Bankpozitif Kredi ve Kalkınma Bankası Anonim Şirketi

Consolidated Financial Statements As at and for the Year Ended 31 December 2019 With Independent Auditors' Report

Bankpozitif Kredi ve Kalkınma Bankası Anonim Şirketi

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KPMG

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Bankpozitif Kredi ve Kalkınma Bankası A.Ş.

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the consolidated financial statements of Bankpozitif Kredi ve Kalkınma Bankası A.Ş. ("the Bank") and its subsidiary (together "the Group"), which comprise the consolidated statement of financial position as at 31 December 2019, the consolidated statements of profit or loss, profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2019, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing ("ISA"s). Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Turkey, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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Key Audit Matters

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

Impairment of loans and finance lease receivables ("loans") measured at amortised cost

Refer to "Significant accounting policies" Note 3 to the consolidated financial statements relating to the impairment of loans measured at amortised cost.

The key audit matter	*How the matter was addressed in our audit*
As of 31 December 2019, loans comprise 69% of the Group's total assets. The Group recognizes its loans in accordance with IFRS 9 Financial Instruments standard ("Standard"). The Bank applies the "expected credit loss model" which contains significant assumptions and estimates in determining the impairment of financial assets in accordance with the Standard. The significant assumptions and estimates of the Group's management are as follows: • significant increase in credit risk, • incorporating the forward looking macroeconomic information in calculation of credit risk, • design and implementation of expected credit loss model. The determination of the impairment of loans measured at amortised cost depends on the credit default status, the model based on the change in the credit risk at the first recognition date and the classification of the loans measured at amortised cost according to the model. Establishing an accurate classification is a significant process as the calculation of expected credit loss varies to the staging of the financial assets. The Group calculates expected credit losses on both individual and collective basis. Individual provisions consider the estimated future performance of the business and the fair value of the collateral provided for credit transactions. Provisions set aside for the Group are modeled on prospective expectations by means of data collection in the past and the current period. Impairment on loans measured at amortised cost was considered to be a key audit matter, due to the significance of the estimates, assumptions, the level of judgements and its complex structure as explained above.	The audit procedures for expected credit loss calculations include below: • We tested the design and operating effectiveness of the controls on lending, collateralization, collection, follow-up, classification and impairment procedures are with the involvement of information risk management specialists. • We evaluated the Group's contractual cash flow tests prepared by the Bank for loans and the results of the tests have been evaluated for compliance with loan agreements. • We evaluated the adequacy of the subjective and objective criteria that is defined in the Group's impairment accounting policy compared with the Standard. • We evaluated the Group's business model and methodology and the evaluation of the calculations were carried out with the control testing and detailed analysis by the involvement of specialists. • We performed loan reviews for selected loan samples which include a detailed examination of loan files and related information and testing their classification. In this context, the current status of the loan customer has been evaluated by including prospective information and macroeconomic variables. • We evaluated the adequacy of the expected credit loss calculations by selecting sample for the loans which are assessed on individual basis. • We tested the accuracy and completeness of the data in the calculation models for the loans which are assessed on collective basis. The expected credit loss calculation was tested through recalculation. The models used for the calculation of the risk parameters were examined and the risk parameters were recalculated. • We assessed the macroeconomic models which are used to reflect forward looking expectations and tested the effect of the risk parameters by recalculation method. • We evaluated quantitative and qualitative the assessments which are used in determining the significant increase in credit risk. • Additionally, we also evaluated the adequacy of the consolidated financial statement disclosures related to impairment of loans measured at amortised cost.

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

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

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

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

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Responsibilities of auditors in an audit file as follows:

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

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

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

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.

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

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

We communicate with 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.

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

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

KPMG Bağımsız Denetim ve Serbest Muhasebeci Mali Müşavirlik A.Ş.
A member firm of KPMG International Cooperative

Orhan Akova
Partner

2 March 2020
Istanbul, Turkey

BANKPOZİTİF KREDİ VE KALKINMA BANKASI ANONİM ŞİRKETİ

Consolidated Statement of Financial Position
As at 31 December 2019

(Currency - In thousands of Turkish Lira)

		Audited 31 December 2019	Audited 31 December 2018
ASSETS			
Cash and balances with central banks	*10*	4	2,602
Due from banks and financial institutions	*10*	11,666	2,181
Interbank and other money market placements	*10*	50,531	-
Reserve deposits at central banks	*11*	67,503	72,466
Trading assets	*12*	10,365	13,092
Investment securities	*13*	64,044	87,517
Loaned securities	*13*	5,439	593
Loans and finance lease receivables	*14*	641,489	722,976
Tangible assets	*15*	9,744	2,417
Intangible assets	*16*	5,513	6,239
Deferred tax assets	*9*	3,626	2,164
Investment property	*17*	-	46,279
Assets held for sale	*17*	46,861	855
Other assets	*18*	12,639	11,960
Total assets		**929,424**	**971,341**
LIABILITIES			
Other money market deposits	*19*	5,275	590
Trading liabilities	*12*	5,995	6,775
Funds borrowed	*20*	543,189	613,380
Other liabilities	*21*	47,078	28,604
Provisions	*22*	16,872	11,640
Total liabilities		**618,409**	**660,989**
EQUITY			
Share capital and share premium	*23*	379,114	379,114
Legal reserves	*23*	16,168	16,168
Fair value reserve of debt instruments at fair value through other comprehensive income (FVOCI), net of tax	*23*	8,478	9,521
Accumulated losses		(92,745)	(94,451)
Total equity		**311,015**	**310,352**
Total equity and liabilities		**929,424**	**971,341**

The accompanying notes are an integral part of these consolidated financial statements.

BANKPOZİTİF KREDİ VE KALKINMA BANKASI ANONİM ŞİRKETİ

Consolidated Statement of Profit or Loss
For the year ended 31 December 2019

(Currency - In thousands of Turkish Lira)

	Note	Audited 2019	Audited 2018
Interest income			
Interest income on loans and finance lease receivables		67,116	71,712
Interest income on deposits with other banks and financial institutions		1,843	4,963
Interest income on investment securities		10,469	6,878
Interest income on interbank and other money market placements		1,309	4,204
Other interest income		20,284	28,413
Total interest income		**101,021**	**116,170**
Interest expense			
Interest expense on other money market deposits		(3,835)	(2,009)
Interest expense on funds borrowed		(26,961)	(33,411)
Interest expense on debt securities issued		-	(20,947)
Other interest expense		(10,202)	(7,838)
Total interest expense		**(40,998)**	**(64,205)**
Net interest income		**60,023**	**51,965**
Fees and commission income	*4*	5,985	8,105
Fees and commission expense	*4*	(351)	(667)
Net fee and commission income	*4*	**5,634**	**7,438**
Net trading income and foreign exchange gain	*5, 24*	3,100	5,254
Other operating income	*6*	2,084	2,034
Total operating income		**70,841**	**66,691**
Net impairment reversal/(loss) on financial assets	*14*	**(20,014)**	**(38,797)**
Personnel expenses	*7*	(23,009)	(24,273)
Depreciation and amortisation	*15, 16*	(3,757)	(2,272)
Administrative expenses	*8*	(19,833)	(21,486)
Taxes other than on income		(821)	(611)
Other expenses		(1,842)	(16,861)
Total operating expenses		**(49,262)**	**(65,503)**
Profit/(loss) before income tax		**1,565**	**(37,609)**
Income tax	*9*	921	(392)
Profit/(loss) for the year		**2,486**	**(38,001)**

The accompanying notes are an integral part of these consolidated financial statements.

BANKPOZİTİF KREDİ VE KALKINMA BANKASI ANONİM ŞİRKETİ

Consolidated Statement of Profit or Loss and Other Comprehensive Income
For the year ended 31 December 2019

(Currency - In thousands of Turkish Lira)

	Audited 2019	Audited 2018
Profit/(loss) for the year	**2,486**	**(38,001)**
Other comprehensive income		
Items that will never be reclassified to profit or loss		
Re-measurement of employee termination benefits	(1,000)	(2,075)
Related tax	220	418
	(780)	**(1,657)**
Items that are or may be reclassified to profit or loss		
Net change in fair value of financial assets measured at fair value through other comprehensive income (FVOCI)	(2,752)	5,966
Net amount reclassified to the income statement on sale of debt instruments at FVOCI	1,388	(154)
Related tax	321	(1,209)
	(1,043)	**4,603**
Other comprehensive income for the year, net of income tax	**(1,823)**	**2,946**
Total comprehensive income for the year	**663**	**(35,055)**

The accompanying notes are an integral part of these consolidated financial statements.

BANKPOZİTİF KREDİ VE KALKINMA BANKASI ANONİM ŞİRKETİ

Consolidated Statement of Changes in Equity
For the year ended 31 December 2019

(Currency - In thousands of Turkish Lira)

	Note	Share capital	Share premium	Adjustments to share capital	Legal reserves	Fair value reserve of debt instruments at FVOCI, net of tax	Accumulated losses	Total
At 1 January 2018		**337,292**	**20,121**	**21,701**	**16,168**	**4,918**	**(33,616)**	**366,584**
Accounting policy change (IFRS 9)		-	-	-	-	-	(21,177)	(21,177)
Restated balance at 1 January 2018		**337,292**	**20,121**	**21,701**	**16,168**	**4,918**	**(54,793)**	**345,407**
Total comprehensive income for the year								
Loss for the year		-	-	-	-	-	(38,001)	(38,001)
Other comprehensive income								
Re-measurements of employee termination benefit, net of tax	*22*	-	-	-	-	-	(1,657)	(1,657)
Net change in fair value of financial assets measured at fair value through other comprehensive income (FVOCI), net of tax	*23*	-	-	-	-	4,603	-	4,603
Total other comprehensive income		**-**	**-**	**-**	**-**	**4,603**	**(1,657)**	**2,946**
Total comprehensive income for the year		**-**	**-**	**-**	**-**	**4,603**	**(39,658)**	**(35,055)**
At 31 December 2018		**337,292**	**20,121**	**21,701**	**16,168**	**9,521**	**(94,451)**	**310,352**

	Note	Share capital	Share premium	Adjustments to share capital	Legal reserves	Fair value reserve of debt instruments at FVOCI, net of tax	Accumulated losses	Total
At 1 January 2019		**337,292**	**20,121**	**21,701**	**16,168**	**9,521**	**(94,451)**	**310,352**
Total comprehensive income for the year								
Profit for the year		-	-	-	-	-	2,486	2,486
Other comprehensive income								
Re-measurements of employee termination benefit, net of tax	*22*	-	-	-	-	-	(780)	(780)
Net change in fair value of financial assets measured at fair value through other comprehensive income (FVOCI), net of tax	*23*	-	-	-	-	(1,043)	-	(1,043)
Total other comprehensive income		**-**	**-**	**-**	**-**	**(1,043)**	**(780)**	**(1,823)**
Total comprehensive income for the year		**-**	**-**	**-**	**-**	**(1,043)**	**1,706**	**663**
At 31 December 2019		**337,292**	**20,121**	**21,701**	**16,168**	**8,478**	**(92,745)**	**311,015**

The accompanying notes are an integral part of these consolidated financial statements.

BANKPOZİTİF KREDİ VE KALKINMA BANKASI ANONİM ŞİRKETİ

Consolidated Statement of Cash Flows
For the year ended 31 December 2019

(Currency - In thousands of Turkish Lira)

		Audited	Audited
	Note	**2019**	**2018**
Cash flows from operating activities			
Interest received		85,042	98,357
Interest paid		(40,450)	(38,565)
Fees and commissions received		5,425	6,692
Fees and commissions paid		(351)	(667)
Trading income		5,531	4,705
Recoveries from non-performing loans	*14*	1,493	12,376
Cash payments to employees and other parties		(21,697)	(20,776)
Cash received from other operating activities		2,820	2,034
Cash paid to other operating activities		(40,570)	(19,010)
		(2,757)	**45,146**
Change in banks and financial institutions		-	-
Change in trading assets		785	(836)
Change in reserve deposits at central banks		4,488	(2,754)
Change in loans and finance lease receivables		90,507	99,160
Change in other assets		34	21,892
Change in customer deposits		(61)	-
Change in interbank and other money market deposits		4,686	(29,561)
Change in other liabilities		14,881	(17,913)
Net cash from operating activities		**112,624**	**115,134**
Cash flows from investing activities			
Purchases of investment securities	*13*	(13,302)	(41,264)
Proceeds from sale and redemption of investment securities	*13*	39,779	38,027
Purchases of tangible assets	*15*	(8,799)	(776)
Proceeds from the sale of premises and equipment	*15*	-	14
Purchases of intangible assets	*16*	(129)	(38)
Net cash used in investing activities		**17,549**	**(4,037)**
Cash flows from financing activities			
Proceeds from funds borrowed	*20*	1,140,905	1,508,764
Repayment of funds borrowed	*20*	(1,209,882)	(1,235,495)
Proceeds from debt securities issued		-	354,000
Repayment of debt securities issued		-	(981,124)
Net cash used in financing activities		**(68,977)**	**(353,855)**
Effect of net foreign exchange difference on cash and cash equivalents		(3,809)	2,147
Net increase / (decrease) in cash and cash equivalents		**57,387**	**(240,611)**
Cash and cash equivalents at 1 January	*10*	4,783	245,394
Cash and cash equivalents at 31 December	*10*	**62,170**	**4,783**

The accompanying notes are an integral part of these consolidated financial statements.

Notes to the consolidated financial statements

1. Corporate information

General

Bankpozitif Kredi ve Kalkınma Bankası A.Ş. ("BankPozitif" or "the Bank") was incorporated in Turkey on 9 April 1999 as Toprak Yatırım Bankası A.Ş. as a subsidiary of Toprakbank A.Ş. On 30 November 2001, Toprakbank A.Ş. (the previous parent company) was taken over by the Saving Deposit Insurance Fund ("SDIF"). As a result, SDIF became the controlling shareholder of Toprak Yatırım Bankası A.Ş., C Faktoring A.Ş. acquired 89.92% of the Bank's shares on 1 November 2002 in an auction from SDIF. Following the acquisition, the name of the Bank was changed as C Kredi ve Kalkınma Bankası A.Ş.. C Faktoring A.Ş. and its nominees increased their shareholding to 100% by share capital increases and by purchasing other third party minority shareholders' shares.

Negotiations of the new shareholding structure of the Bank which began in 2005 were finalised and a final share subscription agreement was signed on 13 December 2005. Under this agreement, Bank Hapoalim B.M. ("Bank Hapoalim") acquired a 57.55% stake in BankPozitif by means of a capital injection to be made through Tarshish-Hapoalim Holdings and Investments Ltd. ("Tarshish"), a wholly-owned subsidiary of Bank Hapoalim. On 23 December 2005, the name of the Bank was changed as Bankpozitif Kredi ve Kalkınma Bankası A.Ş.. Legal approvals concerning the new partnership have been obtained from Israeli and Turkish authorities in 2006 and extraordinary general assembly of the Bank was convened on 31 October 2006.

On 8 April 2008, Tarshish's share in BankPozitif increased to 65.00% by way of share capital increase. On 7 April 2009, Tarshish acquired 4.825% shares of BankPozitif from C Faktoring A.Ş. and Tarshish's share in BankPozitif increased to 69.83%.

As at 31 December 2019, 69.83% (31 December 2018 – 69.83%) of the shares of the Bank belong to Tarshish and are controlled by Bank Hapoalim and 30.17% (31 December 2018 – 30.17%) of the shares belong to C Faktoring A.Ş..

The registered head office address of the Bank is located at Rüzgarlıbahçe Mah. Kumlu Sok. No: 3 Yesa Blokları Kavacık 34805 Beykoz – Istanbul / Turkey.

(Currency - In thousands of Turkish Lira)

1. Corporate information *(continued)*

Nature of activities of the Bank / Group

The Bank carries out its activities as corporate and retail banking. The Bank's corporate services mainly include corporate lending, project finance, trade finance and financial leasing. In retail banking, the Bank mainly provides retail lending products such as consumer loans, home equity, mortgages, and vehicle to its customers. Apart from lending business, the Bank provides insurance and investment products to its customers. As a non-deposit taking bank, the Bank borrows funds from financial markets and from its counterparties.

C Bilişim Teknolojileri ve Telekomünikasyon Hizmetleri A.Ş. ("C Bilişim") is specialised in software development and provides other technological support services to the financial sector including the Bank.

As at 31 December 2019, the Bank provides services through its head office. As at 31 December 2019, the number of employees for the Bank and its consolidated subsidiary are 56 and 2, respectively (31 December 2018 – 63 and 2).

For the purposes of the consolidated financial statements, the Bank and its consolidated subsidiary are referred to as "the Group".

The subsidiary included in consolidation and effective shareholding percentages of the Group at 31 December 2019 and 31 December 2018 are as follows:

	Place of incorporation	Principal activities	Effective shareholding and voting rights	
			31 December 2019	31 December 2018
C Bilişim	Istanbul/Turkey	Software development and technology	100%	100%

2. Basis of preparation

2.1 Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs). They were authorized for issue by the Group's Management.

The Bank and its subsidiary which are incorporated in Turkey maintain their books of account and prepare their statutory financial statements in accordance with the regulations on accounting and reporting framework and accounting standards which are determined by the provisions of Turkish Banking Law, accounting standards promulgated by the Turkish Commercial Code and Tax Legislation.

In preparation of the consolidated financial statements of the Group, the same accounting policies except than IFRS 16 and methods of computation have been followed as compared to the most recent annual financial statements as of 31 December 2019. Other new IFRS/IAS amendments in effect do not have significant impact on the accounting policies, financial position and performance of the Group.

2. Basis of preparation *(continued)*

2.2 Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for the following assets and liabilities are measured at fair value;

- derivative financial instruments
- trading assets
- financial assets at the fair value through profit or loss
- financial assets measured at fair value through other comprehensive income
- investment property

2.3 Functional and presentation currency

These consolidated financial statements are presented in TL, which is the Bank's functional currency. Except as indicated, financial statements presented in TL has been rounded to the nearest thousand.

2.4 Use of estimates and judgements

The preparation of the financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

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

In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the consolidated financial statements are as follows;

Key sources of estimation uncertainty

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

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

In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are in Notes 9, 22 and 28.

(Currency - In thousands of Turkish Lira)

2. Basis of preparation *(continued)*

2.5 Changes in accounting policies

Except for the changes below, the Group has consistently applied the accounting policies as disclosed in the financial statements as at and for the year ended 31 December 2018.

The Group has started to apply IFRS 16 Leases standard ("IFRS 16") published by in the accompanying consolidated financial statements starting from 1 January 2019.

IFRS 16 Leases standard abolishes the dual accounting model currently applied for lessees through recognizing finance leases in the balance sheet whereas not recognizing operational lease. Instead, it is set forth a single model similar to the accounting of finance leases (on balance sheet). For lessors, the accounting stays almost the same.

This standard is applied with modified retrospective approach recognizing the cumulative effect of initially applying the standard at the date of initial application. In this context, comparative information is not restated.

A lease liability and a right-of-use asset is recognised at the date of initial application for leases previously classified as an operating lease applying IAS 17. That lease liability is measured at the present value of the remaining lease payments, discounted using the Bank's alternative borrowing rate at the date of initial application. Besides, that right-of-use asset is measured at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application.

Transition disclosures of IFRS 16

	Not	31 December 2018	IFRS 16 Impact	1 January 2019	31 December 2019
Tangible Assets (Net)	(1)	2,417	6,847	9,264	9,744
Other Liabilities (Net) (*)	(2)	-	6,847	6,847	6,567

(1) For leases classified as operating leases in accordance with IAS 17, TL 6,847 thousand lease liabilities and right-of-use assets amount has been reflected to financial statements as of 1 January 2019 in accordance with IFRS 16.

(2) As of 1 January 2019, the weighted average of the alternative funding interest rates applied to TL and EURO lease liabilities are 22.5% and 3%, respectively.

(*) Obligations under lease liabilities are presented in other liabilities in financial statements.

2.6 Other disclosures

The accounting policies and the valuation principles applied in the preparation of the accompanying financial statements are explained in Notes 3.1 to 3.23.

(Currency - In thousands of Turkish Lira)

3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by Group entities.

3.1 Basis of consolidation

i) Subsidiaries

Subsidiaries are investees controlled by the Group. The Group controls an investee if it is exposed to, or has rights to, variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

The purchase method of accounting is used for acquired businesses. The purchase method of accounting involves allocating the cost of the business combination to the fair value of assets acquired and liabilities and contingent liabilities assumed at the date of acquisition. The excess of the cost of acquisition over the fair value of Group's share of the identifiable net assets acquired is recorded as goodwill. There is no negative goodwill recognised by the Group. The financial statements of the subsidiary is prepared for the same reporting period as the parent Bank, using consistent accounting policies.

(ii) Transactions eliminated on consolidation

Intra-group balances, and any unrealised income and expenses arising from intra-group transactions, are eliminated in the preparation of the consolidated financial statements. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

3.2 Foreign currency

i) Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at exchange rates 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 exchange rate at that 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 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 was determined. Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the retranslation of equity instruments – fair value through other comprehensive income or a financial liability designated as a hedge of the net investment in a foreign operation.

Foreign currency translation rates used by the Group are as follows:

	USD / TL (full)	**EUR / TL (full)**
31 December 2019	5.9402	6.6506
31 December 2018	5.2609	6.0280

3. Significant accounting policies *(continued)*

3.3 Interest

Interest income and expense are recognised in profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability.

When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment, call and similar options) but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts.

Interest income and expense presented in the statement of profit or loss and other comprehensive income include:

- interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis;
- interest for investment securities – fair value through other comprehensive income calculated on an effective interest basis,
- interest income and expense arising from currency swaps, cross currency swaps, futures and interest rate cap/floor agreements which are presented as other interest income and expense in the accompanying consolidated financial statements.

3.4 Fees and commissions

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate of the loan. Fees and commission arising from negotiating or participating in the negotiation of a transaction for a third party are recognised on completion of the underlying transaction.

Fees for bank transfers and other banking transaction services are recorded as income when collected.

3.5 Net trading income

Net trading income comprises gains less loss related to trading assets and liabilities, and includes all realised and unrealised fair value changes and interest. Any realised or unrealised fair value changes and interest of non-qualifying derivatives, held for risk management purposes, are recorded as foreign exchange gain.

3.6 Dividends

Dividends are recognised when the shareholders’ right to receive the payments is established.

3. Significant accounting policies *(continued)*

3.7 Income tax

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

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the reporting date.

Deferred tax assets are recognised for all deductible temporary differences, carry-forward of unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carry-forward of unused tax losses can be utilised.

Deferred tax is not recognised for:

- temporary differences on the initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss;
- temporary differences related to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future; and
- taxable temporary differences arising on the initial recognition of goodwill.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at 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 asset can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities, and deferred taxes relate to the same taxable entity and the same taxation authority.

3. Significant accounting policies *(continued)*

3.8 Financial assets and liabilities

Recognition

The Group recognises a financial asset or financial liability in its statement of financial position when and only when it becomes a party to the contractual provisions of the instrument. It shall be recognised a financial asset or a financial liability in its statement of financial position when, and only when, an entity becomes party to the contractual provisions of the instrument. A regular way purchase or sale of financial assets shall be recognised and derecognised, as applicable, using trade date accounting or settlement date accounting. Purchase and sale transactions of securities are recognized at the settlement date.

Assessment of the Business Model

As per IFRS 9, the business model is determined at a level that reflects how groups of financial assets are managed together to achieve a particular business objective. The business model does not depend on management’s intentions for an individual instrument. Accordingly, this condition is not an instrument-by-instrument approach to classification and should be determined on a higher level of aggregation.

During assessment of the business model for management of financial assets, it must be considered all relevant evidence that is available at the date of the assessment. Such relevant evidence includes below:

- how the performance of the business model and the financial assets held within that business model are evaluated and reported to the key management personnel;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way in which those risks are managed; and
- how managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected).

Assessment of the business model is not performed on the basis of scenarios that the entity does not reasonably expect to occur, such as so-called ‘worst case’ or ‘stress case’ scenarios.

If cash flows are realised in a way that is different from the expectations at the date that it is assessed the business model, that does not give rise to a prior period error in the financial statements nor does it change the classification of the remaining financial assets held in that business model as long as it is considered all relevant information that was available at the time that it made the business model assessment. However, when the business model is assessed for newly originated or newly purchased financial assets, it must be considered information about how cash flows were realised in the past, along with all other relevant information.

The business models are divided into three categories. These categories are defined below:

- A business model whose objective is to hold assets in order to collect contractual cash flows: a business model whose objective is to hold assets in order to collect contractual cash flows are managed to realise cash flows by collecting contractual payments over the life of the instrument. The financial assets that are held within the scope of this business model are measured at amortised cost when the contractual terms of the financial asset meet the condition of giving rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

3. Significant accounting policies *(continued)*

3.8 Financial assets and liabilities *(continued)*

Assessment of the Business Model *(continued)*

- A business model whose objective is achieved by both collecting contractual cash flows and selling financial assets: it may be held financial assets in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets. Fair value change of the financial assets that are held within the scope of this business model are recognized under other comprehensive income when the contractual terms of the financial asset meet the condition of giving rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.
- Other business models: financial assets are measured at fair value through profit or loss if they are not held within a business model whose objective is to hold assets to collect contractual cash flows or within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.

Classification Methodology

The financial assets included within the scope of IFRS 9 are determined and the SPPI test based on the financial assets and sub-products as well as the Business Model shall be determined on the basis of IFRS 9 standards.

Financial assets held by the Bank in line with the management model for the purpose of collecting contractual cash flows consisting of only the interest and principal should be recognized by using the amortized cost method if such contractual cash flows consist of only the interest and principal. The following criteria should be taken into consideration for the financial assets evaluated in this context:

(a) frequency and sales amount of sales made in previous periods,

(b) whether the sales were made close to the maturity date of the financial asset,

(c) causes of sales and future forecasts for sales.

Measurement Categories of Financial Assets and Liabilities

As of 1 January 2018, all financial assets are classified based on the business model for managing the financial assets. Accordingly, financial assets are classified in three main categories as listed below:

- Financial assets measured at amortized cost,
- Financial assets measured at fair value through other comprehensive income,
- Equity instruments measured at fair value through other comprehensive income,
- Financial assets measured at fair value through profit or loss.

3. Significant accounting policies *(continued)*

3.8 Financial assets and liabilities *(continued)*

Explanations on Financial Assets

The Group categorizes its financial assets as "Fair Value Through Profit/Loss", "Fair Value Through Other Comprehensive Income" or "Measured at Amortized Cost". Such financial assets are recognized or derecognized according to IFRS 9 - Financial Instruments. Financial assets are measured at fair value at initial recognition in the financial statements. During the initial recognition of financial assets other than "Financial Assets at Fair Value Through Profit or Loss", transaction costs are added to fair value or deducted from fair value. The Group recognizes a financial asset into financial statements when it becomes a party to the contractual terms of a financial instrument. During the first recognition of a financial asset into the financial statements, business model determined by Bank management and the nature of contractual cash flows of the financial asset are taken into consideration. When the business model determined by the Bank's management is changed, all affected financial assets are reclassified and this reclassification is applied prospectively. In such cases, no adjustments is made to earnings, losses or interest that were previously recorded in the financial statements.

a) Financial assets at the fair value through profit or loss: "Financial assets at fair value through profit/loss" are financial assets other than the ones that are managed with business model that aims to hold to collect contractual cash flows or business model that aims to collect both the contractual cash flows and cash flows arising from the sale of the assets; and if the contractual terms of the financial asset do not lead to cash flows representing solely payments of principal and interest at certain date; that are either acquired for generating a profit from short- term fluctuations in prices or are financial assets included in a portfolio aiming to short-term profit making. Financial assets at the fair value through profit or loss are initially recognized at fair value and remeasured at their fair value after recognition. All gains and losses arising from these valuations are reflected in the income statement.

b) Financial Assets at Fair Value Through Other Comprehensive Income: In addition to financial assets within a business model that aims to hold to collect contractual cash flows and aims to hold to sell, financial asset with contractual terms that lead to cash flows are solely payments of principal and interest at certain dates, they are classified as fair value through other comprehensive income. Financial assets at fair value through other comprehensive income are recognized by adding transaction cost to acquisition cost reflecting the fair value of the financial asset. After the recognition, financial assets at fair value through other comprehensive income are remeasured at fair value. Interest income calculated with effective interest rate method arising from financial assets at fair value through other comprehensive income and dividend income from equity securities are recorded to income statement. "Unrealized gains and losses" arising from the difference between the amortized cost and the fair value of financial assets at fair value through other comprehensive income are not reflected in the income statement of the period until the acquisition of the asset, sale of the asset, the disposal of the asset, and impairment of the asset and they are recognized under the "Accumulated other comprehensive income or expense to be reclassified through profit or loss" under shareholders' equity. Equity securities, which are classified as financial assets at fair value through other comprehensive income, that have a quoted market price in an active market and whose fair values can be reliably measured are carried at fair value. During initial recognition an entity may irrevocably elect to record the changes of the fair value of the investment in an equity instrument that is not held for trading purposes in the other comprehensive income. In the case of this preference, the dividend from the investment is taken into the financial statements as profit or loss.

3. Significant accounting policies *(continued)*

3.8 Financial assets and liabilities *(continued)*

***Explanations on Financial Assets** (continued)*

c) Equity Instruments Measured at Fair Value Through Other Comprehensive Income: At initial recognition, it can be made an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument within the scope of IFRS 9 that is neither held for trading nor contingent consideration recognised by an acquirer in a business combination to which IFRS 3 applies. Such election is made on an instrument by instrument basis.

Amounts presented in other comprehensive income shall not be subsequently recycled to profit or loss. However, the cumulative gain or loss shall be recycled to prior period's profit or loss. Dividends on such investments are recognised in profit or loss unless the dividend clearly represents a recovery of part of the cost of the investment. IFRS 9 impairment requirements are not applicable for equity instruments.

d) Financial Assets Measured at Amortized Cost: Financial assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest are classified as financial assets measured at amortized cost. Financial assets measured at amortized cost are initially recognized at acquisition cost including the transaction costs which reflect the fair value of those instruments and subsequently recognized at amortized cost by using effective interest rate method. Interest income obtained from financial assets measured at amortized cost is recognized under income statement.

e) Derivative Financial Assets: The major derivative instruments utilized by the Group are foreign currency and interest rate swaps, cross currency swaps, currency options and currency forwards. Derivative financial instruments of the Group are classified under IFRS 9, "Derivative Financial Assets Designated at Fair Value through Profit or Loss". Payables and receivables arising from the derivative instruments are recorded in the off-balance sheet accounts at their contractual values. Derivative transactions are valued at their fair values subsequent to their acquisition. In accordance with the classification of derivative financial instruments, if the fair value is positive, the amount is classified as "Derivative Financial Assets Designated at Fair Value Through Profit or Loss" or "Derivative Financial Assets Designated at Fair Value Through Other Comprehensive Income", if the fair value is negative, the amount is classified as "Derivative Financial Liabilities Designated at Fair Value Through Profit or Loss" or "Derivative Financial Liabilities Designated at Fair Value Through Other Comprehensive Income". The fair value differences of derivative financial instruments are recognized in the income statement under trading profit/loss line in profit/loss from derivative financial transactions.

f) Loans: Loans are financial assets that have fixed or determinable payments terms and are not quoted in an active market. Loans are initially recognized at acquisition cost plus transaction costs presenting their fair value and thereafter measured at amortized cost using the "Effective Interest Rate (internal rate of return) Method". Group's loans are recognized under the "Measured at Amortized Cost" account.

Explanations on Financial Liabilities

Deposits, funds borrowed and debt securities issued: The Bank is not entitled to collect customer deposits. Money market deposits, funds borrowed and debt securities issued are initially measured at fair value plus transaction costs, and subsequently measured at their amortised cost using the effective interest method.

3. Significant accounting policies *(continued)*

3.8 Financial assets and liabilities *(continued)*

Derecognition of financial instruments

Derecognition of financial assets due to change in the contractual terms

Based on IFRS 9, the renegotiation or modification of the contractual cash flows of a financial asset can lead to the derecognition of the existing financial asset. When the modification of a financial asset results in the derecognition of the existing financial asset and the subsequent recognition of the modified financial asset, the modified asset is considered a "new" financial asset.

When it is assessed the characteristics of the new contractual terms of the financial asset, it is also evaluated the contractual cash flows including foreign currency rate changes, conversion to equity, counterparty changes and solely principal and interest on principle.

When the contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in the derecognition of that financial asset, it is recalculated the gross carrying amount of the financial asset and recognised a modification gain or loss in profit or loss.

Derecognition of financial liabilities

Where all risks and rewards of ownership of the asset have not been transferred to another party and it is retained control of the asset, it is continued to be recognised the remaining portion of the asset and liabilities arising from such asset.

When it is retained substantially all the risks and rewards of ownership of the transferred asset, the transferred asset continues to be recognised in its entirety and the consideration received is recognised as a liability.

Derecognition of a financial asset without any change in the contractual terms

The asset is derecognised if the contractual rights to cash flows from the financial asset are expired or the related financial asset and all risks and rewards of ownership of the asset are transferred to another party.

Except for equity instruments measured at FVOCI, the total amount consisting of the gain or loss arising from the difference between the book value and the amount obtained and any accumulated gain directly accounted in equity shall be recognised in profit or loss.

A financial liability (or a part of a financial liability) shall be removed from the statement of financial position when, and only when, it is extinguished—i.e. when the obligation specified in the contract is discharged or cancelled or expires.

3. Significant accounting policies *(continued)*

3.8 Financial assets and liabilities *(continued)*

Reclassification of financial instruments

It shall be reclassified all affected financial assets based on classification principles of IFRS 9 when, and only when, it is changed the business model for managing financial assets.

It is fulfilled the requirements of reclassification during transition to IFRS 9 and such reclassification details are presented in transition disclosures.

Restructuring and refinancing of financial instruments

It may be changed the original contractual terms of a loan (maturity, repayment structure, guarantees and sureties) which were previously signed, in case the loan cannot be repaid or if a potential payment difficulty is encountered based on the new financing power and structure of the borrower.

Restructuring is to change the financial terms of existing loans in order to facilitate the payment of debt. Refinancing is granting a new loan which will cover either the principal or the interest payment in whole or in part of one or a few existing loans due to the anticipated financial difficulty which the customer or group encounter currently or will encounter in the future.

Changes in the original terms of a credit risk can be made in the current contract or through a new contract.

Explanations on Expected Credit Loss

The Group allocates impairment for expected loss on financial assets measured at amortized cost and measured at fair value through other comprehensive income. As of 1 January 2018, the Group recognizes provisions for impairment in accordance with IFRS 9 requirements.

The expected credit loss estimates are required to be unbiased, probability-weighted and include supportable information about past events, current conditions, and forecasts of future economic conditions.

These financial assets are divided into three categories depending on the gradual increase in credit risk observed since their initial recognition:

Stage 1: For the financial assets at initial recognition or that do not have a significant increase in credit risk since initial recognition. Impairment for credit risk is recorded in the amount of 12-month expected credit losses.

Stage 2: In the event of a significant increase in credit risk since initial recognition, the financial asset is transferred to Stage 2. Impairment for credit risk is determined on the basis of the instrument's lifetime expected credit losses.

Stage 3: Stage 3 includes financial assets that have objective evidence of impairment at the reporting date. For these assets, lifetime expected credit losses are recognized and interest revenue is calculated on the net carrying amount.

3. Significant accounting policies *(continued)*

3.8 Financial assets and liabilities *(continued)*

Forward Looking Information

Any macroeconomic expectations within the scope of the IFRS 9 directly affect the provisions (Expected Credit Loss). The Bank uses progressive macroeconomic information in its significant increase in credit risk assessment and the anticipated credit loss calculation.

In order to generate estimates based on macroeconomic reflections, the Bank uses speculative grade in global corporate average cumulative default rates published by S&P global rating. While calibrating the Bank's probability of default rates, Bayesian scaler approach is used together with the normal and worst scenario for speculative default rates together with portfolio average probability of default rate for cash and non-cash portfolio separately.

As a result, the provisions calculated may change considering the prospective macroeconomic expectations. The Bank regularly reviews the parameters and model it uses in its calculations and updates them when necessary.

Significant Increase in Credit Risk

In determining the significant increase in credit risk, the Bank performs qualitative and quantitative assessments.

<u>Quantitative Assessment</u>

In the event that any of the following conditions occur as a result of a qualitative assessment, the Bank classifies the financial asset as Stage 2 (Significant Increase in Credit Risk):

- receivables overdue for more than 30 days as of the reporting date,
- receivables that are monitored closely,
- any change in a payment plan due to refinancing, restructuring or a preferential agreement when the loan is considered not in default or not excluded from the financial statements as long as the change is not a result of any commercial reasons.

<u>Qualitative Assessment</u>

The quantitative reason explaining the significant increase in credit risk is based on the comparison of the credit rating of the borrower calculated at the opening of the loan and the credit rating assigned to the same loan at the reporting date.

The Bank classifies the credit receivable within the scope of close monitoring if there is a decrease in the borrower's predetermined level as a result of the quantitative evaluation.

Low Credit Risk

In accordance with IFRS 9, in case the risk of default of a financial instrument is low, the borrower has a strong structure to meet its contractual cash flow obligations in the short term and any negative changes in economic conditions and operating conditions in the longer term reduce the borrower's ability to fulfill its contractual cash-flow obligations only to a certain extent, the Bank considers the credit risk of such financial instrument to be low.

The Bank does not conclude that a financial instrument has a low credit risk if only the risk of loss related to such financial instrument is considered to be low due to the value of the collateral and the credit risk of the financial instrument is not considered low without such collateral. Additionally, the Bank does not assess any financial instruments as having a low credit risk only because such financial instruments are less risky compared to any other financial instruments of the Bank or the credit risk of the region where the business operates.

3. Significant accounting policies *(continued)*

3.8 Financial assets and liabilities *(continued)*

Low Credit Risk *(continued)*

The Bank assumes that the credit risk of a financial instrument does not increase significantly after the initial recognition of it in the financial statements if it is determined that a financial instrument has a low credit risk at the reporting date.

The Bank applies a low credit risk assessment only for its securities portfolio.

Use of Judgements and Estimates

The significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements as at end for the year ended 31 December 2018 except estimations used for expected credit loss calculation according to IFRS 9.

Measurement of fair values

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 in the principal or, in its absence, the most advantageous market to which the Group has access at that date. The fair value of a liability reflects its non-performance risk.

When measuring the fair value of an asset or a liability, the Group uses market observable data as far as possible. Fair values are categorised into different levels in a fair value hierarchy based on the inputs used in the valuation techniques as follows:

Level 1: Quoted market price (unadjusted) in an active market for 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 using 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.

If the inputs used to measure the fair value of an asset or a liability might be categorised in different levels of the fair value hierarchy, then the fair value measurement is categorised in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.

The Group recognises transfers between levels of the fair value hierarchy at the end of the reporting period during which the change has occurred. Further information about the assumptions made in measuring fair values is included in Note 28 – fair value of financial and non-financial instruments.

Repurchase and resale transactions

The Group enters into sales of securities under agreements to repurchase such securities. Such securities, which have been sold subject to a repurchase agreement ('repos'), continue to be recognised in the statement of financial position and are measured in accordance with the accounting policy of the security portfolio which they are part of. Securities sold subject to repurchase agreements ('repos') are reclassified in the consolidated financial statements as loaned securities when the transferee has the right by contract or custom to sell or repledge the collateral. The counterparty liability for amounts received under these agreements is included in other money market deposits. The difference between sale and repurchase price is treated as interest expense and accrued over the life of the repurchase agreements using effective interest method.

3. Significant accounting policies *(continued)*

3.8 Financial assets and liabilities *(continued)*

Repurchase and resale transactions *(continued)*

Securities purchased with a corresponding commitment to resell at a specified future date (‘reverse repos’) are not recognised in the consolidated statement of financial position, as the Group does not obtain control over the assets. Amounts paid under these agreements are included in other money market placements. The difference between purchase and resale price is treated as interest income and accrued over the life of the reverse repurchase agreement using effective interest method.

3.9 Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances held with central banks and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by the Group in the management of its short-term commitments.

Cash and cash equivalents are carried at amortised cost in the consolidated statement of financial position.

3.10 Tangible Assets

Recognition and measurement

Items of tangible assets are measured at cost less accumulated depreciation and impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use, and the costs of dismantling and removing the items and restoring the site on which they are located.

Subsequent costs

The cost of replacing part of an item of tangible assets is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The costs of the day-to-day servicing of property and equipment are recognised in profit or loss as incurred.

Depreciation

Depreciation is recognised in the consolidated statement of profit or loss on a straight-line basis over the estimated useful lives of each part of an item of tangible assets. Leased assets are depreciated over the shorter of the lease term and their useful lives. Land is not depreciated. The estimated useful lives are assigned accordance with the existing statutory tax law.

The estimated useful lives for the current and comparative periods are as follows:

▪ buildings	50 years
▪ office equipment, furniture and fixtures	4-10 years
▪ motor vehicles	5-6 years

Leasehold improvements are depreciated on a straight-line method over a period of time of their lease contract.

Depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate.

3. Significant accounting policies *(continued)*

3.11 Intangible assets

i) Goodwill

Goodwill arises on the acquisition of subsidiaries or businesses.

Goodwill represents the excess of the cost of the acquisition over the Group’s interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquiree. When the excess is negative (negative goodwill), it is recognised immediately in consolidated statement of income.

Subsequent measurement

Goodwill is measured at cost less accumulated impairment losses.

ii) Software

Software acquired by the Group is stated at cost less accumulated amortisation and accumulated impairment losses.

Expenditure on internally developed software is recognised as an asset when the Group is able to demonstrate its intention and ability to complete the development and use the software in a manner that will generate future economic benefits, and can reliably measure the costs to complete the development. The capitalised costs of internally developed software include all costs directly attributable to developing the software, and are amortised over its useful life. Internally developed software is stated at capitalised cost less accumulated amortisation and impairment.

Subsequent expenditure on software assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Amortisation is recognised in consolidated statement of income on a straight-line basis over the estimated useful life of the software, from the date that it is available for use. The estimate useful lives of software are three to fifteen years.

3.12 Assets held for sale

An asset (or a disposal group) classified as asset held for sale is measured at lower of carrying value or fair value less costs to sell. An asset (or a disposal group) is regarded as asset held for sale only when the sale is highly probable and the asset (disposal group) is available for immediate sale in its present condition. For a highly probable sale, there must be a valid plan prepared by the management for the sale of asset including identification of possible buyers and completion of sale process. Furthermore, the asset should be actively marketed at a price consistent with its fair value.

3.13 Investment property

Land and buildings that are held to earn rental income or for capital appreciation supply of goods or services, administrative purposes or sale in the ordinary course of business are classified as investment property and carried at fair value where the change in fair value is recognised in the statement of income.

3. Significant accounting policies *(continued)*

3.14 Leases

Based on IFRS 16, at the commencement date, the lease liability is measured at the present value of the lease payments that are not paid at that date. The lease payments shall be discounted using the alternative borrowing interest rate.

After the commencement date, the lease liability is measured by increasing the carrying amount to reflect interest on the lease liability, reducing the carrying amount to reflect the lease payments made; and remeasuring the carrying amount to reflect any reassessment or lease modifications, or to reflect revised in-substance fixed lease.

Interest on the lease liability in each period during the lease term shall be the amount that produces a constant periodic rate of interest on the remaining balance of the lease liability.

After the commencement date, the lease liability is remeasured to reflect changes to the lease payments. The amount of the remeasurement of the lease liability is recognised as an adjustment to the right-of-use asset.

The lease liability is remeasured by discounting the revised lease payments using a revised discount rate, if either there is a change in the lease term or there is a change in the assessment of an option to purchase the underlying asset. However, if there is a change in future lease payments resulting from a change in an index or a rate used to determine those payments or if there is a change in the amounts expected to be payable under a residual value guarantee, an unchanged discount rate is used.

For a lease modification that is not accounted for as a separate lease, at the effective date of the lease modification, the lease liability is remeasured by discounting the revised lease payments using a revised discount rate. The revised discount rate is determined as the alternative borrowing interest rate at the effective date of the modification. The carrying amount of the right-of-use asset is decreased to reflect the partial or full termination of the lease for lease modifications that decrease the scope of the lease. Any gain or loss relating to the partial or full termination of the lease is recognised in profit or loss. A corresponding adjustment to the right-of-use asset is made for all other lease modifications.

Financial lease as lessee

Tangible assets acquired through financial leasing are recognized as assets and the related liabilities as lease payables in assets and liabilities, respectively. In the determination of the related asset and liability amounts, the lower of the fair value of the leased assets and the present value of leasing payments is considered. Financial costs on leasing agreements are distributed throughout the lease periods at fixed interest rates. Interest expenses and foreign exchange losses related with financial leasing are recognized in income statement.

In cases where leased assets are impaired or the expected future benefits of the assets are less than their book values, the book values of such leased assets are reduced to their net realizable values. Depreciation for assets acquired through financial leases is calculated consistently with the same principle as for the tangible assets.

Leases, in which the majority of risks and returns of the related asset belong to the lessor, are classified as operational lease. In operating leases, the rent payments are recognized as expense in income statement in equal amounts over the lease term.

3. Significant accounting policies *(continued)*

3.15 Impairment of non-financial assets

The carrying amounts of the Group's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. The recoverable amount of goodwill is estimated at each reporting date.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in consolidated statement of income. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. 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.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only 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. In the current year no impairment loss has been recognised for the goodwill.

3.16 Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. 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.

A provision for restructuring is recognised when the Group has approved a detailed and formal restructuring plan, and the restructuring either has commenced or has been announced publicly. Future operating costs are not provided for.

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Group recognises any impairment loss on the assets associated with that contract.

3. Significant accounting policies *(continued)*

3.17 Employee benefits

(i) Reserve for employee severance payments

In accordance with the existing social legislation in Turkey, the Group is required to make certain lump-sum payments to employees whose employment is terminated due to retirement or for reasons other than resignation or misconduct. Such payments are calculated on the basis of an agreed formula, are subject to certain upper limits and are recognised in the accompanying consolidated financial statements as accrued. The reserve has been calculated by estimating the present value of the future obligation of the Group that may arise from the retirement of the employees.

(ii) Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

A provision is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

(iii) Other benefits

The bonus provision which was calculated on defined criteria and targets for the upper-management and employees presented as provision in the accompanying consolidated financial statements.

3.18 Fiduciary assets

Assets held by the Group in a fiduciary, agency or custodian capacity for its customers are not included in the consolidated statement of financial position, since such items are not treated as assets of the Group.

3.19 Segment reporting

An operating segment is a component of the Group that engage in business activities from which it may earn income and incur expenses, including income and expenses that relate to transactions with any of the Group’s other components. All operating segments’ operating results are reviewed regularly by the management to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial statements is available.

3. Significant accounting policies *(continued)*

3.20 New standards and interpretations not yet adopted

A number of new standards and amendments to existing standards are not effective at reporting date and earlier application is permitted; however the Bank has not early adopted are as follows:

The revised Conceptual Framework

The revised Conceptual Framework issued on 28 March 2018 by the International Accounting Standards Board ("IASB" or "Board"). The Conceptual Framework sets out the fundamental concepts for financial reporting that guide the Board in developing IFRS Standards. It helps to ensure that the Standards are conceptually consistent and that similar transactions are treated the same way, so as to provide useful information for investors, lenders and other creditors. The Conceptual Framework also assists companies in developing accounting policies when no IFRS Standard applies to a particular transaction, and more broadly, helps stakeholders to understand and interpret the Standards. The revised Framework is more comprehensive than the old one – its aim is to provide the Board with the full set of tools for standard setting. It covers all aspects of standard setting from the objective of financial reporting, to presentation and disclosures. For companies that use the Conceptual Framework to develop accounting policies when no IFRS Standard applies to a particular transaction, the revised Conceptual Framework is effective for annual reporting periods beginning on or after 1 January 2020, with earlier application permitted.

Amendments to IAS 1 and IAS 8 - Definition of Material

In October 2018 the IASB issued Definition of Material (Amendments to IAS 1 and IAS 8). The amendments clarify and align the definition of 'material' and provide guidance to help improve consistency in the application of that concept whenever it is used in IFRS Standards.

The Group does not expect that application of these amendments to IAS 1 and IAS 8 will have significant impact on its consolidated financial statements.

Amendments to IFRS 3 - Definition of a Business

Determining whether a transaction results in an asset or a business acquisition has long been a challenging but important area of judgement. The IASB has issued amendments to IFRS 3 Business Combinations that seek to clarify this matter. The amendments include an election to use a concentration test. This is a simplified assessment that results in an asset acquisition if substantially all of the fair value of the gross assets is concentrated in a single identifiable asset or a group of similar identifiable assets. If a preparer chooses not to apply the concentration test, or the test is failed, then the assessment focuses on the existence of a substantive process. The Group does not expect that application of these amendments to IFRS 3 will have significant impact on its consolidated financial statements.

(Currency - In thousands of Turkish Lira)

4. Net fee and commission income

	2019	2018
Fee and commission income		
Letters of guarantee, credit and other guarantees	4,209	4,464
Credit related fees and commissions	1,492	3,429
Other	284	212
Total fee and commission income	**5,985**	**8,105**
Fee and commission expense		
Corresponding bank fees	(133)	(336)
Others	(218)	(331)
Total fee and commission expense	**(351)**	**(667)**
Net fee and commission income	**5,634**	**7,438**

5. Net trading income and net foreign exchange gain

	2019	2018
Income from trading assets, net	5,008	4,022
Income from investment securities, net	523	683
Foreign exchange gains/losses, net	(2,431)	549
Total	**3,100**	**5,254**

6. Other operating income

	2019	2018
Gain on sales of assets held for sale	221	-
Other(*)	1,863	2,034
Total	**2,084**	**2,034**

(*) Rent income, income from the sale of tangible assets and other income.

(Currency - In thousands of Turkish Lira)

7. Personnel expenses

	2019	**2018**
Wages and salaries	18,064	17,249
Other fringe benefits	2,350	4,679
Compulsory social security obligations	2,595	2,345
Total	**23,009**	**24,273**

8. Administrative expenses

	2019	**2018**
Information technology expenses	6,092	4,669
Consultancy expenses	2,403	3,680
Communication expenses	1,829	2,499
Insurance expenses	1,712	1,387
Human resources intermediary expenses	1,274	745
Lightening expenses	1,257	886
Lawyers expenses	928	606
Traveling expenses	611	661
Transportation expenses	518	432
Operating lease expenses	429	3,278
Consumer trade decision expenses	-	426
Advertising expenses	106	135
Others	2,674	2,082
Total	**19,833**	**21,486**

(Currency - In thousands of Turkish Lira)

9. Taxation

The Group is subject to taxation in accordance with the tax procedures and the legislation effective in Turkey. While the corporate tax rate was at the rate of 20% since 1 January 2016, for all companies, such rate has been set as 22% for the tax bases of the years 2018, 2019, and 2020 based on the legislation of the Amendment on Certain Tax Laws and Other Laws no. 7061. Furthermore, the Council of Ministers has been authorized to reduce the rate of 22% down to 20%.

Corporate tax losses can be carried forward for a maximum period of five years following the year in which the losses were incurred. The tax authorities can inspect tax returns and the related accounting records for a retrospective maximum period of five years. Corporate tax returns are required to be filed by the twentyfifth day of the fourth month following the year-end reporting date and taxes must be paid in one instalment by the end of the fourth month. In Turkey, the tax legislation does not permit a parent company and its subsidiary to file a consolidated tax return. Therefore, provision for taxes, as reflected in the consolidated financial position, has been calculated on a separate-entity basis.

Income tax recognised in the statement of profit or loss

The components of income tax expense as stated below:

	2019	**2018**
Current tax (expense) / income	-	1,209
Deferred tax (expense) / income	921	(1,601)
Income tax in the statement of profit or loss	**921**	**(392)**

Reconciliation between tax expense and the accounting profit multiplied by the statutory income tax rate of the parent for the years ended 31 December 2019 and 2018 is as follows:

	2019	**2018**
Profit/(loss) before income tax	1,565	(37,609)
Income tax using the domestic corporation tax rate 22%	(344)	8,274
Non-deductible expenses	(258)	(176)
Current year losses for which no deferred tax asset is recognized	(416)	(990)
Reversal of previously recognised tax losses	-	(3,146)
Unrecognised deductible temporary differences	1,939	(4,354)
Total income tax expense in the statement of profit or loss	**921**	**(392)**

(Currency - In thousands of Turkish Lira)

9. Taxation *(continued)*

Deferred tax assets and liabilities

Recognised deferred tax assets and liabilities

The deferred tax included in the consolidated financial position and changes recognized in the income tax expense are as follows:

	Deferred tax asset	Deferred tax liability	Deferred tax asset	Deferred tax liability
	2019	**2019**	**2018**	**2018**
Derivative financial instruments	1,319	(1,061)	1,490	(1,297)
Liability for employee provision	1,680	-	1,866	-
Tangible assets	-	(991)	-	(904)
Tax losses	2,096	-	2,096	-
Assets held for sale	-	(888)	-	(982)
Others	1,528	(57)	(71)	(34)
Deferred tax asset / (liability)	**6,623**	**(2,997)**	**5,381**	**(3,217)**
Net off of tax	**(2,997)**	**2,997**	**(3,217)**	**3,217**
Net tax asset / (liability)	**3,626**	**-**	**2,164**	**-**

As at 31 December 2019, TL 2,096 of deferred tax assets are recognised for TL 10,482 of tax losses of the Group (31 December 2018: TL 2,096 of deferred tax assets and TL 10,482 of tax losses), unused tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be used.

Deferred tax assets have not been recognised in respect of the remaining tax losses amounting to TL 82,582 (31 December 2018: TL 79,694).

Reflected as:

	2019	**2018**
Deferred tax assets	3,626	2,164

Movement of net deferred tax assets can be presented as follows:

	2019	**2018**
Deferred tax assets, net at 1 January	2,164	3,765
Effect of IFRS 9 transition		791
Deferred tax recognised in the profit or loss	921	(2,019)
Deferred income tax recognised in other comprehensive income	541	418
Deferred tax assets, net at the end of the year	**3,626**	**2,164**

Deferred tax assets have not been recognised in respect of the following items, because it is not probable that future taxable profit will be available against which the Group can use the benefits therefrom.

	2019	**2018**
Tax losses	82,582	79,694
	82,582	**79,694**

(Currency - In thousands of Turkish Lira)

9. Taxation *(continued)*

Unrecognised deferred tax assets

Due date breakdown of tax losses	2019	2018
2019	2,011	3,777
2020	41,991	41,991
2021	18,944	18,944
2023	17,744	14,982
2024	1,892	-
	82,582	**79,694**

Tax losses carried forward

Recognised tax losses carried forward expire as follows.

	2019	2018
2023	10,482	10,482
	10,482	**10,482**

10. Cash and cash equivalents

	2019	2018
Cash and balances with central banks	4	2,602
- *Cash on hand*	-	-
- *Balances with central banks*	*4*	*2,602*
Due from banks and financial institutions	11,666	2,181
Interbank and other money market placements	50,531	-
Cash and cash equivalents in the statement of financial position	**62,201**	**4,783**
Less: Due from banks with original maturities of more than 3 months, restricted balance and accruals	(31)	-
Cash and cash equivalents in the statement of cash flows	**62,170**	**4,783**

As of 31 December 2019, the expected credit loss for cash and cash equivalents amounting to TL 113 (31 December 2018 – 9).

11. Reserve deposits at central banks

	2019	2018
Turkish Lira	1,239	738
Foreign currency	66,264	71,728
	67,503	**72,466**

(Currency - In thousands of Turkish Lira)

12. Trading assets and liabilities

	2019	2018
Debt instruments		
Turkish government bonds-TL denominated_ FVPL	5,512	7,197
Derivative transactions		
Derivative financial assets	4,853	5,895
Total trading assets	**10,365**	**13,092**
Derivative transactions		
Derivative financial liabilities	5,995	6,775
Total trading liabilities	**5,995**	**6,775**

In the ordinary course of business, the Group enters into various types of transactions that involve derivative financial instruments that include forwards, currency and interest rate swaps, futures, currency options and interest rate cap/floor agreements. A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in price in one or more underlying financial instruments, reference rates or indices.

The table below shows the favourable (assets) and unfavourable (liabilities) fair values of derivative financial instruments. The notional amount is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at period-end and are neither indicative of the market risk nor credit risk.

		2019	
	Fair value assets	**Fair value liabilities**	**Notional amount in TL equivalent**
Forward purchase contracts	-	-	53,462
Forward sale contracts	-	-	54,285
Futures purchase contracts	1	-	33,859
Futures sale contracts	-	172	34,340
Currency swap purchases	943	302	277,963
Currency swap sales	1,222	1,536	280,145
Interest rate swaps	2,687	3,985	150,152
Total derivative financial instruments	**4,853**	**5,995**	**884,206**

		2018	
	Fair value assets	**Fair value liabilities**	**Notional amount in TL equivalent**
Forward purchase contracts	1	-	370
Forward sale contracts	-	-	368
Currency swap purchases	-	2,222	206,991
Currency swap sales	35	1,819	209,268
Interest rate swaps	5,859	2,734	153,443
Total derivative financial instruments	**5,895**	**6,775**	**570,440**

The Group undertakes all of its transactions in derivative financial instruments with banks and other financial institutions. Notional amounts and contractual maturity analysis of derivative transactions are disclosed in Note 27.

(Currency - In thousands of Turkish Lira)

13. Investment and loaned securities

	2019	2018
Investment securities - FVOCI(*)	63,884	87,517
Loaned securities - FVOCI	5,439	593
Equity instruments(**)	160	-
Total	**69,483**	**88,110**

(*) Investment securities consist of CPI indexed government bonds as at 31 December 2019 and 31 December 2018.

(**) Equity instruments correspond to 0.0377% share of Istanbul Stock Exchange Market.

Fair value through other comprehensive income- investment securities

	2019	2018
Fair value through other comprehensive income- investment securities		
Debt instruments		
Turkish government bonds – TL denominated	63,884	87,517
- Gross amount	*63,884*	*87,517*
Total investment securities - FVOCI	**63,884**	**87,517**

As at 31 December 2019, TL denominated investment securities – FVOCI comprise Turkish Government notes having a maturity range between February 2019 – January 2026.

As at 31 December 2019, investment securities – FVOCI with carrying value of TL 45,530 (31 December 2018, investment securities – available-for-sale with carrying value of TL 51,038) are kept in the Central Bank of Turkey and Istanbul Stock Exchange Clearing and Custody Incorporation for legal requirements and as a guarantee for possible stock exchange and money market operations although they are not pledged.

Loaned securities

Carrying value of trading securities – FVOCI given as collateral under repurchase agreements which are classified as loaned securities and related liability are as follows:

	2019	2018
Loaned securities from FVOCI	5,373	593
Loaned securities from trading securities	66	-
Total loaned securities	**5,439**	**593**

(Currency - In thousands of Turkish Lira)

13. Investment and loaned securities *(continued)*

The movement in investment securities - FVOCI (including loaned securities from fair value through other comprehensive income) is summarized as follows:

	2019	**2018**
Balance at 1 January	88,110	74,664
Additions	13,302	41,264
Disposals (sale and redemption)	(39,779)	(38,027)
Change in interest accruals	7,850	10,209
Balance at year end	**69,483**	**88,110**

14. Loans and finance lease receivables

31 December 2019	**Turkish Lira**	**Foreign currency**	**Foreign currency indexed**	**Total**
Corporate loans and finance lease receivables	102,915	460,058	-	562,973
Consumer loans	144	-	345	489
Total loans and finance lease receivables	**103,059**	**460,058**	**345**	**563,462**
Loans and finance lease receivables in arrears	166,476	-	-	166,476
Less: 12 month ECL (stage 1)	(1,645)	-	-	(1,645)
Less: Lifetime ECL significant increase in credit risk (stage 2)	(3,661)	-	-	(3,661)
Less: Lifetime ECL impaired credits (stage 3)	(83,143)	-	-	(83,143)
	181,086	**460,058**	**345**	**641,489**

31 December 2018	**Turkish Lira**	**Foreign currency**	**Foreign currency indexed**	**Total**
Corporate loans and finance lease receivables	36,597	633,486	-	670,083
Consumer loans	698	-	435	1,133
Total loans and finance lease receivables	**37,295**	**633,486**	**435**	**671,216**
Loans and finance lease receivables in arrears	126,563	-	-	126,563
Less: 12 month ECL (stage 1)	(3,151)	-	-	(3,151)
Less: Lifetime ECL significant increase in credit risk (stage 2)	(9,492)	-	-	(9,492)
Less: Lifetime ECL impaired credits (stage 3)	(62,160)	-	-	(62,160)
	89,055	**633,486**	**435**	**722,976**

As at 31 December 2019, loans and finance lease receivables with floating rates are TL 111,017 (31 December 2018 – TL 172,882) and fixed interest rates are TL 452,445 (31 December 2018 – TL 498,334).

(Currency - In thousands of Turkish Lira)

14. Loans and finance lease receivables *(continued)*

Movements in non-performing loans and finance lease receivables:

	31 December 2019	31 December 2018
Non-performing loans and finance lease receivables at 1 January	126,563	58,217
Additions to non-performing loans and finance lease receivables	41,406	82,494
Recoveries	(1,493)	(12,376)
Write-offs	-	(1,772)
Non-performing loans and finance lease receivables at the year end	**166,476**	**126,563**

The distribution of the cash and non-cash loans of the Bank according to credit ratings is as follows at 31 December 2019:

		Current Period	Prior Period
Grade	**Description**	**Weight**	
AA	Maximum Reliability	-	-
AA-	Maximum Reliability	-	-
A+	Very Good Firm	-	-
A	Very Good Firm	0.08	5.07
A-	Very Good Firm	-	-
BBB+	Reliable and Qualified	-	-
BBB	Reliable and Qualified	8.59	5.49
BBB-	Reliable and Qualified	-	-
BB+	Low Reliably and risky	-	-
BB	Low Reliably and risky	3.19	6.49
BB-	Low Reliably and risky	-	-
B+	Weak	29.90	-
B	Weak	28.16	24.79
CCC	Maximum Risk	7.64	30.65
CC	Maximum Risk	0.14	13.34
D	Bankruptcy	22.31	14.17

Movements in the expected credit losses for loans and finance lease receivables:

	31 December 2019	31 December 2018
Reserve at the beginning of the year	74,803	17,275
IFRS 9 transition impact	-	17,046
Provision net of recoveries(1)	13,646	40,482
- Expected credit loss	*15,224*	*50,701*
- Recoveries	*(1,578)*	*(10,219)*
Reserve at the year end	**88,449**	**74,803**

(Currency - In thousands of Turkish Lira)

15. Tangible Assets

	Right-of-use asset(*)	Office equipment, furniture and fixtures	Leasehold improvements	Motor vehicles	Total
Cost					
Balance at 1 January 2018	-	15,732	7,369	562	23,663
Additions	-	776	-	-	776
Disposals	-	(14)	-	-	(14)
Balance at 31 December 2018	**-**	**16,494**	**7,369**	**562**	**24,425**
Balance at 1 January 2019	6,846	16,494	7,369	562	31,271
Additions	1,539	6,850	-		8,389
Disposals	-	(1,757)	(3,771)		(5,528)
Balance at 31 December 2019	**8,385**	**21,587**	**3,598**	**562**	**34,132**
Depreciation					
Balance at 1 January 2018	-	14,321	6,319	281	20,921
Depreciation charge for the year	-	986	9	97	1,092
Disposals	-	(5)	-	-	(5)
Balance at 31 December 2018	**-**	**15,302**	**6,328**	**378**	**22,008**
Balance at 1 January 2019	402	15,302	6,328	378	22,410
Depreciation charge for the year	1,416	987	-	106	2,509
Disposals	-	(522)	-	(9)	(531)
Balance at 31 December 2019	**1,818**	**15,767**	**6,328**	**475**	**24,388**
Carrying amounts					
Balance at 1 January 2018	-	1,411	1,050	281	2,742
Balance at 31 December 2018	-	1,192	1,041	184	2,417
Balance at 31 December 2019	6,567	5,820	(2,730)	87	9,744

(*) Transition of IFRS 16

(Currency - In thousands of Turkish Lira)

16. Intangible assets

	Goodwill	Purchased software	Developed software	Total
Cost				
Balance at 1 January 2018	70,731	29,214	538	100,483
Additions	-	38	-	38
Disposals	-	-	-	-
Balance at 31 December 2018	**70,731**	**29,252**	**538**	**100,521**
Balance at 1 January 2019	70,731	29,252	538	100,521
Additions	-	129	-	129
Disposals	-	-	-	-
Balance at 31 December 2019	**70,731**	**29,381**	**538**	**100,650**
Amortisation and impairment losses				
Balance at 1 January 2018	70,731	22,066	305	93,102
Amortisation charge for the year	-	1,180	-	1,180
Disposals	-	-	-	-
Balance at 31 December 2018	**70,731**	**23,246**	**305**	**94,282**
Balance at 1 January 2019	70,731	23,246	305	94,282
Amortisation charge for the year	-	855	-	855
Disposals	-	-	-	-
Balance at 31 December 2019	**70,731**	**24,101**	**305**	**95,137**
Carrying amounts				
Balance at 31 December 2017	-	7,148	233	7,381
Balance at 31 December 2018	-	6,006	233	6,239
Balance at 31 December 2019	-	5,280	233	5,513

Intangible assets consist of purchased software and developed software.

The carrying amount of goodwill at 31 December 2019 was nil (31 December 2018 – none).

(Currency - In thousands of Turkish Lira)

17. Assets held for sale and investment properties

Assets held for sale	1 January – 31 December 2019	1 January – 31 December 2018
Balance at 1 January	855	-
Additions (*)	46,720	855
Sale of the asset	(714)	-
Total	**46,861**	**855**

The Group has classified its investment property amounting to TL 46,720 as assets held for sale as of 31 December 2019 which was classified as investment property amounting to TL 46,279 as of 31 December 2018.

The following table shows a reconciliation from the beginning balances to the ending balances for fair value measurements in Level 3 of the fair value hierarchy:

Investment properties	1 January – 31 December 2019	1 January – 31 December 2018
Balance at 1 January	-	58,279
Additions	-	-
Change in fair value	-	(12,000)
Total	**-**	**46,279**

18. Other assets

	2019(*)	2018(*)
Prepaid expenses	4,486	4,178
Collateral given for derivative and other transactions	4,469	5,472
Prepaid taxes	534	144
Advances given	13	3
Others	3,137	2,163
Total	**12,639**	**11,960**

As at 31 December 2019, the expected credit loss for other asset amounting to TL 25 (31 December 2018 – 19).

19. Other money market deposits

	2019		2018	
	Turkish Lira	Foreign currency	Turkish Lira	Foreign currency
Obligations under repurchase agreements	**5,275**	**-**	**590**	**-**
Central Bank of Turkey	-	-	-	-
BIST	*4,980*	-	*356*	-
Other	*295*	-	*234*	-
Total	**5,275**	**-**	**590**	**-**

As at 31 December 2019, other money market deposits of TL 5,275 (31 December 2018 – TL 590) have fixed interest rates.

(Currency - In thousands of Turkish Lira)

20. Funds borrowed

	2019		2018	
	Turkish Lira	**Foreign currency**	**Turkish Lira**	**Foreign currency**
Short-term(1)				
Fixed interest	-	60,211	1,197	62,175
Floating interest	-	208,795	-	264,920
Long-term(1)				
Fixed interest	-	274,183	-	285,088
Floating interest	-	-	-	-
Total	**-**	**543,189**	**1,197**	**612,183**

(1) Based on original maturities.

Repayments of long term borrowing are as follows:

	2019		2018	
	Floating rate	**Fixed rate**	**Floating rate**	**Fixed rate**
2021	-	40,026	-	5,404
2022	-	40,025	-	36,278
Thereafter	-	194,134	-	243,406
Total	**-**	**274,183**	**-**	**285,088**

Floating rate borrowings have interest rate repricing periods of 1 to 6 months.

As at 31 December 2019 and 31 December 2018, funds borrowed are unsecured.

As at 31 December 2019 and 31 December 2018, the Group has not had any defaults of principal, interest or redemption amounts.

Reconciliation of movement of funds borrowed to cash flows from financing activities

	31 December 2018	**Cash items**	**Foreign currency conversion adjustments**	**Other non-cash items**	**31 December 2019**
Funds borrowed(*)	613,380	(96,131)	27,154	(1,214)	543,189
Total	**613,380**	**(96,131)**	**27,154**	**(1,214)**	**543,189**

	31 December 2017	**Cash items**	**Foreign currency conversion adjustments**	**Other non-cash items**	**31 December 2018**
Funds borrowed	339,028	202,327	70,942	1,083	613,380
Total	**339,028**	**202,327**	**70,942**	**1,083**	**613,380**

(*) The group has USD and EUR funds borrowed whose interest rates are between 0.73% and 5.75% as of 31 December 2019 (31 December 2018: between 0.73% and 8.85%).

(Currency - In thousands of Turkish Lira)

21. Other liabilities

	2019	2018
Current accounts of loan customers	37,740	21,377
Lease payables	6,967	-
Unearned commission income	1,092	1,768
Taxes and funds payables	608	381
Insurance payables	90	83
Collateral received for derivative transactions	-	4,140
Others	581	855
Total	**47,078**	**28,604**

The following table summarises lease payables details:

	2019		2018	
	Gross	**Net**	**Gross**	**Net**
1 Year	2,682	1,474	-	-
1- 4 year	4,924	2,275	-	-
More than 4 years	4,261	3,218	-	-
Total	**11,867**	**6,967**	**-**	**-**

22. Provisions

	2019	2018
Employee termination benefits	4,420	3,392
Vacation pay liability	1,625	1,354
Bonus provision	1,207	2,468
Other (1)	9,620	4,426
Total	**16,872**	**11,640**

(1) The provision provided for legal cases amounting to TL 595 and general provision for noncash loans amounting to TL 8,994 (31 December 2018: TL 1,438 and TL 2,958) is recognized in other provisions.

The movement in provision for employee termination benefits is as follows:

	2019	2018
At 1 January	3,392	1,206
Charge / (reversal) during the year	28	111
Actuarial gain/loss (1)	1,000	2,075
At 31 December	**4,420**	**3,392**

(1) The actuarial loss amounting to TL 1,000 (31 December 2018: TL 2,075 gain) was recognized in retained earnings in 2019.

(Currency - In thousands of Turkish Lira)

22. Provisions *(continued)*

Employee termination benefits

In accordance with existing social legislation in Turkey, the Bank and its subsidiary incorporated in Turkey are required to make lump-sum payments to employees whose employment is terminated due to retirement or for reasons other than resignation or misconduct. In Turkey, such payments are calculated on the basis of 30 days' pay per year of employment at the rate of pay applicable at the date of retirement or termination. In the consolidated financial statements as at 31 December 2019 and 2018, the Group reflected a liability calculated using the Projected Unit Credit Method and based upon factors derived using their experience of personnel terminating their services and being eligible to receive retirement pay and discounted by using the current market yield on government bonds at the reporting date.

The principal actuarial assumptions used at the reporting dates are as follows:

	2019	**2018**
Discount rate	4.07%	4.07%
Expected rates of salary/limit increases	10.50%	10.50%

Actuarial gains / losses arising from changes in discount rates and expected rates of salary / limit increases and other demographic assumptions are recognised in other comprehensive income.

Other provisions

Other provision includes upper-management and employees bonus and retention agreement provision which was calculated on defined criteria and targets.

23. Capital and reserves

	2019	**2018**
Number of common shares, TL 0.1 (in full TL), par value (Authorised and issued)	3.372.923.500	3.372.923.500

Share capital and share premium

As at 31 December 2019 and 31 December 2018, the composition of shareholders and their respective percentage of ownership are summarized as follows:

	31 December 2019		**31 December 2018**	
	Amount	**%**	**Amount**	**%**
Tarshish	235,515	69.83	235,515	69.83
C Faktoring A.Ş.	101,777	30.17	101,777	30.17
	337,292	**100.00**	**337,292**	**100.00**
Share premium	20,121		20,121	
Restatement effect	21,701		21,701	
Share capital and share premium	**379,114**		**379,114**	

There are no rights, preferences and restrictions on the distribution of dividends and the repayment of capital.

(Currency - In thousands of Turkish Lira)

23. Capital and reserves *(continued)*

Legal reserves

The legal reserves consist of first and second legal reserves in accordance with the Turkish Commercial Code. The first legal reserve is appropriated out of the statutory profits at the rate of 5%, until the total reserve reaches a maximum of 20% of the entity's share capital. The second legal reserve is appropriated at the rate of 10% of all distributions in excess of 5% of the entity's share capital. The first and second legal reserves are not available for distribution unless they exceed 50% of the share capital, but may be used to absorb losses in the event that the general reserve is exhausted.

Other reserves

Financial assets measured at FVOCI reserve

The financial assets measured at FVOCI reserve includes the cumulative net change in the fair value of financial assets measured at FVOCI investment securities until the investment is derecognised or impaired.

As at 31 December 2019, financial assets measured at FVOCI reserve is TL 8,478 (31 December 2018 TL 9,521).

Dividends

No dividend payments were made as at 31 December 2019 (31 December 2018: None). Since the General Assembly has not been made as of the announcement of the financial statement, the distribution of profit has not been decided yet.

24. Related parties

The Group is controlled by Bank Hapoalim and C Faktoring A.Ş. which owns 69.83% and 30.17% of ordinary shares, respectively (31 December 2018 – 69.83% and 30.17%, respectively). The ultimate controlling shareholder of the Group is Bank Hapoalim. For the purpose of these consolidated financial information, unconsolidated subsidiaries, shareholders, and companies controlled by Bank Hapoalim and C Faktoring A.Ş. are referred to as related parties.

In the course of conducting its banking business, the Group conducted various business transactions with related parties. These include loans, customer accounts, funds borrowed and non-cash transactions. These are all commercial transactions and realised on an arms-length basis. The volumes of related party transactions, outstanding balances at period-end and relating expense and income for the period are as follows:

	Shareholders		**Directors and key management personnel**		**Others**	
	2019	**2018**	**2019**	**2018**	**2019**	**2018**
Loans and finance lease receivables						
At 1 January	-	-	-	9	-	-
At end of the period/year	-	-	-	-	-	-
Interest income	-	-	-	-	-	-

(Currency - In thousands of Turkish Lira)

24. Related parties *(continued)*

As at 31 December 2019, no provisions have been recognised in respect of loans given to related parties (31 December 2018 – none).

	Shareholders		Directors and key management personnel		Others	
	2019	**2018**	**2019**	**2018**	**2019**	**2018**
Funds borrowed						
At 1 January	264,920	-	-	-	5,401	7,593
At end of the period/year[2]	208,795	264,920	-	-	-	5,401
Interest expense [1]	(12,016)	(15,940)	-	-	(539)	(505)

[1] Interest expense in the above tables for 2019 represents the balances as of 31 December 2019.

[2] There is 50,000 USD committed line from the main shareholder. 35,000 USD is used at 31 December 2019 whose maturity is 4 March 2020.

Other balances with related parties:

Related party		Deposits	Other liabilities	Non-cash loans	Other interest expense
Shareholders	31 December 2019	-	3	3,705	-
	31 December 2018	-	3	3,284	-
Directors and key management personnel	31 December 2019	-	-	-	-
	31 December 2018	-	27	-	-
Others	31 December 2019	-	7,254	6	-
	31 December 2018	-	566	6	-

Transactions with related parties:

Related party		Foreign exchange trading gain/(loss)	Other interest income	Other interest expenses	Other operating income	Other operating expenses
Shareholders	2019	-	-	-	3	-
	2018	-	-	-	-	-
Directors and key management personnel	2019	-	-	-	-	-
	2018	-	-	-	-	-
Others	2019	3	1	-	-	-
	2018	-	-	-	1	-

Compensation of key management personnel of the Group

The executive and non-executive members of Board of Directors and management received remuneration and fees amounted to TL 8,304 (31 December 2018 – TL 7,771) comprising salaries and other benefits.

25. Commitments and contingencies

In the normal course of business activities, the Bank and its subsidiaries undertake various commitments and incur certain contingent liabilities that are not presented in the financial statements including:

	2019	**2018**
Letters of guarantee	135,327	220,436
Commitments	-	3,042
Letters of credit	-	-
Other guarantees	16,436	17,877
Loss allowances (amounts arising from ECL)	(8,994)	(2,958)
Total non-cash loans	**142,769**	**238,397**

25. Commitments and contingencies *(continued)*

Explanation on Lawsuit

The counterpart of the Debt Liquidation and Right of Repurchase Agreement entered into by and between Gaziantep Çağlar and the Bank that was being kept in the land register was falsified by forgery of documents. With such forged document, it was irregularly made the subject of the execution proceeding with judgment for TL 48,378 in the Gaziantep 13th Execution Office. This falsified document was unlawfully used in an enforcement proceeding with judgement. The Bank initiated the following three legal procedures regarding this fraud:

1. The Bank filed a complaint to the Enforcement Court of Gaziantep against the proceeding filed against the Bank claiming that the underlying document for the proceeding had not been appropriate for the said enforcement proceeding with judgement and the irregularities had occurred during proceeding filing transactions. The court accepted the Bank's objections and ruled for the cancellation of the proceeding. The Provisional Appeal Court and the Supreme Court of Appeals ratified the decision, and the decision to cancel the enforcement proceedings has been finalized.
2. Upon the rescission of the injunction decision taken by the Civil Court of Enforcement, the Bank filed another negative declaratory action before the Gaziantep Commercial Court of First Instance in order to re-stop the ongoing proceeding, and the Court dismissed the action. The justified decision did not clearly state as to why the action had been rejected, it only stated that the decision had been taken based on two Supreme Court decisions, both of which were used as examples but in fact they were not related to the subject matter of the action filed by the Bank. The Bank applied to the Provisional Appeal Court (the 1st degree appeal) against this decision. The Provisional Appeal Court did not review the action on merit due to the fact that the evidence indicated in the case file had not been gathered and accepted the appeal request, ruled on revoking the Local Court's decision and decided to send the case file back to the local court for it to be re-reviewed. After the Provisional Appeal Court's decision, the litigation is still ongoing and the court decided to wait for the finalization of the decision rendered by the Aggravated Felony Court and postponed the hearing to be held on 25 March 2020.
3. The Bank filed a complaint with the Office of the Chief Public Prosecutor of Gaziantep about the persons attempted in fraud. At the end of the proceedings, all criminal files have been merged into a single Aggravated Felony Court file. The Court ruled that some defendants should be sentenced for crimes such as Aggravated Fraud, Forgery on Special Documents and Wrongful Conduct. The Court has already written its justified decision and the Public Prosecutor's Office and the Bank appealed the decision with the request that the related accuseds should be sentenced to heavier punishments.

26. Financial risk management

Strategy in using financial instruments

BankPozitif's risk approach is to achieve sound and sustainable low risk profile on consolidated basis, through the identification, measurement and monitoring of all types of risks inherent in the nature of the business activities. The main principle of the Group is to manage the credit risk effectively, to eliminate the market risk by not carrying positions and intelligent handling of operational risks supporting the group in achieving its strategic goals. With this understanding, the Group has given priority to create a risk aware culture in which all functions of the Group understand the risks being exposed; to have well-defined areas of responsibilities; to identify and map the risks and controls of each process and to have prudent procedures for the new products and applications.

26. Financial risk management *(continued)*

BankPozitif's basic risk classifications and policies can be summarised as follows:

- well managing the credit risk through a high standardised credit risk management,
- minimizing market risk with the avoidance of currency, interest rate and maturity positions,
- identifying, assessing, monitoring and controlling of the operational risks inherent in products, activities, systems and material processes.

In the credit risk management process of the Group, sound risk management practices are targeted in compliance with Basel recommendations.

In accordance with the BankPozitif's market risk management strategy; the Group aims not to carry market risk positions and intends to create matching assets and liabilities to eliminate asset liability management risks i.e. maturity risk and interest rate sensitivity risk.

Additionally, in order to minimise the market risk, marketable securities portfolio is limited proportional to the total assets size with a conservative trade limit and most of the securities are floating rate notes.

The Bank declares its risk appetite and tolerance levels for the primary risk areas on a Board approved policy since 2010.

Board of Directors is the highest authority to set all risk management guidelines, and it is responsible for ensuring that the Group implements all necessary risk management techniques in compliance with the related regulatory requirements both in Turkey and Israel. Board of Directors follows its duties not only by itself but also through audit committee, which is composed of two board members and responsible for the supervision of the efficiency and adequacy of BankPozitif's internal systems, namely internal control, risk management, internal audit and compliance. The audit committee also oversees the proper functioning of these systems and the accounting and reporting systems and is responsible for the integrity of the information produced.

All risk limits are set by the Board of Directors and reviewed on a regular basis.

The main functions and authority of the Board of Directors related to risk management activities are as follows;

- to define the risk policy of the Group, including that of all its subsidiaries, regarding exposure to various risks (credit risks, market risks, operational risks, liquidity risks and others),
- to manage and guide all the activities of internal systems directly/through committees,
- to approve new business lines, products or activities that would have a substantial effect on activities of the Group,

The Group manages its exposure to all types of risks through the asset and liability management committee ("ALCO") and executive committee, set by Board of Directors and comprising members of senior management, and a representative of main shareholder (board member/consultant of Board of Directors nominated by Bank Hapoalim) and also through limits set on the credit, treasury and asset liability management activities of the Group. These limits are approved and quarterly reviewed by Board of Directors and ALCO and executive committee supervise the compliance with the limits,

Permanent learning program for the Board of Directors is in place from the beginning of 2011 including the subjects risk management, corporate governance in general and corporate governance in the financial sector, Basel documentations, reporting standards (IFRS and Banking Regulation and Supervision Agency) and audit,

In summary, in order not to be exposed to liquidity, interest rate and foreign currency risk, the Group aims to keeps its funding structure in line with the asset structure (in terms of currency, maturity and interest rate) and hedges its positions through various derivative transactions. In addition to that, the Group does not prefer to take speculative positions on currency, interest rate and maturity that might create risk to the Group due to changes in the prices or mismatch of assets and liabilities.

(Currency - In thousands of Turkish Lira)

26. Financial risk management *(continued)*

Strategy in using financial instruments

Credit risk

Credit risk refers to the risk that a contractual partner/the counterparty defaults on its contractual obligations or does not deliver in full accordance with the conditions of contract and cannot perform its obligations partially or completely on the terms set.

Although, the Bank has an asset decreasing strategy, the main focus is defined as credit activities, credits are the most significant part of its activities and thus managed meticulously. The Bank follows credit policy is reviewed and approved by Board of Directors at certain intervals and whenever necessary. The process for approving, amending and renewing is clearly regulated together with collateral requirements. All facilities are assessed prior to approval via a series of evaluation meetings to ensure that the strict criteria laid out in the Group is adhered to regarding the issues like sector, sub-sector, collateral, maturity, project type etc.

To avoid the default risks to the best possible extend, the Group applies a well-defined "credit allocation process" and afterwards monitoring of the portfolio is being executed using a number of precautionary actions by relevant functions.

31 December 2019	Loans and finance lease receivables	Due from banks and financial institutions	Investment securities and loaned securities	Non cash loans
Carrying amount				
12 month ECL (stage 1)	324,304	11,779	69,776	151,763
Lifetime ECL significant increase in credit risk (stage 2)	239,158	-	-	-
Lifetime ECL impaired credits (stage 3)	166,476	-	-	-
Allowance for impairment				
- 12 month ECL (stage 1)	(1,645)	(113)	(293)	(1,916)
- Lifetime ECL significant increase in credit risk (stage 2)	(3,661)	-	-	(7,078)
- Lifetime ECL impaired credits (stage 3)	(83,143)	-	-	-
	641,489	**11,666**	**69,483**	**142,769**

31 December 2018	Loans and finance lease receivables	Due from banks and financial institutions	Investment securities and loaned securities	Non cash loans
Carrying amount				
12 month ECL (stage 1)	491,789	2,190	88,183	241,355
Lifetime ECL significant increase in credit risk (stage 2)	179,427	-	-	-
Lifetime ECL impaired credits (stage 3)	126,563	-	-	-
Allowance for impairment				
- 12 month ECL (stage 1)	(3,151)	(9)	(73)	(2,399)
- Lifetime ECL significant increase in credit risk (stage 2)	(9,492)	-	-	(559)
- Lifetime ECL impaired credits (stage 3)	(62,160)	-	-	-
	722,976	**2,181**	**88,110**	**238,397**

26. Financial risk management *(continued)*

Credit risk *(continued)*

The Bank manages its credit portfolio as per following main principles;

Creating credit risk awareness throughout the Group

Senior management is responsible for putting the policies into practice approved by Board of Directors and identifying and managing of credit risk is the joint concern of all staff of the Bank.

The day-to-day management of credit risk is devolved to individual business units, such as the loans and risk monitoring departments of corporate and retail business, which perform regular appraisals of quantitative and qualitative information relating to counterparty credit with respect to their loan policies and procedures.

Having a reliable credit allocation function

Credit approval authorities and their approval limits are also decided by board based on a combination of “rating” and “being new/existing customers” pillars.

Credit approval processes for both retail and corporate loans are centralised. Retail and corporate loans and risk monitoring departments are organised independently from the sales and marketing departments. The retail and corporate loans and risk monitoring departments do not have any sales targets and are solely responsible for the evaluation and allocation of new loans and monitoring the performance of the loan portfolio. Loans and risk monitoring departments are not included in any phase of the pricing of loans.

All the credit marketing, allocation and follow up stages are defined in corporate and retail loan policies, which are approved and reviewed regularly by Board of Directors.

Within the light of “no exception policy” applied in the Group, the compliance of loan disbursements with internal and legal regulations are checked by internal control unit prior to disbursement.

Risk limits

There are risk limits, set by Board of Directors, in line with the risk appetite, describing relevant credit limits such as single borrower limit, group exposure limit, sectorial limit, credit approval authorities and their approval limits. Risk limits are determined by comparing Turkey and Israel legislations and the most conservative limitation is taken as benchmark while determining the internal limit. These limits are approved and quarterly reviewed by Board of Directors and ALCO and executive committee supervise the compliance with the limits.

Although the Bank is not subject to local regulation in terms of credit limits (due to being an investment bank), the Bank set internal credit limits. Single borrower limit is set as 15% (it is lower than the regulatory requirement of 25%) of total equity. In addition to this, the limit for group of borrower is set as 25% of total equity.

Sectoral distribution of loans is monitored on a daily and monthly basis and sectoral analysis of those loans is made in accordance with their risk concentration every year. The Group set a limit on single sector concentration by 30% of total loan book.

Although the Bank is not subject to local regulation in terms of credit limits in addition to sectorial and borrower limits, the Group has limits on own risk groups’ indebtedness as 10% of total equity. Furthermore a limit on largest borrowers and groups is set as 120% of total equity.

The Group seeks to manage its credit risk exposure through diversification of lending activities to avoid undue concentrations of risks with individuals or groups of customers in specific locations or businesses.

As at 31 December 2019, the share of the Group’s loan to its top 20 credit customers in its total loan portfolio is 99% (31 December 2018 – 98%).

26. Financial risk management *(continued)*

Credit risk *(continued)*

Measuring risk

The Bank uses two internally developed rating systems i.e. borrower rating system and facility rating system. Borrower rating is the measure of borrower's creditworthiness that is mapped by the bank to a risk grade and then to a PD (probability of default). Facility rating assesses the risk of a facility, taking into account associated collateral and guarantees and provides view for the recovery of the risk. Both systems are regularly validated by an independent outsource audit company over a set of sample.

Facility rating system was developed in 2008 and is being used for the corporate loan customers. This module, differently from the borrower rating module as explained above, rates the transaction instead of the corporate customer and reflects the expected loss amount in case of a default by taking into account collateral types which are subject to coefficients. The Bank uses borrower rating system and collateral coefficients during provision calculation in line with the BRSA regulations.

Both rating systems are being used in credit decisions, the first one giving the indications for borrowers repayment capacity, while the second one for facility's repayment capacity. Requirement of facility rating of BB or higher for the new credit clients is the main principle.

In line with the IFRS 9 and BRSA regulations, the Bank uses borrower rating system and collateral coefficients during provision calculations.

Under IFRS 9 expected loss of credit portfolio is calculated regularly by the Bank. In the calculation, PD values of Bank for each rating category is determined by transition matrix model designed on the borrower rating changes of the corporate customers.

Monitoring the risk

Risk management department controls structure of portfolio by product type, maturity, sector, geographical concentration, rating, currency, collateral and borrower/group of borrowers. The department also monitors concentration levels of the portfolio using internationally accepted criterion, makes recommendations and reports its findings at appropriate managerial levels. Additionally, it calculates sectorial diversification of the loan portfolio in accordance with Herfindahl-Herschman Concentration Index. Bank's credit portfolio, either retail or corporate, is monitored through several analysis and stress tests by predetermined scenarios to measure profit or loss and results are reported at appropriate managerial levels.

(Currency - In thousands of Turkish Lira)

26. Financial risk management *(continued)*

Credit risk *(continued)*

Segment information by sectorial concentration for loans and finance lease receivables and non-cash loans is as follows:

31 December 2019	Cash loans	Non-cash loans	Total
Electric production and supply	171,247	21,439	192,686
Other commercial services	130,601	-	130,601
Holding companies	64,351	6	64,357
Food, beverage and tobacco industries	63,872	4	63,876
Public works and civil engineering	50,337	10,088	60,425
Building contractor (general and special trade)	29,416	17,339	46,755
Personal other services	-	43,326	43,326
Transportation	41,582	178	41,760
Other financial institutions	-	33,706	33,706
Electrical and electronic equipment	-	13,251	13,251
Machinery and equipment	-	10,741	10,741
Trade	-	1,655	1,655
Consumer loans	489	-	489
Textile and clothing	-	30	30
Others	3,715	-	3,715
Total performing loans	**555,610**	**151,763**	**707,373**
Loans in arrears	174,328	-	174,328
Loss allowances (amounts arising from ECL)	(88,449)	(8,994)	(97,443)
Total loans	**641,489**	**142,769**	**784,258**

31 December 2018	Cash loans	Non-cash loans	Total
Electric production and supply	238,455	18,389	256,844
Other commercial services	126,188	-	126,188
Other financial institutions	-	48,285	48,285
Holding companies	77,948	4,226	82,174
Food, beverage and tobacco industries	79,458	4	79,462
Public works and civil engineering	46,685	35,877	82,562
Building contractor (general and special trade)	39,678	20,024	59,702
Personal other services	2,575	42,224	44,799
Transportation	40,430	158	40,588
Machinery and equipment	-	11,426	11,426
Electrical and electronic equipment	-	13,188	13,188
Consumer loans	1,133	-	1,133
Metal and by-products	-	9,733	9,733
Trade	-	17,673	17,673
Textile and clothing	796	30	826
Others	6,870	20,118	26,988
Total performing loans	**660,216**	**241,355**	**901,571**
Loans in arrears	137,563	-	137,563
Loss allowances (amounts arising from ECL)	(74,803)	(2,958)	(77,761)
Total loans	**722,976**	**238,397**	**961,373**

(Currency - In thousands of Turkish Lira)

26. Financial risk management *(continued)*

Credit risk *(continued)*

Monitoring the risk (continued)

Total collateralisation coverage of cash lons 96%, non-cash loans are 66% as at 31 December 2019 (31 December 2018 – cash lons 99.73%, non-cash loans 78%).

The following table sets out the collateralisation of Bank's cash and non-cash loan portfolio, including finance lease receivables:

	31 December 2019	31 December 2018
Loans and financial lease receivables in arrears		
Secured by mortgages	129,605	116,055
Secured by guarantee	9,717	9,719
Unsecured	27,154	789
Total	**166,476**	**126,563**
Loans and financial lease receivables in arrears		
Secured by mortgages	239,493	271,364
Secured by assignment and cheques	159,410	266,595
Secured by pledge	109,039	109,316
Secured by guarantee	51,393	15,297
Secured by cash	4,009	7,267
Unsecured	118	1,377
Total	**563,462**	**671,216**
Non-cash loans		
Secured by guarantee	78,235	151,076
Unsecured	52,234	53,000
Secured by assignment and cheques	16,436	32,877
Secured by pledge	4,655	4,220
Secured by cash	203	182
Total	**151,763**	**241,355**

Liquidity risk

Liquidity risk is the probability of loss arising from a bank's inability to meet its obligations when they come due without incurring unacceptable losses. Liquidity risk includes (1) the inability to manage unplanned decreases or changes in funding sources (2) the failure to recognise or address changes in market conditions that affect the ability to liquidate assets quickly and with minimal loss in value.

The Board of Directors reviews the liquidity risk management policy and approves the liquidity and funding policies, ensures the effective of practice of policies and integrations with the Bank's risk management system. The Board of Directors determines the assumptions in liquidity risk measurement and monitoring. The Board of Directors establishes risk appetite of the Bank in liquidity risk management and identifies the risk limits in accordance with the risk appetite and reviews it regularly.

(Currency - In thousands of Turkish Lira)

26. Financial risk management *(continued)*

Liquidity risk *(continued)*

The Group manages liquidity risk by daily controls of financial planning and control department and treasury department; weekly ALCO meetings, comprising members of senior management of the Bank and through limits on the positions which can be taken by the Bank's Treasury and Financial Institutions Department.

In order to manage this risk, the Group measures and manages its cash flow commitments on a daily basis, and maintains liquid assets, which it judges sufficient to meet its commitments. There are risk limits set for liquidity risks as; ratio of total assets maturing within one month to total liabilities maturing within one month cannot be lower than 100% (It is set as 80% for foreign currency assets to liabilities). ALCO closely monitors daily, weekly and monthly liquidity position of the bank and has the authority to take actions where necessary.

The Group uses various methods, including predictions of daily cash positions, and scenario analysis to monitor and manage its liquidity risk to avoid undue concentration of funding requirements at any point in time or from any particular source. Risk management and treasury departments monitor daily liquidity gaps in all currencies.

Liquidity position of the Group is measured on monthly basis with three scenarios i.e. global scenario, local scenario and bank specific scenario which are run on TL positions, foreign currency positions and on a total basis. The scenarios aim to show the repayment capacity of the Group using only quasi cash assets against the liabilities of 1 month and 1 year periods. Since the Group has funding centered asset creating structure, the Group does not prefer to take any liquidity risk (monitored cumulatively) in any currency, in any point in any time as decided by the top management of the Group.

A contingency plan, which has been developed with a view to alerting to a change in the liquidity environment at various levels and establishing ways to act, in advance, with respect to such situations, in order to prevent any delay in identifying a crisis and to establish in advance the hierarchy of responsibility and the steps to be taken in each of the scenarios.

The table on the next two pages analyses assets and liabilities of the Group into relevant maturity groupings based on the remaining period at reporting date to contractual maturity date.

31 December 2019	**Carrying amount**	**Gross outflow**	**On demand**	**Up to 1 month**	**1 to 3 months**	**3 months to 1 year**	**1 to 5 Years**	**Over 5 years**
Interbank and other money market deposits	5,275	5,277	-	5,277	-	-	-	-
Funds borrowed	543,189	570,176	-	252,552	25,986	38,356	177,351	75,931
Current account of loan customers [(1)]	37,741	37,817	-	35,952	-	1,865	-	-
	586,205	**613,270**	**-**	**293,781**	**25,986**	**40,221**	**177,351**	**75,931**

[(1)] Included in other liabilities.

31 December 2018	**Carrying amount**	**Gross outflow**	**On demand**	**Up to 1 month**	**1 to 3 months**	**3 months to 1 year**	**1 to 5 years**	**Over 5 years**
Interbank and other money market deposits	590	590	-	590	-	-	-	-
Funds borrowed	613,380	651,280	-	322,340	15,307	41,165	165,151	107,317
Current account of loan customers [(1)]	21,376	21,376	-	19,919	-	-	1,457	-
	635,346	**673,246**	**-**	**342,849**	**15,307**	**41,165**	**166,608**	**107,317**

[(1)] Included in other liabilities.

(Currency - In thousands of Turkish Lira)

26. Financial risk management *(continued)*

Liquidity risk *(continued)*

The table below analyses contractual maturities of derivative transactions:

31 December 2019	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	1 to 5 years	Over 5 years	Total
Forward purchase contracts	5,940	47,522	-	-	-	-	53,462
Forward sale contracts	5,964	48,321	-	-	-	-	54,285
Currency swap purchases	92,397	49,562	26,602	64,511	44,891	-	277,963
Currency swap sales	93,466	48,511	26,673	65,290	46,205	-	280,145
Interest rate swaps	-	-	-	-	-	150,152	150,152
Futures purchase contracts	16,038	17,821	-	-	-	-	33,859
Futures sale contracts	16,197	18,143	-	-	-	-	34,340
	230,002	**229,880**	**53,275**	**129,801**	**91,096**	**150,152**	**884,206**

31 December 2018	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	1 to 5 years	Over 5 years	Total
Forward purchase contracts	370	-	-	-	-	-	370
Forward sale contracts	368	-	-	-	-	-	368
Currency swap purchases	18,870	150,018	38,103	-	-	-	206,991
Currency swap sales	18,918	150,990	39,360	-	-	-	209,268
Interest rate swaps	-	-	-	-	-	153,443	153,443
	38,526	**301,008**	**77,463**	**-**	**-**	**153,443**	**570,440**

Market risk

The Group has low risk appetite towards products which are subject to market risks. Market risks arise from open positions in interest rate, currency and equity/commodity prices, all of which are exposed to general and specific market movements.

The interest rate and exchange rate risks of the financial positions taken by the Bank related to financial position and off-balance sheet accounts are measured and while calculating the capital adequacy, the amount subject to value at risk (VaR) is taken into consideration by the standard method. As at 31 December 2019, the highest potential loss of the securities portfolio was generated by historical simulation method as TL 52 (31 December 2018 – TL 345) for one day.

The Group has the principle not to carry equity/commodity portfolios which may cause losses based on the price changes.

The Group has a cautious approach towards derivatives transactions. In principle, derivatives are dealt only for the hedging of banking book. Trade or “market-making” in financial derivative instruments is not among the ordinary activities of the Group and possible only by specific authorisation of the Board of Directors and subject to VaR limits as well as stress scenarios.

The Board of Directors of the Bank determines the risk limits for primary risks carried by the Bank and quarterly revises these limits. For the purpose of hedging market risk, the Bank primarily aims to balance the foreign currency position, create matching assets and liabilities and manage positive liquidity.

(Currency - In thousands of Turkish Lira)

26. Financial risk management *(continued)*

Currency risk

The Group takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. Foreign currency risk indicates the possibility of the potential losses that the Group is subject to due to the exchange rate movements in the market. The Group does not prefer to carry foreign currency risk and holds foreign currency asset and liability items together with derivatives in balance against the foreign currency risk.

The Group manages foreign currency risk by daily controls of financial planning and control department and treasury department; weekly ALCO meetings, comprising members of senior management of the Bank and through limits on the positions which can be taken by the Bank's treasury department.

The concentrations of assets, liabilities and off balance sheet items are as follows:

31 December 2019	**USD**	**EUR**	**Others**	**Total**
Assets				
Due from banks and financial institutions	2,050	3,414	38	5,502
Fair value through comprehensive income	2,687	-	-	2,687
Reserve deposits at Central Banks	66,264	-	-	66,264
Loans and finance lease receivables	347,010	113,048	345	460,403
Other assets	329	-	-	329
Total assets	**418,340**	**116,462**	**383**	**535,185**
Liabilities				
Trading liabilities	3,985	-	-	3,985
Funds borrowed	269,006	274,183	-	543,189
Other liabilities	3,100	23,781	-	26,881
Total liabilities	**276,091**	**297,964**	**-**	**574,055**
Gross exposure	**142,249**	**(181,502)**	**383**	**(38,870)**
Off-balance sheet position				
Net notional amount of derivatives	(144,550)	181,460	(305)	36,605
Net exposure	**(2,301)**	**(42)**	**78**	**(2,265)**

(Currency - In thousands of Turkish Lira)

26. Financial risk management *(continued)*

Currency risk

31 December 2018	USD	EUR	Others	Total
Assets				
Due from banks and financial institutions	1,298	452	119	1,869
Fair value through comprehensive income	5,859	-	-	5,859
Reserve deposits at central Banks	71,728	-	-	71,728
Loans and finance lease receivables	462,547	170,940	434	633,921
Other assets	5,078	-	-	5,078
Total assets	**546,510**	**171,392**	**553**	**718,455**
Liabilities				
Trading liabilities	2,734	-	-	2,734
Funds borrowed	327,095	285,088	-	612,183
Other liabilities	8,071	10,092	-	18,163
Total liabilities	**337,900**	**295,180**	**-**	**633,080**
Gross exposure	**208,610**	**(123,788)**	**553**	**85,375**
Off-balance sheet position				
Net notional amount of derivatives	(206,435)	124,266	(427)	(82,596)
Net exposure	**2,175**	**478**	**126**	**2,779**

Sensitivity analysis

A 10% weakening of TL against the foreign currencies at 31 December 2019 and 31 December 2018 would have effect on the equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant.

	31 December 2019		31 December 2018	
	Equity	**Profit or loss**	**Equity**	**Profit or loss**
USD	(230)	(230)	218	218
EUR	(4)	(4)	48	48
Other currencies	8	8	13	13
Total	**(226)**	**(226)**	**279**	**279**

A 10% strengthening of the TL against the foreign currencies at 31 December 2019 and 31 December 2018 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.

26. Financial risk management *(continued)*

Interest rate risk

Interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of change in market interest rates. Interest rate risk is the risk that the value of a financial instrument will fluctuate because of change in market interest rates. The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flows.

The Group mainly funds its TL assets through its shareholders' equity and is not exposed to interest rate risk in TL assets and liabilities. Foreign currency assets of the Group give rise to interest rate risk as a result of mismatches or gaps in the amounts of foreign currency assets and liabilities and that mature or reprice in a given period. The Group prefers to protect itself from the effects created by the interest rate volatility and to have a match in interest rate risk. Interest rate sensitivity of the Bank is measured and monitored by duration analysis and PV01 analysis by risk management and financial planning and control departments accompanied by an interest sensitive gap representation to illustrate the negative and positive amounts of relevant time buckets.

The Group manages interest rate risk by the ALCO under the supervision of Board of Directors. The Group does not aim to generate income from the mismatch of interest rate sensitive assets and liabilities and nor make losses. Therefore the main objective of interest rate management is to eliminate interest rate sensitivity risk by creating matching assets and liabilities. In case of need, the Group utilises interest rate cap/floor agreements, interest rate swaps and setting limits on the positions, which can be taken by the Group's credit and treasury divisions to hedge the interest rate sensitivity of the Group.

(Currency - In thousands of Turkish Lira)

26. Financial risk management *(continued)*

Cash flow and fair value interest rate risk *(continued)*

The table below summarises the Group's exposure to interest rate risk on the basis of the remaining period at the reporting date to the repricing date:

31 December 2019	**Up to 1 month**	**1 to 3 months**	**3 to 6 months**	**6 months to 1 year**	**1 to 2 years**	**2 to 3 years**	**3 to 4 years**	**4 to 5 years**	**Over 5 years**	**Non-interest bearing**	**Total**
Assets											
Cash and balances with central banks	-	-	-	-	-	-	-	-	-	4	4
Due from banks and financial institutions	-	-	-	-	-	-	-	-	-	11,666	11,666
Interbank and other money market placements	50,531	-	-	-	-	-	-	-	-	-	50,531
Reserve deposits at central banks	67,396	-	-	-	-	-	-	-	-	107	67,503
Trading assets	645	3,168	5,762	445	345	-	-	-	-	-	10,365
Investment securities	17,561	17,305	29,018	-	-	-	-	-	-	160	64,044
Loan securities	235	-	5,204	-	-	-	-	-	-	-	5,439
Loans and finance lease receivables	14,067	17,498	49,944	38,723	143,265	48,738	35,052	133,041	83,134	78,027	641,489
Other assets	-	-	-	-	-	-	-	-	-	78,383	78,383
Total assets	**150,435**	**37,971**	**89,928**	**39,168**	**143,610**	**48,738**	**35,052**	**133,041**	**83,134**	**168,347**	**929,424**
Liabilities											
Other money market deposits	5,275	-	-	-	-	-	-	-	-	-	5,275
Funds borrowed	246,383	23,917	977	-	-	-	-	124,699	147,213	-	543,189
Trading liabilities	1,692	4,289	-	-	14	-	-	-	-	-	5,995
Other liabilities [(1)]	11,456	25	1,893	774	-	665	-	-	5,472	43,665	63,950
Total liabilities	**264,806**	**28,231**	**2,870**	**774**	**14**	**665**	**-**	**124,699**	**152,685**	**43,665**	**618,409**
Financial position interest sensitivity gap	**(114,371)**	**9,740**	**87,058**	**38,394**	**143,596**	**48,073**	**35,052**	**8,342**	**(69,551)**	**124,682**	**311,015**
Off-balance sheet interest sensitivity gap, net	(1,092)	(231)	(71)	(779)	(1,313)	-	-	-	150,152	-	146,666
Total interest sensitivity gap	**(115,463)**	**9,509**	**86,987**	**37,615**	**142,283**	**48,073**	**35,052**	**8,342**	**80,601**	**124,682**	**457,681**

[(1)] Other liabilities comprise other liabilities and provisions.

(Currency - In thousands of Turkish Lira)

26. Financial risk management *(continued)*

Cash flow and fair value interest rate risk *(continued)*

31 December 2018	Up to 1 month	1 to 3 months	3 to 6 months	6 months to 1 year	1 to 2 years	2 to 3 years	3 to 4 years	4 to 5 years	Over 5 years	Non interest bearing	Total
Assets											
Cash and balances with central banks	-	-	-	-	-	-	-	-	-	2,602	2,602
Due from banks and financial institutions	-	-	-	-	-	-	-	-	-	2,181	2,181
Interbank and other money market placements	-	-	-	-	-	-	-	-	-	-	-
Reserve deposits at central banks	68,324	-	-	-	-	-	-	-	-	4,142	72,466
Trading assets	36	7,893	5,163	-	-	-	-	-	-	-	13,092
Investment securities	38,981	15,695	32,841	-	-	-	-	-	-	-	87,517
Loan securities	233	-	360	-	-	-	-	-	-	-	593
Loans and finance lease receivables	31,529	170,988	17,098	48,632	59,424	100,422	27,232	29,240	186,652	51,759	722,976
Other assets	-	-	-	-	-	-	-	-	-	69,914	69,914
Total assets	**139,103**	**194,576**	**55,462**	**48,632**	**59,424**	**100,422**	**27,232**	**29,240**	**186,652**	**130,598**	**971,341**
Liabilities											
Other money market deposits	590	-	-	-	-	-	-	-	-	-	590
Funds borrowed	316,075	14,944	17,765	18,139	36,278	36,278	36,278	36,278	101,345	-	613,380
Trading liabilities	42	5,877	856	-	-	-	-	-	-	-	6,775
Debt securities issued	-	-	-	-	-	-	-	-	-	-	-
Other liabilities [1]	8,267	-	-	-	-	1,458	-	-	-	30,519	40,244
Total liabilities	**324,974**	**20,821**	**18,621**	**18,139**	**36,278**	**37,736**	**36,278**	**36,278**	**101,345**	**30,519**	**660,989**
Financial position interest sensitivity gap	**(185,871)**	**173,755**	**36,841**	**30,493**	**23,146**	**62,686**	**(9,046)**	**(7,038)**	**85,307**	**100,079**	**310,352**
Off-balance sheet interest sensitivity gap, net	(49)	(969)	(1,257)	-	-	-	-	-	153,443	-	151,168
Total interest sensitivity gap	**(185,920)**	**172,786**	**35,584**	**30,493**	**23,146**	**62,686**	**(9,046)**	**(7,038)**	**238,750**	**100,079**	**461,520**

[1] Other liabilities comprise other liabilities and provisions.

(Currency - In thousands of Turkish Lira)

26. Financial risk management *(continued)*

Cash flow and fair value interest rate risk *(continued)*

As at 31 December 2019 and 31 December 2018, the effective interest rate applied on balance sheet items summarized as follows:

31 December 2019 (%)	TL	USD	EUR	CHF
Due from banks and financial institutions	-	-	-	-
Interbank and other money market placements	11.36	-	-	-
Investment securities FVOCI	6.98	-	-	-
Loans and finance lease receivables				
- Corporate loans	17.37	7.61	4.66	-
- Retail loans	18.36	-	-	7.22
Other money market deposits	-	-	-	-
Funds borrowed	-	5.28	2.84	3.76
Current account of loan customers [1]	9.42	-	0.90	-

31 December 2018 (%)	TL	USD	EUR	CHF
Due from banks and financial institutions	13.00	2.00	-	-
Interbank and other money market placements	25.21	-	-	-
Investment securities FVOCI	7.52	-	-	-
Loans and finance lease receivables				
- Corporate loans	31.64	7.66	4.85	-
- Retail loans	18.57	-	-	7.20
Other money market deposits	-	-	-	-
Funds borrowed	17.92	7.62	2.94	3.76
Current account of loan customers [1]	18.86	2.00	-	-

[1] Included in other liabilities.

The Bank’s value at market risks as of 31 December 2019 and as of 31 December 2018 calculated as per the statutory financial statements prepared for BRSA reporting purposes within the scope of “Regulation on Measurement and Assessment of Capital Adequacy Ratios of Banks” published in Official Gazette no. 26333 dated 1 November 2006, are as follows:

	2019			2018		
	Average	**Highest**	**Lowest**	**Average**	**Highest**	**Lowest**
Interest rate risk	27,139	43,813	17,788	26,715	40,938	14,600
Counter party risk	-	-	-	-	-	-
Currency risk	6,326	31,425	838	5,406	11,238	2,050
Total value-at-risk	**33,465**	**75,238**	**18,626**	**32,121**	**52,176**	**16,650**

Capital Management

Internal capital adequacy assessment process

Within the risk management framework of the Bank, a comprehensive internal capital adequacy assessment process (“ICAAP”) is performed since 2009 which is reviewed and approved by Board of Directors.

(Currency - In thousands of Turkish Lira)

26. Financial risk management *(continued)*

Cash flow and fair value interest rate risk *(continued)*

Exposure to interest rate risk – non-trading portfolios

Interest rate sensitivity of the banking book is calculated as the difference of discounted cash flows of assets and liabilities. With this method, the future changes of interest rates and their effects on the cash flow of asset and liabilities are simulated and the influence of these changes on the interest income and equity of the Bank is assessed. The exercise is subject to PV01 and worst case scenario limit which are (1) 100 bps parallel shift of yield curves and (2) worst case shifts of yield curves which refer to parallel and non-parallel (flattening and steepening) shift of TL (500 bps) and foreign currency (200 bps) yield curves. Limits are determined on ALCO and Board of Directors levels and subject to Board of Directors monthly review.

Change at portfolio value/Total equity (%)	**31 December 2019**	**31 December 2018**
Local TL interest rate		
+500 bps	(1.43)	(0.66)
-400 bps	2.62	1.06
Foreign currency interest rate		
+200 bps EUR	3.02	3.60
-200 bps EUR	0.24	(0.34)
+200 bps USD	(3.67)	(6.16)
-200 bps USD	3.47	6.90

Capital adequacy

To monitor the adequacy of its capital, the Group uses ratios established by BRSA. These ratios measure capital adequacy (minimum 8% as required by Banking Law) by comparing the Group's eligible capital with its financial position assets, off-balance sheet commitments and market and other risk positions at weighted amounts to reflect their relative risk. The regulatory capital and the capital adequacy ratio declared by the Group as 31 December 2019 and 31 December 2018 is as follows:

	31 December 2019	**31 December 2018**
Amount subject to credit risk (I)	780,082	859,433
Amount subject to market risk (II)	36,713	18,813
Amount subject to operational risk (III)	107,332	71,057
Total risk-weighted assets, value at market risk and operational risk (IV) = (I+II+II)	**924,127**	**949,303**
Capital for the purpose of calculating the capital adequacy ratio	305,663	304,641
Capital adequacy ratio	**33.08%**	**32.69%**

(Currency - In thousands of Turkish Lira)

27. Classification of financial assets and financial liabilities

The table below provides reconciliation between line items in the statement of financial position and categories of financial instruments.

31 December 2019	*Note*	FVPL	Loans and lease receivables at AC	FVOCI	Other amortised cost	Total carrying amount
Cash and balances with central banks	*10*	-	4	-	-	4
Due from banks and financial institutions	*10*	-	11,666	-	-	11,666
Interbank and other money market placements	*10*	-	50,531	-	-	50,531
Reserve deposits at central banks	*11*	-	67,503	-	-	67,503
Trading assets	*12*	10,365	-	-	-	10,365
Investment securities	*13*	-	-	64,044	-	64,044
Loaned securities	*13*	-	-	5,439	-	5,439
Loans and finance lease receivables	*14*	-	641,489	-	-	641,489
Total financial assets		**10,365**	**771,193**	**69,483**	**-**	**851,041**
Other money market deposits	*19*	-	-	-	5,275	5,275
Trading liabilities	*12*	5,995	-	-	-	5,995
Funds borrowed	*20*	-	-	-	543,189	543,189
Current accounts of loan customers[1]	*22*	-	-	-	47,078	47,078
Total financial liabilities		**5,995**	**-**	**-**	**595,542**	**601,537**

(1) Included in other liabilities.

31 December 2018	*Note*	FVPL	Loans and lease receivables at AC	FVOCI	Other amortised cost	Total carrying amount
Cash and balances with central banks	*10*	-	2,602	-	-	2,602
Due from banks and financial institutions	*10*	-	2,181	-	-	2,181
Reserve deposits at central banks	*11*	-	72,466	-	-	72,466
Trading assets	*12*	13,092	-	-	-	13,092
Investment securities	*13*	-	-	87,517	-	87,517
Loaned securities	*13*	-	-	593	-	593
Loans and finance lease receivables	*14*	-	722,976	-	-	722,976
Total financial assets		**13,092**	**800,225**	**88,110**	**-**	**901,427**
Other money market deposits	*19*	-	-	-	590	590
Trading liabilities	*12*	6,775	-	-	-	6,775
Funds borrowed	*20*	-	-	-	613,380	613,380
Current accounts of loan customers[1]	*22*	-	-	-	21,377	21,377
Total financial liabilities		**6,775**	**-**	**-**	**635,347**	**642,122**

(1) Included in other liabilities.

(Currency - In thousands of Turkish Lira)

28. Fair value of financial and non-financial instruments

Valuation of assets measured at fair value

This table below analyses financial and non-financial instruments measured at fair value at the end of the reporting period, by the level in the fair value hierarchy into which the fair value measurement is categorised. The amounts are based on the values recognised in the statement of financial position.

31 December 2019	Level 1	Level 2	Level 3	Total
Financial instruments				
Financial assets at FVPL	5,512	4,853	-	10,365
Investment and loaned securities at FVOCI	69,483	-	-	69,483
	74,995	**4,853**		**79,858**
Financial instruments				
Financial liabilities at FVPL	-	5,995	-	5,995
	-	**5,995**	**-**	**5,995**

31 December 2018	Level 1	Level 2	Level 3	Total
Non-financial instruments				
Investment property	-	-	46,279	46,279
Financial instruments				
Financial assets at FVPL	7,197	5,895	-	13,092
Investment and loaned securities an FVOCI	88,110	-	-	88,110
	95,307	**5,895**	**46,279**	**147,481**
Financial instruments				
Financial liabilities at FVPL	-	6,775	-	6,775
	-	**6,775**	**-**	**6,775**

(Currency - In thousands of Turkish Lira)

28. Fair value of financial and non-financial instruments *(continued)*

Financial instruments not measured at fair value – fair value hierarchy

	31 December 2019		31 December 2018	
	Carrying value	**Fair value**	**Carrying value**	**Fair value**
Financial assets:				
Loans and finance lease receivables	**641,489**	**720,225**	**722,977**	**792,699**
Financial liabilities:				
Funds borrowed	543,189	570,176	613,970	643,553
Debt securities issued	**543,189**	**570,176**	**613,970**	**643,553**

Loans and finance lease receivables

Loans and finance lease receivables are net of provisions for impairment. The estimated fair value of loans and finance lease receivables represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates to determine fair value.

Estimated fair value of lease contracts receivables represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates to determine fair value.

Other money market deposits, funds borrowed and current accounts of loan customers

The estimated fair value of other money market deposits and current accounts of loan customers without quoted market price is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

The estimated fair value of fixed interest bearing funds borrowed is based on discounted cash flows using interest rates for new debts with similar remaining maturity and the estimated fair value of floating interest bearing funds borrowed are equal to their carrying value.

Fair values of remaining financial assets and liabilities carried at amortised cost, including cash and balances with central banks, due from banks and financial institutions, interbank and other money market placements, reserve deposits at central banks, deposits from other banks are considered to approximate their respective carrying values due to their short-term nature.

(Currency - In thousands of Turkish Lira)

29. Operating segments

The Group has four reportable segments, namely headquarter and treasury, corporate banking, retail banking, and non-financial services (includes activities of C Bilişim), which are the Group's strategic business units. The strategic business units offer different products and services, and are managed separately based on the Group's management and internal reporting structure. The following table summarises the Group's operating segments details.

31 December 2019	Asset management and treasury	Corporate banking	Retail banking	Non-financial services	Total
Interest income	37,316	63,467	112	126	101,021
Interest expense	(39,402)	(1,596)	-	-	(40,998)
Internal transfer rate income/(expense)	47,711	(47,472)	(239)	-	-
Net interest income	**45,625**	**14,399**	**(127)**	**126**	**60,023**
Net fee and commission income / (expense)	(85)	5,665	54	-	5,634
Net trading income and foreign exchange gain, net	1,840	202	(1)	1,059	3,100
Other operating income	1,446	209	-	429	2,084
Total operating income	**48,826**	**20,475**	**(74)**	**1,614**	**70,841**
Net impairment loss on financial and non-financial assets	432	(20,433)	(13)	-	(20,014)
Total operating expenses	(31,098)	(16,507)	(634)	(1,023)	(49,262)
Profit / (loss) before income tax	**18,160**	**(16,465)**	**(721)**	**591**	**1,565**
Income tax	921	-	-	-	921
Net profit/(loss) for the year	**19,081**	**(16,465)**	**(721)**	**591**	**2,486**
Total assets	**272,436**	**648,395**	**954**	**7,639**	**929,424**
Total liabilities	**579,135**	**38,914**	**27**	**333**	**618,409**

(Currency - In thousands of Turkish Lira)

29. Operating segments *(continued)*

31 December 2018	**Asset management and treasury**	**Corporate banking**	**Retail banking**	**Non-financial services**	**Total**
Interest income	47,638	67,152	420	960	116,170
Interest expense	(62,845)	(1,360)	-	-	(64,205)
Intersegment revenue	53,158	(52,846)	(312)	-	-
Net interest income	**37,951**	**12,946**	**108**	**960**	**51,965**
Net fee and commission income	(212)	7,655	(5)	-	7,438
Net trading income and foreign exchange gain, net	3,486	1,686	69	13	5,254
Other operating income	319	1,376	-	339	2,034
Total operating income	**41,544**	**23,663**	**172**	**1,312**	**66,691**
Net impairment loss on financial and non-financial assets	101	(39,031)	133	-	(38,797)
Total operating expenses	(25,188)	(38,772)	(753)	(790)	(65,503)
Profit/(Loss) before income tax	**16,457**	**(54,140)**	**(448)**	**522**	**(37,609)**
Income tax	(392)	-	-	-	(392)
Net profit / (loss) for the year	**16,065**	**(54,140)**	**(448)**	**522**	**(38,001)**
Total assets	**189,965**	**771,943**	**2,060**	**7,373**	**971,341**
Total liabilities	**636,881**	**23,344**	**106**	**658**	**660,989**

30. Rating

None.

31. Events after the reporting period

None.