 million, a 2.5% increase from the previous year.

Total assets as at 31 December 2017 were AMD 209 billion, a 3% decrease over the previous year. Loans to customers amounted to AMD 95 billion, a 20% decrease over last year. The gross corporate loan portfolio decreased by 22% and amounted to AMD 84 billion. The gross retail loan portfolio showed a 7% decrease amounting to AMD 22 billion. Current accounts and deposits from customers were AMD 159 billion, a 6% increase from the previous year, reflecting our customers continued confidence in the Bank and its global brand.

Stephen Banner
Board Member

Ara Alexanian
Board Member

Independent Auditor's Report

To the Board of HSBC Bank Armenia CJSC

Our opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of HSBC Bank Armenia CJSC (the "Bank") as at 31 December 2017, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS").

What we have audited

The Bank's financial statements comprise:

- the statement of financial position as at 31 December 2017;
- the statement of profit or loss and other comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include significant accounting policies and other explanatory information.

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 believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

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 of the Auditor's Professional Ethics Code and Auditor's Independence Rules that are relevant to our audit of the financial statements in the Republic of Armenia. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code.

Independent Auditor's Report (Continued)

Other information

Management is responsible for the other information. The other information obtained at the date of this auditor's report comprises Business Review and Financial Analysis (but does not include the financial statements and our auditor's report thereon).

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 on the other information obtained prior to the date of this auditor's report, 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 those charged with governance for the financial statements

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

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

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

Auditor's responsibilities for the audit of the financial statements

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

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism 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.

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Independent Auditor's Report (Continued)

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

Altaf Tapla
Managing Partner

Anahit Gyozalyan
Auditor

PricewaterhouseCoopers Armenia LLC.

23 April 2018
Yerevan, Republic of Armenia

Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 December 2017

	Notes	2017 AMD'000	2016 AMD'000
Interest income	4	12,955,726	17,649,493
Interest expense	4	(4,752,407)	(5,304,386)
Net interest income		**8,203,319**	**12,345,107**
Fee and commission income	5	3,622,549	3,700,449
Fee and commission expense	6	(466,002)	(518,690)
Net fee and commission income		**3,156,547**	**3,181,759**
Net gain/(loss) on financial instruments at fair value through profit or loss	7	187,691	(3,214)
Net foreign exchange gain	8	1,044,549	1,617,896
Net gain on available-for-sale financial assets		-	2,742
Other operating income		260,388	82,262
Other operating expenses	9	(549,137)	(348,967)
Operating income		**12,303,357**	**16,877,585**
Impairment losses	10	(14,185,858)	(16,886,681)
Net operating loss		**(1,882,501)**	**(9,096)**
Personnel expenses		(4,083,834)	(3,829,441)
Other general administrative expenses	11	(4,155,149)	(4,207,813)
Loss before income tax		**(10,121,484)**	**(8,046,350)**
Income tax credit	12	2,180,901	1,379,496
Loss for the year		**(7,940,583)**	**(6,666,854)**
Other comprehensive (loss)/income, net of income tax			
Items that are or may be reclassified subsequently to profit or loss:			
Revaluation reserve for available-for-sale financial assets:			
- Net change in fair value		(82,002)	634,362
- Net change in fair value transferred to profit or loss		-	2,194
Other comprehensive (loss)/ income for the year, net of income tax		**(82,002)**	**636,556**
Total comprehensive loss for the year		**(8,022,585)**	**(6,030,298)**

The financial statements as set out on pages 13 to 78 were approved by the Board of the Bank. The financial statements were signed by the Management of the Bank on 12 April 2018.

Paul Edgar
Chief Executive Officer

Astghik Drambyan
Chief Financial Officer/Deputy CEO

The accompanying notes on pages 17 to 78 are an integral part of these financial statements.

Statement of Financial Position as at 31 December 2017

	Notes	2017 AMD'000	2016 AMD'000
ASSETS			
Cash and cash equivalents	13	69,465,410	54,076,716
Financial instruments at fair value through profit or loss	14	1,314,070	922,745
Available-for-sale financial assets	15	23,299,746	24,773,867
Loans and advances to banks	16	10,566,868	6,238,794
Loans to customers	17	95,431,247	119,590,354
Current tax asset		16,325	632,010
Deferred tax asset	12	1,152,217	-
Property, equipment and intangible assets	18	3,135,984	3,418,325
Other assets	19	4,267,355	5,508,006
Total assets		**208,649,222**	**215,160,817**
LIABILITIES			
Deposits and balances from banks	20	6,884,250	11,595,885
Current accounts and deposits from customers	21	158,579,491	149,832,833
Deferred tax liability	12	-	899,429
Other liabilities	22	4,199,145	5,825,448
Total liabilities		**169,662,886**	**168,153,595**
EQUITY			
Share capital	23	18,434,350	18,434,350
Share-based payments reserve		95,927	94,788
Revaluation reserve for available-for-sale financial assets		175,089	257,091
Revaluation reserve for land and buildings		233,772	233,772
Retained earnings		20,047,198	27,987,221
Total equity		**38,986,336**	**47,007,222**
Total liabilities and equity		**208,649,222**	**215,160,817**

The accompanying notes on pages 17 to 79 are an integral part of these financial statements.

Statement of Cash Flows for the year ended 31 December 2017

	Notes	2017 AMD'000	2016 AMD'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Interest receipts		11,846,215	15,957,949
Interest payments		(4,773,406)	(5,514,233)
Fee and commission receipts		3,583,990	3,375,491
Fee and commission payments		(480,573)	(744,623)
Net receipts/(payments) from financial instruments at fair value through profit or loss		218,394	(118,436)
Net receipts from foreign exchange		1,110,776	1,429,979
Net other expense receipts / (payments)		22,494	(132,043)
Staff costs paid		(3,210,068)	(3,850,785)
Other general administrative expenses paid		(3,154,310)	(2,349,273)
(Increase)/decrease in operating assets			
Financial instruments at fair value through profit or loss		(427,429)	85,447
Available-for-sale financial assets		1,261,341	(9,818,910)
Loans and advances to banks		(4,172,054)	4,826,140
Loans to customers		13,247,265	22,733,540
Other assets		(1,269,005)	137,853
Increase/(decrease) in operating liabilities			
Deposits and balances from banks		(5,352,250)	(33,437,326)
Current accounts and deposits from customers		6,901,256	(10,059,619)
Other liabilities		(20,341)	2,268
Net cash from/(used in) operating activities before income tax paid		**15,332,295**	**(17,476,581)**
Income tax paid		-	(851,915)
Cash flows from/(used in) operating activities		**15,332,295**	**(18,328,496)**
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of property, equipment and intangible assets		(650,970)	(527,831)
Sales of property, equipment and intangible assets		4,325	10,328
Cash flows used in investing activities		**(646,645)**	**(517,503)**
Net increase / (decrease) in cash and cash equivalents		**14,685,650**	**(18,845,999)**
Effect of changes in exchange rates on cash and cash equivalents		703,044	36,200
Cash and cash equivalents as at the beginning of the year		53,546,716	72,356,515
Cash and cash equivalents as at the end of the year	13	**68,935,410**	**53,546,716**

The accompanying notes on pages 17 to 79 are an integral part of these financial statements.

Statement of Changes in Equity for the year ended 31 December 2017

AMD'000	Share capital	Share-based payments reserve	Revaluation reserve for available-for-sale financial assets	Revaluation reserve for land and buildings	Retained earnings	Total
Balance as at 1 January 2016	**18,434,350**	**96,063**	**(379,465)**	**233,772**	**34,651,632**	**53,036,352**
Loss for the year	-	-	-	-	(6,666,854)	(6,666,854)
Other comprehensive income						
Items that are or may be reclassified subsequently to profit or loss:						
Net change in fair value of available-for-sale financial assets, net of income tax	-	-	634,362	-	-	634,362
Net change in fair value of available-for-sale financial assets transferred to profit or loss, net of income tax	-	-	2,194	-	-	2,194
Total other comprehensive income	**-**	**-**	**636,556**	**-**	**-**	**636,556**
Total comprehensive income/(loss) for the year	**-**	**-**	**636,556**	**-**	**(6,666,854)**	**(6,030,298)**
Transactions with owners, recorded directly in equity						
Share-based payments	-	(1,275)	-	-	2,443	1,168
Total transactions with owners	**-**	**(1,275)**	**-**	**-**	**2,443**	**1,168**
Balance as at 31 December 2016	**18,434,350**	**94,788**	**257,091**	**233,772**	**27,987,221**	**47,007,222**
Balance as at 1 January 2017	**18,434,350**	**94,788**	**257,091**	**233,772**	**27,987,221**	**47,007,222**
Loss for the year	-	-	-	-	(7,940,583)	(7,940,583)
Other comprehensive loss						
Items that are or may be reclassified subsequently to profit or loss:						
Net change in fair value of available-for-sale financial assets, net of income tax	-	-	(82,002)	-	-	(82,002)
Net change in fair value of available-for-sale financial assets transferred to profit or loss, net of income tax	-	-	-	-	-	-
Total other comprehensive loss	**-**	**-**	**(82,002)**	**-**	**-**	**(82,002)**
Total comprehensive loss for the year	**-**	**-**	**(82,002)**	**-**	**(7,940,583)**	**(8,022,585)**
Transactions with owners, recorded directly in equity						
Share-based payments	-	1,139	-	-	560	1,699
Total transactions with owners	**-**	1,139	**-**	**-**	560	1,699
Balance as at 31 December 2017	**18,434,350**	**95,927**	**175,089**	**233,772**	**20,047,198**	**38,986,336**

The accompanying notes on pages 17 to 79 are an integral part of these financial statements.

Notes to the Financial Statements

1 Background

(a) Organisation and operations

HSBC Bank Armenia CJSC (the "Bank") was registered as a closed joint stock company in Armenia in 1995. The Bank provides a wide spectrum of financial and banking services and operates from its offices and branches located in the capital of the Republic of Armenia. The activities of the Bank are regulated by the Central Bank of the Republic of Armenia (the "CBA").

As at 31 December 2017 the Bank had 9 (31 December 2016: 10) offices and branches. The average number of persons employed by the Bank during the year was 414 (2016: 415).

The Bank's registered office is 66 Teryan Street, Yerevan 0009, Republic of Armenia.

The Bank is owned by HSBC Europe B.V. (70%) and Wings Establishment (30%).

The Bank's Parent Company is HSBC Europe B.V. The party with ultimate control over the Bank is HSBC Holdings PLC.

Related party transactions are detailed in Note 30.

(b) Operating environment of the Bank

The Bank's operations are primarily located in Armenia. Consequently, the Bank is exposed to the economic and financial markets of Armenia which display characteristics of an emerging market. The legal, tax and regulatory frameworks continue to develop and are subject to frequent changes and varying interpretations, refer to Note 28.

The economic environment of the Republic of Armenia is significantly influenced by the level of business activity in the Russian Federation and significant cash movements flow from the Russian Federation to the Republic of Armenia. Therefore, a decline in business activity, stock market volatility and other risks experienced in the Russian Federation could have a flow-on negative effect on the financial and corporate sectors of the Republic of Armenia.

The Republic of Armenia displays certain characteristics of an emerging market. The Armenian economy was growing in 2017 after overcoming the economic recession of 2015 and 2016. The financial markets continue to be volatile. This operating environment has a significant impact on the Bank's operations and financial position. Management is taking necessary measures to ensure sustainability of the Bank's operations. However, the future effects of the current economic situation are difficult to predict and management's current expectations and estimates could differ from actual results.

The amount of provision for impaired loans is based on management's appraisals of these assets at the end of the reporting period after taking into consideration the cash flows that may result from foreclosure less costs for obtaining and selling the collateral. The market in the Republic of Armenia for many types of collateral, especially real estate, has been affected by the economic downturn, resulting in a low level of liquidity for certain types of assets. As a result, the actual realisable value on future foreclosure may differ from the value ascribed in estimating allowances for impairment at the end of the reporting period. Under IFRS, impairment losses on financial assets expected as a result of future events, no matter how likely, cannot be recognised until such events arise.

2 Basis of preparation

(a) Statement of compliance

The accompanying financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS").

(b) Basis of measurement

The financial statements are prepared under the historical cost convention, as modified by the initial recognition of financial instruments based on fair value, and by the revaluation of repossessed collateral, available-for-sale financial assets, and financial instruments categorised at fair value through profit or loss. The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

(c) Functional and presentation currency

The functional currency of the Bank is the Armenian Dram ("AMD") as, being the national currency of the Republic of Armenia, it reflects the economic substance of the majority of underlying events and circumstances relevant to the Bank.

The AMD is also the presentation currency for the purposes of these financial statements.

Financial information presented in AMD is rounded to the nearest thousand.

(d) Use of estimates and judgments

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results could differ from those estimates.

Estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Information about significant areas of estimation uncertainty and critical judgments in applying accounting policies is described in the following notes:

- Deferred tax asset – Note 12
- Fair value of derivatives – Note 14;
- Loan impairment estimates – Note 17;
- Revaluation of land and buildings – Note 18;
- Revaluation of repossessed collateral – Note 19;
- Fair value of financial instruments – Note 32.

2 Basis of preparation (continued)

(e) Presentation of statement of financial position in order of liquidity

The Bank does not have a clearly identifiable operating cycle and therefore does not present current and non-current assets and liabilities separately in the statement of financial position. Instead, assets and liabilities are presented in order of their liquidity. Refer to Note 24 for analysis of financial instruments by expected maturity.

3 Significant accounting policies

The accounting policies set out below are applied consistently to all periods presented in these financial statements.

(a) Foreign currency translation and presentation of foreign currency items

Transactions in foreign currencies are translated to the functional currency of the Bank at the official exchange rates of the CBA at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the official exchange rate of the CBA at the reporting date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the reporting period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value is determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments, unless the difference is due to impairment in which case foreign currency differences that have been recognised in other comprehensive income are reclassified to profit or loss or qualifying cash flow hedges to the extent that the hedge is effective, which are recognised in other comprehensive income.

At 31 December 2017, the principal rate of exchange used for translating foreign currency balances was USD 1 = AMD 484.10 (2016: USD 1 = AMD 483.94), EUR 1 = AMD 580.10 (2016: EUR1=AMD 512.20), GBP 1 = 653.54 (2016: GBP 1 = AMD 595.54).

(b) Cash and cash equivalents

Cash and cash equivalents are items which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash and cash equivalents include notes and coins on hand, unrestricted balances (nostro accounts, overnight deposits and placements with original maturities of less than three months) held with the CBA and other banks. The minimum reserve deposit with the CBA is considered to be a cash equivalent due to the absence of restrictions on its withdrawability. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

3 Significant accounting policies (continued)

(c) Financial instruments

(i) Classification

Financial instruments at fair value through profit or loss are financial assets or liabilities that are:

- acquired or incurred principally for the purpose of selling or repurchasing in the near term,
- part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking,
- derivative financial instruments (except for derivative financial instruments that are designated and effective hedging instruments), or
- upon initial recognition, designated as at fair value through profit or loss.

The Bank may designate financial assets and liabilities at fair value through profit or loss where either:

- the assets or liabilities are managed, evaluated and reported internally on a fair value basis;
- the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise; or
- the asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

All trading derivatives in a net receivable position (positive fair value), as well as options purchased, are reported as assets. All trading derivatives in a net payable position (negative fair value), as well as options written, are reported as liabilities.

Management determines the appropriate classification of financial instruments in this category at the time of the initial recognition. Derivative financial instruments and financial instruments designated as at fair value through profit or loss upon initial recognition are not reclassified out of the category at fair value through profit or loss. Financial assets that would have met the definition of loan and receivables may be reclassified out of the fair value through profit or loss or available-for-sale category if the entity has an intention and ability to hold it for the foreseeble future or until maturity. Other financial instruments may be reclassified out of the category at fair value through profit or loss only in rare circumstances. Rare circumstances arise from a single event that is unusual and highly unlikely to recur in the near term.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those that the Bank:

- intends to sell immediately or in the near term;
- upon initial recognition designates as at fair value through profit or loss;
- upon initial recognition designates as available-for-sale; or
- may not recover substantially all of its initial investment, other than because of credit deterioration.

3 Significant accounting policies (continued)

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified as loans and receivables, held-to-maturity investments or financial instruments at fair value through profit or loss.

(ii) Recognition

Financial assets and liabilities are recognised in the statement of financial position when the Bank becomes a party to the contractual provisions of the instrument. All regular way purchases of financial assets are accounted for at the settlement date.

(iii) Measurement

A financial asset or liability is initially measured at its fair value plus, in the case of a financial asset or liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or liability.

Subsequent to initial recognition, financial assets, including derivatives that are assets, are measured at their fair values, without any deduction for transaction costs that may be incurred on sale or other disposal, except for:

- loans and receivables which are measured at amortised cost using the effective interest method;
- held-to-maturity investments that are measured at amortised cost using the effective interest method;
- investments in equity instruments that do not have a quoted market price in an active market and whose fair value can not be reliably measured which are measured at cost.

All financial liabilities, other than those designated at fair value through profit or loss and financial liabilities that arise when a transfer of a financial asset carried at fair value does not qualify for derecognition, are measured at amortised cost less impairment.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition and includes transaction costs. Measurement at cost is only applicable to investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured and derivatives that are linked to, and must be settled by, delivery of such unquoted equity instruments. Refer to Note 14.

(iv) Amortised cost

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument.

3 Significant accounting policies (continued)

(v) *Fair value measurement principles*

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. Fair value measurement assumes a transaction taking place in the principal market for the asset or liability, or in the absence of a principal market, the most advantageous market for the asset or liability. The fair value of a liability reflects its non-performance risk.

When available, the Bank measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

When there is no quoted price in an active market, the Bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all the factors that market participants would take into account in these circumstances.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price, i.e. the fair value of the consideration given or received. If the Bank determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is supported wholly by observable market data or the transaction is closed out.

If an asset or a liability measured at fair value has a bid price and an ask price, the Bank measures assets and long positions at the bid price and liabilities and short positions at the ask price.

The Bank recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

(vi) *Gains and losses on subsequent measurement*

A gain or loss arising from a change in the fair value of a financial asset or liability is recognised as follows:

- a gain or loss on a financial instrument classified as at fair value through profit or loss is recognised in profit or loss;
- a gain or loss on an available-for-sale financial asset is recognised as other comprehensive income in equity (except for impairment losses and foreign exchange gains and losses on debt financial instruments available-for-sale) until the asset is derecognised, at which time the cumulative gain or loss previously recognised in equity is recognised in profit or loss. Interest in relation to an available-for-sale financial asset is recognised in profit or loss using the effective interest method.

3 Significant accounting policies (continued)

For financial assets and liabilities carried at amortised cost, a gain or loss is recognised in profit or loss when the financial asset or liability is derecognised or impaired, and through the amortisation process.

(vii) Derecognition

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability in the statement of financial position. The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

The Bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised.

In transactions where the Bank neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset, it derecognises the asset if control over the asset is lost.

In transfers where control over the asset is retained, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred assets.

If the Bank purchases its own debt, it is removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is included in gains or losses arising from early retirement of debt.

The Bank writes off assets deemed to be uncollectible.

(viii) Repurchase and reverse repurchase agreements

Securities sold under sale and repurchase (repo) agreements are accounted for as secured financing transactions, with the securities retained in the statement of financial position and the counterparty liability included in amounts payable under repo transactions. The difference between the sale and repurchase prices represents interest expense and is recognised in profit or loss over the term of the repo agreement using the effective interest method.

Securities purchased under agreements to resell (reverse repo) are recorded as amounts receivable under reverse repo transactions within loans and advances to banks or loans to customers, as appropriate. The difference between the purchase and resale prices represents interest income and is recognised in profit or loss over the term of the repo agreement using the effective interest method.

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

3 Significant accounting policies (continued)

(ix) Derivative financial instruments

Derivative financial instruments include forwards and spots, foreign exchanges.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

Changes in the fair value of derivatives are recognised immediately in profit or loss.

(x) Offsetting

Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously. Such a right of set off (a) must not be contingent on a future event and (b) must be legally enforceable in all of the following circumstances: (i) in the normal course of business, (ii) the event of default and (iii) the event of insolvency or bankrupt.

(d) Property and equipment

(i) Owned assets

Items of property and equipment are stated at cost less accumulated depreciation and impairment losses, except for land and buildings, which are stated at revalued amounts as described below.

Where an item of property and equipment comprises major components having different useful lives, they are accounted for as separate items of property and equipment.

(ii) Revaluation

Land and buildings are subject to revaluation on a regular basis. The frequency of revaluation depends on the movements in the fair values of the land and buildings being revalued. A revaluation increase on an item of land and building is recognised as other comprehensive income directly in equity except to the extent that it reverses a previous revaluation decrease recognised in profit or loss, in which case it is recognised in profit or loss. A revaluation decrease on an item of land or buildings is recognised in profit or loss except to the extent that it reverses a previous revaluation increase recognised as other comprehensive income directly in equity, in which case it is recognised in other comprehensive income.

Management uses independent valuation firms to estimate the fair value of land and buildings. The valuation firms use the income approach and the comparable sales approach depending on availability and reliability of information.

3 Significant accounting policies (continued)

(iii) Depreciation

Depreciation is charged to profit or loss on a straight-line basis over the estimated useful lives of the individual assets. Depreciation commences on the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and ready for use. Leasehold improvements are depreciated over the shorter of the asset useful life and lease term. Land and construction in progress are not depreciated. The estimated useful lives are as follows:

- buildings	20 years
- leasehold improvements	up to 10 years
- vehicles	5 years
- computer equipment	4 to 7 years
- other	5 years

(e) Intangible assets

Acquired intangible assets are stated at cost less accumulated amortisation and impairment losses.

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software.

Subsequent expenditure on intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates.

Costs associated with developing or maintaining computer software programs are recognised as an expense as incurred.

Amortisation is charged to profit or loss on a straight-line basis over the estimated useful lives of intangible assets. The estimated useful lives are as follows:

- computer software	3 to 5 years
- other	10 years

(f) Repossessed collateral

Repossessed collateral represents financial and non-financial assets acquired by the Bank in settlement of overdue loans. The assets are initially recognised at fair value when acquired and included in premises and equipment, other financial assets, investment properties or inventories within other assets depending on their nature and the Bank's intention in respect of recovery of these assets, and are subsequently remeasured and accounted for in accordance with the accounting policies for these categories of assets.

(g) Loans and advances to banks

Amounts of loan and advances to banks are recorded when the Bank advances money to counterparty banks with no intention of trading the resulting unquoted non-derivative receivable due on fixed or determinable dates. Amounts of loan and advances to banks are carried at amortised cost.

3 Significant accounting policies (continued)

(h) Loans to customers

Loans to customers are recorded when the Bank advances money to purchase or originate an unquoted non-derivative receivable from a customer due on fixed or determinable dates, and has no intention of trading the receivable. Loans to customers are carried at amortised cost.

(i) Impairment

(i) Financial assets carried at amortised cost

Financial assets carried at amortised cost consist principally of loans and other receivables (loans and receivables). The Bank reviews its loans and receivables to assess impairment on a regular basis. A loan or receivable is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the loan or receivable and that event (or events) has had an impact on the estimated future cash flows of the loan that can be reliably estimated.

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, breach of loan covenants or conditions, restructuring of a loan or advance on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, deterioration in the value of collateral, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers in the group, or economic conditions that correlate with defaults in the group.

The Bank first assesses whether objective evidence of impairment exists individually for loans and receivables that are individually significant, and individually or collectively for loans and receivables that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed loan or receivable, whether significant or not, it includes the loan in a group of loans and receivables with similar credit risk characteristics and collectively assesses them for impairment. Loans and receivables that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment, are estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods, and to remove the effects of past conditions that do not exist currently.

3 Significant accounting policies (continued)

If there is objective evidence that an impairment loss on a loan or receivable has been incurred, the amount of the loss is measured as the difference between the carrying amount of the loan or receivable and the present value of estimated future cash flows including amounts recoverable from guarantees and collateral discounted at the loan or receivable's original effective interest rate. Contractual cash flows and historical loss experience adjusted on the basis of relevant observable data that reflect current economic conditions provide the basis for estimating expected cash flows.

In some cases the observable data required to estimate the amount of an impairment loss on a loan or receivable may be limited or no longer fully relevant to current circumstances. This may be the case when a borrower is in financial difficulties and there is little available historical data relating to similar borrowers. In such cases, the Bank uses its experience and judgment to estimate the amount of any impairment loss.

All impairment losses in respect of loans and receivables are recognised in profit or loss and are only reversed if a subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

When a loan is uncollectable, it is written off against the related allowance for loan impairment. The Bank writes off a loan balance (and any related allowances for loan losses) when management determines that the loans are uncollectible and when all necessary steps to collect the loan are completed.

(ii) Financial assets carried at cost

Financial assets carried at cost include unquoted equity instruments included in available-for-sale financial assets that are not carried at fair value because their fair value can not be reliably measured. If there is objective evidence that such investments are impaired, the impairment loss is calculated as the difference between the carrying amount of the investment and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset.

All impairment losses in respect of these investments are recognised in profit or loss and can not be reversed.

(iii) Available-for-sale financial assets

Impairment losses on available-for-sale financial assets are recognised by transferring the cumulative loss that is recognised in other comprehensive income to profit or loss as a reclassification adjustment. The cumulative loss that is reclassified from other comprehensive income to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

For an investment in an equity security available-for-sale, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed, with the amount of the reversal recognised in profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised in other comprehensive income.

3 Significant accounting policies (continued)

(iv) Non-financial assets

Non-financial assets, other than deferred taxes, are assessed at each reporting date for any indications of impairment. 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. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. An impairment loss is recognised when the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

All impairment losses in respect of non-financial assets are recognised 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 reversed 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 amortisation, if no impairment loss had been recognised.

(j) Provisions

A provision is recognised in the statement of financial position when the Bank has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(k) Credit related commitments

In the normal course of business, the Bank enters into credit related commitments, comprising undrawn loan commitments, letters of credit and guarantees, and provides other forms of credit insurance.

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

A financial guarantee liability is recognised initially at fair value net of associated transaction costs, and is measured subsequently at the higher of the amount initially recognised less cumulative amortisation or the amount of provision for losses under the guarantee. Provisions for losses under financial guarantees and other credit related commitments are recognised when losses are considered probable and can be measured reliably.
Financial guarantee liabilities and provisions for other credit related commitment are included in other liabilities.
Loan commitments are not recognised, except for the following:

- loan commitments that the Bank designates as financial liabilities at fair value through profit or loss;
- if the Bank has a past practice of selling the assets resulting from its loan commitments shortly after origination, then the loan commitments in the same class are treated as derivative instruments;

3 Significant accounting policies (continued)

- loan commitments that can be settled net in cash or by delivering or issuing another financial instrument;
- commitments to provide a loan at a below-market interest rate.

(l) Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares are recognised as a deduction from equity, net of any tax effects.

(i) Dividends

The ability of the Bank to declare and pay dividends is subject to the rules and regulations of the Armenian legislation.

Dividends in relation to ordinary shares are reflected as an appropriation of retained earnings in the period when they are declared.

(m) Taxation

Income tax comprises current and deferred tax. Income tax is recognised in profit or loss except to the extent that it relates to items of other comprehensive income or transactions with shareholders recognised directly in equity, in which case it is recognised within other comprehensive income or directly within equity.

Current tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the initial recognition of assets or liabilities that affect neither accounting nor taxable profit. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the temporary differences, unused tax losses and credits can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(n) Income and expense recognition

Interest income and expense are recognised for all debt instruments on an accrual basis in profit or loss using the effective interest method.

Loan origination fees, loan servicing fees and other fees that are considered to be integral to the overall profitability of a loan, together with the related transaction costs, are deferred and amortised to interest income over the estimated life of the financial instrument using the effective interest method.

3 Significant accounting policies (continued)

Other fees, commissions and other income and expense items are recognised in profit or loss when the corresponding service is provided.

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

(o) Employee benefits

Staff costs and related contributions

Wages, salaries, contributions to the Republic of Armenian state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits are accrued in the year in which the associated services are rendered by the employees of the Bank.

Share-based payment transactions

Share-based payment arrangements in which the Bank receives goods or services as consideration for equity instruments in the ultimate parent company are accounted for as equity-settled share-based payment transactions.

The grant date fair value of share-based payment awards granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period that the employees unconditionally become entitled to the awards. The amount recognised as an expense is adjusted to reflect the number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date.

If upon vesting recharge is arranged to fund a group entity, the payment is recorded in equity. The difference between settlement amount and the grant date fair value of share-based payment is recorded in retained earnings in the year the share-based payment award is vested and settled.

(p) Deposits and balances from banks

Amounts of deposits and balances from banks are recorded when money or other assets are advanced to the Bank by counterparty banks. The non-derivative liability is carried at amortised cost.

(q) Current accounts and deposits from customers

Customer accounts are non-derivative liabilities to individuals, state or corporate customers and are carried at amortised cost.

3 Significant accounting policies (continued)

(r) Adoption of new or revised standards and interpretations

The following amended standards became effective for the Bank from 1 January 2017, but did not have any material impact on the Bank:

- Disclosure Initiative – Amendments to IAS 7 (issued on 29 January 2016 and effective for annual periods beginning on or after 1 January 2017).
- Recognition of Deferred Tax Assets for Unrealised Losses – Amendment to IAS 12 (issued on 19 January 2016 and effective for annual periods beginning on or after 1 January 2017).
- Amendments to IFRS 12 included in Annual Improvements to IFRSs 2014-2016 Cycle (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2017).

(s) New accounting pronouncements

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2018 or later, and which the Bank has not early adopted.

IFRS 9 "Financial Instruments: Classification and Measurement" (amended in July 2014 and effective for annual periods beginning on or after 1 January 2018). Key features of the new standard are:

- Financial assets are required to be classified into three measurement categories: those to be measured subsequently at amortised cost, those to be measured subsequently at fair value through other comprehensive income (FVOCI) and those to be measured subsequently at fair value through profit or loss (FVPL).
- Classification for debt instruments is driven by the entity's business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest (SPPI). If a debt instrument is held to collect, it may be carried at amortised cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets may be classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets but will be included in assessing the SPPI condition.
- Investments in equity instruments are always measured at fair value. However, management can make an irrevocable election to present changes in fair value in other comprehensive income, provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are presented in profit or loss.
- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.
- IFRS 9 introduces a new model for the recognition of impairment losses – the expected credit losses (ECL) model. There is a 'three stage' approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired (or lifetime ECL for trade receivables). Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL. The model includes operational simplifications for lease and trade receivables.

3 Significant accounting policies (continued)

- Hedge accounting requirements were amended to align accounting more closely with risk management. The standard provides entities with an accounting policy choice between applying the hedge accounting requirements of IFRS 9 and continuing to apply IAS 39 to all hedges because the standard currently does not address accounting for macro hedging.

Based on an analysis of the Bank's financial assets and financial liabilities as at 31 December 2017 and on the basis of the facts and circumstances that exist at that date, the Management of the Bank is expecting the following impact on its financial statements from the adoption of the new standard on 1 January 2018.

The following table reconciles the carrying amounts of financial assets, from their previous measurement categories in accordance with IAS 39 into their new measurement categories upon transition to IFRS 9 on 1 January 2018:

AMD'000	Measurement category IAS 39	Measurement category IFRS 9	Carrying value per IAS 39 (closing balance at 31 December 2017)	Effect Premeasurement ECL	Carrying value per IFRS 9 (opening balance at 1 January 2018)
Cash and cash equivalents	L&R	AC	68,935,410	(174,395)	68,761,015
Mandatory cash balances with the Central Bank of Armenia	L&R	AC	530,000	-	530,000
Investments in debt securities	FVTPL	FVTPL (mandatory)	1,117,957	-	1,117,957
Investments in debt securities	AFS	FVOCI	23,267,614	-	23,267,614
Total investments in debt securities			**24,385,571**	-	**24,385,571**
Investments in equity securities	AFS	FVOCI	32,132	-	32,132
Due from other banks	L&R	AC	10,566,868	(473)	10,566,395
Loans and advances to customers	L&R	AC	95,431,247	486,576	95,917,823
Other financial assets	L&R	AC	2,813,698	(44,514)	2,769,184
Total financial assets			**202,694,926**	**267,194**	**202,962,120**

No significant changes are expected for financial liabilities. The actual IFRS 9 impact on transition at 1 January 2018 could be different as a result of changes in balance sheet position, market conditions and forward-looking economic assumptions.

The new standard also introduces expanded disclosure requirements and changes in presentation. These are expected to change the nature and extent of the Bank's disclosures about its financial instruments particularly in the year of the adoption of the new standard.

IFRS 15, Revenue from Contracts with Customers (issued on 28 May 2014 and effective for the periods beginning on or after 1 January 2018). The new standard introduces the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed. The Bank has assessed the impact of IFRS 15 and expects that the standard will have no significant effect, when applied, on the financial statements.

IFRS 16, Leases (issued on 13 January 2016 and effective for annual periods beginning on or after 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing.

3 Significant accounting policies (continued)

Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. The Bank is currently assessing the impact of the new standard on its financial statements.

IFRS 17 "Insurance Contracts" (issued on 18 May 2017 and effective for annual periods beginning on or after 1 January 2021). IFRS 17 replaces IFRS 4, which has given companies dispensation to carry on accounting for insurance contracts using existing practices. As a consequence, it was difficult for investors to compare and contrast the financial performance of otherwise similar insurance companies. IFRS 17 is a single principle-based standard to account for all types of insurance contracts, including reinsurance contracts that an insurer holds. The standard requires recognition and measurement of groups of insurance contracts at: (i) a risk-adjusted present value of the future cash flows (the fulfilment cash flows) that incorporates all of the available information about the fulfilment cash flows in a way that is consistent with observable market information; plus (if this value is a liability) or minus (if this value is an asset) (ii) an amount representing the unearned profit in the group of contracts (the contractual service margin). Insurers will be recognising the profit from a group of insurance contracts over the period they provide insurance coverage, and as they are released from risk. If a group of contracts is or becomes loss-making, an entity will be recognising the loss immediately. The Bank is currently assessing the impact of the new standard on its financial statements.

IFRIC 22 "Foreign currency transactions and advance consideration" (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018). This interpretation considers how to determine the date of the transaction when applying the standard on foreign currency transactions, IAS 21. The interpretation applies where an entity either pays or received consideration in advance for foreign currency-denominated contracts. The interpretation specifies that the date of transaction is the date on which the entity initially recognises the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration. If there are multiple payments or receipts in advance, the Interpretation requires an entity to determine the date of transaction for each payment or receipt of advance consideration. The Bank is currently assessing the impact of the new standard on its financial statements.

IFRIC 23 "Uncertainty over Income Tax Treatments" (issued on 7 June 2017 and effective for annual periods beginning on or after 1 January 2019). IAS 12 specifies how to account for current and deferred tax, but not how to reflect the effects of uncertainty. The interpretation clarifies how to apply the recognition and measurement requirements in IAS 12 when there is uncertainty over income tax treatments. An entity should determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments based on which approach better predicts the resolution of the uncertainty. An entity should assume that a taxation authority will examine amounts it has a right to examine and have full knowledge of all related information when making those examinations. If an entity concludes it is not probable that the taxation authority will accept an uncertain tax treatment, the effect of uncertainty will be reflected in determining the related taxable profit or loss, tax bases, unused tax losses, unused tax credits or tax rates, by using either the most likely amount or the expected value, depending on which method the entity expects to better predict the resolution of the uncertainty. An entity will reflect the effect of a change in facts and circumstances or of new information that affects the judgments or estimates required by the interpretation as a change in accounting estimate.

3 Significant accounting policies (continued)

Examples of changes in facts and circumstances or new information that can result in the reassessment of a judgment or estimate include, but are not limited to, examinations or actions by a taxation authority, changes in rules established by a taxation authority or the expiry of a taxation authority's right to examine or re-examine a tax treatment. The absence of agreement or disagreement by a taxation authority with a tax treatment, in isolation, is unlikely to constitute a change in facts and circumstances or new information that affects the judgments and estimates required by the Interpretation. The Bank is currently assessing the impact of the new standard on its financial statements.

The following other new pronouncements are not expected to have any material impact on the Bank when adopted:

- Sale or Contribution of Assets between an Investor and its Associate or Joint Venture - Amendments to IFRS 10 and IAS 28 (issued on 11 September 2014 and effective for annual periods beginning on or after a date to be determined by the IASB).
- Amendments to IFRS 15, Revenue from Contracts with Customers (issued on 12 April 2016 and effective for annual periods beginning on or after 1 January 2018).
- Amendments to IFRS 2, Share-based Payment (issued on 20 June 2016 and effective for annual periods beginning on or after 1 January 2018).
- Amendments to IFRS 4, Insurance Contracts (issued on 12 September 2016 and effective for annual periods beginning on or after 1 January 2018).
- Transfers of Investment Property – Amendments to IAS 40 (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018).
- Annual Improvements to IFRSs 2014-2016 cycle – Amendments to IFRS 1 an IAS 28 (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018).
- Plan Amendment, Curtailment or Settlement – Amendments to IAS 19 (issued on 7 February 2018 and effective for annual periods beginning on or after 1 January 2019).

Unless otherwise described above, the new standards and interpretations are not expected to affect significantly the Bank's financial statements.

4 Interest income and expense

	2017 AMD'000	2016 AMD'000
Interest income		
Loans to customers	10,165,117	14,776,873
Available-for-sale financial assets	1,801,934	2,020,121
Loans and advances to banks	568,598	631,713
Cash and cash equivalents	324,007	148,710
Financial instruments at fair value through profit or loss	96,070	72,076
Total interest income	**12,955,726**	**17,649,493**
Interest expense		
Current accounts and deposits from customers	4,575,930	4,101,878
Deposits and balances from banks and other financial institutions	176,477	1,202,508
Total interest expense	**4,752,407**	**5,304,386**

Included within loans to customers line under interest income for the year ended 31 December 2017 is a total of AMD 2,080,876 thousand (2016: AMD 1,734,965 thousand) accrued on impaired financial assets.

5 Fee and commission income

	2017 AMD'000	2016 AMD'000
Fee and commission income not relating to financial instruments at fair value through profit or loss:		
Credit facilities	2,198,901	2,231,472
Letters of credit and guarantees	490,175	476,697
Remittances	320,911	381,849
Credit cards	315,059	345,200
Account services	111,906	156,257
ATM services	19,687	29,264
Insurance agency	8,471	17,965
Other	157,439	61,745
Total fee and commission income	**3,622,549**	**3,700,449**

Credit facilities mainly represent the amounts of commission income received from loans provided to Armenian businesses by HSBC Bank plc.

Credit cards mainly represent the amounts of commission income received from fees charged for credit cards issuance and credit cards service.

6 Fee and commission expense

	2017 AMD'000	2016 AMD'000
Fee and commission expense not relating to financial instruments at fair value through profit or loss:		
Card transactions fees	343,926	320,404
Settlement transactions	70,212	69,347
Loans and borrowings	10,913	106,873
Other	40,951	22,066
Total fee and commission expense	**466,002**	**518,690**

7 Net gain/(loss) on financial instruments at fair value through profit or loss

	2017 AMD'000	2016 AMD'000
Debt financial instruments	64,642	99,987
Foreign currency contracts	123,049	(103,201)
Total net gain/(loss) on financial instruments at fair value through profit or loss	**187,691**	**(3,214)**

8 Net foreign exchange gain

	2017 AMD'000	2016 AMD'000
Gain on foreign exchange transactions	1,110,776	1,429,979
Net (loss)/gain from revaluation of financial assets and liabilities	(66,227)	187,917
Total net foreign exchange gain	**1,044,549**	**1,617,896**

9 Other operating expenses

	2017 AMD'000	2016 AMD'000
Write-down of non-current assets to fair value less costs to sell	326,269	-
Payments to Deposit Guarantee Fund	222,868	209,300
Fines and penalties	-	139,667
Total other operating expenses	**549,137**	**348,967**

10 Impairment losses

	2017 AMD'000	2016 AMD'000
Loans to customers (Note 17)	13,807,927	16,629,881
Other assets (Note 19)	377,931	256,800
Total impairment losses	**14,185,858**	**16,886,681**

11 Other general administrative expenses

	2017 AMD'000	2016 AMD'000
HSBC Group IT support costs and other charges	1,552,834	1,552,976
Depreciation and amortisation (Note 18)	933,310	1,011,547
Rent of property	536,091	555,922
Communication and information services	140,527	114,631
Advertising and marketing	111,348	89,409
Security	105,797	87,078
Professional services	84,146	73,941
Travel and entertainment expenses	74,235	52,694
Utilities	73,842	74,704
IT related costs	69,346	76,551
Insurance	68,652	101,135
Repair and maintenance	67,689	77,073
Currency shipment charges	27,848	25,404
Charity and sponsorship	23,442	32,581
Other	286,042	282,167
Total other general administrative expenses	**4,155,149**	**4,207,813**

12 Income tax credit

	2017 AMD'000	2016 AMD'000
Current tax	(149,756)	209,789
Deferred tax	(2,031,145)	(1,589,285)
Total income tax credit	**(2,180,901)**	**(1,379,496)**

In 2017 the applicable tax rate for current and deferred tax is 20% (2016: 20%).

Reconciliation of effective tax rate:

	2017 AMD'000	%	2016 AMD'000	%
Loss before income tax	**(10,121,484)**		**(8,046,350)**	
Income tax credit at the applicable tax rate	(2,024,297)	20.0	(1,609,270)	20.0
(Non-deductible expenses)/income exempt from taxation, net	(6,848)	0.1	19,985	(0.2)
(Over)/Under provided in prior years	(149,756)	1.5	209,789	(2.6)
Total income tax credit	**(2,180,901)**	**21.5**	**(1,379,496)**	**17.1**

12 Income tax credit (continued)

(a) Deferred tax asset and liability

Temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes give rise to net deferred tax asset as of 31 December 2017 and net deferred tax liability as of 31 December 2016.

The deductible temporary differences do not expire under current tax legislation.

Movements in temporary differences during the years ended 31 December 2017 and 2016 are presented as follows:

AMD'000	Balance 1 January 2017	Recognised in profit or loss	Recognised in other comprehensive income	Balance 31 December 2017
Cash and cash equivalents	26,476	36,081	-	62,557
Financial instruments at fair value through profit or loss	64,086	(8,403)	-	55,683
Available-for-sale financial assets	64,273	-	(20,501)	43,772
Loans and advances to banks	2,832	14,534	-	17,366
Loans to customers	2,427,214	(1,868,431)	-	558,783
Property and equipment	(73,863)	(3,953)	-	(77,816)
Other assets	55,376	(37,198)	-	18,178
Other liabilities	(264,965)	(11,981)	-	(276,946)
Tax loss carry forwards	(1,402,000)	(151,794)	-	(1,553,794)
Total movement	**899,429**	**(2,031,145)**	**(20,501)**	**(1,152,217)**

AMD'000	Balance 1 January 2016	Recognised in profit or loss	Recognised in other comprehensive income	Balance 31 December 2016
Cash and cash equivalents	39,473	(12,997)	-	26,476
Financial instruments at fair value through profit or loss	41,048	23,038	-	64,086
Available-for-sale financial assets	(94,866)	-	159,139	64,273
Loans and advances to banks	17,682	(14,850)	-	2,832
Loans to customers	2,698,653	(271,439)	-	2,427,214
Property and equipment	(51,433)	(22,430)	-	(73,863)
Other assets	14,469	40,907	-	55,376
Other liabilities	(335,451)	70,486	-	(264,965)
Tax loss carry forwards	-	(1,402,000)	-	(1,402,000)
Total movement	**2,329,575**	**(1,589,285)**	**159,139**	**899,429**

12 Income tax credit (continued)

(b) Tax loss carry forwards

According to Armenian tax legislation the maximum term for recovery of tax losses is 5 years. Based on the above, tax loss carry forwards expire as follows:

	2017 AMD'000	2016 AMD'000
Tax loss carry-forwards expiring by the end of:		
- 31 December 2021	1,373,794	1,402,000
- 31 December 2022	180,000	-
Total tax loss carry forwards	**1,553,794**	**1,402,000**

(c) Income tax recognised in other comprehensive income

The tax effects relating to components of other comprehensive income for the years ended 31 December 2017 and 2016 comprise the following:

	2017			2016		
AMD'000	**Amount before tax**	**Tax benefit**	**Amount net-of-tax**	**Amount before tax**	**Tax expense**	**Amount net-of-tax**
Revaluation of land and buildings	-	-	-	-	-	-
Net change in fair value of available-for-sale financial assets	(102,503)	20,501	(82,002)	792,953	(158,591)	634,362
Net change in fair value of available-for-sale financial assets transferred to profit or loss	-	-	-	2,742	(548)	2,194
Other comprehensive income	**(102,503)**	**20,501**	**(82,002)**	**795,695**	**(159,139)**	**636,556**

13 Cash and cash equivalents

	31 December 2017 AMD'000	31 December 2016 AMD'000
Cash on hand	**3,475,849**	**5,345,244**
Nostro accounts with the CBA		
(net of credit card settlement deposit)	**31,179,930**	**31,547,130**
Deposit with the CBA	**3,001,110**	**3,000,780**
Nostro accounts with other banks		
- rated AA-	31,078,161	13,361,741
- rated from A- to A+	200,360	149,917
Total nostro accounts with other banks	**31,278,521**	**13,511,658**
Cash equivalents		
Money market overnight placements		
- rated AA-	-	141,904
Total cash equivalents	**-**	**141,904**
Cash and cash equivalents in the statement of cash flows	**68,935,410**	**53,546,716**
Credit card settlement deposit with the CBA	530,000	530,000
Cash and cash equivalents in the statement of financial position	**69,465,410**	**54,076,716**

13 Cash and cash equivalents (continued)

No cash and cash equivalents are impaired or past due. The above ratings are based on Standard and Poor's rating agency ratings.

Nostro accounts with the CBA include mandatory minimum reserve deposits calculated in accordance with regulations promulgated by the CBA at 2% to 18% (31 December 2016: 2% to 18%) from the attracted funds for AMD and foreign currency funds correspondingly, depending on currency. Withdrawal from such reserves is not restricted; however, the Bank is subject to penalties if the required minimum average balance is not periodically maintained.

As at 31 December 2017, in addition to balances with the CBA, the Bank had two HSBC Group member banks (31 December 2016: one HSBC Group member bank) whose balance exceeded 10% of equity. The gross value of these balances as at 31 December 2017 is AMD 30,897,633 thousand (31 December 2016: AMD 10,769,804 thousand).

14 Financial instruments at fair value through profit or loss

	31 December 2017 AMD'000	31 December 2016 AMD'000
Debt and other fixed-income instruments		
Armenian Government treasury bills		
- rated B+	1,117,957	636,930
Derivative financial instruments		
Foreign currency contracts		
- rated AA-	196,113	285,815
Total financial instruments at fair value through profit or loss	**1,314,070**	**922,745**

Financial instruments at fair value through profit or loss comprise financial instruments held for trading.

Financial assets of the Bank are classified as per Standard & Poor's rating agency ratings. In the cases when Standard & Poor's rating agency ratings are not available, rating agency Fitch IBCA's ratings are used by applying the rating correspondence table of Bloomberg information system.

No financial assets at fair value through profit or loss are past due or impaired.

Foreign currency contracts

The table below summarises, by major currencies, the contractual amounts of forward currency contracts outstanding at 31 December 2017 and 2016 with details of the contractual exchange rates and remaining periods to maturity. Foreign currency amounts presented below are translated at rates ruling at the reporting date. The resultant unrealised gains and losses on these unmatured contracts, along with the amounts payable and receivable on the matured but unsettled contracts, are recognised in profit or loss and in financial instruments at fair value through profit or loss, as appropriate.

14 Financial instruments at fair value through profit or loss (continued)

	Notional amount		Weighted average contractual exchange rates	
	31 December 2017 AMD'000	31 December 2016 AMD'000	31 December 2017 AMD'000	31 December 2016 AMD'000
Buy USD sell AMD				
Less than 3 months	3,869,787	3,212,739	480.2	476.0
Between 3 and 12 months	5,092,540	3,847,691	472.0	465.5
Buy USD sell EUR				
Less than 3 months	58,005	-	1.2	-
Buy USD sell AUD				
Less than 3 months	-	57,317	-	1.4
Buy USD sell RUB				
Less than 3 months	-	26,888	-	65.1
Buy USD sell CAD				
Less than 3 months	37,965	80,003	1.3	1.3
Buy RUB sell USD				
Less than 3 months	-	28,502	-	65.5
Buy EUR sell USD				
Less than 3 months	58,010	-	1.2	-
Buy AMD sell USD				
Less than 3 months	1,077,937	1,394,002	482.9	484.8

15 Available-for-sale financial assets

	31 December 2017 AMD'000	31 December 2016 AMD'000
Debt and other fixed-income instruments		
Armenian Government treasury bills		
- rated B+	23,267,614	24,028,968
Other corporate bonds		
- Unrated	-	712,867
Total debt and other fixed-income instruments	**23,267,614**	**24,741,835**
Equity instruments – Unquoted		
ACRA credit reporting	19,140	19,140
Armenian Card	12,143	12,143
SWIFT	849	749
Total equity instruments – Unquoted	**32,132**	**32,032**
Total available-for-sale financial assets held by the Bank	**23,299,746**	**24,773,867**

15 Available-for-sale financial assets (continued)

No available-for-sale financial assets are past due or impaired.

Available-for-sale financial assets of the Bank are classified as per Standard & Poor's rating agency ratings. In the cases when Standard & Poor's rating agency ratings are not available, rating agency Fitch IBCA's ratings are used by applying the rating correspondence table of Bloomberg information system.

As at 31 December 2016 unrated corporate bonds are represented by the corporate bonds issued by a local financial institution.

Investments without a determinable fair value

Available-for-sale investments stated at cost comprise unquoted equity securities in the financial services industry. There is no market for these investments and there have not been any recent transactions that provide evidence of the current fair value. In addition, discounted cash flow techniques yield a wide range of fair values due to the uncertainty regarding future cash flows in this industry.

16 Loans and advances to banks

	31 December 2017 AMD'000	31 December 2016 AMD'000
Local banks	3,285,315	6,223,504
Rated AA-	7,268,919	15,290
Unrated	12,634	-
Total loans and advances to banks	**10,566,868**	**6,238,794**

No loans and advances to banks are impaired or past due. The above ratings are per Standard & Poor's rating agency ratings. In the cases when Standard & Poor's rating agency ratings are not available, rating agency Fitch IBCA's ratings are used.

As at 31 December 2017 the Bank had one bank (2016: one bank) whose balances exceeded 10% of equity. These balances as at 31 December 2017 were AMD 7,262,811 thousand (2016: 4,823,076).

The loans and advances to local banks as at 31 December 2017 have been repaid by 31 January 2018 and 31 December 2016 were repaid by 31 January 2017.

The loans and advances to local banks in AMD 1,884,109 thousand are secured by Armenian government treasury bonds as at 31 December 2017 (2016: 4,823,076). The amount excludes overcollateralization.

17 Loans to customers

	31 December 2017 AMD'000	31 December 2016 AMD'000
Loans to corporate customers		
Loans to large corporates	56,269,712	64,737,839
Loans to small and medium size companies	27,772,189	42,620,766
Total loans to corporate customers	**84,041,901**	**107,358,605**
Loans to retail customers		
Mortgage loans	14,013,030	15,034,500
Credit cards	2,287,820	2,503,302
Construction loans	415,702	484,722
Auto loans	167,540	328,228
Consumer loans	2,513,515	3,699,810
Other loans to retail customers	2,602,549	1,671,496
Total loans to retail customers	**22,000,156**	**23,722,058**
Gross loans to customers	**106,042,057**	**131,080,663**
Impairment allowance	(10,610,810)	(11,490,309)
Net loans to customers	**95,431,247**	**119,590,354**

Movements in the loan impairment allowance by classes of loans to customers for the year ended 31 December 2017 are as follows:

	Loans to corporate customers AMD'000	Loans to retail customers AMD'000	Total AMD'000
Balance at the beginning of the year	**11,300,623**	**189,686**	**11,490,309**
Net charge	13,607,384	200,543	13,807,927
Net write-offs	(13,209,954)	(171,476)	(13,381,430)
Unwinding of discount on impairment allowance and restructured loans provision adjustment	(1,476,875)	-	(1,476,875)
Effect of foreign currency translation	170,830	49	170,879
Balance at the end of the year	**10,392,008**	**218,802**	**10,610,810**

During the year ended 31 December 2017 the Bank has written off the excess of loan amount outstanding over expected recoverable amount. Movements in the loan impairment allowance by classes of loans to customers for the year ended 31 December 2016 are as follows:

	Loans to corporate customers AMD'000	Loans to retail customers AMD'000	Total AMD'000
Balance at the beginning of the year	**5,221,615**	**77,160**	**5,298,775**
Net charge	16,516,260	113,621	16,629,881
Net write-offs	(8,640,963)	(1,541)	(8,642,504)
Unwinding of discount on impairment allowance and restructured loans provision adjustment	(1,734,966)	-	(1,734,966)
Effect of foreign currency translation	(61,323)	446	(60,877)
Balance at the end of the year	**11,300,623**	**189,686**	**11,490,309**

17 Loans to customers (continued)

(a) Credit quality of loans to customers

The following table provides information on the credit quality of loans to customers as at 31 December 2017:

	Loans to corporate customers	Mortgage loans	Credit cards	Construction loans	Auto loans	Consumer loans	Other loans to retail customers	Total
	AMD'000	AMD'000	AMD'000	AMD'000	AMD'000	AMD'000	AMD'000	AMD'000
Neither past due nor impaired								
Loans to large corporates	35,414,164	-	-	-	-	-	-	35,414,164
Loans to small and medium size companies	12,362,472	-	-	-	-	-	-	12,362,472
Loans to retail customers	-	13,201,044	2,262,817	257,702	167,540	2,506,852	2,293,981	20,689,936
Total neither past due nor impaired	**47,776,636**	**13,201,044**	**2,262,817**	**257,702**	**167,540**	**2,506,852**	**2,293,981**	**68,466,572**
Past due but not impaired								
- less than 30 days overdue	820,219	85,869	19,543	953	-	1,685	18,993	947,262
- 30 to 90 days overdue	-	21,416	193	-	-	558	-	22,167
- 91 to 180 days overdue	-	1,959	5,267	-	-	20	-	7,246
- 181 to 360 days overdue	-	-	-	-	-	-	230,403	230,403
- over 360 days overdue	2,670,862	164,346	-	-	-	-	13,192	2,848,400
Total past due but not impaired	**3,491,081**	**273,590**	**25,003**	**953**	**-**	**2,263**	**262,588**	**4,055,478**
Loans individually determined to be impaired (gross)								
- less than 30 days overdue	11,869,907	38,445	-	-	-	-	-	11,908,352
- 30 to 90 days overdue	989,496	-	-	-	-	-	-	989,496
- 91 to 180 days overdue	-	-	-	157,047	-	-	-	157,047
- 181 to 360 days overdue	2,264,705	42,426	-	-	-	-	-	2,307,131
- over 360 days overdue	17,650,076	457,525	-	-	-	4,400	45,980	18,157,981
Total individually impaired loans (gross)	**32,774,184**	**538,396**	**-**	**157,047**	**-**	**4,400**	**45,980**	**33,520,007**
Less impairment provisions	(10,392,005)	(166,789)	(20,367)	(7,166)	(2,860)	(9,616)	(12,007)	(10,610,810)
Total loans and advances to customers	**73,649,896**	**13,846,241**	**2,267,453**	**408,536**	**164,680**	**2,503,899**	**2,590,542**	**95,431,247**

17 Loans to customers (continued)

The following table provides information on the credit quality of loans to customers as at 31 December 2016:

	Loans to corporate customers	Mortgage loans	Credit cards	Construc-tion loans	Auto loans	Consumer loans	Other loans to retail customers	Total
	AMD'000	AMD'000	AMD'000	AMD'000	AMD'000	AMD'000	AMD'000	AMD'000
Neither past due nor impaired								
Loans to large corporates	40,408,506	-	-	-	-	-	-	40,408,506
Loans to small and medium size companies	24,064,673	-	-	-	-	-	-	24,064,673
Loans to retail customers	-	13,987,733	2,475,275	428,785	326,433	3,684,308	1,572,163	22,474,697
Total neither past due nor impaired	**64,473,179**	**13,987,733**	**2,475,275**	**428,785**	**326,433**	**3,684,308**	**1,572,163**	**86,947,876**
Past due but not impaired								
- less than 30 days overdue	295,001	32,223	9,279	3,361	-	7,696	3,853	351,413
- 30 to 90 days overdue	2,355,395	142,634	14,320	-	-	7,806	2,023	2,522,178
- 91 to 180 days overdue	2,716,297	43,944	4,428	-	-	-	47,475	2,812,144
- 181 to 360 days overdue	1,477,264	7,562	-	-	-	-	-	1,484,826
- over 360 days overdue	3,526,954	405,011	-	52,576	1,795	-	-	3,986,336
Total past due but not impaired	**10,370,911**	**631,374**	**28,027**	**55,937**	**1,795**	**15,502**	**53,351**	**11,156,897**
Loans individually determined to be impaired (gross)								
- less than 30 days overdue	4,270,104	15,201	-	-	-	-	-	4,285,305
- 30 to 90 days overdue	6,489,488	11,797	-	-	-	-	-	6,501,285
- 91 to 180 days overdue	1,197,569	257,795	-	-	-	-	-	1,455,364
- 181 to 360 days overdue	4,185,661	-	-	-	-	-	-	4,185,661
- over 360 days overdue	16,371,693	130,600	-	-	-	-	45,982	16,548,275
Total individually impaired loans (gross)	**32,514,515**	**415,393**	**-**	**-**	**-**	**-**	**45,982**	**32,975,890**
Less impairment provisions	**(11,300,623)**	**(122,083)**	**(38,807)**	**(892)**	**(8,710)**	**(6,939)**	**(12,255)**	**(11,490,309)**
Total loans and advances to customers	**96,057,982**	**14,912,417**	**2,464,495**	**483,830**	**319,518**	**3,692,871**	**1,659,241**	**119,590,354**

17 Loans to customers (continued)

All not overdue loans are assigned the same credit rating according to the Bank's internal policies and have no signs of downgrade as at 31 December 2017 and 31 December 2016.

(b) Key assumptions and judgments for estimating loan impairment

(i) Loans to corporate customers

Loan impairment results from one or more events that occurred after the initial recognition of the loan and that have an impact on the estimated future cash flows associated with the loan, and that can be reliably estimated. Loans without individual signs of impairment do not have objective evidence of impairment that can be directly attributed to them.

The objective indicators of loan impairment for loans to corporate customers include the following:

- Overdue payments under the loan agreement.
- Significant difficulties in the financial conditions of the borrower.
- Significant deterioration in business environment, negative changes in the borrower's markets.

The Bank estimates loan impairment for loans to corporate customers based on an analysis of the future cash flows (including estimated foreclosure value of collateral in case the Bank will conclude that cash flows from the business activity of the borrower is not sufficient to repay the loan) for loans with individual signs of impairment and based on its past loss experience for portfolios of loans for which no indications of impairment has been identified.

A modelling approach based on historic loss rate modelled allowance is used for portfolio provision, while in determining the individual impairment allowance for loans to corporate customers, management makes the following key assumptions:

- Historical Loss Rate of 9.46% (31 December 2016: 4.63%) determined based on the previous 60 months (31 December 2016: 60 months) credit losses.
- Estimated emergence periods of 7 months (31 December 2016: 7 months) is defined for whole portfolio.
- A discount up to 80% (31 December 2016: 80%) to the appraised value if the asset pledged is sold. The discount is computed based on several assumptions, including, but not limited to, collateral type, liquidity and location.
- A delay up to 24 months (31 December 2016: up to 24 months) in obtaining proceeds from the foreclosure of collateral for loans with individual signs of impairment.

Changes in these estimates could affect the loan impairment provision. For example, to the extent that the net present value of the estimated cash flows differs by minus one percent, the impairment allowance on loans to corporate customers as at 31 December 2017 would be AMD 736,499 thousand higher (2016: AMD 960,580 thousand higher).

17 Loans to customers (continued)

(ii) Loans to retail customers

The Bank estimates loan impairment for loans to retail customers based on Historical Loss Rate (HLR) methodology for all unsecured loans and secured loans with up to 90 days delinquency and discounted cash-flow (DCF) methodology is applied for secured assets that are 90 or more days past due. The significant assumptions used in determining the impairment losses for loans to retail customers as at 31 December 2017 include:

- Historical annual loss rates of 0.41% (31 December 2016: 0.25%) for mortgage and other loans secured by real estate, 2.27% (31 December 2016: 2.17%) for auto loans, 0.29% (31 December 2016: 0.38%) for consumer loans and 1.02% (31 December 2016: 0.98%) for credit cards are determined based on the previous 60 months (31 December 2016: 60 months) loss data.
- Estimated emergence periods of 6 months (31 December 2016: 6 months) for mortgage and other loans secured by real estate, 8 months (31 December 2016: 8 months) for car loans, 9 months (31 December 2016: 9 months) for overdrafts and credit cards between occurrence of an impairment loss and identification of the loss.
- In case of DCF it is expected that the cash flow from the sale of the pledge will flow in 18 months' time (31 December 2016: 18 months' time). If property liquidation values provided by the valuation agency are available, then that value is used for discounting, otherwise the average market price per square meter is used by applying a reduction of 25% (31 December 2016: 25%) from market value.
- Unsecured loans overdue more than 180 days (31 December 2016: 180 days) are considered as a loss.

Changes in these estimates could affect the loan impairment provision. For example, to the extent that the net present value of the estimated cash flows differs by minus three percent, the impairment allowance on loans to retail customers as at 31 December 2017 would be AMD 653,441 thousand higher (2016: AMD 705,971 thousand higher).

17 Loans to customers (continued)

(c) Analysis of collateral and other credit enhancements

(i) Loans to corporate customers

The following tables provides fair value information on collateral and other credit enhancements securing loans to corporate customers, net of impairment, by types of collateral:

31 December 2017 AMD'000	Loans to customers, carrying amount	Fair value of collateral assessed in the reporting period
Loans without individual signs of impairment		
Cash and deposits	263	263
Armenian Government treasury bills	2,091,701	2,091,701
Real estate	36,695,738	36,695,738
Motor vehicles	73,700	73,700
Equipment	501,152	501,152
Stock	2,829,859	2,829,859
Other collateral	68,051	68,051
Corporate guarantees (unrated)	2,169,545	2,169,545
No collateral or other credit enhancement – personal guarantees	1,127,902	-
Total loans without individual signs of impairment	**45,557,911**	**44,430,009**
Overdue but not impaired loans		
Real estate	3,369,209	3,369,209
Motor vehicles	42,800	42,800
Stock	39,464	39,464
Total overdue but not impaired loans	**3,451,473**	**3,451,473**
Overdue and impaired loans		
Borrower settlement account	3,519,004	-
Real estate	19,177,045	19,177,045
Equipment	1,461,310	1,461,310
Stock	133,336	133,336
Other	327,787	327,787
No collateral or other credit enhancement – personal guarantees	22,030	-
Total overdue and impaired loans	**24,640,512**	**21,099,478**
Total loans to corporate customers	**73,649,896**	**68,980,960**

17 Loans to customers (continued)

31 December 2016 AMD'000	Loans to customers, carrying amount	Fair value of collateral assessed in the reporting period
Loans without individual signs of impairment		
Borrower settlement account	3,739,650	-
Cash and deposits	1,604	1,604
Armenian Government treasury bills	2,426,994	2,426,994
Real estate	49,824,326	49,824,326
Motor vehicles	325,084	325,084
Equipment	370,687	370,687
Stock	2,099,710	2,099,710
Other collateral	68,251	68,251
Corporate guarantees (unrated)	1,197,034	1,197,034
No collateral or other credit enhancement – personal guarantees	1,679,587	-
Total loans without individual signs of impairment	**61,732,927**	**56,313,690**
Overdue but not impaired loans		
Real estate	9,262,705	9,262,705
Other	589,169	589,169
Corporate guarantees (unrated)	108,657	108,657
Stock	40,000	40,000
No collateral or other credit enhancement – personal guarantees	176	-
Total overdue but not impaired loans	**10,000,707**	**10,000,531**
Overdue and impaired loans		
Borrower settlement account	350,687	-
Real estate	20,782,424	20,782,424
Equipment	1,511,344	1,511,344
Other	1,020,886	1,020,886
Corporate guarantees (unrated)	584,286	584,286
No collateral or other credit enhancement – personal guarantees	74,721	-
Total overdue and impaired loans	**24,324,348**	**23,898,940**
Total loans to corporate customers	**96,057,982**	**90,213,161**

The tables above exclude overcollateralisation. For loans secured by multiple types of collateral, collateral that is most relevant for impairment assessment is disclosed.

Loans secured with borrower settlement accounts also have other collateral pledged to the Bank.

The Bank can not reliably estimate the fair value of personal guarantees.

17 Loans to customers (continued)

(ii) Loans to retail customers

Mortgage, construction and other loans to retail customers are secured by real estate. The Bank's policy is to issue mortgage and construction loans with a loan-to-value ratio of a maximum of 80%.

The fair value of collateral is at least equal to carrying amounts of individual mortgage and construction loans as at 31 December 2017 and 2016.

For mortgage and contsruction loans past due more than 90 days the Bank updates the appraised values of collateral obtained at inception of the loans to the current values considering the approximate changes in property values. The Bank also obtains specific individual valuation of collateral at each reporting date for significant secured loans.

Credit card loans are not secured.

Auto loans are secured by the underlying cars. The Bank's policy is to issue auto loans with a loan-to-value ratio of a maximum of 70%.

Consumer loans represent unsecured personal loans.

(d) Industry and geographical analysis of the loan portfolio

Loans to customers were issued primarily to customers located within the Republic of Armenia who operate in the following economic sectors:

	31 December 2017 AMD'000	31 December 2016 AMD'000
Trade	26,774,573	26,505,200
Construction	7,292,929	7,581,879
Food and beverages	17,423,484	25,700,992
Services	10,344,031	19,917,319
Energy	3,738,103	5,723,607
Manufacturing	6,661,754	10,312,291
Agriculture	3,381,459	2,760,077
Finance	2,092,333	2,427,026
Other	6,333,235	6,430,214
Loans to individuals	22,000,156	23,722,058
Total loans to customers (gross)	**106,042,057**	**131,080,663**
Impairment allowance	(10,610,810)	(11,490,309)
Total loans to customers (net)	**95,431,247**	**119,590,354**

(e) Significant credit exposures

As at 31 December 2017 the Bank had three borrowers or groups of connected borrowers (2016: three), whose loan balances exceeded 10% of equity. The gross value of these loans as at 31 December 2017 was AMD 15,629,537 thousand (2016: AMD 15,508,372 thousand).

18 Property, equipment and intangible assets

AMD'000	Land and buildings	Leasehold improvements	Vehicles	Computer equipment	Intangible assets	Other	Total
Cost/revalued amount							
Balance at 1 January 2017	**1,499,918**	**2,981,598**	**183,774**	**1,675,959**	**3,880,939**	**1,397,898**	**11,620,086**
Additions	-	14,462	16,800	121,386	479,183	19,138	650,969
Disposals/write-offs	-	(170,634)	(17,211)	(10,124)	(10,527)	(24,886)	(233,382)
Balance at 31 December 2017	**1,499,918**	**2,825,426**	**183,363**	**1,787,221**	**4,349,595**	**1,392,150**	**12,037,673**
Depreciation, amortisation and impairment losses							
Balance at 1 January 2017	**(101,394)**	**(2,648,801)**	**(112,867)**	**(1,486,756)**	**(2,570,726)**	**(1,281,217)**	**(8,201,761)**
Depreciation and amortisation charge	(101,418)	(102,054)	(20,775)	(105,715)	(558,021)	(45,327)	(933,310)
Disposals/write-offs	-	170,634	17,211	10,124	10,527	24,886	233,382
Balance at 31 December 2017	**(202,812)**	**(2,580,221)**	**(116,431)**	**(1,582,347)**	**(3,118,220)**	**(1,301,658)**	**(8,901,689)**
Carrying amount							
At 31 December 2017	**1,297,106**	**245,205**	**66,932**	**204,874**	**1,231,375**	**90,492**	**3,135,984**
Cost/revalued amount							
Balance at 1 January 2016	**1,498,401**	**2,979,924**	**158,746**	**1,632,631**	**3,583,200**	**1,393,495**	**11,246,397**
Additions	1,517	8,844	44,000	71,463	357,618	44,077	527,519
Disposals/write-offs	-	(7,170)	(18,972)	(28,135)	(59,879)	(39,674)	(153,830)
Balance at 31 December 2016	**1,499,918**	**2,981,598**	**183,774**	**1,675,959**	**3,880,939**	**1,397,898**	**11,620,086**
Depreciation, amortisation and impairment losses							
Balance at 1 January 2016	**-**	**(2,521,441)**	**(115,717)**	**(1,417,803)**	**(2,039,580)**	**(1,247,598)**	**(7,342,139)**
Depreciation and amortisation charge	(101,394)	(134,530)	(16,122)	(96,764)	(591,025)	(71,712)	(1,011,547)
Disposals/write-offs	-	7,170	18,972	27,811	59,879	38,093	151,925
Balance at 31 December 2016	**(101,394)**	**(2,648,801)**	**(112,867)**	**(1,486,756)**	**(2,570,726)**	**(1,281,217)**	**(8,201,761)**
Carrying amount							
At 31 December 2016	**1,398,524**	**332,797**	**70,907**	**189,203**	**1,310,213**	**116,681**	**3,418,325**

18 Property, equipment and intangible assets (continued)

Revalued assets

At 31 December 2017 land and buildings were revalued based on the results of an independent appraisal performed by an independent valuator. The resulting fair values were not materially different from the carrying value of the land and buildings and no revaluation impact was recorded in the financial statements.

The carrying value of land and buildings as of 31 December 2017, if the land and buildings would not have been revalued would be AMD 1,024,345 thousand (31 December 2016: AMD 1,096,041 thousand).

19 Other assets

	31 December 2017 AMD'000	31 December 2016 AMD'000
Other financial assets		
Receivables for letters of credit	1,855,092	4,068,524
Accrued commissions	504,215	569,210
Other	454,391	233,573
Total financial assets	**2,813,698**	**4,871,307**
Other non-financial assets		
Prepayments	52,986	36,592
Materials and supplies	45,393	27,369
Repossessed collateral	1,355,278	572,738
Total non-financial assets	1,453,657	636,699
Total other assets	**4,267,355**	**5,508,006**

Settlements of receivables for letters of credit did not require the use of cash and cash equivalents and was excluded from the statement of cash flows.

Repossessed collateral represents real estate assets acquired by the Bank in settlement of overdue loans. The Bank expects to dispose of the assets in the foreseeable future. The transaction did not require the use of cash and cash equivalents and was excluded from the statement of cash flows.

No other assets are impaired.

Movements in the other assets impairment allowance for the year ended 31 December 2017 are as follows:

	Accrued commissions AMD'000	Receivables for letters of credit AMD'000	Receivables for other assets AMD'000	Total AMD'000
Balance at the beginning of the year	-	-	-	-
Net charge	256,903	80,768	40,260	377,931
Net write-offs	(256,903)	(80,768)	(40,260)	(377,931)
Balance at the end of the year	-	-	-	-

19 Other assets (continued)

Movements in the other assets impairment allowance for the year ended 31 December 2016 are as follows:

	Accrued commissions AMD'000	Total AMD'000
Balance at the beginning of the year	-	-
Net charge	256,800	256,800
Net write-offs	(256,800)	(256,800)
Balance at the end of the year	-	-

There are no counterparties in receivables for letters of credit whose balances exceed 10% of equity. Receivables for letters of credit are represented by receivables from local Armenian companies.

20 Deposits and balances from banks

	31 December 2017 AMD'000	31 December 2016 AMD'000
Correspondent accounts and overnight placements of other banks	618,931	10,417
Members of HSBC Group	5,816,459	10,922,995
Loans received from the CBA	375,588	545,949
Financial institutions	73,272	116,524
Total deposits and balances from banks	**6,884,250**	**11,595,885**

As at 31 December 2017 the Bank had one bank (31 December 2016: two banks), whose balances exceeded 10% of equity. The gross value of these balances as at 31 December 2017 were AMD 5,816,459 thousand (2016: AMD 10,928,102 thousand).

Included in loans from financial institutions and the CBA are loans from international and governmental financial institutions and the CBA with arrangements to sub-lend these funds to borrowers for qualifying loans. The qualifying loans under these agreements are loans to small and medium size businesses and the energy efficiency sector.

21 Current accounts and deposits from customers

	31 December 2017 AMD'000	31 December 2016 AMD'000
Current accounts		
- Retail	40,918,548	38,717,213
- Corporate	34,508,917	28,459,594
Term deposits		
- Retail	72,753,233	68,373,927
- Corporate	10,392,097	14,184,018
Other	6,696	98,081
Total current accounts and deposits from customers	**158,579,491**	**149,832,833**

21 Current accounts and deposits from customers (continued)

As at 31 December 2017, the Bank maintained customer deposit balances of AMD 1,024,402 thousand (31 December 2016: AMD 1,185,818 thousand) that served as collateral for loans and unrecognised credit instruments granted by the Bank.

As at 31 December 2017, the Bank had two customers (31 December 2016: two customers), whose balances exceeded 10% of equity. These balances as at 31 December 2017 were AMD 18,176,949 thousand (2016: AMD 11,366,297 thousand).

22 Other liabilities

	31 December 2017 AMD'000	31 December 2016 AMD'000
Other financial liabilities		
Payables for letters of credit	1,855,092	4,068,524
Payables to HSBC Group	691,475	286,447
Accrued expenses	117,642	132,487
Foreign currency derivative contracts at fair value through profit or loss	6,489	2,328
Other	333,396	217,038
Total other financial liabilities	**3,004,094**	**4,706,824**
Other non-financial liabilities		
Accrued employee benefit costs	833,540	725,146
Deferred income	301,769	341,322
Payable to Deposit Guarantee Fund	59,742	52,156
Total other non-financial liabilities	**1,195,051**	**1,118,624**
Total other liabilities	**4,199,145**	**5,825,448**

23 Share capital

(a) Issued capital

The authorised, issued and outstanding share capital comprises 609,400 ordinary shares of AMD 30.25 thousand each (2016: 609,400 of AMD 30.25 thousand each).

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

(b) Dividends

Dividends payable are restricted to the maximum retained earnings of the Bank determined according to legislation of the Republic of Armenia.

No dividends were declared and paid during 2017 (2016: nil).

24 Risk management

Management of risk is fundamental to the business of banking and is an essential element of the Bank's operations. The major risks faced by the Bank are those related to market risk, credit risk and liquidity risk.

(a) Risk management policies and procedures

Risk management policies aim to identify, analyse and manage the risks faced by the Bank, to set appropriate risk limits and controls, and to continuously monitor risk levels and adherence to limits. Risk management policies and procedures are reviewed regularly to reflect changes in market conditions, products and services offered and emerging best practice.

The Board has overall responsibility for the oversight of the risk management framework, overseeing the management of key risks and reviewing its risk management policies and procedures as well as approving large exposures.

Credit, market and liquidity risks both at portfolio and transactional levels are managed and controlled by the Asset and Liability Management Committee (the "ALCO") and Risk Management Meeting (the "RMM").

(b) 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, currency and equity financial instruments, which are exposed to general and specific market movements and changes in the level of volatility of market prices.

The objective of market risk management is to manage and control market risk exposures within acceptable parameters, whilst optimising the return on risk.

The Bank manages its market risk by setting open position limits in relation to financial instrument, interest rate maturity and currency positions which are monitored on a regular basis.

The Bank's market risk policy is in line with HSBC Group standards.

(i) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.The Bank is exposed to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may also decrease or create losses in the event that unexpected movements occur.

24 Risk management (continued)

Interest rate gap analysis

Interest rate risk is managed principally through monitoring interest rate gaps. A summary of the interest gap position for major financial instruments as at 31 December 2017 and 2016 is as follows:

AMD'000	Less than 3 months	3-12 months	1-5 years	More than 5 years	Non-interest bearing	Carrying amount
31 December 2017						
ASSETS						
Cash and cash equivalents	3,001,110	-	-	-	66,464,300	69,465,410
Financial instruments at fair value through profit or loss	1,117,957	-	-	-	196,113	1,314,070
Available-for-sale financial assets	7,548,987	11,640,825	3,974,280	103,522	32,132	23,299,746
Loans and advances to banks	10,566,868	-	-	-	-	10,566,868
Loans to customers	83,353,021	3,299,382	8,775,940	2,904	-	95,431,247
Other financial assets	-	-	-	-	2,813,698	2,813,698
Total financial assets	**105,587,943**	**14,940,207**	**12,750,220**	**106,426**	**69,506,243**	**202,891,039**
LIABILITIES						
Deposits and balances from banks	5,889,731	95,937	279,651	-	618,931	6,884,250
Current accounts and deposits from customers	41,442,723	41,339,375	2,049,345	-	73,748,048	158,579,491
Other financial liabilities	-	-	-	-	3,004,094	3,004,094
Total financial liabilities	**47,332,454**	**41,435,312**	**2,328,996**	**-**	**77,371,073**	**168,467,835**
Interest rate gap	**58,255,489**	**(26,495,105)**	**10,421,224**	**106,426**	**(7,864,830)**	**34,423,204**

24 Risk management (continued)

AMD'000	Less than 3 months	3-12 months	1-5 years	More than 5 years	Non-interest bearing	Carrying amount
31 December 2016						
ASSETS						
Cash and cash equivalents	3,142,684	-	-	-	50,934,032	54,076,716
Financial instruments at fair value through profit or loss	636,930	-	-	-	285,815	922,745
Available-for-sale financial assets	6,887,425	12,675,945	5,085,463	93,002	32,032	24,773,867
Loans and advances to banks	6,238,794	-	-	-	-	6,238,794
Loans to customers	115,372,936	1,904,748	2,310,199	2,471	-	119,590,354
Other financial assets	-	-	-	-	4,871,307	4,871,307
Total financial assets	**132,278,769**	**14,580,693**	**7,395,662**	**95,473**	**56,123,186**	**210,473,783**
LIABILITIES						
Deposits and balances from banks	7,196,225	3,854,243	535,000	-	10,417	11,595,885
Current accounts and deposits from customers	55,087,416	29,288,904	1,564,812	-	63,891,701	149,832,833
Other financial liabilities	-	-	-	-	4,706,824	4,706,824
Total financial liabilities	**62,283,641**	**33,143,147**	**2,099,812**	**-**	**68,608,942**	**166,135,542**
Interest rate gap	**69,995,128**	**(18,562,454)**	**5,295,850**	**95,473**	**(12,485,756)**	**44,338,241**

24 Risk management (continued)

Average interest rates

The Bank monitors interest rates for its financial instruments. The table below summarises interest rates at the respective reporting dates. For securities, the interest rates represent yields to maturity based on market quotations at the reporting date:

	2017 Average effective interest rate, %			2016 Average effective interest rate, %		
	AMD	USD	Other currencies	AMD	USD	Other currencies
Interest bearing assets						
Cash and cash equivalents	4.6	-	-	4.9	-	8.6
Financial instruments at fair value through profit or loss	10.6	-	-	12.4	-	-
Available-for-sale financial assets	7.9	-	-	10.3	-	-
Loans and advances to banks	6.4	1.3	-	5.7	-	-
Loans to customers	12.3	8.0	7.3	14.4	9.5	7.6
Interest bearing liabilities						
Deposits and balances from banks	9.3	-	1.6	9.3	1.5	1.6
Current accounts and deposits from customers						
- Current accounts and demand deposits	2.3	0.9	0.6	2.1	1.1	-
- Term deposits	9.0	4.0	1.3	11.5	4.3	1.2

Interest rate sensitivity analysis

The management of interest rate risk based on interest rate gap analysis is suplemented by monitoring the sensitivity of financial assets and liabilities. An analysis of sensitivity of profit or loss and equity (net of taxes) to changes in interest rates (repricing risk) based on a simplified scenario of a 100 basis point (bp) symmetrical fall or rise in all positions of interest-bearing assets and liabilities, excluding financial instruments at fair value though profit or loss and financial assets available-for-sale, existing as at 31 December 2017 and 2016 is as follows:

	2017		2016	
	Profit or loss AMD'000	Equity AMD'000	Profit or loss AMD'000	Equity AMD'000
100 bp parallel rise	421,526	421,526	848,854	848,854
100 bp parallel fall	(421,692)	(421,692)	(848,854)	(848,854)

24 Risk management (continued)

An analysis of sensitivity of profit or loss and equity as a result of changes in the fair value of financial instruments at fair value though profit or loss and financial assets available-for-sale due to changes in the interest rates based on positions existing as at 31 December 2017 and 2016 and a simplified scenario of a 100 bp symmetrical fall or rise in all yield curves is as follows:

	2017		2016	
	Profit or loss AMD'000	**Equity AMD'000**	**Profit or loss AMD'000**	**Equity AMD'000**
100 bp parallel rise	(30,549)	(115,834)	(21,190)	(130,574)
100 bp parallel fall	32,968	119,518	23,173	134,561

(ii) Currency risk

The Bank has assets and liabilities denominated in several foreign currencies.

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign currency exchange rates. Although the Bank hedges its exposure to currency risk, such activities do not qualify as hedging relationships in accordance with IFRS.
The following table shows the foreign currency exposure structure of financial assets and financial liabilities as at 31 December 2017:

	AMD	**USD**	**EUR**	**Other currencies**	**Total**
	AMD'000	**AMD'000**	**AMD'000**	**AMD'000**	**AMD'000**
ASSETS					
Cash and cash equivalents	31,627,408	30,333,957	5,621,852	1,882,193	69,465,410
Financial instruments at fair value through profit or loss	1,118,124	195,562	384	-	1,314,070
Available-for-sale financial assets	23,298,898	-	848	-	23,299,746
Loans and advances to banks	3,285,315	7,266,319	8,685	6,549	10,566,868
Loans to customers	26,795,911	56,770,231	11,865,105	-	95,431,247
Other financial assets	410,539	1,527,128	876,031	-	2,813,698
Total financial assets	**86,536,195**	**96,093,197**	**18,372,905**	**1,888,742**	**202,891,039**
LIABILITIES					
Deposits and balances from banks	1,067,791	-	5,816,459	-	6,884,250
Current accounts and deposits from customers	42,918,181	102,414,762	11,739,391	1,507,157	158,579,491
Other financial liabilities	803,081	1,054,642	909,962	236,409	3,004,094
Total financial liabilities	**44,789,053**	**103,469,404**	**18,465,812**	**1,743,566**	**168,467,835**
Net position as at 31 December 2017	**41,747,142**	**(7,376,207)**	**(92,907)**	**145,176**	**34,423,204**
The effect of derivatives held for risk management and regular way currency contracts	**(7,884,390)**	**7,922,350**	**5**	**(37,965)**	**-**

24 Risk management (continued)

The following table shows the foreign currency exposure structure of financial assets and liabilities as at 31 December 2016:

	AMD	USD	EUR	Other currencies	Total
	AMD'000	AMD'000	AMD'000	AMD'000	AMD'000
ASSETS					
Cash and cash equivalents	31,048,882	17,508,833	3,477,281	2,041,720	54,076,716
Financial instruments at fair value through profit or loss	636,930	282,002	-	3,813	922,745
Available-for-sale financial assets	24,773,118	-	749	-	24,773,867
Loans and advances to banks	6,223,504	-	3,474	11,816	6,238,794
Loans to customers	29,352,709	74,835,804	15,295,697	106,144	119,590,354
Other financial assets	195,390	1,190,018	3,485,899	-	4,871,307
Total financial assets	**92,230,533**	**93,816,657**	**22,263,100**	**2,163,493**	**210,473,783**
LIABILITIES					
Deposits and balances from banks	672,889	5,787,184	5,135,812	-	11,595,885
Current accounts and deposits from customers	39,596,509	94,651,593	13,789,882	1,794,849	149,832,833
Other financial liabilities	373,266	758,073	3,434,187	141,298	4,706,824
Total financial liabilities	**40,642,664**	**101,196,850**	**22,359,881**	**1,936,147**	**166,135,542**
Net position as at 31 December 2016	**51,587,869**	**(7,380,193)**	**(96,781)**	**227,346**	**44,338,241**
The effect of derivatives held for risk management and regular way currency contracts	**(5,666,428)**	**5,802,134**	**-**	**(135,706)**	**-**

A strengthening of the AMD, as indicated below, against the following currencies at 31 December 2017 and 2016 would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis is based on foreign currency exchange rate variances that the Bank considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant.

	2017		2016	
	Profit or loss AMD'000	Equity AMD'000	Profit or loss AMD'000	Equity AMD'000
10% depreciation of USD against AMD	(54,614)	(54,614)	157,770	157,770
10% depreciation of EUR against AMD	9,290	9,290	(9,678)	(9,678)

A weakening of the AMD against the above currencies at 31 December 2017 and 2016 would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

24 Risk management (continued)

(c) Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Bank has policies and procedures for the management of credit exposures (both for recognised financial assets and unrecognised contractual commitments). The credit policy is reviewed and approved by the Board of Directors.

The credit policy is in line with HSBC Group standards.

The credit policy establishes:

- procedures for review and approval of loan credit applications,
- methodology for the credit assessment of borrowers (corporate and retail),
- methodology for the credit assessment of counterparties, issuers and insurance companies,
- methodology for the evaluation of collateral,
- credit documentation requirements,
- procedures for the ongoing monitoring of loans and other credit exposures.

Corporate loan credit applications are originated by the relevant relationship managers via the Credit Approval and Relationship Management (the "CARM") system and are then passed on for review to the Head of Wholesale Banking and approval to the Chief Risk Officer or Regional Credit and Risk team within the established credit approval limits. Analysis reports are based on a structured analysis focusing on the customer's business and financial performance. All legal documents regarding credit facilities are prepared and amended based on the approved CARM application.

The Bank continuously monitors the performance of individual credit exposures and regularly reassesses the creditworthiness of its customers. The review is based on the customer's most recent financial statements and other information submitted by the borrower, or otherwise obtained by the Bank.

Retail loan credit applications are reviewed by the Retail Credit department through verification of application data with criteria set in the Retail Banking Wealth Management (the "RBWM") Risk and Reward Plans (RRPs) approved by the Board of Directors.

The Bank monitors concentrations of credit risk by industry/sector and by geographic location. The Bank determines asset caps for each loan type, which are monitored on a regular basis.

The maximum exposure to credit risk is generally reflected in the carrying amounts of financial assets in the statement of financial position and unrecognised contractual commitment amounts. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant.

24 Risk management (continued)

The maximum exposure to credit risk from financial assets at the reporting date is as follows:

	2017 AMD'000	2016 AMD'000
ASSETS		
Cash and cash equivalents	65,989,561	48,731,472
Financial instruments at fair value through profit or loss	1,314,070	922,745
Available-for-sale debt assets	23,267,614	24,741,835
Loans and advances to banks	10,566,868	6,238,794
Loans to customers	95,431,247	119,590,354
Other financial assets	2,813,698	4,871,307
Credit related commitments and guarantees	27,634,355	30,295,009
Total maximum exposure	**227,017,413**	**235,391,516**

The Bank holds collateral against loans and advances to customers in the form of mortgage of property, other registered pledge over assets, and guarantees. The current market value of collateral is regularly assessed by independent appraisal companies approved by the Bank in case of properties and by invoice values for goods in turnover and similar items, and in the event of negative movements in market prices the borrower might be requested to put up additional collateral.

Collateral generally is not held against claims under derivative financial instruments, investments in securities, and loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activities.

For the analysis of collateral held against loans to customers and of concentration of credit risk in respect of loans to customers refer to Note 17.

The maximum exposure to credit risk from unrecognised contractual commitments at the reporting date is presented in Note 26.

Offsetting financial assets and financial liabilities

The disclosures set out in the tables below include financial assets and financial liabilities that:

- are offset in the Bank's statement of financial position; or
- are subject to an enforceable master netting arrangement or similar agreement that covers similar financial instruments, irrespective of whether they are offset in the statement of financial position.

The similar agreements include derivative clearing agreements, global master repurchase agreements, and global master securities lending agreements. Similar financial instruments include derivatives, sales and repurchase agreements, reverse sale and repurchase agreements and securities borrowing and lending agreements. Financial instruments such as loans and deposits are not disclosed in the table below unless they are offset in the statement of financial position.

24 Risk management (continued)

The Bank receives and accepts collateral in the form of marketable securities in respect of sale and repurchase, and reverse sale and repurchase agreements.

Such collateral is subject to standard industry terms. This means that securities received/given as collateral can be pledged or sold during the term of the transaction but must be returned on maturity of the transaction.

The above arrangements do not meet the criteria for offsetting in the statement of financial position. This is because they create a right of set-off of recognised amounts that is enforceable only following an event of default, insolvency or bankruptcy of the Bank or the counterparties.

The table below shows financial assets and financial liabilities subject to offsetting, enforceable master netting arrangements and similar arrangements as at 31 December 2017:

AMD'000 Types of financial assets/liabilities	Gross amounts of recognised financial asset/liability	Gross amount of recognised financial liability/asset offset	Net amount of financial assets/ liabilities	Related amounts not offset Financial Instruments (non-cash collateral)	Net amount
Reverse sale and repurchase agreements	3,972,333	-	3,972,333	(3,972,333)	-
Total financial assets	**3,972,333**	**-**	**3,972,333**	**(3,972,333)**	**-**

The table below shows financial assets and financial liabilities subject to offsetting, enforceable master netting arrangements and similar arrangements as at 31 December 2016:

AMD'000 Types of financial assets/liabilities	Gross amounts of recognised financial asset/liability	Gross amount of recognised financial liability/asset offset	Net amount of financial assets/ liabilities	Related amounts not offset Financial Instruments (non-cash collateral)	Net amount
Reverse sale and repurchase agreements	7,244,091	-	7,244,091	(7,244,091)	-
Total financial assets	**7,244,091**	**-**	**7,244,091**	**(7,244,091)**	**-**

24 Risk management (continued)

(d) Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk exists when the maturities of assets and liabilities do not match. The matching and or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to liquidity management. It is unusual for financial institutions ever to be completely matched since business transacted is often of an uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses.

The Bank maintains liquidity management with the objective of ensuring that funds will be available at all times to honor all cash flow obligations as they become due. The Bank's liquidity policy is developed in accordance with HSBC Group policies and local regulations. The liquidity policy is reviewed and approved by the ALCO and the Board.

The Bank seeks to actively support a diversified and stable funding base comprising core corporate and retail customer deposits, debt securities in issue, long-term and short-term loans from other banks, accompanied by diversified portfolios of highly liquid assets, in order to be able to respond quickly and smoothly to unforeseen liquidity requirements.

The liquidity management policy requires:

- projecting cash flows by major currencies and considering the level of liquid assets necessary in relation thereto;
- maintaining a diverse range of funding sources;
- managing the concentration and profile of debts;
- maintaining debt financing plans;
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any interruption to cash flow;
- maintaining liquidity and funding contingency plans;
- monitoring liquidity ratios against regulatory requirements.

Long-term, or structural, liquidity and funding risk management is the collective responsibility of ALCO. Main objectives of ALCO include managing the balance sheet with a view to enhance profitability and promote efficiency in the use of capital and funding by enhancing return on risk assets, reviewing all risks and ensuring their prudent management.

Global Markets department is responsible for the short-term or operational liquidity risk management of the Bank. Global Markets department should maintain adequate portfolio of short-term liquid assets, largely made up of: short-term liquid securities, loans and advances to banks and other inter-bank facilities. All significant transactions which can impact the Bank's liquidity position are pre-agreed with Global Markets department by Businesses.

24 Risk management (continued)

The following tables show the undiscounted cash flows on financial liabilities and credit-related commitments on the basis of their remaining contractual maturity. The total gross inflow and outflow disclosed in the tables is the contractual, undiscounted cash flow on the financial liability or commitment. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee can be called. The maturity analysis for financial liabilities as at 31 December 2017 is as follows:

AMD'000	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	More than 5 years	Total
Non-derivative liabilities						
Deposits and balances from banks	662,351	19,833	5,975,866	341,661	-	6,999,711
Current accounts and deposits from customers	84,021,977	10,112,505	45,264,045	22,007,959	1,525,937	162,932,423
Other financial liabilities	1,240,497	345,479	1,159,974	258,145	-	3,004,095
Total liabilities	**85,924,825**	**10,477,817**	**52,399,885**	**22,607,765**	**1,525,937**	**172,936,229**
Credit related commitments and letters of credit	**24,805,743**	**-**	**-**	**-**	**-**	**24,805,743**
Performance guarantees	**2,090,964**	**-**	**-**	**-**	**-**	**2,090,964**
Financial guarantees	**234,205**	**-**	**-**	**-**	**-**	**234,205**
Other commitments	**503,443**	**-**	**-**	**-**	**-**	**503,443**

The maturity analysis for financial liabilities as at 31 December 2016 is as follows:

AMD'000	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	More than 5 years	Total
Non-derivative liabilities						
Deposits and balances from banks	681,04	1,336,203	3,907,533	5,991,940	-	11,916,718
Current accounts and deposits from customers	75,902,13	10,963,715	42,334,889	24,195,803	1,350,982	154,747,520
Other financial liabilities	753,48	369,554	3,235,063	348,721	-	4,706,824
Total liabilities	**77,336,65**	**12,669,472**	**49,477,485**	**30,536,464**	**1,350,982**	**171,371,062**
Credit related commitments and letters of credit	**26,872,32**	**-**	**-**	**-**	**-**	**26,872,328**
Performance guarantees	**2,368,96**	**-**	**-**	**-**	**-**	**2,368,969**
Financial guarantees	**846,25**	**-**	**-**	**-**	**-**	**846,257**
Other commitments	**207,45**	**-**	**-**	**-**	**-**	**207,455**

24 Risk management (continued)

In accordance with Armenian legislation, individuals can withdraw their term deposits at any time, forfeiting, in most cases, the accrued interest. These deposits are classified in accordance with their stated maturity dates. The principal amount of such deposits, by each time band, is as follows:

- less than 1 month: AMD 7,610,122 thousand (2016: AMD 7,007,535 thousand);
- from 1 to 3 months: AMD 9,261,651 thousand (2016: AMD 9,044,531 thousand);
- from 3 to 12 months: AMD 35,931,555 thousand (2016: AMD 32,508,309 thousand);
- from 1 to 5 years: AMD 18,363,768 thousand (2016: AMD 18,341,680 thousand);
- more than 5 years: AMD 836,966 thousand (2016: AMD 796,686 thousand).

24 Risk management (continued)

The table below shows an analysis, by expected maturities, of the amounts recognised in the statement of financial position as at 31 December 2017:

AMD'000	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	More than 5 years	No maturity	Overdue	Total
Cash and cash equivalents	69,465,410	-	-	-	-	-	-	69,465,410
Financial instruments at fair value through profit or loss	1,128,052	25,834	160,184	-	-	-	-	1,314,070
Available-for-sale financial assets	3,015,455	4,533,532	11,640,825	3,974,280	103,522	32,132	-	23,299,746
Loans and advances to banks	10,566,868	-	-	-	-	-	-	10,566,868
Loans to customers	5,587,465	6,290,499	25,193,822	39,032,345	6,168,705	-	13,158,411	95,431,247
Current tax asset	-	-	16,325	-	-	-	-	16,325
Deferred tax assets	-	-	-	-	-	1,152,217	-	1,152,217
Property, equipment and intangible assets	-	-	-	-	-	3,135,984	-	3,135,984
Other assets	681,554	356,332	2,543,146	258,145	-	49,038	379,140	4,267,355
Total assets	**90,444,804**	**11,206,197**	**39,554,302**	**43,264,770**	**6,272,227**	**4,369,371**	**13,537,551**	**208,649,222**
Deposits and balances from banks	662,125	19,773	5,913,322	289,030	-	-	-	6,884,250
Current accounts and deposits from customers	84,001,795	10,057,447	43,962,546	19,717,326	840,377	-	-	158,579,491
Deferred tax liability	-	-	-	-	-	-	-	-
Other liabilities	1,331,542	394,273	2,129,926	343,404	-	-	-	4,199,145
Total liabilities	**85,995,462**	**10,471,493**	**52,005,794**	**20,349,760**	**840,377**	**-**	**-**	**169,662,886**
Net position as at 31 December 2017	**4,449,342**	**734,704**	**(12,451,492)**	**22,915,010**	**5,431,850**	**4,369,371**	**13,537,551**	**38,986,336**

24 Risk management (continued)

The table below shows an analysis, by expected maturities, of the amounts recognised in the statement of financial position as at 31 December 2016:

AMD'000	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	More than 5 years	No maturity	Overdue	Total
Cash and cash equivalents	54,076,716	-	-	-	-	-	-	54,076,716
Financial instruments at fair value through profit or loss	661,561	47,616	213,568	-	-	-	-	922,745
Available-for-sale financial assets	4,292,549	2,594,876	12,675,944	5,085,464	93,002	32,032	-	24,773,867
Loans and advances to banks	6,238,794	-	-	-	-	-	-	6,238,794
Loans to customers	7,248,550	8,408,918	29,037,394	51,746,739	8,342,165	-	14,806,588	119,590,354
Current tax asset	-	-	632,010	-	-	-	-	632,010
Property, equipment and intangible assets	-	-	-	-	-	3,418,325	-	3,418,325
Other assets	621,449	374,515	3,819,092	348,721	-	30,403	313,826	5,508,006
Total assets	**73,139,619**	**11,425,925**	**46,378,008**	**57,180,924**	**8,435,167**	**3,480,760**	**15,120,414**	**215,160,817**
Deposits and balances from banks	680,422	1,332,485	3,875,235	5,707,743	-	-	-	11,595,885
Current accounts and deposits from customers	75,879,628	10,896,877	40,825,866	21,429,539	800,923	-	-	149,832,833
Deferred tax liability	-	-	-	-	-	899,429	-	899,429
Other liabilities	837,327	1,150,213	3,356,736	481,155	17	-	-	5,825,448
Total liabilities	**77,397,377**	**13,379,575**	**48,057,837**	**27,618,437**	**800,940**	**899,429**	-	**168,153,595**
Net position as at 31 December 2016	**(4,257,758)**	**(1,953,650)**	**(1,679,829)**	**29,562,487**	**7,634,227**	**2,581,331**	**15,120,414**	**47,007,222**

24 Risk management (continued)

As at 31 December 2017 the Bank has a liquidity gap of assets and liabilities on demand and up to 12 months. This liquidity gap arises from the fact that an important source of funding for the Bank as of 31 December 2017 were customer accounts on demand. Management believes that in spite of a substantial portion of customer accounts being on demand, diversification of these deposits by number and type of depositors, and the past experience of the Bank indicate that these customer accounts provide a long-term and stable source of funding for the Bank.

The key measures used by the Bank for managing liquidity risk and funding risk are liquidity coverage ratio, liquid asset buffer ratio, net stable funding ratio, depositor and term funding maturity concentrations, which are monitored and managed on daily basis. Liquidity and funding risk appetite is defined by the Bank in a Risk Appetite Statement approved by the Board. The CBA sets and monitors liquidity requirements for the Bank. Under the current requirements set by the CBA, banks have to maintain the ratios of liquid assets to total assets and liquid assets to on demand liabilities above the prescribed minimum level. For this purpose liquid assets include cash and cash equivalents and Government treasury bills, which are not pledged or the use of which is not restricted in any way. As at 31 December 2017, this minimum level was 15% and 60% respectively. The Bank was in compliance with the statutory liquidity ratios as at 31 December 2017 and 2016 and over the periods.

The following table shows the liquidity ratios calculated in accordance with the requirements of the CBA, as at 31 December:

	2017 AMD'000	2016 AMD'000
At 31 December		
Ratio of liquid assets to total assets	45%	36%
Ratio of liquid assets to on demand liabilities	125%	116%

Regular liquidity stress testing under a variety of scenarios covering both normal and more severe market conditions is performed and reveiwed by ALCO quarterly. There is also a Contingency Funding Plan in place, which defines early warning indicators, crises management team, responsibilities, urgent liquidity sources, as well as crisis scenarios and Bank's mitigating actions.

25 Capital management

The CBA sets and monitors capital requirements for the Bank.

The Bank defines as capital those items defined by statutory regulation as capital for credit institutions. Under the current capital requirements set by the CBA, banks have to maintain a ratio of capital to risk weighted assets (statutory capital ratio) above the prescribed minimum level. As at 31 December 2017, this minimum level was 12%. The Bank was in compliance with the statutory capital ratio as at 31 December 2017 and 2016 and over the periods.

Regular stress testing covering both normal and more severe market conditions is performed to assess the impact on statutory capital ratio. The result of stress tests are reviewed by the ALCO on a quarterly basis and by the Board on an annual basis.

25 Capital management (continued)

The following table shows the composition of the capital position calculated in accordance with the requirements of the CBA calculated based on reports provided to the CBA, as at 31 December:

	2017 AMD'000	2016 AMD'000
Tier 1 capital		
Share capital	18,434,350	18,434,350
Retained earnings	18,088,360	26,028,383
General Reserve (CBA)	1,958,838	1,958,838
Adjustment to CBA accounting principles	(3,413,480)	(10,504,088)
Other deductions	(3,018,638)	(3,059,590)
Total tier 1 capital	**32,049,430**	**32,857,893**
Tier 2 capital		
Revaluation reserve for available-for-sale financial assets, gross of tax	218,862	321,364
Revaluation reserve for land and buildings	292,215	292,215
Share-based payment reserve	95,927	94,788
Total tier 2 capital	**607,004**	**708,367**
Total capital	**32,656,434**	**33,566,260**
Risk weighted assets, combining credit, market and operational risks	**173,438,234**	**202,361,504**
Total capital ratio	**18.83%**	**16.6%**

The risk-weighted assets are measured by means of a hierarchy of risk weights classified according to the nature and reflecting an estimate of credit, market and other risks associated with each asset and counterparty, taking into account any eligible collateral or guarantees. A similar treatment is adopted for unrecognised contractual commitments, with some adjustments, to reflect the more contingent nature of the potential losses.

26 Commitments

The Bank has outstanding commitments to extend loans. These commitments take the form of approved loans and credit card limits and overdraft facilities.

The Bank provides financial guarantees and letters of credit to guarantee the performance of customers to third parties. These agreements have fixed limits and generally extend for a period of up to five years.

The Bank applies the same credit risk management policies and procedures when granting credit commitments, financial guarantees and letters of credit as it does for granting loans to customers.

26 Commitments (continued)

The contractual amounts of commitments are set out in the following table by category. The amounts reflected in the table for commitments assume that amounts are fully advanced. The amounts reflected in the table for guarantees and letters of credit represent the maximum accounting loss that would be recognised at the reporting date if counterparties failed completely to perform as contracted.

	31 December 2017 AMD'000	31 December 2016 AMD'000
Contracted amount		
Loan and credit line commitments	13,602,520	16,030,728
Credit card commitments	4,580,498	4,682,468
Performance guarantees	2,090,964	2,368,969
Undrawn overdraft facilities	6,574,914	5,465,166
Letters of credit	47,811	693,966
Financial guarantees	234,205	846,257
Other commitments	503,443	207,455
Total commitments	**27,634,355**	**30,295,009**

The total outstanding contractual commitments above do not necessarily represent future cash requirements, as these commitments may expire or terminate without being funded. However, the majority of loan and credit line commitments do not represent an unconditional commitment by the Bank. The fair value of commitments was AMD 447.125 thousand as at 31 December 2017 (31 December 2016: AMD 426,306 thousand).

Of these commitments, AMD 13,618,839 thousand are to 10 customers as at 31 December 2017 (31 December 2016: AMD 13,587,656 thousand are to 10 customers).

27 Operating leases

Non-cancelable operating lease rentals are payable as follows:

	31 December 2017 AMD'000	31 December 2016 AMD'000
Less than 1 year	442,325	451,768
Between 1 and 5 years	1,356,820	1,411,892
More than 5 years	27	1,781
Total operating lease rentals payable	**1,799,172**	**1,865,441**

The Bank leases a number of land and buildings under operating leases. The leases typically run for an initial period of five to ten years, with an option to renew the lease after that date. Lease payments are usually increased annually to reflect market rentals. None of the leases includes contingent rentals.

28 Contingencies

(a) Litigation

Management is unaware of any significant actual, pending or threatened claims against the Bank.

(b) Taxation contingencies

The taxation system in the Republic of Armenia continues to evolve and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are sometimes contradictory and subject to varying interpretation by different tax authorities. Taxes are subject to review and investigation by a number of authorities, which have the authority to impose severe fines, penalties and interest charges. A tax year remains open for review by the tax authorities during the three subsequent calendar years.

These circumstances may create tax risks in the Republic of Armenia that are substantially more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Armenian tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on the financial position, if the authorities were successful in enforcing their interpretations, might be material but is unlikely to be significant.

29 Custody activities

The Bank provides custody services to its customers, whereby it holds securities on behalf of customers and receives fee income for providing these services. These securities are not assets of the Bank and are not recognised in the statement of financial position.

30 Related party transactions

(a) Transactions with the members of the Board and the Key Management Personnel

Total compensation is as follows:

	2017 AMD'000	2016 AMD'000
Total renumeration	628,965	533,302
Benefits-in-kind	76,397	143,671
Total renumeration and benefits-in-kind	**705,362**	**676,973**
Share-based payments	13,067	8,245
Total compensation	**718,429**	**685,218**

30 Related party transactions (continued)

The outstanding balances and interest rates are as follows:

	2017 AMD'000	2016 AMD'000
Statement of financial position		
ASSETS		
Loans to customers (contractual interest rate: 4.0% - 18.0%)	567,426	639,900
LIABILITIES		
Current accounts and deposits from customers (contractual interest rate: 0.0% - 7%)	498,920	151,087

Amounts included in the statement of profit or loss and other comprehensive income are as follows:

	2017 AMD'000	2016 AMD'000
Profit or loss		
Interest income	32,766	42,560
Interest expense	(8,570)	(4,000)

(b) Transactions with other related parties

Other related parties include entities under common control of the Bank's ultimate controlling party and other related parties of key management personnel. The outstanding balances and the related interest rates are as follows:

	31 December 2017 AMD'000		31 December 2016 AMD'000	
	Entities under common control	Other related parties	Entities under common control	Other related parties
Cash and cash equivalents (contractual interest rate: 0.0%)	31,092,993	-	13,508,595	-
Loans and advances to banks (contractual interest rate: 1.3%)	7,262,811	-	-	-
Loans to customers (contractual interest rate: 6.3 %- 18.0%)	-	208,872	-	3,054
Financial instruments at fair value through profit or loss	196,113	-	285,815	-
Deposits and balances from banks (contractual interest rate: 0.0% – 1.6%)	6,435,971	-	10,933,412	-
Current accounts and deposits from customers (contractual interest rate: 0.0% – 8.5%)	-	317,492	-	534,438
Other liabilities	2,466,736	-	4,021,702	-

30 Related party transactions (continued)

Amounts included into the statement of profit or loss and other comprehensive income are as follows:

	2017 AMD'000 Entities under common control	Other related parties	2016 AMD'000 Entities under common control	Other related parties
Interest income	155,336	19,014	37,827	5,756
Interest expense	(124,195)	(6,959)	(847,930)	(25,904)
Gain/(Loss) from foreign currency contracts	119,408	-	(104,613)	-
Fee and commission expense	(79,651)	(2,161)	(103,422)	-
Other operating income	34,998	4,603	27,177	5,593
Administrative and other operating expenses	(1,552,834)	-	(1,552,976)	-

Other rights and obligations with related parties are as follows:

	31 December 2017 AMD'000 Entities under common control	31 December 2016 AMD'000 Entities under common control
Guarantees issued to the Group at the year-end	870,150	865,708
Unused credit facilities	-	14,518,200
Foreign currency contracts	10,136,239	8,620,254

31 Derivative financial instruments

The table below sets out fair values, at the end of the reporting period, of currencies receivable or payable under foreign exchange forward contracts entered into by the Bank. The table reflects gross positions before the netting of any counterparty positions (and payments) and covers the contracts with settlement dates after the end of the respective reporting period. The contracts are short term in nature:

	2017 AMD'000 Contracts with positive fair value	Contracts with negative fair value	2016 AMD'000 Contracts with positive fair value	Contracts with negative fair value
Foreign exchange forwards: fair values, at the end of the reporting period, of				
- USD receivable on settlement (+) (Note 14)	195,562	(943)	284,436	(2,326)
- USD payable on settlement (-) (Note 22)	384	(5,379)	1,379	(2)
Net fair value of foreign exchange forwards	**195,946**	**(6,322)**	**285,815**	**(2,328)**

32 Financial assets and liabilities: fair values and accounting classifications

(a) Accounting classifications

The table below sets out the carrying amounts of financial assets and financial liabilities as at 31 December 2017:

AMD'000	Trading	Loans and receivables	Available-for-sale	Other amortised cost	Total carrying amount
Cash and cash equivalents	-	69,465,410	-	-	69,465,410
Financial instruments at fair value through profit or loss	1,314,070	-	-	-	1,314,070
Available-for-sale financial assets	-	-	23,299,746	-	23,299,746
Loans and advances to banks	-	10,566,868	-	-	10,566,868
Loans to customers	-	95,431,247	-	-	95,431,247
Other financial assets	-	2,813,698	-	-	2,813,698
Total financial assets	**1,314,070**	**178,277,223**	**23,299,746**	**-**	**202,891,039**
Deposits and balances from banks	-	-	-	6,884,250	6,884,250
Current accounts and deposits from customers	-	-	-	158,579,491	158,579,491
Other financial liabilities	6,489	-	-	2,997,605	3,004,094
Total financial liabilities	**6,489**	**-**	**-**	**168,461,346**	**168,467,835**

The table below sets out the carrying amounts of financial assets and financial liabilities as at 31 December 2016:

AMD'000	Trading	Loans and receivables	Available-for-sale	Other amortised cost	Total carrying amount
Cash and cash equivalents	-	54,076,716	-	-	54,076,716
Financial instruments at fair value through profit or loss	922,745	-	-	-	922,745
Available-for-sale financial assets	-	-	24,773,867	-	24,773,867
Loans and advances to banks	-	6,238,794	-	-	6,238,794
Loans to customers	-	119,590,354	-	-	119,590,354
Other financial assets	-	4,871,307	-	-	4,871,307
Total financial assets	**922,745**	**184,777,171**	**24,773,867**	**-**	**210,473,783**
Deposits and balances from banks	-	-	-	11,595,885	11,595,885
Current accounts and deposits from customers	-	-	-	149,832,833	149,832,833
Other financial liabilities	2,328	-	-	4,704,496	4,706,824
Total financial liabilities	**2,328**	**-**	**-**	**166,133,214**	**166,135,542**

32 Financial assets and liabilities: fair values and accounting classifications (continued)

(b) Fair values and fair value hierarchy

The Bank measures fair values for financial instruments using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: Quoted market price (unadjusted) in an active market for an identical instrument.
- Level 2: Valuation techniques based on observable inputs, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- Level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

The estimates of fair value are intended to approximate the price that would be received on the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. However given the uncertainties and the use of subjective judgment, the fair value should not be interpreted as being realisable in an immediate sale of the assets or transfer of liabilities.

Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm's length.

The Bank uses widely recognised valuation models for determining the fair value of common and more simple financial instruments like interest rate and currency swaps that use only observable market data and require little management judgment and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over the counter derivatives like interest rate swaps.

The estimated fair values of all financial instruments except for unquoted equity securities available-for-sale approximate their carrying values. As at 31 December 2017 fair value of unquoted equity securities available-for-sale with a carrying value of AMD 32,132 thousand (2016: AMD 32,032 thousand) cannot be determined.

32 Financial assets and liabilities: fair values and accounting classifications (continued)

The following assumptions are used by management to estimate the fair values of financial instruments:

- discount rates of 1.3%-6.4% (31 December 2016: 5.7%) and 7.3%-12.3% (31 December 2016: 7.6%-14.4%) are used for discounting future cash flows from loans and advances to banks and loans to customers, respectively; discount rates of 0.6% - 9.0% (31 December 2016: 1.1% - 11.5%) are used for discounting future cash flows for liabilities;
- the fair value of variable rate instruments is not materially different from carrying amount;
- the fair value of government bonds is estimated based on government bonds yield curve.

The table below analyses financial instruments measured at fair value for the years ended 31 December 2017 and 2016, by the level in the fair value hierarchy into which the fair value measurement is categorised:

	2017	2016
AMD'000	**Level 2**	**Level 2**
Financial instruments at fair value through profit or loss		
- Government treasury bills	1,117,957	636,930
- Derivative assets	196,113	285,815
- Derivative liabilities	(6,489)	(2,328)
Available-for-sale financial assets		
- Government treasury bills	23,267,614	24,028,968
- Corporate bonds	-	712,867

The following table analyses the fair value of financial instruments not measured at fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised as at 31 December 2017:

AMD'000	**Level 2**	**Level 3**	**Total fair values**	**Total carrying amount**
ASSETS				
Cash and cash equivalents	69,465,410	-	69,465,410	69,465,410
Loans to banks	10,566,868	-	10,566,868	10,566,868
Loans to customers	-	95,431,247	95,431,247	95,431,247
Other financial assets	-	2,813,698	2,813,698	2,813,698
LIABILITIES				
Deposits and balances from banks	6,884,250	-	6,884,250	6,884,250
Current accounts and deposits from customers	75,427,465	83,152,026	158,579,491	158,579,491
Other financial liabilities	-	3,004,094	3,004,094	3,004,094

32 Financial assets and liabilities: fair values and accounting classifications (continued)

The following table analyses the fair value of financial instruments not measured at fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised as at 31 December 2016:

AMD'000	Level 2	Level 3	Total fair values	Total carrying amount
ASSETS				
Cash and cash equivalents	54,076,716	-	54,076,716	54,076,716
Loans to banks	6,238,794	-	6,238,794	6,238,794
Loans to customers	-	119,590,354	119,590,354	119,590,354
Other financial assets	-	4,871,307	4,871,307	4,871,307
LIABILITIES				
Deposits and balances from banks	11,595,885	-	11,595,885	11,595,885
Current accounts and deposits from customers	67,176,807	82,656,026	149,832,833	149,832,833
Other financial liabilities	-	4,706,824	4,706,824	4,706,824

Management believes that the fair values of loans to customers as at 31 December 2017 and 31 December 2016 approximates their carrying values as the majority of loans to customers are at floating rates.

33 Events after the end of the reporting period

There were no events after the reporting period that may require adjustment of or disclosure in the Bank's financial statements for the year ended 31 December 2017.

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