# HSBC BANK ANONİM ŞİRKETİ

## CONSOLIDATED FINANCIAL STATEMENTS
## FOR THE YEAR ENDED 31 DECEMBER 2019
## TOGETHER WITH INDEPENDENT AUDITOR'S REPORT

## Independent auditor's report

To the General Assembly of HSBC Bank A.Ş.

## Report on the audit of the consolidated financial statements

### Opinion

We have audited the consolidated financial statements of HSBC Bank A.Ş. (the "Bank") and its subsidiaries (together 'the Group'), which comprise the consolidated statement of financial position as at December 31, 2019, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at December 31, 2019, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

### Basis for opinion

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

### Key audit matters

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

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

| Key Audit Matter | How the matter is addressed in our audit |
|---|---|
| ***Recognition of impairment on financial assets within the scope of IFRS 9 "Financial Instruments" Standard and related significant disclosures*** | |
| As presented in Note 2 as the Group recognizes expected credit losses of financial assets in accordance with IFRS 9. We considered the impairment of financial assets as a key audit matter since:<br>- Amount of on and off balance sheet items that are subject to expected credit loss calculation is material to the financial statements<br>- There are complex and comprehensive requirements of IFRS 9<br>- Policies implemented by the Group management include compliance risk to the regulations and other practices.<br>- Structured processes of IFRS 9 are advanced and complex.<br>- Judgements and estimates used in expected credit loss calculation are complex and comprehensive.<br>- Disclosure requirements of IFRS 9 are comprehensive and complex | Our audit procedures included among others include:<br>- Evaluating the appropriateness of accounting policies as to the requirements of IFRS 9, Group's past experience, local and global practices.<br>- Reviewing and testing of structured processes which are used to calculate expected credit losses by involving our Information technology and Process audit specialists.<br>- Evaluating the reasonableness of management's key judgements, estimates and data sources used in expected credit loss calculations considering the standard requirements, sectorial, local and global practices<br>- Assessing the appropriateness of definition of significant increase in credit risk, default criteria, modification, probability of default, loss given default, exposure at default and forward looking assumptions together with the significant judgements and estimates used in these calculations to regulations and group's past performance. Evaluating the alignment of those forward looking parameters to Group's internal processes where applicable.<br>- Assessing the completeness and the accuracy of the data used for expected credit loss calculation<br>- Testing the mathematical accuracy of expected credit loss calculation on sample basis<br>- Evaluating the judgments and estimates used for the individually assessed financial assets<br>- Evaluating the accuracy and the necessity of post-model adjustments<br>- Auditing of IFRS 9 disclosures |

**Other Matter**

The consolidated financial statements of the Group as of December 31, 2018 were audited by another independent audit firm, who expressed an unqualified opinion in their audit reports dated November 5, 2019.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

From the matters communicated with the Board of Directors 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 auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner who supervised and concluded this independent auditor's report is Damla Harman.

Güney Bağımsız Denetim ve Serbest Muhasebeci Mali Müşavirlik Anonim Şirketi
A member firm of Ernst & Young Global Limited

Damla Harman, SMMM
Partner

April 24, 2020
İstanbul, Türkiye

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## CONSOLIDATED BALANCE SHEET AT 31 DECEMBER 2019

(Amounts expressed in thousands of Turkish Lira ("TL") unless otherwise indicated.)

| | Note | 31 December 2019 | 31 December 2018 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash balances and demand deposits with central banks | 6 | 874,926 | 4,736,023 |
| Restricted deposits with the Central Bank | 6 | 2,236,361 | 1,329,432 |
| Loans and advances to banks | 7 | 11,005,690 | 8,470,450 |
| Financial assets measured at fair value through profit or loss | | | |
| - Financial assets measured at fair value through profit or loss | 8 | 465,539 | 27,013 |
| *of which pledged as collateral* | | *3,821* | *3,708* |
| - Trading derivatives | 9 | 1,597,102 | 1,001,127 |
| - Equity Instruments | 8 | 32,788 | 20,223 |
| Loans and advances to customers | 10 | 16,295,364 | 14,821,002 |
| Financial assets measured at fair value through OCI | 11 | 1,230,698 | 511,129 |
| *of which pledged as collateral* | | *264,634* | *502,515* |
| Intangible assets | 12 | 168,439 | 150,954 |
| Property and equipment | 13 | 224,791 | 101,877 |
| Deferred income tax assets | 18 | 211,012 | 247,398 |
| Asset held for resale | 14 | 2,095 | 1,369 |
| Other assets | 14 | 613,846 | 660,916 |
| **Total assets** | | **34,958,651** | **32,078,913** |
| **LIABILITIES** | | | |
| Deposits from banks | 15 | 235,310 | 1,876,508 |
| Deposits from customers | 16 | 27,502,815 | 22,977,440 |
| Other borrowed funds | 17 | 1,368,001 | 2,783,586 |
| Trading derivative liabilities | 9 | 1,440,432 | 941,094 |
| Income taxes payable | 18 | 34,039 | 10,506 |
| Other provisions | 19 | 102,469 | 147,316 |
| Employee benefit provisions/reserves | 20 | 142,203 | 131,632 |
| Lease liabilities | | 124,393 | - |
| Other liabilities | 21 | 866,522 | 611,169 |
| **Total liabilities** | | **31,816,184** | **29,479,251** |
| **EQUITY** | | | |
| Share capital | 22 | 939,625 | 939,625 |
| Statutory and other reserves | 23 | 201,207 | 124,947 |
| Retained earnings | 23 | 2,001,635 | 1,535,090 |
| **Equity attributable to shareholders of the Bank** | | **3,142,467** | **2,599,662** |
| Non-controlling interests in equity | | - | - |
| **Total equity** | | **3,142,467** | **2,599,662** |
| **Total liabilities and equity** | | **34,958,651** | **32,078,913** |
| **Commitments and contingencies** | **29** | **4,765,426** | **3,658,162** |

The accompanying notes set out on pages 5 to 79 form an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENT OF INCOME AND COMPREHENSIVE INCOME AT 31 DECEMBER 2019

(Amounts expressed in thousands of Turkish Lira ("TL") unless otherwise indicated.)

| | Note | 31 December 2019 | 31 December 2018 |
|---|---|---|---|
| Interest income calculated using the effective interest method | 24 | 3,252,768 | 3,027,592 |
| Interest expense calculated using the effective interest method | 24 | (1,739,182) | (1,555,025) |
| **Net interest income** | | **1,513,586** | **1,472,567** |
| Fee and commission income | 25 | 500,209 | 480,382 |
| Fee and commission expense | 25 | (42,489) | (41,336) |
| **Net fee and commission income** | | **457,720** | **439,046** |
| Trading Gains/(Losses) on Securities | 26 | 78,568 | 7,311 |
| Derivative Financial Transactions Gains/(Losses) | 26 | 268,429 | 2,014,624 |
| Foreign Exchange Gains/(Losses) | 26 | (436,704) | (2,413,095) |
| Other operating income | | 80,864 | 93,246 |
| **Operating income** | | **1,962,463** | **1,613,699** |
| Net impairment losses | 28 | (125,468) | (403,492) |
| Personnel expenses | 27 | (503,847) | (459,738) |
| Depreciation of property, equipment and right of use assets | 27 | (61,855) | (22,891) |
| Amortisation of intangible assets | 27 | (26,237) | (21,287) |
| Other operating expenses | 27 | (633,781) | (569,910) |
| **Profit before income tax** | | **611,275** | **136,381** |
| Income tax | 18 | (142,249) | (43,336) |
| **Profit for the year** | | **469,026** | **93,045** |
| **Other comprehensive income:** | | | |
| *Items that are or may be reclassified to profit or loss* | | | |
| **Financial assets measured at fair value through OCI** | | **90,383** | **(30,217)** |
| - Change in fair value | | (22,596) | 7,554 |
| - Amount transferred to profit or loss | | 112,979 | (37,771) |
| **Net gain on cash flow hedges** | | **(2,559)** | **(2,831)** |
| - Change in fair value | | - | - |
| - Amount transferred to profit or loss | | (2,559) | (2,831) |
| ***Items that are or may not be reclassified to profit or loss*** | | | |
| **Actuarial gain/(loss) related to employee benefits** | | **4,638** | **3,124** |
| - Effect of change in actuarial assumptions | | 4,638 | 3,124 |
| **Income tax relating to components of other comprehensive income** | **18** | **(18,683)** | **6,557** |
| **Other comprehensive loss for the year, net of tax** | | **73,779** | **(23,367)** |
| **Total comprehensive profit for the year** | | **542,805** | **69,678** |
| **Total comprehensive income attributable to:** | | | |
| Shareholders of the Bank | | 542,805 | 69,678 |
| Non-controlling interest | | - | - |
| Basic and diluted profit per share attributable to the equity holders of the Bank (expressed in TL per thousand share) | 2 | 0.007190 | 0.001426 |

The accompanying notes set out on pages 5 to 79 form an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
## FOR THE YEAR ENDED 31 DECEMBER 2019

(Amounts expressed in thousands of Turkish Lira ("TL") unless otherwise indicated.)

| | Attributable to owners of the Bank | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Share Capital** | **Legal Reserves** | **Statutory Reserves** | **Retained earnings** | **Total** | **Non controlling interest** | **Total equity** |
| **Balance at 1 January 2018** | **939,625** | **195,034** | **(42,914)** | **1,736,775** | **2,828,520** | **-** | **2,828,520** |
| Effects of changes in accounting policies | - | - | (5,846) | (262,690) | (268,536) | - | (268,536) |
| **Restated Balance at 1 January 2018** | **939,625** | **195,034** | **(48,760)** | **1,474,085** | **2,559,984** | **-** | **2,559,984** |
| Profit for the year | - | - | - | 93,045 | 93,045 | - | 93,045 |
| Other comprehensive expense for the year | - | - | (23,367) | - | (23,367) | - | (23,367) |
| **Total comprehensive profit for the year** | **-** | **-** | **(23,367)** | **93,045** | **69,678** | **-** | **69,678** |
| Transfer to statutory reserves | - | 2,040 | - | (2,040) | - | - | - |
| Dividend paid | - | - | - | (30,000) | (30,000) | - | (30,000) |
| **Balance at 31 December 2018** | **939,625** | **197,074** | **(72,127)** | **1,535,090** | **2,599,662** | **-** | **2,599,662** |
| **Balance at 1 January 2019** | **939,625** | **197,074** | **(72,127)** | **1,535,090** | **2,599,662** | **-** | **2,599,662** |
| Effects of changes in accounting policies | - | - | - | - | - | - | - |
| **Restated Balance at 1 January 2019** | **939,625** | **197,074** | **(72,127)** | **1,535,090** | **2,599,662** | **-** | **2,599,662** |
| Profit for the year | - | - | - | 469,026 | 469,026 | - | 469,026 |
| Other comprehensive expense for the year | - | - | 73,779 | - | 73,779 | - | 73,779 |
| **Total comprehensive profit for the year** | **-** | **-** | **73,779** | **469,026** | **542,805** | **-** | **542,805** |
| Transfer to statutory reserves | - | 2,481 | - | (2,481) | - | - | - |
| Dividend paid | - | - | - | - | - | - | - |
| **Balance at 31 December 2019** | **939,625** | **199,555** | **1,652** | **2,001,635** | **3,142,467** | **-** | **3,142,467** |

The accompanying notes set out on pages 5 to 79 form an integral part of these consolidated financial statements.

# HSBC BANK A.Ş.

## CONSOLIDATED STATEMENT OF CASH FLOWS
## FOR THE YEAR ENDED 31 DECEMBER 2019

(Amounts expressed in thousands of Turkish Lira ("TL") unless otherwise indicated.)

| | Note | 31 December 2019 | 31 December 2018 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Net profit for the year | | 469,026 | 93,045 |
| **Adjustments for non-cash items:** | | | |
| Unrealised gain/ (loss) on trading securities, net | | (506) | (1,120) |
| Impairment losses | 28 | 348,413 | 524,240 |
| Recovery for loans | 28 | (222,945) | (120,748) |
| Measurement of derivative financial instruments at fair value | | 96,637 | (119,364) |
| Amortisation of intangible assets | 27 | 26,237 | 21,287 |
| Depreciation of property and equipment | 27 | 61,855 | 22,891 |
| Provision for current and deferred income taxes | | 142,249 | 43,336 |
| Other provisions | | (44,847) | (32,037) |
| Provision for employee benefits | | 7,337 | 24,172 |
| Unrealized losses on other liabilities | | 219,767 | 103,373 |
| Unearned commission income | | 3,574 | (6,301) |
| Interest income – net | | (1,513,586) | (1,472,567) |
| Interest paid | | (1,918,988) | (1,410,763) |
| Interest received | | 3,215,516 | 2,957,269 |
| **Cash flows from operating profits before changes in operating assets and liabilities** | | **889,739** | **626,713** |
| **Changes in :** | | | |
| Balances with central banks | | (906,929) | (28,469) |
| Loans and advances to banks | | 13,583 | (11,247) |
| Trading securities | | (449,676) | 230,894 |
| Loans and advances to customers | | (1,638,737) | 255,940 |
| Other assets | | (147,399) | (470,244) |
| Deposits from banks | | (1,641,198) | 367,105 |
| Deposits from customers | | 4,616,722 | 7,924,175 |
| Other liabilities | | 307,093 | 128,980 |
| | | **1,043,198** | **9,023,847** |
| **Income taxes paid** | | **(155,888)** | **(110,173)** |
| **Net cash generated / (used) in operating activities** | | **887,310** | **8,913,674** |
| **Cash flows from investing activities:** | | | |
| Purchase of property and equipment | | (32,533) | (50,157) |
| Proceeds from the sale of property and equipment | | - | 8,099 |
| Purchase of intangible assets | | (64,430) | (24,311) |
| Proceeds from the sale of property and equipment | | 20,708 | - |
| Purchase of investment securities | | (938,512) | (147,633) |
| Redemption of investment securities | | 335,700 | 903,718 |
| **Net cash used in investing activities** | | **(679,067)** | **689,716** |
| **Cash flows from financing activities** | | | |
| Proceeds from borrowed funds | | - | 596,445 |
| Repayments of borrowed funds | | (1,481,051) | (1,891,720) |
| Proceeds from finance leases | | (39,466) | - |
| **Net cash used in financing activities** | | **(1,520,517)** | **(1,295,275)** |
| **Net (decrease)/increase in cash and cash equivalents** | | **(1,312,274)** | **8,411,488** |
| Effects of foreign exchange-rate changes on cash and cash equivalents | | 4,245 | 1,695 |
| Cash and cash equivalents at beginning of the year | 5 | 13,188,645 | 4,775,462 |
| **Cash and cash equivalents at year end** | **5** | **11,880,616** | **13,188,645** |

The accompanying notes set out on pages 5 to 79 form an integral part of these consolidated financial statements.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 1 - GENERAL INFORMATION

It has been approved by the decision of the Council of Ministers dated 27 June 1990 and numbered 90/644 that HSBC Bank A.Ş. (“the Bank”, “the Parent Bank”, “HSBC Bank”) was established to conduct banking activities and the articles of association published in the Official Gazette No. 2611 dated 18 September 1990. The Parent Bank is a foreign-capitalized bank which has been registered in accordance with the Law on Encouraging Foreign Investments numbered 6224. On 20 September 2001 the ‘Share Sales Agreement’ regarding the sale of all shares of Demirbank T.A.Ş. which was under in Saving Deposit Insurance Fund was signed by the Bank’s main shareholder HSBC Bank Plc. According to this agreement the required procedures shall be completed by 31 October 2001 and all shares of the Demirbank T.A.Ş., together with a part of the assets and liabilities shall be transferred to HSBC Bank Plc on 31 October 2001. In 14 December 2001, Demirbank T.A.Ş. and the Bank merged under the name of HSBC Bank Anonim Şirketi and continued its activities. Based on the approval of the Banking Regulation and Supervision Agency dated 21 June 2017, 10.01% share of HSBC Bank Plc.'s 100% ownership of the Bank’s capital was transferred to HSBC Bank Middle East Limited and remaining 89.99% share of HSBC Bank Plc. was transferred to HSBC Middle East Holdings B.V. through share transfer agreement dated 29 June 2017.

The Bank is registered in Istanbul, Turkey at the following address: Büyükdere Caddesi No: 128 D Blok 34394, Esentepe, Şişli, Istanbul.

The Bank and the Bank’s subsidiary, HSBC Yatırım Menkul Değerler A.Ş. (“HSBC Yatırım”), HSBC Yatırım’s subsidiary, HSBC Portföy Yönetimi A.Ş. (“HSBC Portföy”) and HSBC Ödeme Sistemleri ve Bilgisayar Teknolojileri Basın Yayın ve Müşteri Hizmetleri A.Ş. are in the consolidation scope (“the Group”).

As of 31 December 2019, the Group has 2,063 employees (31 December 2018: 2,258 employees).

As of 31 December 2019, the Parent Bank has 77 branches dispersed throughout the country (31 December 2018: 82 branches).

As of 31 December 2019, the consolidated subsidiaries, the Bank’s share percentage and the Bank’s risk group share percentage are as follows:

| | Title | Address (City / Country) | Bank’s share percentage - If different voting percentage (%) | Bank’s risk group share percentage (%) |
|---|---|---|---|---|
| 1 | HSBC Yatırım ve Menkul Değerler A.Ş. | Esentepe Mahallesi Büyükdere Caddesi No:128 Şişli 34394, İSTANBUL | 99.87 | 0.13 |
| 2 | HSBC Ödeme Sistemleri ve Bilgisayar Teknolojileri Basın Yayın ve Müşteri Hizmetleri A.Ş | Esentepe Mahallesi Büyükdere Caddesi No:128 Şişli 34394, İSTANBUL | 100.00 | - |

## NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES

### 2.1 Basis of preparation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). These financial statements have been prepared under the historical cost convention, except for those assets and liabilities measured at fair value.

The Company and its subsidiaries 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 and accounting standards promulgated by the other relevant laws and regulations. The consolidated financial statements have been prepared in accordance with IFRS and presented in Turkish Lira ("TL"). For the purpose of fair presentation in accordance with IFRS, certain adjustments and reclassifications have been made to the statutory financial statements.

These consolidated financial statements have been approved by the Board of Directors on 24 April 2020.

### 2.2 Summary of Significant Accounting Policies, Judgments and Estimates

#### 2.2.1 Use of estimates and judgements

The preparation of the consolidated financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the application of policies and in the measurement of income and expenses in the profit and loss statement and in the carrying value of assets and liabilities in the statement of financial position, and in the disclosure of information in the notes to the financial statements.

The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making judgments about carrying values of assets and liabilities that are not readily apparent from other sources. The actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognized in the year in which the estimate is revised.

The Bank's management has made an assessment of its ability to continue as a going concern and is satisfied that it has the resources to continue in business for the foreseeable future. Furthermore, management is not aware of any material uncertainties that may cast significant doubt on the Bank's ability to continue as a going concern. Therefore, the financial statements continue to be prepared on the going concern basis.

The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 3.

#### 2.2.2 Foreign Currency Translation

#### a. Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency").

The consolidated financial statements are presented in Turkish Lira ("TL"), which is the Bank's and Group's functional currency.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### b. Transactions and balances

Transactions are recorded in TL, which represents its functional currency. Transactions in foreign currencies are translated into the functional currency of the Bank at exchange rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are converted into TL at the exchange rates ruling at balance sheet date with the resulting exchange differences recognized in the statement of comprehensive income as foreign exchange gain or loss. Gains and losses arising from foreign currency transactions are reflected in the consolidated statement of comprehensive income as realized during the year.

### 2.2.3 Consolidation

The consolidated financial statements comprise the financial statements of the Bank and all its subsidiaries, drawn up to 31 December 2019.

### a. Subsidiaries

Subsidiaries are the entities controlled by the Bank. The control exists if and only if; 1) when the Bank has the power over an affiliate which that power, directly or indirectly, give rights to govern the financial and operating policies of the entity so as to obtain benefits from its activities, 2) exposure, or rights, to variable returns from its involvement with the affiliate, 3) the ability to use its power over the affiliate to affect the amount of its returns. The Bank re-assess its control power over its subsidiaries if there is an indication that there are changes to any of the three elements of control. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Subsidiaries are fully consolidated from the date of acquisition, being the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group.

The balance sheets and statements of comprehensive income of the subsidiaries are consolidated on a line-by-line basis and the carrying value of the investment held by the Bank and its subsidiaries is eliminated against the related equity. Intercompany transactions and balances between the Group companies are eliminated on consolidation. The dividends arising from subsidiaries are eliminated from profit of the year.

The financial statements of the subsidiaries are prepared using the consistent accounting policies with the Bank.

Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The list of principal subsidiaries at 31 December 2019 and 2018 is as follows:

| Name of subsidiary | Country of incorporation | Nature of business | 31 December 2019 Bank's shareholding (%) | 31 December 2018 Bank's shareholding (%) |
|---|---|---|---|---|
| HSBC Yatırım Menkul Değerler A.Ş. ("HSBC Yatırım") | Turkey | Investment management | 99.87 | 99.87 |
| HSBC Portföy Yönetimi A.Ş. ("HSBC Portföy") | Turkey | Portfolio management | 100.00 | 100.00 |
| HSBC Ödeme Sistemleri ve Bilgisayar Teknolojileri Basın Yayın ve Müşteri Hizmetleri A.Ş. | Turkey | Technology | 100.00 | 100.00 |

HSBC Yatırım was established on 29 January 1997 and to engage mainly in purchasing, selling and investing in any kind of securities, stocks, treasury bills and government bonds provided from capital markets; to manage mutual funds and to make transactions as an intermediary.

HSBC Portföy was established in August 2003 as an affiliate of HSBC Yatırım in order to engage in the portfolio management of domestic and international funds, post-employment benefit plans funds and portfolio management of domestic and international real and juristic persons.

Non-financial subsidiary of the Parent Bank is HSBC Ödeme Sistemleri ve Bilgisayar Teknolojileri Basın Yayın ve Müşteri Hizmetler A.Ş. HSBC Ödeme Sistemleri ve Bilgisayar Teknolojileri Basın Yayın ve Müşteri Hizmetleri A.Ş. was established on 10 December 1999 to provide VIP services either for its clients or the clients of the legal entities, and in this respect, to provide hospitality, catering and private waiting room. As of 17 October 2019, dischargement process of HSBC Ödeme has started. In pursuit of completion of legal necessities regarding dischargement, dischargement will be placed as of the date of May 11, 2020.

### b. Fund management

The Group manages and administers open-ended mutual funds and private pension funds. The financial statements of these entities are not included in these consolidated financial statements. Information about the Group's funds management is set out in Note 32.

### 2.2.4 Related parties

Related parties include entities, which the Group has the ability to exercise significant influence in making financial and operating decisions. For the purpose of these consolidated financial statements, shareholders, companies controlled by or affiliated with them and their ultimate owners, directors and executive officers are considered and referred to as related parties (Note 31).

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 2.2.5 Financial assets

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 recognize 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 Group management and the nature of contractual cash flows of the financial asset are taken into consideration. When the business model determined by the Parent Bank's management is changed, all affected financial assets are reclassified and this reclassification is applied prospectively. In such cases, no adjustments are made to earnings, losses or interest that were previously recorded in the financial statements

### a. Financial Assets at Fair Value through Profit or Loss

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. Financial assets at fair value through profit/loss are financial assets other than the ones that are managed with business model that aimed 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 in case of 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 measured at their fair value after recognition. All gains and losses arising from these valuations are reflected in the income statement. According to uniform chart of accounts explanations interest income earned on financial asset and the difference between their acquisition costs and amortized costs are recorded as interest income in the statement of profit or loss. The differences between the amortized costs and the fair values of such assets are recorded under trading account income/losses in the statement of profit or loss. In cases where such assets are sold before their maturities, the gains/losses on such sales are recorded under trading account income/losses.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 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.

“Unrealized gains and losses” arising from changes in the fair value of financial assets classified as financial assets at fair value through other comprehensive income are recognized in the shareholders’ equity as “Other accumulated comprehensive income that will be reclassified in profit or loss”, until the related fair value differences accumulated in the shareholders’ equity are transferred to the income statement. Interest and dividends received from financial assets at fair value through other comprehensive income are recorded in interest income and dividend income as appropriate.

During initial recognition an entity can choose in an irrevocable was 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.

All equity instruments class classified as fair value through other comprehensive income are measured at fair value. However, in limited circumstances, cost may be an appropriate estimate of fair value. That may be case if insufficient more recent information is available to measure fair value, or if there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within the range.

### c. Financial Assets Measured at Amortised 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 amortised cost. These financial assets are initially recognized at total of acquisition and transaction cost. After their initial recognition, they are carried at “Amortised Cost” using the “effective interest method”. Group’s loans are recorded under the “Measured at Amortised Cost” account. As of 31 December 2019 and 31 December 2018, the Group has no marketable securities measured at amortised cost.

### 2.2.6 Financial liabilities

Financial liabilities including deposits from banks, deposits from customers and other borrowed funds are recognised initially at fair value, net of transaction costs. Subsequently, financial liabilities are carried at amortised cost, net of transaction costs, and any difference between the amount at initial recognition and the redemption value is recognised in profit and loss over the period of the financial liability using the effective interest method.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 2.2.7 Fair value of financial instruments

The Group measures the fair value of its financial instruments based on a framework for measuring fair value that categorizes financial instruments based on a three-level hierarchy of the inputs to the valuation technique, as discussed below.

**Level 1:** Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market.

**Level 2:** Observable inputs other than Level 1 quoted prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data (for example derived from prices) for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments, as well as debt securities without quoted prices and certain derivative contracts whose values are determined using pricing models, discounted cash flow methodologies, or similar techniques with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes government and corporate debt securities with prices in markets that are not active and certain OTC derivative contracts.

**Level 3:** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. If a fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs, that measurement is a Level 3 measurement.

The level in the fair value hierarchy within which the fair value measurement is categorized in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. For this purpose, the significance of an input is assessed against the fair value measurement in its entirety.

### 2.2.8 Sale and repurchase agreements

Securities subject to repurchase agreements (“Repo”) are classified as “Financial assets at fair value difference through profit or loss”, “Financial assets at fair value difference through other comprehensive income” in the balance sheet according to the investment purposes and measured according to the portfolio of the Group to which they belong. Funds obtained under repurchase agreements are accounted under “Funds provided under repurchase agreements” in liability accounts and differences between the sale and repurchase prices determined by these repurchase agreements are accrued evenly over the life of the repurchase agreement using the “Effective interest (internal return) method”. Funds given against securities purchased under agreements to resell (“Reverse repo”) are accounted under “Loans and advances to Banks” in the balance sheet. The difference between the purchase and resell price determined by these repurchase agreements is accrued evenly over the life of repurchase agreements using the “Effective interest rate method”. Group has no securities lending transactions.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 2.2.9 IFRS 9 Financial Instruments

IFRS 9 replaced IAS 39 Financial Instruments: recognition and measurement, related to the classification and measurement of financial instruments.

IFRS 9 sets out the new principles for the classification and measurement of financial instruments, impairment for credit risk on financial assets and general hedge accounting.

The Group applied the IFRS 9 requirements by adjusting the opening balance sheet and opening equity at 1 January 2018, with no restatement of comparative periods.

**Classification and measurement of financial assets**

According to IFRS 9 requirements, classification and measurement of financial assets will depend on the business model within which financial assets are managed and their contractual cash flow characteristics whether the cash flows represent solely payments of principal and interest.

**Assessment whether contractual cash flows are solely payments of principal and interest**

For the purposes of this assessment, "Principal" is defined as the fair value of the financial asset on initial recognition. "Interest" is defined as consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as a profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Group will consider the contractual terms of the instrument. This will include assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Group consider:

- Contingent events that would change the amount and timing of cash flows;
- Leverage features;
- Prepayment and extension terms
- Features that modify consideration for the time value of money

The Group fulfills the on-balance sheet classification and measurement criteria by applying the procedures described above for all financial assets.

Upon initial recognition each financial asset will be classified as either fair value through profit or loss ("FVPL"), amortized cost or fair value through other comprehensive income ("FVOCI"). As the requirements under IFRS 9 are different than the assessments under the existing IAS 39 rules, the classification and measurement of financial liabilities remain largely unchanged under IAS 39.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Impairment of financial assets

The Group recognizes a loss allowance for expected credit losses on financial assets measured in amortized cost and financial assets at fair value through other comprehensive income.

These financial assets are divided into three categories below depending on the 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, a lifetime expected credit loss is recorded.

### Calculation of expected credit losses

The calculation of expected credit losses consists of three main parameters: probability of default (PD), loss given default (LGD) and exposure at default (EAD). PDs and LGDs used in the ECL calculation are point in time ("PIT")-based for key portfolios and consider both current conditions and expected macro-economic change.

While the expected credit loss is estimated, three scenarios (central scenario, downside scenario, upside scenario) are evaluated. Each of these scenarios was associated with the different PD and LGD.

The three economic scenarios represent the 'most likely' outcome and two less likely outcomes referred to as the Upside and Downside scenarios. Each outer scenario is consistent with a probability of 10%, while the Central scenario is assigned the remaining 80%, according to the decision of HSBC's senior management. This weighting scheme is deemed appropriate for the unbiased estimation of ECL in most circumstances. Additionally, Alternative Downside scenarios have been created to reflect management's view of risk in some circumstances.

In addition, a certain portion of commercial and corporate loans is assessed individually in accordance with the internal policies in the calculation of the expected credit losses based on IFRS 9. Such calculations are made by discounting the expected cash flows from the individual financial instrument to its present value using the effective interest rate.

When measuring expected credit losses, it shall be considered the risk or probability that a credit loss occurs by reflecting the possibility that a credit loss occurs and the possibility that no credit loss occurs, even if the possibility of a credit loss occurring is very low. Such assessment is made by reflecting the estimate of expected credit losses which is unbiased and probability-weighted determined by evaluating a range of possible outcomes.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Probability of Default (PD)

The PD represents the likelihood of a default over a specified time period. A 12-month PD represents the likelihood of default determined for the next 12 months and a lifetime PD represents the probability of default over the remaining lifetime of the instrument. The lifetime PD calculation is based on a series of 12-month PIT PDs. In modeling, factors such as segment information, systematic and non-systematic information are taken into consideration. It is used internal rating systems for commercial portfolio to measure risk level. The internal rating models used for the commercial portfolio include customer financial information and non-financial (a kind of qualitative survey responses) information. Whereas behavioural and application scorecards used in the retail portfolio include; the behavioural data of the customer and the product in the Parent Bank, the demographic information of the customer, and the behavioural data of the customer in the sector. In the retail portfolio, a structure was constructed on the segment based structure and the distribution of the customers among the predetermined segments. Segments are formed by product-specific variables and product based. Probability of default calculation has been carried out based on past information, current conditions and forward looking macroeconomic parameters.

### Loss Given Default (LGD)

The LGD represents an estimate of the loss at the time of a potential default occurring during the life of a financial instrument. The LGD is calculated taking into account expected future cash flows from collateral and other credit enhancements by considering time value of money.

LGD calculations are performed using historical data which best reflects current conditions, by formation of segments based on certain risk factors that are deemed important for each portfolio and inclusion of forward-looking information and macroeconomic expectations. LGD summarizes all cash flows from customers subsequent to default. It covers all costs and collections that occur during the collection cycle, including collections from collaterals. It also includes the "time value of money" calculated by means of deducting costs and additional losses from the present value of collections. The Parent Bank bases its estimates on models for collateralized portfolios and on previous experience for unsecured parties, except for corporate loans that are assigned by the Basel Committee individually or as designated by the Basel Committee.

### Exposure at Default (EAD):

The EAD represents an estimate of the exposure to credit risk at the time of a potential default occurring during the life of a financial instrument. It represents the cash flows outstanding at the time of default, considering expected repayments, interest payments and accruals, discounted at the effective interest rate. Future drawdowns on facilities are considered through a credit conversion factor (CCF) that is reflective of historical drawdown and default patterns and the characteristics of the respective portfolios. While the expected credit loss is estimated, three scenarios (baseline scenario, bad scenario, optimistic scenario) are evaluated. Each of these scenarios was associated with the probability of different default and loss in default.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Consideration of the Macroeconomic Factors

Probability of default parameters are determined by considering macroeconomic factors. The macroeconomic variables used in the calculation of the expected loss are as follows:

- Annual percentage change of Gross Domestic Product (GDP) in USD
- Annual percentage change in revenue growth rate
- Annual percentage change in USD/TRY
- Unemployment rate
- Inflation rate
- Industrial production index

Stages were determined through the models created using internal information for the Parent Bank simplified method has been applied for other financial institutions.

### Calculating the Expected Loss Period

Lifetime ECL is calculated by taking into account maturity extensions, repayment options and the period during which the Parent Bank will be exposed to credit risk. The time in financial guarantees and other irrevocable commitments represents the credit maturity for which the liabilities of the Parent Bank. Behavioural maturity analysis has been performed on credit cards and overdraft accounts. With the exception of credit cards and other revolving facilities, the maximum period for which the credit losses are determined is the contractual life of a financial instrument unless there is the legal right to call it earlier. However due to segment-based approach to retail loans the maturity of the 95 percentile is calculated as the credit life.

### Significant increase in credit risk

Group makes qualitative and quantitative assessments regarding assessment of significant increase in credit risk of financial assets to be classified as stage 2 (Significant Increase in Credit Risk).

Within the scope of quantitative assessment, the quantitative reason explaining the significant increase in the credit risk is based on a comparison of the probability of default calculated at the origination of the loan and the probability of default assigned for the same loan as of the reporting date. If there is a significant deterioration in PD, it is considered that there is a significant increase in credit risk and the financial asset is classified as stage 2. In this context, Group has calculated thresholds at which point the relative change is a significant deterioration. In the quantitative evaluation of the significant increase in credit risk, the Parent Bank considers the absolute thresholds as well as the relative thresholds as an additional layer. Receivables below the absolute threshold value of default are not included in the relative threshold value comparison.

Group classifies the financial asset as Stage 2 (Significant Increase in Credit Risk) where any of the following conditions are satisfied as a result of a qualitative assessment:

- Loans overdue more than 30 days as of the reporting date
- Loans classified as watch-list
- When there is a change in the payment plan
- Receivables with a negative probability above the predetermined threshold values between the probability of default at the date of release and the probability of default at the reporting date.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 2.2.10 Derecognition of financial assets and liabilities

Financial assets are derecognised when the contractual rights to receive the cash flows from these assets have ceased to exist or the assets have been transferred and substantially all the risks and rewards of ownership of the assets are also transferred (that is, if substantially all the risks and rewards have not been transferred, the Bank tests control to ensure that continuing involvement on the basis of any retained powers of control does not prevent derecognition). Financial liabilities are derecognised when they have been redeemed or otherwise extinguished.

Financial assets measured at fair value through OCI and financial assets at fair value through profit or loss that are sold are derecognized and corresponding receivables from the buyer for the payment are recognized as at the date the Group commits to sell the assets. The specific identification method is used to determine the gain or loss on derecognition.

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

*Reclassification of financial instruments*

Based on IFRS 9, The Parent Bank shall be reclassified all affected financial assets at amortized cost to financial assets measured at fair value through other comprehensive income and fair value through profit or loss in the subsequent accounting when, and only when, it is changed the business model for managing financial assets.

*Restructuring and refinancing of financial instruments*

The Parent Bank 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.

The restructuring is the modification of the loan contract terms of the borrower or the partial or complete refinancing of the loan due to financial difficulties that the borrower may encounter or will likely encounter in the payments.

To reclassify the restructured corporate and commercial loans as performing loans from non-performing loans, the following conditions must be met:

- All of the overdue payments that cause the loan to be classified in the non-performing loans have been collected without using the collaterals.
- There is no delayed payment of the receivable as of the reclassification date and the last two payments before this date are due and complete.
- Ensuring the classification requirements of the company in the first or second stage.

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

In the case of Personal Loans, if the non-fulfillment of the payment obligation to the Parent Bank results from the temporary liquidity shortage, loans may be restructured in order to provide the borrower with liquidity power and to collect the receivable of the Parent Bank.

- The loan, which is restructured in the process of performing-private restructuring loans (need-vehicle-housing), is considered as close monitoring and is followed in close monitoring at the time of restructured loan period.
- Performing-Individual restructuring in the credit card process can be subtracted from close monitoring if paid 12 months from the date of restructuring and paid at least 10% of the restructured / financed principal amount.
- There is no restructuring of loan and credit card related to the non-performing loans.

### 2.2.11 Derivative financial instruments

In order to reduce the foreign exchange position risk the Parent Bank conducts currency forward purchase and sale transaction agreements, currency swap purchase and sale transaction agreements and option purchase and sale agreements. In order to reduce the interest risk, the Parent Bank conducts interest futures and forward interest rate agreements. The fair value differences of derivative instruments that are reflected in the profit and loss accounts are measured at fair value and associated with income statement during recognition. If the fair value of derivative financial instruments is positive, it is disclosed under the main account "Trading Derivatives at Financial Assets measured at Fair Value through Profit or Loss" and if the fair value difference is negative, it is disclosed under "Trading Derivative Liabilities". Differences arising from the valuation of fair value are reflected in the "Net Trading Income" account under income statement.

### 2.2.12 Hedge accounting

Until 30 June 2017, Group applied cash flow hedge accounting by cross currency swap transactions in order to hedge itself from the changes in the interest rates of the fixed-rate time deposits, which have maturity of 1-3 month. Group has performed strength tests for risk protection accounting in balance sheet date, while the effective portions are classified as "Accumulated Other Comprehensive Income or Expense Reclassified through Profit or Loss" in shareholders' equity, the ineffective portion is recognized at income statement.

In periods where cash flows (interest expense) regarding the risk protected entries, affect the income statements, the loss/gain of the related risk protection tool is reduced from shareholders' equity and shown in income statement.

If the underlying hedge does not conform to the hedge accounting requirements, according to the adjustments made to the carrying value of the hedged item, for which the risk is hedged by a portfolio hedge, are amortized with the straight line method within the time to maturity and recognized under the "Trading Income". As of 31 December 2019, no hedge accounting is applied.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 2.2.13 Property and equipment

All property and equipment are carried at cost less accumulated depreciation and impairment, if any. Depreciation is calculated using the straight-line method to write down the cost of such assets to their residual values over their estimated useful life as follows:

| | |
|---|---|
| Buildings | 50 years |
| Motor vehicles | 5 years |
| Other equipment, furniture and fixtures | 3 years - 50 years |

The assets residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Assets that are subject to depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less cost to sell and value in use.

Gains and losses on disposal of property and equipment are determined by reference to their carrying amount and are taken into account for the determination of net profit.

Subsequent expenditures are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repair and maintenance costs are charged to other operating expenses during the financial period in which they are incurred.

Leasehold improvements comprise primarily the capitalised branch refurbishment costs.

### 2.2.14 Intangible assets

Intangible assets consist of software, rights and trademarks.

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 profit or loss on a straight-line basis over the estimated useful life of the software, from the date that it is available for use. The amortisation periods for intangible assets which approximate the economic useful lives of such assets are 3-5 years.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 2.2.15 Accounting for leases

#### a. Finance leases

The Group recognized assets held under finance leases on the basis of the lower of its fair value and the present value of the lease payments. Fixed assets acquired under finance lease contracts are classified in tangible assets and amortized over their estimated useful lives. Leased assets are included in the property and equipment and depreciation is charged on a straight-line basis over the useful life of the asset. If there is any diminution in value of the leased asset, a "Provision for value decrease" is recognized. Liabilities arising from the leasing transactions are included in "Financial lease payables" in the balance sheet. Interest and foreign exchange expenses regarding lease transactions are presented the income statement. The Bank does not provide finance lease services as a "Lessor".

At the commencement date of a lease, a lessee measures the lease liability at the present value of the lease payments that are not paid at that date (i.e., the lease liability), at the same date recognizes an asset representing the right to use the underlying asset and depreciates it during the lease term. The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate. Lessees are required to recognize the interest expense on the lease liability and the depreciation expense on the right-of-use asset separately.

Explanations on "IFRS 16 Leases" are explained in Note 2.3

### 2.2.16 Factoring Receivables

Factoring receivables are measured at amortized cost using the effective interest rate method after deducting unearned interest income and when specific provisions for impairment are provided under IFRS 9 requirements.

### 2.2.17 Deposits and borrowings

Deposits and borrowings are initially measured at fair value plus transaction costs, and subsequently measured at their amortised cost using the effective interest method.

When the Group sells a financial asset and simultaneously enters into a "repo" or "stock lending" agreement to repurchase the asset (or a similar asset) at a fixed price on a future date, the arrangement is accounted for as a deposit, and the underlying asset continues to be recognised in the consolidated financial statements.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 2.2.18 Income taxes

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

**a. Income taxes payable**

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from 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 balance sheet date.

Current tax assets and liabilities are offset by the Group when it intends to settle on a net basis and the legal right to offset exists.

Taxes other than on income are recorded within other operating expenses (Note 27).

**b. Deferred income taxes**

Group calculates and accounts for deferred income taxes for all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in these financial statements in accordance with “Income Taxes Standard” (“IAS 12”). In the deferred tax calculation, the enacted tax rate, in accordance with the tax legislation, is used as of the balance sheet date. Deferred tax assets and liabilities are presented as net in the financial statements in accordance with IAS 12.

The calculated deferred tax asset and deferred tax liability are presented as net in these financial statements. After net off the net deferred tax asset is presented as deferred tax asset on the balance sheet and net deferred tax liability presented as deferred tax liability on balance sheet.

### 2.2.19 Retirement benefit obligations

Employment termination benefits represent the present value of the estimated total provision of the future probable obligation of the Group arising from the retirement of the employees calculated in accordance with the Turkish Labour Law. In accordance with existing social legislation and Turkish Labour Law in Turkey, the Group is required to make lump-sum termination indemnities to each employee whose employment is terminated due to retirement or for reasons other than resignation or misconduct and who has completed at least one year of service. Provision is made for the present value of the defined benefit obligation calculated using the projected unit credit method. All actuarial gains and losses are recognised immediately in other comprehensive income.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 2.2.20 Provisions, contingent assets and contingent liabilities

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

Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation. The discount rate reflects current market assessments of the time value of money and the risks specific to the liability. The discount rate shall be a pre-tax rate and shall not reflect risks for which future cash flow estimates have been adjusted.

Possible assets or obligations that arise from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group are not included in the consolidated financial statements and are treated as contingent assets or liabilities.

### 2.2.21 Interest income and expense

Interest income is recorded according to the effective interest rate method (rate equal to net present value of future cash flows or financial assets and liabilities) defined in the IFRS 9 “Financial Instruments” standard by applying the effective interest rate to the gross carrying amount of a financial asset except for: purchased or originated credit-impaired financial assets or financial assets that are not purchased or originated credit-impaired financial assets but subsequently have become credit-impaired financial assets. When applying the effective interest rate method, an entity identifies fees that are an integral part of the effective interest rate method of a financial instrument. Fees that are an integral part of the effective interest rate of a financial instrument are treated as an adjustment to the effective interest rate, unless the financial instrument is measured at fair value, with the change in fair value being recognized in profit or loss.

When applying the effective interest method, The Bank amortized any fees, transaction costs and other premiums or discounts that are included in the calculation of the effective interest rate over the expected life of the financial instrument. In case an interest was accrued on a security before its acquisition, the collected interest is divided into two parts as interest before and after the acquisition and only the interest of the period after the acquisition is recorded as interest income in the financial statements. If the expectation for the cash flows from financial asset is revised for reasons other than the credit risk, the change is reflected in the carrying amount of asset and in the related statement of profit or loss line and is amortized over the estimated life of financial asset.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 2.2.22 Fee and commission income and expense

All fees and commission income/expenses are recognized on an accrual basis in accordance with the matching principle or "Effective Rate Method (Internal Rate of Return Method)" and IFRS 15 "Revenue from Customer Contracts", except for certain commission income for various banking services, which are recorded as income at the time of collection. Contract based fees or fees received in return for services such as the purchase and sale of assets on behalf of a third party or legal person are recognized as income at the time of collection.

### 2.2.23 Net trading income

Net trading income includes gains and losses arising from disposals of trading financial assets, financial assets measured at fair value through OCI and gains and losses on trading purpose derivative transactions.

### 2.2.24 Share capital and dividends

Share capital is recognized at the nominal amount and amounts received in excess of the par value are recognized in share premium account. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from proceeds.

Dividends on ordinary shares are recognised in equity in the period in which they are approved by the Bank's shareholders. Dividends for the year that are declared after the balance sheet date are disclosed within the post balance sheet events note.

### 2.2.25 Acceptances

Acceptances comprise undertakings by the Group to pay bills of exchange drawn on customers, if the latter fails to meet their obligation. Acceptances are accounted for as off-balance sheet transactions.

### 2.2.26 Other credit related commitments and financial guarantee contracts

In the normal course of business, the Group enters into other credit related commitments including loan commitments, letters of credit and letters of guarantees. These are reported as off-balance sheet items at their notional amounts.

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

Financial guarantee liabilities are initially recognised at their fair value, and the initial fair value is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee has become probable).

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 2.2.27 Offsetting

Financial assets and liabilities are offset and the net amount reported in the consolidated balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted by the accounting standards, or for gains and losses arising from a group of similar transactions such as in the Group's trading activity.

### 2.2.28 Cash and cash equivalents

The cash and cash equivalents comprise balances with less than 90 days' original maturity including cash and balances with the central banks excluding reserve requirements and loans and advances to banks (Note 5).

### 2.2.29 Segment Reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the management. All transactions between business segments are conducted on an arm´s length basis, with intra-segment revenue and costs being eliminated in head office. Income and expenses directly associated with each segment are included in determining business segment performance.

In accordance with IFRS 8, the Group has the following business segments: retail banking, wholesale banking and treasury and capital markets banking.

### 2.2.30 Fiduciary and trust activities

The Group provides fiduciary and trust services to individuals and other institutions, whereby it holds and manages assets or invests funds received in various financial instruments at the direction of the customer. The Group receives fee income for providing these services. Trust assets held by the Group in a fiduciary, agency or custodian capacity for its customers are not recognized in the financial statements, since such items are not as assets of the Group. The Group is not exposed to any credit risk relating to such placements, as it does not guarantee these investments.

### 2.2.31 Earnings per share

Earnings per share presented in other comprehensive income are determined by dividing net profit by the weighted average number of shares outstanding during the year concerned.

| | **2019** | **2018** |
|---|---|---|
| Profit attributable to equity holders of the Group | 469,026 | 93,045 |
| Weighted average number of ordinary shares in issue | 65,229,000,000 | 65,229,000,000 |
| **Basic and diluted earnings per share (expressed in TL per 1,000 share)** | **0.007190** | **0.001426** |

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 2.3 New and Revised International Financial Reporting Standards

### *a) Standards, amendments and interpretations applicable as at 31 December 2019*

**IFRS 16 Leases**

The IASB has published a new standard, IFRS 16 'Leases'. The new standard brings most leases on-balance sheet for lessees under a single model, eliminating the distinction between operating and finance leases. Lessor accounting however remains largely unchanged and the distinction between operating and finance leases is retained. IFRS 16 supersedes IAS 17 'Leases' and related interpretations and is effective for periods beginning on or after January 1, 2019.

Lessees have recognition exemptions to applying this standard in case of short-term leases (i.e., leases with a lease term of 12 months or less) and leases of ’low-value’ assets (e.g., personal computers, office equipment, etc.). At the commencement date of a lease, a lessee measures the lease liability at the present value of the lease payments that are not paid at that date (i.e., the lease liability), at the same date recognises an asset representing the right to use the underlying asset (i.e., the right-of-use asset) and depreciates it during the lease term. The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee’s incremental borrowing rate. Lessees are required to recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset separately.

Lessees are required to remeasure the lease liability upon the occurrence of certain events (e.g. a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). Under these circumstances, the lessee recognises the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

***Implementation of IFRS 16***

IFRS 16 Leasing 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 financial leases (on balance sheet). For lessors, the accounting stays almost the same. The Group has started to apply “IFRS 16 Leases” Standard starting from January 1, 2019.

Set out below are the new accounting policies of the Group upon adoption of IFRS 16:

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Right of Use Assets

The Group recognizes right-of-use assets at the commencement date of the lease (i.e., the date the underlying asset is available for use). Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any remeasurement of lease liabilities. The cost of right-of-use assets includes the amount of lease liabilities recognized, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received.

The right to use includes the presence of:

- The initial measurement of the lease;
- The amount obtained by deducting all lease payments received from all lease payments made on or on the date of actual lease, and
- All initial direct costs incurred by the Group.

At the end of the lease term of the underlying asset's service, the transfer of the Group is reasonably finalized, and the Group depreciates the asset until the end of the life of the underlying asset on which the lease actually began. Right-of-use assets are subject to impairment.

### Lease Liabilities

The Group measures the lease obligation at the present value of the unpaid lease payments on the date that the lease commences.

Lease payments included in the measurement of the lease obligation on the date that the lease actually commences, consists of the following payments to be made for the right of use of the underlying asset during the lease period and not paid on the date the lease actually starts:

- Fixed payments,
- Variable lease payments based on an index or rate, the first measurement made using an index or rate on the actual date of the lease.
- Amounts expected to be paid by the Group under the residual value commitments
- The use price of this option and, if the Group is reasonably confident that it will use the purchase option;
- Fines for termination of the lease if the lease term indicates that the Group will use an option to terminate the lease.

Variable lease payments that do not depend on an index or rate are recognized as an expense in the period in which the event or condition that triggered the payment occurred. The Group revises the revised discount rate for the remainder of the lease term, if the implicit interest rate in the lease can be easily determined; the Group’s alternative borrowing interest rate at the date of the revaluation.

After the effective date of the lease, the Group measures the lease obligation as follows:
- Increase the carrying amount to reflect the interest on the lease obligation; and
- Decreases the carrying amount to reflect the lease payments made.

In addition, in the event of a change in the lease term, in essence a change in fixed lease payments or a change in the assessment of the option to buy the underlying asset, the value of the lease obligations is remeasured.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Short-term leases and leases of low-value assets

The Group applies the short-term lease recognition exemption to its short-term leases of machinery and equipment (i.e., those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). It also applies the lease of low-value assets recognition exemption to leases of office equipment that are considered of low value. Lease payments on short-term leases and leases of low-value assets are recognized as expense on a straight-line basis over the lease term.

The Group has started to apply IFRS 16, the right of assets classified under tangible assets as of December 31, 2019 amounted to TL 154,874, lease liability amounted to TL 124,393, financing expense amounted to TL 18.991 and depreciation expense amounted to TL 31,143.

The following table shows the movement of lease liability as of 31 December 2019.

| | **31 December 2019** |
|---|---|
| **Opening Balance – 1 January 2019** | **134,053** |
| Additions | 9,319 |
| Payments | (39,466) |
| Interest expense | 18,991 |
| FX gain/losses | 1,496 |
| **Total** | **124,393** |

### Amendments to IAS 28 "Investments in Associates and Joint Ventures" (Amendments)

In October 2017, the IASB issued amendments to IAS 28 *Investments in Associates and Joint Ventures*. The amendments clarify that a company applies IFRS 9 *Financial Instruments* to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture.

IFRS 9 Financial Instruments excludes interests in associates and joint ventures accounted for in accordance with IAS 28 Investments in Associates and Joint Ventures. In this amendment, IASB clarified that the exclusion in IFRS 9 applies only to interests a company accounts for using the equity method. A company applies IFRS 9 to other interests in associates and joint ventures, including long-term interests to which the equity method is not applied and that, in substance, form part of the net investment in those associates and joint ventures. The amendments did not have a impact on the financial position or performance of the Group.

### IFRIC 23 Uncertainty over Income Tax Treatments

The interpretation clarifies how to apply the recognition and measurement requirements in "IAS 12 Income Taxes" when there is uncertainty over income tax treatments.

When there is uncertainty over income tax treatments, the interpretation addresses:
- whether an entity considers uncertain tax treatments separately;
- the assumptions an entity makes about the examination of tax treatments by taxation authorities;
- how an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; and
- how an entity considers changes in facts and circumstances.

The amendments did not have impact on the financial position or performance of the Group.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Annual Improvements – 2015–2017 Cycle

In December 2017, the IASB issued Annual Improvements to IFRS Standards 2015–2017 Cycle, amending the following standards:

- IFRS 3 Business Combinations and IFRS 11 Joint Arrangements — The amendments to IFRS 3 clarify that when an entity obtains control of a business that is a joint operation, it remeasures previously held interests in that business. The amendments to IFRS 11 clarify that when an entity obtains joint control of a business that is a joint operation, the entity does not remeasure previously held interests in that business.
- IAS 12 *Income Taxes* — The amendments clarify that all income tax consequences of dividends (i.e. distribution of profits) should be recognised in profit or loss, regardless of how the tax arises.
- IAS 23 *Borrowing Costs* — The amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalisation rate on general borrowings.

The amendments are not applicable for the Group and will not have an impact on the financial position or performance of the Group.

### Plan Amendment, Curtailment or Settlement” (Amendments to IAS 19)

On 7 February 2018, the IASB published Amendments to IAS 19 “Plan Amendment, Curtailment or Settlement” The amendments require entities to use updated actuarial assumptions to determine current service cost and net interest for the remainder of the annual reporting period after a plan amendment, curtailment or settlement occurs. These amendments are applied for annual periods beginning on or after 1 January 2019. The amendments did not have impact on the financial position or performance of the Group.

### Prepayment Features with Negative Compensation (Amendments to IFRS 9)

The IASB issued minor amendments to IFRS 9 Financial Instruments to enable companies to measure some prepayable financial assets at amortised cost.

Applying IFRS 9, a company would measure a financial asset with so-called negative compensation at fair value through profit or loss. Applying the amendments, if a specific condition is met, entities will be able to measure at amortised cost some prepayable financial assets with so-called negative compensation. The amendments did not have a significant impact on the financial position or performance of the Group.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

***a) Standards, amendments and interpretations that are issued but not effective as at 31 December 2019:***

Standards, interpretations and amendments to existing standards that are issued but not yet effective up to the date of issuance of the consolidated financial statements are as follows. The Group will make the necessary changes if not indicated otherwise, which will be affecting the consolidated financial statements and disclosures, when the new standards and interpretations become effective.

**IFRS 17: The new Standard for insurance contracts**

The IASB issued IFRS 17, a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. IFRS 17 model combines a current balance sheet measurement of insurance contract liabilities with the recognition of profit over the period that services are provided. Certain changes in the estimates of future cash flows and the risk adjustment are also recognised over the period that services are provided. Entities will have an option to present the effect of changes in discount rates either in profit and loss or in OCI. The standard includes specific guidance on measurement and presentation for insurance contracts with participation features. IFRS 17 will become effective for annual reporting periods beginning on or after 1 January 2023; early application is permitted. The Group is in the process of assessing the impact of the standard on financial position or performance of the Group.

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

In December 2015, the IASB postponed the effective date of this amendment indefinitely pending the outcome of its research project on the equity method of accounting. Early application of the amendments is still permitted.

The Group will wait until the final amendment to assess the impacts of the changes.

**Definition of a Business (Amendments to IFRS 3)**

In October 2018, the IASB issued amendments to the definition of a business in IFRS 3 Business Combinations. The amendments are intended to assist entities to determine whether a transaction should be accounted for as a business combination or as an asset acquisition.

The amendments:

- clarify the minimum requirements for a business;
- remove the assessment of whether market participants are capable of replacing any missing elements;
- add guidance to help entities assess whether an acquired process is substantive;
- narrow the definitions of a business and of outputs; and
- introduce an optional fair value concentration test.

The amendments to IFRS 3 are effective for annual reporting periods beginning on or after 1 January 2020 and apply prospectively. Earlier application is permitted.

Overall, the amendments are not applicable for the Group and will not have an impact on the financial position or performance of the Group.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Definition of Material (Amendments to IAS 1 and IAS 8)

In October 2018, the IASB issued amendments to IAS 1 Presentation of Financial Statements and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors to align the definition of ‘material’ across the standards and to clarify certain aspects of the definition. The new definition states that, ’Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity. The amendments clarify that materiality will depend on the nature or magnitude of information, or both. An entity will need to assess whether the information, either individually or in combination with other information, is material in the context of the financial statements.

The amendments to IAS 1 and IAS 8 are required to be applied for annual periods beginning on or after 1 January 2020. The amendments must be applied prospectively and earlier application is permitted.

Overall, the amendments are not applicable for the Group and will not have an impact on the financial position or performance of the Group.

### Amendments to IFRS 9, IAS 39 and IFRS 7- Interest Rate Benchmark Reform

The amendments issued to IFRS 9 and IAS 39 which are effective for periods beginning on or after 1 January 2020 provide certain reliefs for 4 fundamental matters in connection with interest rate benchmark reform. These reliefs are related to hedge accounting as follows:

- Highly probable requirement
- Prospective Assessments
- Retrospective Assessments
- Separately identifiable risk components

Reliefs used as a result of amendments in IFRS 9 and IAS 39 is aimed to be disclosed in financial statements based on the amendments made in IFRS 7. The Group expects no significant impact on its balance sheet and equity.

### Amendments to IAS 1- Classification of Liabilities as Current and Non-Current Liabilities

23 January 2020, the IASB issued amendments to IAS 1 Presentation of Financial Statements. The amendments issued to IAS 1 which are effective for periods beginning on or after 1 January 2022, clarify the criteria for the classification of a liability as either current or non-current. Amendments must be applied retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Early application is permitted. The Group expects no significant impact on its balance sheet and equity.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 2.4 Statement of Cash Flows

The cash and cash equivalents balance comprises cash and balances with central banks (excluding restricted reserve deposits), deposits with banks and other financial institutions and other money market placements with an original maturity of three months or less.

Changes in cash and cash equivalents related to operating activities reflect cash flows generated by the Group's operations.

Changes in cash and cash equivalents related to investing activities reflect cash flows resulting from acquisitions and disposals of subsidiaries, as well as acquisitions and disposals of premises and equipment.

Changes in cash and cash equivalents related to financing activities reflect the cash inflows and outflows resulting from transactions with shareholders and cash flows related to subordinated debt.

## NOTE 3 - CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amount of assets and liabilities, income and expense.

Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates. Judgements, which have the most significant impact on the amounts recognised in the consolidated financial statements and estimates which can cause a significant adjustment to the carrying amount of assets and liabilities include:

*Impairment losses on loans and advances*: Assets measured at amortized cost are evaluated for impairment as per the explanations disclosed in section "2.9. IFRS 9 Financial Instruments".

*Fair value of derivatives:* Where valuation techniques are used to determine fair values, they are validated and periodically reviewed. Changes in assumptions about these factors could affect the reported fair values.

The Group, as a general principle does not carry any significant foreign currency position, by hedging its foreign currency positions with derivative products.

## NOTE 4 - FINANCIAL RISK MANAGEMENT

This section provides details of the Group exposure to risk and describes the methods used by management to control risk. The Bank and its affiliates' have exposure to the following risks from its use of financial instruments:

a) credit risk
b) liquidity risk
c) market risks
d) operational risks

The nature of the risks and the approach to managing risk differs fundamentally between the trading and non-trading portfolios; section 4.2 contains risk management information related to the trading portfolio.

**Risk management framework**

The Bank risk management framework was established according to the Turkish Banking Law and Regulation on Internal Systems of Banks and Internal Capital Adequacy Assessment Process. An independent Risk Management Unit ("RMU") reports to the Audit Committee and functioning according to the risk policies and strategies set by the Board.

The Bank gives utmost attention to the risks associated with products and employs contemporary risk management systems and techniques. An integrated risk management and control functions have been established during the course of growth in operations in Turkey.

Market risk objective is to manage and control market risk exposures while maintaining a market profile consistent with our risk appetite. Therefore a range of tools are used to monitor and limit market risk exposures including sensitivity analysis, VaR and stress testing. HSBC Bank A.Ş. strategy is to reduce exposure to these risks and minimise volatility in capital resources, cash flows and distributable reserves."

Well-established loan administration and monitoring facilities are employed in daily business. The Bank applies Customer Risk Rating ("CRR") system for corporate customers and scorecard for retail customers in order to measure credit risk and provision is allocated through IFRS 9 models.

Regular scenario analysis and stress tests are carried out in order to estimate the possible deterioration in capital adequacy and to determine the liquidity level under adverse market conditions. Contingency plans and policies are kept updated accordingly.

The Bank established Operational Risk monitoring and reporting procedures and integrated into all the functions in the Bank. Close monitoring of operational loss events and Key Risk Indicators is undertaken by the RMU and first line of defence and reported to top management as well as the Audit Committee. A Basel compliant operational risk database has been constructed and is updated continuously.

## NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)

Robust and dynamic limiting mechanisms based on the best industry practices and independent limit following units have been put in place for the optimal risk management.

The RMU coordinates the enterprise wide risk management activities in the Bank and implements the Basel framework for better risk management. Bank Risk Committee and Asset & Liability Committees have been formed in order to bring together the risk and business teams. These Committees meet regularly and takes necessary actions. These Committees and the Audit Committee have also sustained the coordination between the RMU, Internal Control Unit and Internal Audit.

The Audit Committee consists of two non-executive directors, including the Chair, which complies with local regulations. The Committee has a further non-executive director in attendance as an observer and the Board member responsible for internal systems. The Audit Committee, which was established to assist the Board of Directors in its auditing and supervising activities, is responsible for:

a) The supervision of the efficiency and effectiveness of the internal control, risk management and internal audit systems of the Bank, functioning of these systems as well as accounting and reporting systems within the framework of related procedures, and the integrity of information generated;
b) The preliminary assessment on the selection process of independent audit firms and the systematic monitoring of the activities of these companies;
c) The maintenance and coordination of the internal audit functions of corporations subject to consolidated internal audits.

### 4.1 Derivative financial instruments

The Group enters into a variety of derivative financial instruments for hedging and risk management purposes. This note describes the derivatives used. Details of the nature and terms of derivative instruments outstanding at the balance sheet dates are set out in Note 9. Derivative financial instruments used include swaps, futures, forwards, options and other similar types of contracts whose value changes in response to changes in interest rates, foreign exchange rates and gold prices. Except futures, derivatives are individually negotiated over-the-counter contracts. A description of the main types of derivative instruments used is set out below:

*Swaps*

Swaps are over-the-counter agreements to exchange future cash flows based upon agreed notional amounts. Most commonly used swaps are currency swaps. The Group is subject to credit risk arising from the respective counterparties' failure to perform. Market risk arises from the possibility of unfavourable movements in market rates relative to the contractual rates of the contract.

*Futures and forwards*

Futures and forward contracts are commitments to either purchase or sell a designated financial instrument, currency, commodity or an index at a specified future date for a specified price and may be settled in cash or another financial asset. Futures are standardized exchange-traded contracts whereas forwards are individually traded over-the-counter contracts. Initial margin requirements for futures are met in cash or other instruments, and changes in the future contract values are settled daily. Therefore credit risk is limited to the net positive change in the market value for a single day. Futures contracts have limited credit risk because the counterparties are futures exchanges. Forward contracts result in credit exposure to the counterparty. Futures and forward contracts both result in exposure to market risk based on changes in market prices relative to contracted amounts.

**NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)**

*Options*

Options are derivative financial instruments that give the buyer, in exchange for a premium payment, the right, but not the obligation, to either purchase from (call option) or sell (put option) to the writer a specified underlying at a specified price on or before a specified date. The Group enters into foreign exchange and interest rate options. Foreign currency options provide protection against rising or falling currency rates. The Group as a buyer of over-the-counter options is subject to market risk and credit risk since the counterparty is obliged to make payments under the terms of the contract if the Group exercises the option. As the writer of over-the-counter options, the Group is subject to market risk and liquidity risk only since it is obliged to make payments if the option is exercised. Options are mainly traded for clients' needs.

## 4.2 Trading activities

The Group maintains active trading positions in non-derivative financial instruments. Most of the trading activities are customer driven. In anticipation of customer demand, an inventory of capital market instruments is carried and access to market liquidity is maintained by quoting bid and offer prices to and trading with other market makers.

Positions are also taken in the interest rate, foreign exchange, debt and equity markets based on expectations of future market conditions. These activities constitute the proprietary trading business and enable the Group to provide customers with capital market products at competitive prices. As trading strategies depend on both market-making and proprietary positions, given the relationships between instruments and markets, those are managed in concert to maximize net trading income. Trading activities are managed by type of risk involved and on the basis of the categories of trading instruments held.

*Counterparty credit risk*

The Group's counterparty credit exposure at balance sheet date from financial instruments held or issued for trading purposes is represented by the fair value of instruments with a positive fair value at that date, as recorded on the balance sheet. Notional amounts disclosed in the notes to the consolidated financial statements do not represent the amounts to be exchanged by the parties to derivatives and do not measure the exposure to credit or market risks. The amounts to be exchanged are based on the terms of the derivatives.

*Market risk*

Market risk is defined as the risk of the decrease in value of the trading portfolio due to shifts in interest rate, currency, stock market, and commodity and option prices. To measure possible losses internally, in addition to taking into consideration the calculations made by the standard method in statutory reportings, the Parent Bank uses Value-at-Risk (VaR), Value at Risk under Stress (VaRS) and Additional Risk Capital Requirement (ARCR) models. The difference between the risk pointed by the internal models and the standard method is taken into account in the calculation of economic capital.

**NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)**

The Parent Bank monitors market risk through daily currency option limits, maximum loss limits, portfolio size limits and sensitivity to interest (Present Value Basis Points - PVBP in the breakdown of portfolio, maturity and currency), in addition to VaR limits that are separately applied on the basis of portfolio and risk factor (interest, currency risk). Risk monitoring and control activities are carried out by independent units.

VaR is calculated by the historical simulation method by calibrating over the daily profit/loss data of the last two years, and scenarios are updated every two weeks. VaR is calculated on the basis of one-way confidence interval of 99% and a daily holding period, in summary, indicates the observed worst 5th loss number eventually re-calculated according to portfolio's last 500 daily market changes regarding the subjected day. Backtesting is also performed daily to test the accuracy of the estimates VaR method consists.

The value subject to risk under stress, is calculated weekly for 1 year stress period within 99% trust interval on the basis of a holding period of 10 days. In this context, the portfolio's stress RMD within 250 days stress period regarding the subjected day, indicates the worst 2nd and 3rd loss numbers average observed as a result of re-calculated according to daily market changes. For the general of HSBC Group the stress period is calibrated once every 3 months taking the worst market conditions into consideration and in addition taking different risk profiles into consideration; countrywide stress period evaluations and impact analysis are being done and reported from 1 January 2007 to date.

Additional Risk Capital Requirement represents the loss that can occur due to the possibility of a decrease in the credit worthiness of issuers of securities in the trading portfolio. In addition to VaR and PVBP restrictions, Stress Tests are also being used to measure the potential effects of possible but extreme situations in various financial factors or market movements on the value of the portfolio. Stress Test results are assessed by the Senior Management in order to determine the effects of such incidents on the financials and to take necessary precautions to narrow down possible losses.

Market risk limits are evaluated by related senior management including the Risk Management Unit Manager, Market and Counterparty Risk Unit Manager, and Chief Executive of the Bank. Limits are reviewed at least once a year by the Risk Management Committee and presented to the Audit Committee and Board of Directors for approval. Risk Management Committee can set a sublimit and can change the limits, with the main limits set by the Board of Directors remaining fixed.

Market risk limits and actualizations are tracked daily by management and business lines, are presented weekly to the Board of Directors, monthly to ALCO, Risk Management Committee and Audit Committee.

The limit usages are being monitored through various checkpoints that are the rate of change in the price of main components of market risk (currency risk and interest rate risk), volatility, Price Value Basis Point ("PVBP") and market liquidity risk. Stress scenarios, liquidity, gap, and volatility analysis have been performed consistently. The purposes of these analyses are to be prepared for the possible risks and to make quick decisions regarding the targeted profitability.

**NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)**

Market opportunities have been observed invariably for risk-reducing positions, procedures which provide protection against the risk and insurance transactions if appropriate. Currency and Total Liquidity Ratio, VaR and PVBP limits and excesses in limits, the internal capital requirement and stress test results have been reported to the top executive and Market Risk Committee as monthly.

**A. Liquidity risk**

The objective of liquidity and funding management is to ensure that liquidity resources are adequate, both as to the amount and quality, to ensure that there is no significant risk that liabilities cannot be met as they fall due, to ensure that a prudent structural funding profile is maintained and illiquid assets (loans) are always funded by core funding sources where core funding sources consist of core deposits and long-term non-deposit debt instruments.

Provided that clauses of Local Regulation on the Measurement and Assessment of Liquidity Adequacy of Banks and Liquidity Coverage Ratio are reserved, Bank also manages the liquidity and funding risk in accordance with the Group Liquidity and Funding internal risk management framework where liquidity risk and funding risk tolerance and risk appetites are approved by Local ALCO.

Within the internal risk framework, Bank has several key components while managing the liquidity and funding risk, as given below:

- Liquidity Adequacy
- Funding Profile monitoring
- Depositor Concentration monitoring
- Term Funding Maturity Concentration monitoring
- Liquidity Funds Transfer Pricing
- Liquidity Triggers and tactical actions plans
- Contingency Funding Plan
- Balance sheet projections and Strategic Funding Plan through detailed assessment of forward looking funding requirements.

Bank utilises Liquidity Coverage Ratio (both under local and international regulations) and Net Stable Funding Ratio as the main measures of Liquidity Adequacy and Funding Profile, respectively. Additionally, bank monitors and reports deposit concentration and term funding maturity concentration to ALCO at least monthly.

Bank assesses forward looking funding requirements based on the balance sheet projections and the main tool that Bank utilises is the Strategic Funding Plan approved by ALCO in order to ensure that liquidity resources are adequate, both as to the amount and quality, to ensure that there is no significant risk that liabilities cannot be met as they fall due, and to ensure that a prudent structural funding profile is maintained.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)

Bank also considers several Liquidity Triggers and Contingency Funding Plan which approved by ALCO and Board besides ordinary work flow in liquidity and funding management. Liquidity Triggers and Contingency Funding Plan sets out practical actions to manage through stress scenarios and remediation actions, once the stress has stabilised, to revert the entity back to a position within its risk appetite. Any incident that triggers any early warning indicator pre-established within the Liquidity Triggers and Contingency Plan are immediately communicated to ALCO and necessary actions are taken to remediate.

Table below represents lowest, highest and average consolidated liquidity coverage rates by taking their simple averages for the last three-month period of 2019.

| | **Current Period - 31.12.2019** | |
|---|---|---|
| | **TL+FC** | **FC** |
| **Highest (%)** | 424.37 | 514.37 |
| **Date** | 09.12.2019 | 18.12.2019 |
| **Lowest (%)** | 182.07 | 170.32 |
| **Date** | 29.11.2019 | 05.11.2019 |
| **Average (%)** | 234.53 | 401.69 |

Table below represents lowest, highest and average consolidated liquidity coverage rates by taking their simple averages for the last three-month period of 2018.

| | **Prior Period - 31.12.2018** | |
|---|---|---|
| | **TL+FC** | **FC** |
| **Highest (%)** | 529.57 | 537.49 |
| **Date** | 28.12.2018 | 28.12.2018 |
| **Lowest (%)** | 253.22 | 227.95 |
| **Date** | 04.10.2018 | 04.10.2018 |
| **Average (%)** | 309.37 | 324.74 |

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)

The following table presents the cash flows payable by the Group under non-derivative financial liabilities remaining contractual maturities at the balance sheet date. The amounts disclosed in the table are the contractual undiscounted cash flows, whereas the Group manages the inherent liquidity risk based on expected undiscounted cash inflows. All deposits in remaining maturities table of the contractual liabilities are in callable status.

| 31 December 2019 | Demand and up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| Deposits from banks | 237,106 | - | - | - | - | 237,106 |
| Deposits from customers | 23,876,263 | 3,257,860 | 407,533 | 5,844 | - | 27,547,500 |
| Other borrowed funds | 30,720 | - | - | - | 1,726,258 | 1,756,978 |
| **Total liabilities** | **24,144,089** | **3,257,860** | **407,533** | **5,844** | **1,726,258** | **29,541,584** |

| 31 December 2018 | Demand and up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| Deposits from banks | 1,880,815 | - | - | - | - | 1,880,815 |
| Deposits from customers | 19,161,202 | 3,226,383 | 727,607 | 9,957 | - | 23,125,149 |
| Other borrowed funds | 37,960 | 622,355 | 729,027 | - | 2,140,057 | 3,529,399 |
| **Total liabilities** | **21,079,977** | **3,848,738** | **1,456,634** | **9,957** | **2,140,057** | **28,535,363** |

The following table represents the notional amounts of the outstanding derivative cash flows of the Group on contractual maturity basis:

### Derivatives settled on a gross basis

| 31 December 2019 | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| **Derivatives held for trading:** | | | | | | |
| **Foreign exchange derivatives:** | | | | | | |
| - Inflow | 14,557,304 | 9,334,351 | 10,354,856 | 9,045,856 | 4,984,001 | 48,276,368 |
| - Outflow | 14,468,289 | 9,326,525 | 10,346,908 | 9,032,450 | 4,984,001 | 48,158,173 |
| **Interest rate derivatives:** | | | | | | |
| - Inflow | - | - | 3,363 | 68,732 | 16,825 | 88,920 |
| - Outflow | - | - | 1,033 | 30,316 | 11,921 | 43,270 |
| **Total inflow** | **14,557,304** | **9,334,351** | **10,358,219** | **9,114,588** | **5,000,826** | **48,365,288** |
| **Total outflow** | **14,468,289** | **9,326,525** | **10,347,941** | **9,062,766** | **4,995,922** | **48,201,443** |

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)

| 31 December 2018 | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| **Derivatives held for trading:** | | | | | | |
| **Foreign exchange derivatives:** | | | | | | |
| - Inflow | 12,959,134 | 3,348,171 | 8,147,025 | 3,799,751 | - | 28,254,081 |
| - Outflow | 12,905,870 | 3,348,586 | 8,080,192 | 3,813,181 | - | 28,147,829 |
| **Interest rate derivatives:** | | | | | | |
| - Inflow | - | 201 | 3,181 | 46,814 | 29,313 | 79,509 |
| - Outflow | - | 181 | 3,292 | 55,827 | 19,858 | 79,158 |
| **Total inflow** | **12,959,134** | **3,348,372** | **8,150,206** | **3,846,565** | **29,313** | **28,333,590** |
| **Total outflow** | **12,905,870** | **3,348,767** | **8,083,484** | **3,869,008** | **19,858** | **28,226,987** |

### B. Hedging

The gains and losses on ineffective portions of such derivatives are recognised immediately in 'Net trading income'. For the year ended 31 December 2019, there are TL 563 gains on ineffective portions recognised due to hedge ineffectiveness (2018: TL 3,354 gain).

At 31 December 2019, the Group has no hedging instruments.

### C. Market risk

As a commercial Group, the focus is serving the financial needs of the customers, thereby generating exposure to interest rate and foreign exchange risk.

### I. Interest rate risk

The Group's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets (including investments) and interest-bearing liabilities mature or reprice at different times or in differing amounts. In the case of floating rate assets and liabilities, the Group is also exposed to basis risk, which is the difference in repricing characteristics of the various floating rate indices, such as the deposit rate and monthly libor and different types of interest. Treasury activities are aimed at optimizing net interest income, given market interest rate levels consistent with the Group's business strategies.

Asset-liability risk management activities are conducted in the context of the Bank's sensitivity to interest rate changes. In general, as common in current economic environment, the consolidated financial statements are liability sensitive because its interest-earning assets have a longer duration and reprice slightly less frequently than interest-bearing liabilities. This means that in rising interest rate environments, margins earned will narrow as liabilities reprice. However, the actual effect will depend on a number of factors, including the extent to which repayments are made earlier or later than the contracted dates and variations in interest rate sensitivity within repricing periods and among currencies. Interest rate derivatives are primarily used to bridge the mismatch in the repricing of assets and liabilities. This is done in accordance with the guidelines established by the Bank's asset-liability management committee ("ALCO").

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)

Part of the Bank's return on financial instruments is obtained from controlled mismatching of the dates on which interest receivable on assets and interest payable on liabilities are next reset to market rates or, if earlier, the dates on which the instruments mature.

The table below summarises weighted average interest rates for financial instruments by major currencies outstanding at 31 December 2019 and 2018 based on yearly contractual rates.

| | 31 December 2019 | | | 31 December 2018 | | |
|---|---|---|---|---|---|---|
| | **USD (%)** | **EUR (%)** | **TL (%)** | **USD (%)** | **EUR (%)** | **TL (%)** |
| **Assets** | | | | | | |
| Cash and balances with the Central Bank | - | - | - | 2.00 | - | 13.00 |
| Loans and advances to banks | 1.55 | - | 11.40 | 4.07 | 0.97 | 22.90 |
| Financial assets at fair value through profit or loss | 5.82 | 3.29 | 9.27 | 6.10 | 6.84 | 11.91 |
| Financial assets measured at fair value through OCI | - | - | 13.83 | - | - | 11.01 |
| Loans and advances to customers | 6.33 | 4.23 | 17.47 | 5.65 | 4.3 | 21.72 |
| **Liabilities** | | | | | | |
| Deposits from banks | - | - | 5.27 | 2.5 | - | 19.60 |
| Deposits from customers | 1.52 | 0.40 | 9.64 | 3.65 | 2.04 | 22.18 |
| Other borrowed funds | 7.51 | - | - | 6.72 | - | 21.29 |

The balance sheet management is performed by the Assets and Liabilities Management Department in line with the main strategies determined by ALCO.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)

The table below summarises the Group's exposure to interest rate risk at 31 December 2019 and 2018. Included in the table are the Group's financial assets and liabilities in carrying amounts classified in terms of periods remaining to contractual repricing dates.

| 31 December 2019 | Up to 3 months | 3 months to 1 year | 1 year to 5 years | Over 5 years | Non-interest bearing | Total |
|---|---|---|---|---|---|---|
| Cash balances and restricted deposits with Central Bank | - | - | - | - | 3,111,287 | 3,111,287 |
| Loans and advances to banks | 10,994,343 | - | - | - | 11,347 | 11,005,690 |
| Financial assets at fair value through profit or loss | | | | | | |
| - Trading securities | 3,937 | 67,746 | 343,032 | 50,824 | - | 465,539 |
| - Trading derivative | 773,928 | 234,980 | 237,453 | 350,741 | - | 1,597,102 |
| - Equity Instruments | - | - | - | - | 32,788 | 32,788 |
| Loans and advances to customers | 7,744,753 | 2,982,240 | 4,738,816 | 609,071 | 220,484 | 16,295,364 |
| Financial assets measured at fair value through OCI | - | 498,825 | 482,253 | 249,620 | - | 1,230,698 |
| Other assets | 1,052 | 51 | 244,797 | - | 974,283 | 1,220,183 |
| **Total assets** | **19,518,013** | **3,783,842** | **6,046,351** | **1,260,256** | **4,350,189** | **34,958,651** |
| Deposits from banks | 107,446 | - | - | - | 127,864 | 235,310 |
| Deposits from customers | 21,656,543 | 394,864 | 5,358 | - | 5,446,050 | 27,502,815 |
| Other borrowed funds | 1,337,281 | - | - | - | 30,720 | 1,368,001 |
| Trading derivative liabilities | 607,653 | 242,093 | 239,944 | 350,742 | - | 1,440,432 |
| Other liabilities(*) | - | 130,334 | 418,471 | 202,185 | 3,661,103 | 4,412,093 |
| **Total liabilities** | **23,708,923** | **767,291** | **663,773** | **552,927** | **9,265,737** | **34,958,651** |
| **Net interest repricing gap** | **(4,190,910)** | **3,016,551** | **5,382,578** | **707,329** | **(4,915,548)** | **-** |
| Off balance sheet derivative instruments net notional position | 87,998 | (19,106) | 11,982 | - | - | 80,874 |

(*) Shareholders equity is presented under "other liabilities" item in "non-interest bearing".

| 31 December 2018 | Up to 3 months | 3 months to 1 year | 1 year to 5 years | Over 5 years | Non-interest bearing | Total |
|---|---|---|---|---|---|---|
| Cash balances and restricted deposits with Central Bank | 3,534,216 | - | - | - | 2,531,239 | 6,065,455 |
| Loans and advances to banks | 8,430,080 | - | - | - | 40,370 | 8,470,450 |
| Financial assets at fair value through profit or loss | | | | | | |
| - Trading securities | 231 | 14,312 | 5,402 | 7,068 | - | 27,013 |
| - Trading derivative | 415,944 | 458,950 | 126,233 | - | - | 1,001,127 |
| - Equity Instruments | - | - | - | - | 20,223 | 20,223 |
| Loans and advances to customers | 7,437,545 | 2,329,546 | 4,185,190 | 632,308 | 236,413 | 14,821,002 |
| Financial assets measured at fair value through OCI | - | - | 456,176 | 54,953 | - | 511,129 |
| Other assets | 1,986 | 72 | 163,489 | - | 996,967 | 1,162,514 |
| **Total assets** | **19,820,002** | **2,802,880** | **4,936,490** | **694,329** | **3,825,212** | **32,078,913** |
| Deposits from banks | 1,744,608 | - | - | - | 131,900 | 1,876,508 |
| Deposits from customers | 18,900,023 | 659,061 | 8,126 | - | 3,410,230 | 22,977,440 |
| Other borrowed funds | 2,152,682 | 592,944 | - | - | 37,960 | 2,783,586 |
| Trading derivative liabilities | 354,316 | 434,491 | 152,287 | - | - | 941,094 |
| Other liabilities(*) | 181,226 | 186,774 | 296,042 | - | 2,836,243 | 3,500,285 |
| **Total liabilities** | **23,332,855** | **1,873,270** | **456,455** | **-** | **6,416,333** | **32,078,913** |
| **Net interest repricing gap** | **(3,512,853)** | **929,610** | **4,480,035** | **694,329** | **(2,591,121)** | **-** |
| Off balance sheet derivative instruments net notional position | 29,827 | 66,833 | (13,430) | - | - | 83,230 |

(*) Shareholders equity is presented under "other liabilities" item in "non-interest bearing".

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)

The interest rate risk is monitored with methods such as static duration gap and sensitivity analysis based on all interest rate sensitive assets and liabilities. The scenarios include 200 to 500 basis points parallel fall or rise in all yield curves. In the analysis presented below, the sensitivity of the statement of comprehensive income is the effect of possible changes in the interest rates on the net interest income of floating rate financial assets and liabilities at 31 December 2019. The sensitivity of the shareholders' equity at 31 December 2019 is calculated through revaluating the financial assets measured at fair value through OCI taking into account the possible changes in interest rates. The tax effects are not considered in the analysis. Analysis is based on the unconsolidated amounts. The other variables, especially exchanges rates, are assumed to be fixed in this analysis. The same method is applied for 31 December 2019.

| 2019 - Type of Currency | Shocks Applied ( +/- basis points) | Gains/Losses | Gains/Equity-Losses/Equity |
|---|---|---|---|
| 1.TL | 500 | (210,647) | (4.37)% |
| 2.TL | (400) | 198,439 | 4.11% |
| 3.EURO | 200 | (176,633) | (3.66)% |
| 4.EURO | (200) | (18,624) | (0.39)% |
| 3.USD | 200 | 14,444 | 0.30% |
| 6.USD | (200) | (17,779) | (0.37)% |
| **Total (of negative shocks)** | | **162,036** | **3.36%** |
| **Total (of positive shocks)** | | **(372,836)** | **(7.73)%** |

| 2018 - Type of Currency | Shocks Applied ( +/- basis points) | Gains/Losses | Gains/Equity-Losses/Equity |
|---|---|---|---|
| 1.TL | 500 | (140,828) | (3.15)% |
| 2.TL | (400) | 134,464 | 3.01% |
| 3.EURO | 200 | (118,102) | (2.64)% |
| 4.EURO | (200) | 13,876 | 0.31% |
| 3.USD | 200 | 228,618 | 5.12% |
| 6.USD | (200) | (265,950) | (5.96)% |
| **Total (of negative shocks)** | | **(117,610)** | **(2.63)%** |
| **Total (of positive shocks)** | | **(30,312)** | **(0.65)%** |

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)

### II. Currency risk

Foreign exchange exposure is the result of the mismatch of foreign currency denominated assets and liabilities (including foreign currency indexed ones) together with exposures resulting from off-balance sheet foreign exchange derivative instruments. The Group evaluates the exposure for the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

| 31 December 2019 | USD | EUR | Other | Total |
|---|---|---|---|---|
| Cash and cash equivalents | 134,989 | 87,263 | 94,821 | 317,073 |
| Restricted balances with Central Bank | 900,422 | 847,064 | 488,560 | 2,236,046 |
| Loans and advances to banks | 6,673,459 | 4,929 | 4,988 | 6,683,376 |
| Financial assets at fair value through profit or loss | | | | |
| - *Trading securities* | 53,434 | 8,752 | - | 62,186 |
| - *Trading derivative* | 733,202 | 351,750 | 25,662 | 1,110,614 |
| - *Equity Instruments* | - | 27,221 | - | 27,221 |
| Loans and advances to customers | 3,448,592 | 4,881,872 | 140 | 8,330,604 |
| Hedging derivatives | - | - | - | - |
| Financial assets measured at fair value through OCI | - | - | - | - |
| Other assets | 161,360 | 329,808 | 58 | 491,226 |
| **Total assets** | **12,105,458** | **6,538,659** | **614,229** | **19,258,346** |
| Deposits from banks (*) | 16 | 6 | - | 22 |
| Deposits from customers | 10,292,867 | 6,674,171 | 3,611,455 | 20,578,493 |
| Other borrowed funds | 1,368,001 | - | - | 1,368,001 |
| Derivative financial instruments | 626,708 | 342,511 | 6,601 | 975,820 |
| Other liabilities | 166,652 | 17,006 | 2,265 | 185,923 |
| **Total liabilities** | **12,454,244** | **7,033,694** | **3,620,321** | **23,108,259** |
| **Net balance sheet position** | **(348,786)** | **(495,035)** | **(3,006,092)** | **(3,849,913)** |
| Off balance sheet derivative instruments net notional position (*) | 976,514 | 501,101 | 3,042,133 | 4,519,748 |
| **Net foreign currency position** | **627,728** | **6,066** | **36,041** | **669,835** |

(*) "Transactions Related to Foreign Currency Deposits in Turkish Lira Deposits" are recorded in the off-balance sheet as a derivative transaction.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)

| 31 December 2018 | USD | EUR | Other | Total |
|---|---|---|---|---|
| Cash and cash equivalents | 1,128,564 | 1,206,199 | 74,607 | 2,409,370 |
| Restricted balances with Central Bank | 437,555 | 511,744 | 365,888 | 1,315,187 |
| Loans and advances to banks | 8,053,533 | 23,415 | 9,737 | 8,086,685 |
| Financial assets at fair value through profit or loss | | | | |
| - *Trading securities* | 9,408 | 874 | - | 10,282 |
| - *Trading derivative* | 486,377 | 483,030 | 1,537 | 970,944 |
| - *Equity Instruments* | - | 14,656 | - | 14,656 |
| Loans and advances to customers | 2,572,133 | 3,398,010 | 15,293 | 5,985,436 |
| Other assets | 261,005 | 252,738 | 65 | 513,808 |
| **Total assets** | **12,948,575** | **5,890,666** | **467,127** | **19,306,368** |
| Deposits from banks | 1,698,556 | - | - | 1,698,556 |
| Deposits from customers | 8,632,216 | 5,735,909 | 1,278,196 | 15,646,321 |
| Other borrowed funds | 1,553,049 | 30,496 | - | 1,583,545 |
| Derivative financial instruments | 554,243 | 325,026 | 35,904 | 915,173 |
| Other liabilities | 199,057 | 3,634 | 78 | 202,769 |
| **Total liabilities** | **12,637,121** | **6,095,065** | **1,314,178** | **20,046,364** |
| **Net balance sheet position** | **311,454** | **(204,399)** | **(847,051)** | **(739,996)** |
| Off balance sheet derivative instruments net notional position | (229,759) | 316,303 | 828,988 | 915,532 |
| **Net foreign currency position** | **81,695** | **111,904** | **(18,063)** | **175,536** |

Foreign currency translation rates used by the Group as of respective year-ends are as follows:

| | EUR / TL | USD / TL |
|---|---|---|
| 31 December 2017 | 4.5332 | 3.7816 |
| 31 December 2018 | 6.0566 | 5.2885 |
| 31 December 2019 | 6.6779 | 5.9497 |

For the purpose of calculating currency risks, foreign currency indexed loans and securities have been reported in this table in the relevant currency of indexation.

The possible increases or decreases in the shareholders' equity and the income (for both, excluding tax effect) as per an assumption of devaluation of TL by 10% against currencies mentioned below at 31 December 2019 and 2018 are presented in the below table. The analysis below covers all foreign currency denominated assets and liabilities. The other variables, especially the interest rates are assumed to be fixed in this analysis.

| | Change in currency rate in % (*) | Increase /(Decrease) Effect on profit or loss | | Increase /(Decrease) Effect on equity excluding PL | |
|---|---|---|---|---|---|
| | | 31 December 2019 | 31 December 2018 | 31 December 2019 | 31 December 2018 |
| USD | 10 increase | 62,773 | 8,170 | 62,773 | 8,170 |
| USD | 10 decrease | (62,773) | (8,170) | (62,773) | (8,170) |
| EUR | 10 increase | 607 | 11,190 | 607 | 11,190 |
| EUR | 10 decrease | (607) | (11,190) | (607) | (11,190) |

(*) The effect on shareholders' equity also includes the effect of devaluation by 10% of TL against other currencies on the income before tax.

## NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)

### D. Credit risk

The Group is subject to credit risk through its trading, lending, hedging and investing activities and in cases where they act as intermediaries on behalf of customers or other third parties or issues guarantees.

Credit risk associated with trading and investing activities is managed through the Group's market risk management process.

The Group's primary exposures to credit risk arise through its loans and advances. The amount of credit exposure in this regard is represented by the carrying amounts (as per Local practice, carrying amount exclude interest) of these assets on the balance sheet. Internal risk ratings of corporate/commercial/medium size companies are assessed judgementally by relevant approval authorities. A statistical based internal risk rating model is developed and implemented in 2019 and this internal risk rating model is composed of an independent and objective assessment and is reviewed at least annually or during loan applications. Risk rating has become a requirement for loan applications, and ratings are used both to determine credit authorization limits and in credit assessment process.

The Group is exposed to credit risk on various other financial assets, including derivative instruments used for hedging and debt investments. The current credit exposure in respect of these instruments is equal to the carrying amount of these assets in the balance sheet. In addition, the Group is exposed to off balance sheet credit risk through guarantees issued.

In credit risk, there are no specific limitations for a specific geographical region. However, if there will be a risk which is affecting a specific region then the necessary limitation will be applied and the necessary action will be taken in order to revaluation of the risk. Together with this, there are limitations for country risk. Risk monitoring and sectoral based customer group limitations are also conducted. The limitations which are determined for a specific risk group are determined in accordance with Banking Regulation and other relevant regulations. Loan usages are monitored instantly by the system. The credits depending on a risk group are also evaluated in the consolidated financial tables.

As per Group procedures, in all banking transactions approval and control mechanisms and systematically limit and risk control mechanisms are available. In assigning loan limits, extending credit, derivative and other future delivery derivative transactions are conducted depending to management's authorization, approval and control processes. Customer's and bank's treasury department staff based monitoring is conducted on determining daily risk limits and risk allocations with risk concentrations regarding the balance sheet and off-balance transactions conducted. Product based risk parameters are considered when allocating limits for the derivative products.

The Group is not exposed to significant credit risk as an active participant in the international banking market when evaluated with the financial activities of the other financial institutions.

Loan value of receivables from loans and other receivables are regularly traced in accordance with the relevant legislation, if necessary, actions such as limit increasing and decreasing, and strengthening the guarantee structure can be taken. The obtained financial tables regarding the credit requests should be audited in accordance with the relevant legislation. Bank's management has generated a customer degree (rating) system in order to determine loan value and the rate of risks of the corporate and personal loan customers which are subject to corporate.

Concentrations of credit risk (whether on or off balance sheet) that arise from financial instruments exist for groups of counterparties when they have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)

Bank Rating System:

The Bank's rating tool concentration by risk classes as of 31 December 2019 and 2018 is as follows:

| | | Concentration level (%) | |
|---|---|---|---|
| | **Rating class** | **2019** | **2018** |
| Above average | 1-4 | 51.50 | 53.14 |
| Average | 5-6 | 31.44 | 31.08 |
| Below average | 7-10 | 17.06 | 15.79 |

The Bank's internal credit grades is as follows:

| Internal rating grade | Internal rating description | PD range |
|---|---|---|
| 1 | Minimal Default Risk | 0-0.05 |
| 2 | Low Default Risk | 0.05-0.17 |
| 3 | Satisfactory Default Risk | 0.18-0.74 |
| 4 | Fair Default Risk | 0.75-1.92 |
| 5 | Moderate Default Risk | 1.93-4.91 |
| 6 | Significant Default Risk | 4.92-8.86 |
| 7 | High Default Risk | 8.87-15.00 |
| 8 | Special Management | 16.00-99.99 |
| 9-10 | Default Risk | 100.00 |

The credit risk classification of each asset class is the following:

| 31 December 2019 | Corporate | Retail | Total |
|---|---|---|---|
| Stage 1 loans to customers | 9,514,192 | 2,499,549 | 12,013,741 |
| Stage 2 loans to customers | 4,500,874 | 478,996 | 4,979,870 |
| Stage 3 loans to customers | 348,999 | 358,480 | 707,479 |
| **Total gross** | **14,364,065** | **3,337,025** | **17,701,090** |
| Less: Stage 1 loans to customers | (38,595) | (85,871) | (124,466) |
| Less: Stage 2 loans to customers | (735,689) | (58,576) | (794,265) |
| Less: Stage 3 loans to customers | (182,102) | (304,893) | (486,995) |
| **Total expected credit loss** | **(956,386)** | **(449,340)** | **(1,405,726)** |
| **Total net** | **13,407,679** | **2,887,685** | **16,295,364** |

| 31 December 2018 | Corporate | Retail | Total |
|---|---|---|---|
| Stage 1 loans to customers | 8,227,315 | 2,938,298 | 11,165,613 |
| Stage 2 loans to customers | 3,592,847 | 747,796 | 4,340,643 |
| Stage 3 loans to customers | 294,468 | 588,623 | 883,091 |
| **Total gross** | **12,114,630** | **4,274,717** | **16,389,347** |
| Less: Stage 1 loans to customers | (49,219) | (113,844) | (163,063) |
| Less: Stage 2 loans to customers | (646,407) | (113,377) | (759,784) |
| Less: Stage 3 loans to customers | (158,501) | (486,997) | (645,498) |
| **Total expected credit loss** | **(854,127)** | **(714,218)** | **(1,568,345)** |
| **Total net** | **11,260,503** | **3,560,499** | **14,821,002** |

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)

Below table shows the due dates of the past due but not impaired loans,

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Loans contractually past due below 30 days | 4,888,378 | 4,209,777 |
| Loans contractually past due above 30 days and below 60 days | 47,746 | 88,598 |
| Loans contractually past due above 60 days and below 90 days | 43,746 | 42,268 |
| **Total** | **4,979,870** | **4,340,643** |

Loans and Advances Rescheduled:

Restructuring activities include extended and/or rescheduled payment arrangements, arrangement of terms of loan such as modification and deferral of payments, interest rate, foreign exchange (“FX”) type, collateral structure, additional loan etc., there can also be alternatives of granting additional loan or sale of collaterals, sale of debts.

Restructuring may be applied for watch-listed loans or loans in nonperforming loan accounts. If restructuring is applied for a watch-listed loans, that loans will stay in performing loan accounts but its terms (FX rate, payment dates, interest rate etc.) may be changed.

As of 31 December 2019, the total amount of restructured loans is TL 2,217,046 (2018: TL 2,659,679) of which TL 41,376 (2018: TL 6,800) is impaired.

| 31 December 2019 | Past due but not impaired | Neither past due nor impaired | Impaired |
|---|---|---|---|
| Corporate | 2,166,271 | - | 33,073 |
| Retail | 50,775 | - | 8,303 |
| **Total** | **2,217,046** | **-** | **41,376** |

| 31 December 2018 | Past due but not impaired | Neither past due nor impaired | Impaired |
|---|---|---|---|
| Corporate | 1,187,299 | 1,407,958 | 1,818 |
| Retail | 63,263 | 1,159 | 4,982 |
| **Total** | **1,250,562** | **1,409,117** | **6,800** |

Industry sectors:

The Group uses BRSA definitions for the economic sectors in order to be able to make comparisons with the banking sector wide figures. The Board of Directors sets the sectoral limits on lending, and these limits can only be altered by a decision from the Board of Directors. According to credit policy, each individual sector should not exceed the targeted level of 15% on the overall corporate portfolio. The sector concentration is accordingly monitored and reported on a regular basis. Particular attention is given to some sectors which are considered as “low performers” in terms of high non-performing loan (“NPL”) levels. Macroeconomic conditions, NPL levels, expectations about sectors and Group policies are taken into consideration in setting and altering the limits. Sectoral classification is defined in terms of the borrower’s activity area, not based on collaterals.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)

| | 31 December 2019 | | 31 December 2018 | |
|---|---|---|---|---|
| | **Cash** | **Non-cash** | **Cash** | **Non-cash** |
| **Agricultural** | | | | |
| Farming and raising livestock | 2,870 | 6,191 | 2,453 | - |
| Forestry | - | - | - | - |
| Fishing | 32,862 | - | 48,474 | - |
| **Manufacturing** | | | | |
| Mining | 23,745 | 387 | 31,171 | 16 |
| Production | 6,131,705 | 1,856,083 | 5,821,490 | 1,553,610 |
| Electric, gas and water | 980,323 | 33,013 | 522,175 | 48,264 |
| Construction | 1,797,420 | 918,601 | 1,409,205 | 526,545 |
| **Services** | | | | |
| Wholesale and retail trade | 1,008,168 | 802,829 | 1,515,771 | 531,843 |
| Hotel, food and beverage services | 233,729 | 31,134 | 265,773 | 54,011 |
| Transportation and telecommunication | 992,851 | 133,470 | 923,970 | 38,920 |
| Financial Institutions | 939,180 | 761,129 | 501,021 | 721,759 |
| Real estate, renting services | 1,986,831 | 194,908 | 1,111,575 | 161,878 |
| Self-employment services | 213,861 | 10,264 | 96,801 | 5,703 |
| Education services | - | 90 | - | 90 |
| Health and social services | 110,976 | 14,923 | 101,482 | 13,271 |
| Other | 1,840,843 | 2,404 | 2,469,641 | 2,252 |
| **Total** | **16,295,364** | **4,765,426** | **14,821,002** | **3,658,162** |

Rating of debt securities:

| | 31 December 2019 | | 31 December 2018 | |
|---|---|---|---|---|
| **Moody's credit rating model** | **Trading securities** | **Investment securities** | **Trading securities** | **Investment securities** |
| Financial assets: | | | | |
| Aaa | - | - | - | - |
| A1, A2, A3 | - | - | - | - |
| Baa1, Baa2, Baa3 | - | - | - | - |
| Ba1 | - | - | - | - |
| Ba2 (*) | - | - | - | - |
| Ba3 | - | - | 27,013 | 511,129 |
| B1 | 465,539 | 1,230,698 | - | - |
| **Total** | **465,539** | **1,230,698** | **27,013** | **511,129** |

(*) Turkey Government's rating has been downgraded to B1 as of 14 June 2019.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)

Gross maximum exposure:

The below table shows the worst case scenario of credit risk exposure in the absence of any collateral;

| | **2019** | **2018** |
|---|---|---|
| Cash and cash equivalents | 470,917 | 4,086,244 |
| Restricted deposits with central bank | 2,236,361 | 1,329,432 |
| Loans and advances to banks | 11,005,690 | 8,470,450 |
| Financial assets at fair value through profit or loss | | |
| - Trading securities | 465,539 | 27,013 |
| - Trading derivatives | 1,597,102 | 1,001,127 |
| - Equity Instruments | 32,788 | 20,223 |
| Loans and advances to customers | 16,295,364 | 14,821,002 |
| Financial assets measured at fair value through OCI | 1,230,698 | 511,129 |
| Other assets | 502,700 | 505,213 |
| **Total assets** | **33,837,159** | **30,771,833** |
| Credit related commitments | 4,765,426 | 3,658,162 |
| Non-cancellable commitments | 3,805,695 | 3,828,455 |
| **Total commitments** | **8,571,121** | **7,486,617** |
| **Total credit risk exposure** | **42,408,280** | **38,258,450** |

As of 31 December 2019, the total amount of net credit risk is calculated as TL 19,574,306 (2018: TL 18.348.241)

Allowances for impairment:

The Group establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The Group takes a prudent approach its criteria for assessing whether objective evidence of impairment exists, to interpretation of the term ‘objective evidence’ and to quantifying impairment allowance requirements. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a portfolio-basis loan loss allowance established for groups of homogeneous assets in respect of losses that have been incurred but have not been identified on loans subject to individual assessment for impairment.

Write-off policy:

The Group writes off a receivable balance (and uses related allowances for impairment losses) when it is determined that the receivable is uncollectible based on the evidence of insolvency issued by the Court. As per local limitation, there is no contractual write-off on a regular basis. Accounts also can be written off through NPL sales which are performed on average annual basis.

Collateral policy:

The Group’s policy is to require suitable collateral to be provided by certain customers prior to the disbursement of approved loans. The Group currently holds collateral against loans and advances to customers in the form of mortgage interests over property, other registered securities over assets and guarantees. Collateral generally is not held over loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity. Collateral usually is not held against investment securities, and no such collateral was held at 31 December 2019 and 2018.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)

Guarantees and letters of credit are also subject to strict credit assessments before being provided. The agreements specify monetary limits to the Group's obligations. The extent of collateral held for performing non cash loans are 0.71%.

The breakdown of performing cash and non-cash loans and advances to customers by type of collateral is as follows:

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| **Cash loans** | | |
| *Secured loans:* | | |
| Secured by cash collateral | 214,279 | 185,926 |
| Secured by mortgages | 438,287 | 427,290 |
| Secured by other collaterals | 376,921 | 632,244 |
| *Unsecured loans* | 15,964,124 | 14,260,796 |
| **Total performing loans** | **16,993,611** | **15,506,256** |
| **Non cash loans** | | |
| *Secured loans:* | | |
| Secured by cash collateral | 7,302 | 15,158 |
| *Unsecured loans* | 4,758,124 | 3,643,004 |
| **Total non-cash loans** | **4,765,426** | **3,658,162** |

Estimates of the fair value of collateral held against non-performing loans are as follows:

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Mortgage | 252,610 | 209,580 |
| Car pledges | 2,331 | 227 |
| **Total** | **254,941** | **209,807** |

### E. Operational risk

Operational risk expresses the probability of loss that may arise from the overlook of faults and inconsistency with the established rules due to the deficiencies in the Group's internal controls, manner of the management and the personnel that are not in coherence with time and conditions, deficiencies in the bank management, faults and problems in information technology systems and disasters such as earthquake, fire, flood or terror attacks.

The operational risk items in the Bank are determined in accordance with the definition of operational risk by considering the whole processes, products and departments. The control areas are set for operational risks within the Bank and assigning the risks to these control areas follows operational risks. In this context, appropriate monitoring methodology is developed for each control area that covers operational risks and control frequencies are determined. In addition, the Bank monitors and stores operational risk data, based on business segments.

(Amounts expressed in thousands of TL unless otherwise indicated.)

**NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)**

For the regulatory purposes and consideration in statutory capital adequacy ratio, on a consolidated base the Group calculates the amount subject to operational risk with the basic indicator method in accordance with the Section 4 of the " Regulation Regarding Measurement and Evaluation of Banks' Capital Adequacy Ratio" published in the Official Gazette No. 29511 dated 23 October 2015, namely "The Calculation of the Amount Subject to Operational Risk", based on the gross income of the Group for the years ended 2018, 2017 and 2016. The annual gross income is defined as net interest income plus net non-interest income reduced by realised gains/losses from the sale of securities Financial assets measured at fair value through OCI sale and held-to-maturity, non-recurring gains and income derived from insurance claims. As of 31 December 2019, the total amount subject to operational risk is calculated as TL 2,700,068 (2018: TL 2,819,385) and the amount of the related capital requirement is TL 216,005 (2018: TL 225,551).

## F. Capital management

Banks in Turkey are required to comply with capital adequacy guidelines promulgated by the BRSA, which are based upon the standards established by the Bank of International Settlements ("BIS"). These guidelines require banks to maintain adequate levels of regulatory capital against risk-bearing assets and off-balance sheet exposures.

A bank's capital adequacy ratio is calculated by taking the aggregate of its CET1 capital (which comprises paid-in capital, reserves, retained earnings and profit for the current periods minus period loss (if any)) ,its Tier I capital (which comprises certain qualified subordinated loans in accordance with BIS guidelines) and its Tier II capital (which comprises general loan and free reserves, revaluation funds and subordinated loans obtained) minus deductions (which comprises deferred tax assets, intangibles, etc.), and dividing this aggregate by risk weighted assets, which reflect both credit risk and market risk. In accordance with these guidelines, banks must maintain a total capital adequacy ratio of a minimum of 12% including 4% prudential buffer.

The Bank and its individually regulated operations have complied with externally imposed capital requirements throughout the current and prior period. The Group's regulatory capital position on a consolidated basis is as follows:

| | **31 December 2019** | **31 December 2018** |
|---|---|---|
| Tier I capital | 3,343,429 | 2,791,685 |
| Tier II capital | 1,493,981 | 1,679,960 |
| Deductions | (12,945) | (9,603) |
| **Total regulatory capital** | **4,824,465** | **4,462,042** |
| Amount subject to credit risk | 19,574,306 | 18,348,241 |
| Amount subject to market risk | 1,142,225 | 1,003,877 |
| Amount subject to operational risk | 2,700,068 | 2,819,385 |
| **Capital adequacy ratio (%)** | **20.60%** | **20.13%** |

## G. Fair value of financial instruments

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and it is best evidenced by a quoted market price, if one exists.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)

The estimated fair values of financial instruments have been determined by the Group using the available market information and appropriate valuation methodologies. However, judgement is required to interpret market data in developing the estimated fair value. Accordingly, the estimates presented herein are not necessarily the amounts the Group would realise in a current market exchange.

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not presented at their fair value in the Group's balance sheet.

| | 31 December 2019 | | 31 December 2018 | |
|---|---|---|---|---|
| | **Carrying value** | **Fair value** | **Carrying value** | **Fair value** |
| **Financial assets:** | | | | |
| Loans and advances to banks | 11,005,702 | 11,005,690 | 8,470,450 | 8,470,450 |
| Loans and advances to customers | 16,295,364 | 16,568,731 | 14,821,002 | 14,803,322 |
| **Financial liabilities:** | | | | |
| Deposits from banks | 235,310 | 235,310 | 1,876,508 | 1,876,508 |
| Deposits from customers | 27,502,815 | 27,555,253 | 22,977,440 | 23,126,166 |
| Other borrowed funds | 1,368,001 | 1,380,315 | 2,783,586 | 2,780,497 |
| Miscellaneous Payables | 449.882 | 449.882 | 299,065 | 299,065 |

The following methods and assumptions were used to estimate the fair value of the Group's financial instruments:

### Loans and advances to banks

The fair value of overnight deposits is considered to approximate its carrying amounts. The estimated fair value of interest bearing placements is based on discounted cash flows using prevailing money market interest rates at the balance sheet date with similar credit risk and remaining maturity.

### Loans and advances to customers

Loans and advances to customers are net of allowances for impairment. The estimated fair value of loans and advances to customers represent the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates with similar credit risk, currency and remaining maturity to determine their fair value.

### Deposits from customers, deposits from banks and other borrowed funds

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand.

The estimated fair value of other borrowings without quoted market price is based on discounted cash flows using money market interest rates prevailing at the balance sheet date with similar credit risk, currency and remaining maturity.

The estimated fair value of deposits from customers is considered to approximate its carrying amounts as the average maturity is relatively lower.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)

### Fair value hierarchy

IFRS 7 requires disclosure of classification of the financial instruments carried at fair value in financial statements according to the defined levels. These levels depend on the observability of the data used during fair value calculations. Classification for fair value is generated as follows:

Level 1: The fair value of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets determined with reference to quoted market prices.

Level 2: The fair value of other financial assets and financial liabilities are determined in accordance with generally accepted pricing models which are based on discounted cash flow analysis using prices from observable current market transactions.

Level 3: The fair value of the financial assets and financial liabilities where there is no observable market data.

There were no transfers between Levels 1, Level 2 and Level 3 during the period.

There were no changes in calculation techniques during the period.

According to the stated classification principles, the Group's classification of financial assets and liabilities carried at their fair value are as follows:

### Assets and liabilities measured at fair value

| **31 December 2019** | **Level 1** | **Level 2** | **Level 3** | **Total** |
|---|---|---|---|---|
| Financial assets at fair value through profit and loss | | | | |
| - Debt securities | 465,539 | - | - | 465,539 |
| - Trading derivatives | - | 1,597,102 | - | 1,597,102 |
| - Equity Instruments(*) | - | 27,221 | - | 27,221 |
| Financial assets measured at fair value through OCI | | | | |
| - Debt securities | 1,230,698 | - | - | 1,230,698 |
| **Total assets** | **1,696,237** | **1,624,323** | **-** | **3,320,560** |
| Trading derivatives | - | 1,440,432 | - | 1,440,432 |
| **Total liabilities** | **-** | **1,440,432** | **-** | **1,440,432** |

(*) Unquoted share certificates amounting to TL 5.567 measured at cost in accordance with IFRS 9, are not included.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 4 - FINANCIAL RISK MANAGEMENT (Continued)

| 31 December 2018 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Financial assets at fair value through profit and loss | | | | |
| - Debt securities | 27,013 | - | - | 27,013 |
| - Trading derivatives | - | 1,001,127 | - | 1,001,127 |
| - Equity Instruments(*) | - | 14,656 | - | 14,656 |
| Hedging derivatives | | | | |
| Available-for-sale financial assets | | | | |
| - Debt securities | 511,129 | - | - | 511,129 |
| **Total assets** | **538,142** | **1,015,783** | **-** | **1,553,925** |
| Trading Derivatives | - | 941,094 | - | 941,094 |
| **Total liabilities** | **-** | **941,094** | **-** | **941,094** |

(*) Unquoted share certificates amounting to TL 5.567 measured at cost in accordance with IFRS 9, are not included.

### Assets and liabilities not measured at fair value

| 31 December 2019 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets:** | | | | |
| Loans and advanced to bank | - | 11,005,690 | - | 11,005,690 |
| Loans and advances to customers | - | 16,295,364 | - | 16,295,364 |
| **Financial liabilities:** | | | | |
| Deposits from banks | - | 235,310 | - | 235,310 |
| Deposits from customers | - | 27,502,815 | - | 27,502,815 |
| Other borrowed funds | - | 1,368,001 | - | 1,368,001 |

| 31 December 2018 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets:** | | | | |
| Loans and advanced to bank | - | 8,470,450 | - | 8,470,450 |
| Loans and advances to customers | - | 14,821,002 | - | 14,821,002 |
| **Financial liabilities:** | | | | |
| Deposits from banks | - | 1,876,508 | - | 1,876,508 |
| Deposits from customers | - | 22,977,440 | - | 22,977,440 |
| Other borrowed funds | - | 2,783,586 | - | 2,783,586 |

### F. Fiduciary activities

The Group provides custody services to third parties. Those assets that are held in a fiduciary capacity are not included in these consolidated financial statements. Fiduciary capacity of the Group is as follows:

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Investment securities held in custody(*) | 387,264,110 | 93,812,591 |
| Other securities held in custody | 4,564,017 | 4,497,407 |
| Commercial notes received for collection | 169,680 | 217,401 |
| Cheques received for collection | 99,272 | 99,473 |
| Portfolio and investment funds held in custody | 161,637 | - |
| **Total** | **392,258,716** | **98,626,872** |

(*) Mainly consist of notional amount of government and private sector bonds and money market transaction.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 5 - CASH AND CASH EQUIVALENTS

For cash flow statement purposes; cash includes cash on hand, cash in transit, purchased bank cheques, and demand deposits including balances with the Central Bank; cash equivalents include interbank money market placements, reserve deposit unblocked accounts, time deposits at banks with original maturity of less than three months.

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Cash on hand | 404,009 | 649,779 |
| Demand deposits with central banks | 470,917 | 4,086,244 |
| Loans and advances to banks (with original maturity less than three months)(*) | 11,005,690 | 8,452,622 |
| **Cash and cash equivalents in the statement of cash flows** | **11,880,616** | **13,188,645** |

(*) Blocked account are not included.

Accruals from advances to banks amounting to TL 3,876 (2018: TL 17,828) have not been included in cash and cash equivalents.

## NOTE 6 - CASH AND BALANCES WITH THE CENTRAL BANK

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| **Cash and cash equivalents** | | |
| FC | 86,936 | 565,458 |
| TL | 317,073 | 84,321 |
| | **404,009** | **649,779** |
| **Demand deposits at the Central Banks** | | |
| FC | - | 1,843,912 |
| TL | 470,917 | 2,242,332 |
| | **470,917** | **4,086,244** |
| **Reserve deposits at the Central Banks** | | |
| FC | 315 | 1,315,187 |
| TL | 2,236,046 | 14,245 |
| | **2,236,361** | **1,329,432** |
| **Total** | **3,111,287** | **6,065,455** |

The banks operating in Turkey are subject to the Central Bank of the Republic of Turkey's Communiqué numbered 2013/15 and are required to keep a deposit at the CBRT for their Turkish Lira, USD and/or Euro and standard gold.

As of 31 December 2019, the reserve deposit rates vary according to their maturity structure; the reserve deposit rates are realized between 1% and 7% (31 December 2018: 1.50% - 8%) for TL deposits and other liabilities, and between 5% and 21% for FC deposits (31 December 2018: 4% - 20%).

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 7 - LOANS AND ADVANCES TO BANKS

| | 31 December 2019 | | | 31 December 2018 | | |
|---|---|---|---|---|---|---|
| | **TL** | **FC** | **Total** | **TL** | **FC** | **Total** |
| **Loans and advances- demand:** | | | | | | |
| Domestic banks | 372 | - | 372 | - | - | - |
| Foreign banks | - | 10.974 | 10,974 | - | 4,970 | 4,970 |
| | **372** | **10.974** | **11,346** | **-** | **4,970** | **4,970** |
| **Loans and advances-time:** | | | | | | |
| Domestic banks | 14 | - | 14 | 30,422 | 2,656 | 33,078 |
| Foreign banks | 4 | - | 4 | - | 16,915 | 16,915 |
| Interbank money market | 4,321,936 | 6,672,402 | 10,994,338 | 369,999 | 8,045,488 | 8,415,487 |
| | **4,321,954** | **6,672,402** | **10,994,356** | **400,421** | **8,065,059** | **8,465,480** |
| **Total gross loans and advances to banks** | **4,322,326** | **6,683,376** | **11,005,702** | **400,421** | **8,070,029** | **8,470,450** |
| Impairment allowance | (5) | (7) | (12) | - | - | - |
| **Total loans and advances to banks** | **4,322,321** | **6,683,369** | **11,005,690** | **400,421** | **8,070,029** | **8,470,450** |

## NOTE 8 - FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

| | **31 December 2019** | **31 December 2018** |
|---|---|---|
| Derivative financial instruments | 1,597,102 | 1,001,127 |
| Government bonds and treasury bills | 465,539 | 27,013 |
| Equity Instruments | 32,788 | 20,223 |
| **Total financial assets at fair value through profit or loss** | **2,095,429** | **1,048,363** |

The Group has financial assets at fair value through profit or loss as collateral/blocked amounting to TL 3,821 (2018: TL 3,708) as of 31 December 2019. The group have no trading securities subject to repurchase as of 31 December 2019 (2018: None). Government bonds and treasury bills are discount and coupon securities issued by the Government of the Republic of Turkey.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 9 - DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments, and therefore, do not indicate the Group's exposure to credit or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in foreign exchange rates and interest rates based on their terms.

| **31 December 2019** | | **Fair values** | |
|---|---|---|---|
| | **Contract/notional amount** | **Assets** | **Liabilities** |
| ***Derivatives held for trading*** | | | |
| Foreign exchange derivatives: | | | |
| Currency forwards | 14,669,073 | 121,590 | 188,735 |
| Currency swaps | 38,951,559 | 243,376 | 106,617 |
| OTC currency options | 26,087,831 | 616,619 | 617,487 |
| **Total foreign exchange derivatives** | **79,708,463** | **981,585** | **912,839** |
| Interest rate derivatives: | | | |
| Interest rate swaps | 22,680,016 | 89,114 | 43,407 |
| Cross-currency interest rate swaps | 16,726,078 | 526,403 | 484,186 |
| **Total interest rate derivatives** | **39,406,094** | **615,517** | **527,593** |
| **Total derivative assets/ (liabilities) held for trading** | **119,114,557** | **1,597,102** | **1,440,432** |
| **Total recognised derivative assets/ (liabilities)** | **119,114,557** | **1,597,102** | **1,440,432** |

| **31 December 2018** | | **Fair values** | |
|---|---|---|---|
| | **Contract/notional amount** | **Assets** | **Liabilities** |
| ***Derivatives held for trading*** | | | |
| Foreign exchange derivatives: | | | |
| Currency forwards | 11,032,975 | 490,631 | 161,703 |
| Currency swaps | 30,088,486 | 128,525 | 406,032 |
| OTC currency options | 9,817,390 | 245,793 | 246,214 |
| **Total foreign exchange derivatives** | **50,938,851** | **864,949** | **813,949** |
| Interest rate derivatives: | | | |
| Interest rate swaps | 25,273,234 | 79,509 | 79,157 |
| Cross-currency interest rate swaps | 5,463,059 | 56,669 | 47,988 |
| **Total interest rate derivatives** | **30,736,293** | **136,178** | **127,145** |
| **Total derivative assets/ (liabilities) held for trading** | **81,675,144** | **1,001,127** | **941,094** |
| **Total recognised derivative assets/ (liabilities)** | **81,675,144** | **1,001,127** | **941,094** |

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 10 - LOANS AND ADVANCES TO CUSTOMERS

At 31 December 2019 and 2018, distribution of the loan portfolio of the Bank by nature is as follows:

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| **Consumer loans** | | |
| -Mortgage loans | 380,363 | 543,533 |
| -Consumer loans | 578,178 | 737,544 |
| -Automotive loans | 3,481 | 6,126 |
| -Overdraft accounts | 156,791 | 196,848 |
| **Credit cards** | | |
| -Retail | 1,855,007 | 2,198,532 |
| -Corporate | 4,725 | 3,943 |
| **Corporate and commercial loans** | | |
| - Discount and purchase notes | 406,922 | 271,753 |
| - Export loans | 886,282 | 826,932 |
| - Loans to financial institutions | 823,668 | 284,571 |
| - Commercial instalment loans | 40,494 | 132,818 |
| - Corporate loans | 11,731,144 | 10,111,374 |
| - Factoring receivables | 126,556 | 192,282 |
| **Total performing loans** | **16,993,611** | **15,506,256** |
| Total impaired loans | 707,479 | 883,091 |
| **Total gross loans** | **17,701,090** | **16,389,347** |
| Provision for impairment | (1,405,726) | (1,568,345) |
| **Loans and advances to customers** | **16,295,364** | **14,821,002** |

At 31 December 2019 and 2018 factoring receivables comprised the following:

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Factoring receivables in Turkish Lira | 126,556 | 192,282 |
| **Factoring receivables, net** | **126,556** | **192,282** |

Reconciliation of allowance account for losses on loans and advances is as follows:

| | 31 December 2019 | | | |
|---|---|---|---|---|
| | Corporate | Consumer | Credit Cards | Total |
| **At 1 January** | **854,127** | **235,322** | **478,896** | **1,568,345** |
| Provision for loan impairment | 134,698 | 43.039 | 159.736 | 337.473 |
| Amounts recovered during the year | (33,261) | (55,115) | (129,672) | (218,048) |
| Loans written off during the year as uncollectible (-) (*) | (2,614) | (91,988) | (187,442) | (282,044) |
| **At 31 December** | **952,950** | **131,258** | **321,518** | **1,405,726** |

(*) The Parent Bank has concluded the sale of non-performing loans amounting to TL 315,087 for TL 32.800.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 10 - LOANS AND ADVANCES TO CUSTOMERS (Continued)

| | 31 December 2018 | | | |
|---|---|---|---|---|
| | **Corporate** | **Consumer** | **Credit Cards** | **Total** |
| **At 1 January** | **330,217** | **165,858** | **350,116** | **846,191** |
| Impact of adopting IFRS 9 | 33,266 | 60,646 | 233,763 | 327,675 |
| Provision for loan impairment | 500,098 | 63,354 | (44,979) | 518,473 |
| Amounts recovered during the year | (9,141) | (52,889) | (58,718) | (120,748) |
| Loans written off during the year as uncollectible (-) | (313) | (1,647) | (1,286) | (3,246) |
| **At 31 December** | **854,127** | **235,322** | **478,896** | **1,568,345** |

The write-offs and recoveries by categories are as follows:

| | **31 December 2019** | **31 December 2018** |
|---|---|---|
| Write-offs | | |
| Credit cards | 187,442 | 1,735 |
| Mortgage and consumer loans | 91,988 | 1,511 |
| Corporate loans | 2,614 | - |
| **Total write-offs** | **282,044** | **3,246** |

The table below shows the change in the gross carrying amount and the corresponding ECL allowances.

| | 31 December 2019 | | | |
|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| Gross carrying amount as of January 1, 2019 | 11,165,613 | 4,340,643 | 883,091 | 16,389,347 |
| New assets originated or purchased | 8,511,208 | 1,588,240 | - | 10,099,448 |
| Asset derecognised or repaid (excluding write offs) | (7,329,303) | (1,023,449) | (115,652) | (8,468,404) |
| Transfer to Stage 1 | 42,977 | (42,977) | - | - |
| Transfer to Stage 2 | (376,754) | 376,754 | - | - |
| Transfer to Stage 3 | - | (259,341) | 259,341 | - |
| Change to contractual cash flow due to modifications not resulting in derecognition | - | - | - | - |
| Amount written off | - | - | (319,301) | (319,301) |
| **Total** | **12,013,741** | **4,979,870** | **707,479** | **17,701,090** |

| | 31 December 2019 | | | |
|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| ECL allowance as at January 1, 2019 | 163,063 | 759,784 | 645,498 | 1,568,345 |
| Transfer to Stage 1 | 379 | (379) | - | - |
| Transfer to Stage 2 | (16,895) | 16,895 | - | - |
| Transfer to Stage 3 | - | (77,127) | 77,127 | - |
| Impairment allowance for the period, net | (22,081) | 95,092 | 46,414 | 119,425 |
| Amount written off | - | - | (282,044) | (282,044) |
| **Total** | **124,466** | **794,265** | **486,995** | **1,405,726** |

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 10 - LOANS AND ADVANCES TO CUSTOMERS (Continued)

| | 31 December 2018 | | | |
|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| Gross carrying amount as of January 1, 2018 | 12,854,410 | 2,584,499 | 765,434 | 16,204,343 |
| New assets originated or purchased | 7,243,075 | 1,935,784 | - | 9,178,859 |
| Asset derecognised or repaid (excluding write offs) | (7,544,059) | (1,272,618) | (173,330) | (8,990,007) |
| Transfer to Stage 1 | 642,496 | (642,496) | - | - |
| Transfer to Stage 2 | (2,030,309) | 2,030,309 | - | - |
| Transfer to Stage 3 | - | (294,835) | 294,835 | - |
| Change to contractual cash flow due to modifications not resulting in derecognition | - | - | - | - |
| Amount written off | - | - | (3,848) | (3,848) |
| **Total** | **11,165,613** | **4,340,643** | **883,091** | **16,389,347** |

| | 31 December 2018 | | | |
|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| ECL allowance as at January 1, 2018 | 104,147 | 415,447 | 654,272 | 1,173,866 |
| Transfer to Stage 1 | 98,877 | (98,877) | - | - |
| Transfer to Stage 2 | (87,623) | 87,623 | - | - |
| Transfer to Stage 3 | - | (11,736) | 11,736 | - |
| Impairment allowance for the period, net | 47,662 | 367,327 | (17,264) | 397,725 |
| Amount written off | - | - | (3,246) | (3,246) |
| **Total** | **163,063** | **759,784** | **645,498** | **1,568,345** |

The table below shows the credit quality and maximum exposure to credit risk based on the internal credit rating system.

| | **31 December 2019** | **31 December 2018** |
|---|---|---|
| **Internal Rating Grade** | | |
| Strong | 2,537,137 | 2,239,482 |
| Good | 822,329 | 1,855,624 |
| Satisfactory | 10,221,799 | 8,030,699 |
| Sub-Standard | 3,412,346 | 3,380,451 |
| İmpaired | 707,479 | 883,091 |
| **Total** | **17,701,090** | **16,389,347** |

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 10 - LOANS AND ADVANCES TO CUSTOMERS (Continued)

| | | Stage 2 | | | | Stage 3 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **31 December 2019** | **Gross carrying amount** | **Temporary Modification to T&Cs** | **Permanent Modification to T&Cs** | **Refinancing** | **Total performing forborne loans** | **Temporary Modification to T&Cs** | **Permanent Modification to T&Cs** | **Refinancing** | **Total non-performing forborne loans** | **Total forborne loans** | **Forbearance ratio** |
| Corporate Loan | 14,364,065 | - | - | 2,166,271 | 2,166,271 | - | - | 16,493 | 16,493 | 2,182,764 | 15.20% |
| Consumer Loan | 1,243,431 | - | - | 3,318 | 3,318 | - | - | 3,627 | 3,627 | 6,945 | 0.56% |
| Credit Cards | 2,093,594 | - | - | 47,457 | 47,457 | - | - | 4,676 | 4,676 | 52,133 | 2.49% |
| **Total** | **17,701,090** | **-** | **-** | **2,217,046** | **2,217,046** | **-** | **-** | **24,796** | **24,796** | **2,241,842** | **12.66%** |

| | Gross amount of forborne loans | | | ECLs of forborne loans | | | | |
|---|---|---|---|---|---|---|---|---|
| **31 December 2019** | **Stage 2** | **Stage 3** | **Total** | **Stage 2 Individual** | **Stage 2 Collective** | **Stage 3 Individual** | **Stage 3 Collective** | **Total** |
| Corporate Loan | 2,166,271 | 16,493 | 2,182,764 | 641,076 | - | 5,893 | - | 646,969 |
| Consumer Loan | 3,318 | 3,627 | 6,945 | 1,122 | - | 1,311 | - | 2,433 |
| Credit Cards | 47,457 | 4,676 | 52,133 | 30,334 | - | 3,276 | - | 33,610 |
| **Total** | **2,217,046** | **24,796** | **2,241,842** | **672,532** | **-** | **10,480** | **-** | **683,012** |

| | | Stage 2 | | | | Stage 3 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **31 December 2018** | **Gross carrying amount** | **Temporary Modification to T&Cs** | **Permanent Modification to T&Cs** | **Refinancing** | **Total performing forborne loans** | **Temporary Modification to T&Cs** | **Permanent Modification to T&Cs** | **Refinancing** | **Total non-performing forborne loans** | **Total forborne loans** | **Forbearance ratio** |
| Corporate Loan | 12,114,630 | - | - | 1,187,299 | 1,187,299 | - | - | 6,497 | 6,497 | 1,193,796 | 9.85% |
| Consumer Loan | 1,693,084 | - | - | 9,501 | 9,501 | - | - | 297 | 297 | 9,798 | 0.58% |
| Credit Cards | 2,581,633 | - | - | 53,762 | 53,762 | - | - | 6 | 6 | 53,768 | 2.08% |
| **Total** | **16,389,347** | **-** | **-** | **1,250,562** | **1,250,562** | **-** | **-** | **6,800** | **6,800** | **1,257,362** | **7.67%** |

| | Gross amount of forborne loans | | | ECLs of forborne loans | | | | |
|---|---|---|---|---|---|---|---|---|
| **31 December 2018** | **Stage 2** | **Stage 3** | **Total** | **Stage 2 Individual** | **Stage 2 Collective** | **Stage 3 Individual** | **Stage 3 Collective** | **Total** |
| Corporate Loan | 1,187,299 | 6,497 | 1,193,796 | 401,388 | - | 2,428 | - | 403,816 |
| Consumer Loan | 9,501 | 297 | 9,798 | 1,615 | - | 294 | - | 1,909 |
| Credit Cards | 53,762 | 6 | 53,768 | 34,364 | - | 3 | - | 34,367 |
| **Total** | **1,250,562** | **6,800** | **1,257,362** | **437,367** | **-** | **2,725** | **-** | **440,092** |

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 11 - INVESTMENT SECURITIES

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Debt securities - at fair value: | | |
| Government bonds and treasury bills | 1,230,698 | 511,129 |
| **Total securities** | **1,230,698** | **511,129** |

Government bonds, treasury bills and Eurobonds are discount and coupon securities issued by the Government of the Republic of Turkey. At 31 December 2019, investments securities amounting to TL 264,634 (2018: TL 502,515) were pledged to third parties, namely Central Bank of the Republic of Turkey for legal requirements, ISE Settlement and Custody Bank Inc. and other financial institutions as a guarantee for stock exchange and money market operations. The Group has no investment securities subject to repurchase agreement as of 31 December 2019 (2018: None). As of 31 December 2019, the Group has financial assets available for sale in unrestricted account amounting to TL 966,064 (2018: TL 8,614).

Movements of securities measured at fair value through OCI are shown as follows:

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| At January 1 | 511,129 | 1,363,506 |
| Additions | 938,512 | 147,633 |
| Disposal (Sale and redemption) | (335,700) | (903,718) |
| Valuation differences | 116,757 | (76,069) |
| Reclassification due to IFRS 9 | - | (20,223) |
| **Total** | **1,230,698** | **511,129** |

## NOTE 12 - INTANGIBLE ASSETS

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Gross book value | 451,110 | 407,389 |
| Accumulated depreciation (-) | 282,671 | 256,435 |
| **Net book value** | **168,439** | **150,954** |

Movements of intangible assets were as follows:

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| **Opening balance** | **150,954** | **147,930** |
| Additions | 64,430 | 24,311 |
| Disposal (-) | 20,708 | - |
| Depreciation (-) | 26,237 | 21,287 |
| **Closing Net Book Value** | **168,439** | **150,954** |

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 13 - PROPERTY AND EQUIPMENT

| **Prior Period End:** | **Land and Buildings** | **Right of use assets** | **Vehicles** | **Other** | **Total** |
|---|---|---|---|---|---|
| Cost | 17,201 | - | 10,445 | 294,494 | 322,140 |
| Accumulated Depreciation and Impairment (-) | 10,339 | - | 188 | 209,736 | 220,263 |
| **Net Book Value** | **6,862** | **-** | **10,257** | **84,758** | **101,877** |

| **Current Period End** | **Land and Buildings** | **Right of use assets** | **Vehicles** | **Other** | **Total** |
|---|---|---|---|---|---|
| Net Book Value at the Beginning | 6,862 | - | 10,257 | 84,758 | 101,877 |
| Additions(*) | - | 154,875 | 16 | 30,494 | 185,385 |
| Disposals (-) (Cost) | - | - | - | 16,679 | 16,679 |
| Depreciation (-) (Amortization) | - | - | - | 16,031 | 16,031 |
| Depreciation (-) | 287 | 32,143 | 2,099 | 27,294 | 61,823 |
| Cost at Period End | 17,201 | 154,875 | 10,461 | 308,309 | 490,846 |
| Accumulated Depreciation at Period End (-) | 10,626 | 32,143 | 2,287 | 220,999 | 266,055 |
| **Closing Net Book Value** | **6,575** | 122,732 | **8,174** | **87,310** | **224,791** |

(*) Additions includes opening effects of IFRS 16 leasing standard.

## NOTE 14 – OTHER ASSETS

| | **31 December 2019** | **31 December 2018** |
|---|---|---|
| Collaterals given(*) | 476,448 | 492,341 |
| Miscellaneous receivables | 26,252 | 12,872 |
| Prepaid expenses | 26,960 | 39,932 |
| Income accruals | 27,264 | 28,654 |
| Other | 56,922 | 87,117 |
| **Total** | **613,846** | **660,916** |

(*) Includes collateral due to derivative and BIST transactions.

Assets held for resale represent mainly foreclosed assets received against uncollectible loans and advances to customers, to be sold as required by the Turkish Banking Law. Movements in assets held for resale at 31 December 2019 and 2018 were as follows:

| | **2019** | **2018** |
|---|---|---|
| **At 1 January** | **1,369** | **1,825** |
| Additions | 2,023 | 155 |
| Disposals | (1,297) | (611) |
| **At 31 December** | **2,095** | **1,369** |

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 15 - DEPOSITS FROM BANKS

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | **Demand** | **Term** | **Total** | **Demand** | **Term** | **Total** |
| **Foreign currency:** | | | | | | |
| Domestic banks | - | - | - | - | - | - |
| Foreign banks | 22 | - | 22 | 15 | - | 15 |
| | **22** | **-** | **22** | **15** | **-** | **15** |
| **TL:** | | | | | | |
| Domestic banks | - | - | - | - | - | - |
| Foreign banks | 127,842 | 107,446 | 235,288 | 132,870 | 1,743,623 | 1,876,493 |
| | **127,842** | **107,446** | **235,288** | **132,870** | **1,743,623** | **1,876,493** |
| **Total** | **127,864** | **107,446** | **235,310** | **132,885** | **1,743,623** | **1,876,508** |

## NOTE 16 - DEPOSITS FROM CUSTOMERS

| | 31 December 2019 | | | 31 December 2018 | | |
|---|---|---|---|---|---|---|
| | **Demand** | **Term** | **Total** | **Demand** | **Term** | **Total** |
| **Foreign currency deposits:** | | | | | | |
| Saving deposits | 2,155,670 | 12,037,260 | 14,192,930 | 1,418,569 | 9,776,711 | 11,195,280 |
| Commercial deposits | 1,351,090 | 3,651,293 | 5,002,383 | 944,328 | 3,157,511 | 4,101,839 |
| Gold deposits | 1,128,921 | 254,259 | 1,383,180 | 235,468 | 113,734 | 349,202 |
| | **4,635,681** | **15,942,812** | **20,578,493** | **2,598,365** | **13,047,956** | **15,646,321** |
| **TL deposits:** | | | | | | |
| Saving deposits | 335,609 | 3,398,102 | 3,733,711 | 287,253 | 4,989,109 | 5,276,362 |
| Commercial deposits | 469,502 | 2,717,991 | 3,187,493 | 517,655 | 1,534,686 | 2,052,341 |
| Public sector deposits | 3,118 | - | 3,118 | 2,416 | - | 2,416 |
| | **808,229** | **6,116,093** | **6,924,322** | **807,324** | **6,523,795** | **7,331,119** |
| **Total** | **5,443,910** | **22,058,905** | **27,502,815** | **3,405,689** | **19,571,751** | **22,977,440** |

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 17 - OTHER BORROWED FUNDS

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Subordinated debts | 1,337,281 | 1,545,585 |
| Other foreign institutions and banks | 30,720 | 1,238,001 |
| **Total** | **1,368,001** | **2,783,586** |

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Opening balance | 2,783,586 | 3,704,777 |
| Proceeds during the year | - | 596,445 |
| Repayments during the year | (1,481,051) | (1,891,720) |
| Other non-cash movements | 65,466 | 374,084 |
| **Total** | **1,368,001** | **2,783,586** |

## NOTE 18 - TAXATION

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Current tax expense | (106,266) | (10,811) |
| Deferred tax (expense)/income | (35,983) | (32,525) |
| **Tax (expense)/income** | **(142,249)** | **(43,336)** |
| Provision for current taxes payable on income | 34,039 | 10,506 |
| **Current income taxes payable** | **34,039** | **10,506** |

In accordance with the related regulation for prepaid taxes on income, such advance payments during the year are being deducted from the final tax liability for the year. Accordingly, the taxation charge on income is not equal to the final tax liability appearing on the balance sheet. Turkish tax legislation does not permit a parent company and its subsidiaries to file a consolidated tax return. Therefore, provisions for taxes, as reflected in these consolidated financial statements, have been calculated on a separate-entity basis.

Under the Corporate Tax Law numbered 5520, the applicable corporate tax rate is 20%, however, the corporate income tax rate will be applied as 22% for the years 2018, 2019, and 2020 regarding to the "Law on Amendment of Certain Tax Laws and Some Other Laws" numbered 7061 and published in the Official Gazette on 5 December 2017. Corporate tax is payable at a rate of 22% over the corporate tax base of the Bank after adjusting for certain disallowable expenses, exempt income, investment allowance and other additions and deductions. The annual corporate income tax return is required to be filed until 25th day of the fourth month following the close of the related fiscal year. Payments will be carried out in single instalment until the end of the month in which the tax return is to be filed.

Dividends paid to non-resident corporations, which have a fixed place of business or permanent representative in Turkey, or resident corporations are not subject to withholding tax. Otherwise, dividends paid are subject to withholding tax at the rate of 15%. An increase in capital via issuing bonus shares is not considered as a profit distribution and thus does not incur withholding tax.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 18 - TAXATION (Continued)

Corporations are required to pay advance corporation tax quarterly at the rate of 22% on their quarterly determined corporate income. Advance tax return is filed by the 14th of the second month following each quarterly period and is payable on the 17th of the same month. Advance tax paid by corporations is credited against the annual corporation tax liability. The balance of the advance tax paid may be refunded or used to offset against other liabilities to the government. In accordance with the related regulation for prepaid taxes on income, such advance payments during the year are being deducted from the final tax liability for the year. Accordingly, the taxation charge on income is not equal to the final tax liability appearing on the balance sheet.

50% of the capital gains of corporations from sale of participation shares and property which have been in their assets at least for two years is exempt from corporate tax provided that this amount is kept in a special reserve account in the liabilities side of the balance sheet for 5 years.

In Turkey, there is no procedure for a final and definitive agreement on tax assessments, Tax authorities have the right to audit tax declarations and accounting records for 5 years and may issue re-assessment based on their findings for tax purposes.

Under the Turkish taxation system, tax losses can be carried forward to offset against future taxable income for up to 5 years, tax losses cannot be carried back to offset profits from previous periods.

Reconciliation between the theoretical tax amount that would arise using the basic tax rate of the Bank and the actual taxation charge for the year is stated below:

| | **31 December 2019** | **31 December 2018** |
|---|---:|---:|
| **Profit before income taxes** | **611,275** | **136,381** |
| Theoretical income tax of the applicable tax rate of 22% | (134,481) | (30,004) |
| Other tax charges | (7,768) | (13,332) |
| **Tax (expense)/income** | **(142,249)** | **(43,336)** |

**<u>Deferred income taxes</u>**

The deferred tax is calculated using the enacted tax rates that are valid as of the balance sheet date in accordance with the tax legislation in force. According to the Law, which was approved in the Grand National Assembly on 28 November 2017 and published in the Official Gazette dated 5 December 2017, the rate of Corporate Tax for the years 2018, 2019 and 2020 was increased from 20% to 22%. Therefore, deferred tax assets and liabilities are measured at the tax rate of 22% that are expected to apply to these periods when the assets are realised or the liability is settled, based on the Law that have been enacted. For the periods 2021 and after, the reversals of temporary differences are measured by 20%.

Deferred tax assets calculated as of 31 December 2019 amounting to TL 211,012 (31 December 2018: TL 247,398) was recognised in the financial statements. This assessment will be re-performed at each reporting period.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 18 - TAXATION (Continued)

The temporary differences giving rise to the deferred income tax assets and deferred income tax liabilities are as follows:

| | Temporary Differences | DTA/DTL | Temporary Differences | DTA/DTL |
|---|---|---|---|---|
| | 31 December 2019 | | 31 December 2018 | |
| Allowance for loan impairment | 952,032 | 190,406 | 911,591 | 182,318 |
| Unearned revenue | 56,747 | 12,486 | 60,314 | 13,269 |
| Bonus Provision | 74,385 | 16,365 | 59,886 | 13,173 |
| Carry-forward tax losses | - | - | 55,139 | 12,131 |
| Retirement benefit obligations | 57,901 | 11,992 | 54,775 | 11,341 |
| Restructuring Provisions | 4,114 | 905 | 49,459 | 10,881 |
| Litigation Provisions | 36,286 | 7,983 | 38,542 | 8,479 |
| Vacation pay liability | 9,917 | 2,182 | 8,653 | 1,904 |
| Accrued bonus point on credit cards | 4,058 | 893 | 4,623 | 1,017 |
| Other(*) | 101,480 | 20,296 | 65,477 | 14,405 |
| **Deferred tax assets** | | **263,508** | | **268,918** |
| Unrealized gains on derivative instruments | (156,670) | (31,171) | (60,032) | (13,089) |
| Difference between carrying value and tax base of property and equipment | (6,565) | (1,362) | (20,203) | (4,211) |
| Other(*) | (90,741) | (19,963) | (19,181) | (4,220) |
| **Deferred tax liabilities** | | **(52,496)** | | **(21,520)** |
| **Deferred tax assets, net** | | **211,012** | | **247,398** |

(*) Other mainly includes deferred tax effect of other provision, IFRS 16 leasing standard and unquoted share certificate.

The movements of deferred income taxes at 31 December 2019 and 31 December 2018 were as follows:

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| **Balance at 1 January** | **247,398** | **199,829** |
| Charge for the year, net | (35,983) | (32,525) |
| IFRS 9 transition impact | - | 73,537 |
| Tax assets/(liabilities) recognised in other comprehensive income | (403) | 6,557 |
| **Balance at 31 December** | **211,012** | **247,398** |

Income tax effects relating to components of other comprehensive income:

| | 31 December 2019 | | | 31 December 2018 | | |
|---|---|---|---|---|---|---|
| | Before tax amount | Tax (expense) benefit | Net-of-tax amount | Before tax amount | Tax (expense) benefit | Net-of-tax amount |
| Fair value changes of financial assets measured at fair value through OCI | 90,383 | (18,280) | 72,103 | (30,217) | 6,614 | (23,603) |
| Cash flow hedges | (2,559) | 563 | (1,996) | (2,831) | 568 | (2,263) |
| Actuarial gain/(loss) related to employee benefits | 4,638 | (966) | 3,672 | 3,124 | (625) | 2,499 |
| **Other comprehensive income for the year (net presentation)** | **92,462** | **(18,683)** | **73,779** | **(29,924)** | **6,557** | **(23,367)** |

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 19 - OTHER PROVISIONS

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Provision for outstanding legal cases | 35,716 | 32,467 |
| Provisions for refunds related to the applications to the Arbitration Committee | 961 | 6,370 |
| Provision for accumulated credit card bonus | 4,058 | 4,623 |
| Provision for refunds related to case document charges | 570 | 1,284 |
| Restructuring provision | 4,114 | 49,459 |
| Other (*) | 57,050 | 53,113 |
| **Total** | **102,469** | **147,316** |

(*) Contains provisions for non cash loans, accounting maintenance fee and other provisions as a part of IAS 37.

The table below shows the change in ECL allowances for non-cash loans.

| | 31 December 2019 | | | |
|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| ECL allowance as at January 1, 2019 | 8,111 | 9,537 | 6,307 | 23,955 |
| Transfer to Stage 1 | 428 | (428) | - | - |
| Transfer to Stage 2 | (313) | 313 | - | - |
| Transfer to Stage 3 | - | (243) | 243 | - |
| Impairment allowance for the period, net | 2,116 | 6,334 | (4,693) | 3,757 |
| **Total** | **10,342** | **15,513** | **1,857** | **27,712** |

| | 31 December 2018 | | | |
|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| ECL allowance as at January 1, 2019 | 7,031 | 2,056 | 9,298 | 18,385 |
| Transfer to Stage 1 | 85 | (85) | - | - |
| Transfer to Stage 2 | (123) | 123 | - | - |
| Transfer to Stage 3 | - | (7) | 7 | - |
| Impairment allowance for the period, net | 1,118 | 7,450 | (2,998) | 5,570 |
| **Total** | **8,111** | **9,537** | **6,307** | **23,955** |

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 20 - EMPLOYEE BENEFITS

The Group's obligations with respect to the employee benefits are as follows:

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Reserve for post-employment benefit obligations | 57,901 | 56,629 |
| Bonus provision | 74,385 | 66,051 |
| Provision for unused annual vacation | 9,917 | 8,952 |
| **Total** | **142,203** | **131,632** |

The movement in the reserve for employee benefits is as follows:

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| **Balance at 1 January** | **56,629** | **57,539** |
| Service cost | 4,170 | 8,675 |
| Interest cost | 7,805 | 5,805 |
| Paid during the year | (6,065) | (12,266) |
| Actuarial loss/(gain) | (4,638) | (3,124) |
| **Balance at 31 December** | **57,901** | **56,629** |

As of 31 December 2019 the Group has employee termination benefit provision amounting to TL 57,901 (31 December 2018: TL 56,629), and unused vacation provision amounting to TL 9,917 (31 December 2018: TL 8,952).

In accordance with existing Turkish Labour Law, the Group is required to make lump-sum termination indemnities to each employee who has completed one year of service with the Bank and whose employment is terminated due to retirement or for reasons other than resignation or as mentioned in related legislation.

The computation of the liability is based upon the retirement pay ceiling announced. The applicable ceiling amount as of 31 December 2019 is TL 6,379.86 (full TL) (31 December 2018: TL 5,434.42 (full TL)). Employee termination benefit liability is not legally dependent on any kind of funding, and there is no requirement on funding.

The reserve for employment termination benefits represents the present value of the estimated total liability for the future probable obligation of the Group determined by using certain actuarial assumptions. IAS 19 requires actuarial valuation methods to be used in order to calculate Bank's liabilities.

The assumption is that retirement pay ceiling is expected to increase as per the inflation rate every year. Thus discount rate applied shall represent real rate, net of inflation. Since retirement pay ceiling amount is determined once every six months, employee benefit liability of the Bank is calculated from the ceiling amount valid from 1 January 2019, TL 6,379.86 (full TL) (31 December 2018: TL 5,434.42 (full TL)).

Accordingly to the following financial and demographical actuarial assumptions were used in the calculations of the provision:

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Discount rates | 2.55% | 4.50% |
| Interest rates | 12.19% | 16.00% |
| Rate of salary increases | 9.40% | 12.40% |
| Rate of price inflation | 9.40% | 11.00% |

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 21 - OTHER LIABILITIES

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Payables from credit card transactions | 213,846 | 192,646 |
| Blocked Check | 204,297 | 5,564 |
| Administrative payable | 104,845 | 142,539 |
| Unearned income | 72,624 | 69,051 |
| Clearing accounts | 17,579 | 31,018 |
| Clearing checks | 34,290 | 53,244 |
| Saving deposits insurance fund payable | 13,296 | 8,060 |
| Import deposit and transfer orders | 1,049 | 3,074 |
| Collaterals for derivatives | 55,621 | 1,225 |
| Other (*) | 149,075 | 104,748 |
| **Total** | **866.522** | **611,169** |

(*) Other mainly consist of Miscellaneous tax payable and other items.

## NOTE 22 - SHARE CAPITAL

At 31 December 2019, the total statutory nominal value of authorised and paid-in share capital of the Bank is TL 652,290 (2018: TL 652,290) comprising 65,229,000,000 (2018: 65,229,000,000) registered shares of TL 0.01 each. At 31 December 2019 and 2018, inflation adjustment effect of share capital is TL 287,335.

Based on the approval of the Banking Regulation and Supervision Agency dated 21 June 2017, 10,01% share of HSBC Bank Plc.'s 100% ownership of the Bank's capital was transferred to HSBC Bank Middle East Limited and remaining 89,99% share of HSBC Bank Plc. was transferred to HSBC Middle East Holdings B.V. through share transfer agreement dated 29 June 2017.

The issued and fully paid-in share capital is as follows:

| | 31 December 2019 | |
|---|---|---|
| **Shareholders** | **Participation rate (%)** | **TL** |
| HSBC Middle East Holdings B.V. | 89.99 | 586,996 |
| HSBC Bank Middle East Limited | 10.01 | 65,294 |
| **Historical share capital** | **100** | **652,290** |
| Adjustment to share capital | | 287,335 |
| **Total share capital** | | **939,625** |

| | 31 December 2018 | |
|---|---|---|
| **Shareholders** | **Participation rate (%)** | **TL** |
| HSBC Middle East Holdings B.V. | 89.99 | 586,996 |
| HSBC Bank Middle East Limited | 10.01 | 65,294 |
| **Historical share capital** | **100** | **652,290** |
| Adjustment to share capital | | 287,335 |
| **Total share capital** | | **939,625** |

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 23 - RETAINED EARNINGS AND OTHER RESERVES

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Legal reserve | 199,555 | 197,074 |
| Revaluation reserve – investment securities | 25,968 | (46,135) |
| Hedging reserve | 664 | 2,660 |
| Actuarial loss related to employee benefits | (24,980) | (28,652) |
| **Total other reserves** | **201,207** | **124,947** |
| **Retained earnings** | **2,001,635** | **1,535,090** |

The hedging reserve includes the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet realized.

Movements in other reserves were as follows:

| 31 December 2019 | Legal reserves | Revaluation reserves | Hedging reserves | Actuarial loss related to employee benefits | Total |
|---|---|---|---|---|---|
| **At 1 January** | **197,074** | **(46,135)** | **2,660** | **(28,652)** | **124,947** |
| Net change in investments securities, net of tax | - | 72,103 | - | - | 72,103 |
| Gains on cash flow hedges | - | - | (1,996) | - | (1,996) |
| Transfer to statutory reserves | 2,481 | - | - | | 2,481 |
| Net change in the actuarial loss related to employee benefits | - | - | - | 3,672 | 3,672 |
| **At 31 December** | **199,555** | **25,968** | **664** | **(24,980)** | **201,207** |

| 31 December 2018 | Legal reserves | Revaluation reserves | Hedging reserves | Actuarial loss related to employee benefits | Total |
|---|---|---|---|---|---|
| **At 1 January** | **195,034** | **(16,189)** | **5,071** | **(31,166)** | **152,120** |
| Effects of changes in accounting policies | - | (5,846) | - | - | (5,846) |
| Net change in investments securities, net of tax | - | (23,470) | - | - | (23,470) |
| Gains on cash flow hedges | - | - | (2,411) | - | (2,411) |
| Transfer to statutory reserves | 2,040 | - | - | | 2,040 |
| Net change in the actuarial loss related to employee benefits | - | - | - | 2,514 | 2,514 |
| **At 31 December** | **197,074** | **(46,135)** | **2,660** | **(28,652)** | **124,947** |

Retained earnings as per the statutory financial statements other than legal reserves are available for distribution, subject to the legal reserve requirement referred to below.

Under the Turkish Commercial Code, the Group is required to create the following legal reserves from appropriation of earnings, which are available for distribution only in the event of liquidation or losses:

a) First legal reserve, appropriated at the rate of 5% of net income, until the total reserve is equal to 20% of issued and fully paid-in share capital.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 23 - RETAINED EARNINGS AND OTHER RESERVES (Continued)

b) Second legal reserve, appropriated at the rate of at least 10% of distribution in excess of 5% of issued and fully paid-in share capital, without limit. It may be used to absorb losses.

After deducting taxes and setting aside the legal reserves as discussed above, the remaining balance of net profit is available for distribution to shareholders. The legal reserves are restricted and are not available for distribution as dividends unless they exceed 50% of the share capital.

## NOTE 24 - NET INTEREST INCOME

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| **Interest income on:** | | |
| Loans and advances: | | |
| - to banks | 801,707 | 587,871 |
| - to customers | 2,248,044 | 2,284,578 |
| Trading securities | 62,356 | 17,406 |
| Investment securities | 86,543 | 83,683 |
| Reserve Deposits | 39,186 | 47,577 |
| Other | 14,932 | 6,477 |
| **Total interest income** | **3,252,768** | **3,027,592** |
| **Interest expense on:** | | |
| Deposits from customers | 1,417,969 | 1,233,776 |
| Other borrowed funds | 256,356 | 262,645 |
| Deposits from banks | 25,803 | 31,667 |
| Repurchase agreements | 16,390 | 14,050 |
| Interest on leasing (IFRS 16) | 18,991 | - |
| Other | 3,673 | 12,887 |
| **Total interest expense** | **1,739,182** | **1,555,025** |
| **Net interest income** | **1,513,586** | **1,472,567** |

## NOTE 25 - NET FEE AND COMMISSION INCOME

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| **Fee and commission income on:** | | |
| Credit Card Transactions | 252,204 | 242,082 |
| Insurance Commissions | 38,398 | 44,814 |
| Banking Transactions | 14,186 | 38,902 |
| Tefas Fund Platform | 45,218 | 33,509 |
| Non-cash loans | 63,612 | 36,969 |
| Other | 86,591 | 84,106 |
| **Total fee and commission income** | **500,209** | **480,382** |
| **Fee and commission expense on:** | | |
| Non-cash loans | 653 | 696 |
| Other | 41,836 | 40,640 |
| **Total fee and commission expense** | **42,489** | **41,336** |
| **Net fee and commission income** | **457,720** | **439,046** |

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 26 - NET TRADING INCOME

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Derivative financial transactions gains or losses,net | 268,429 | 2,014,624 |
| Foreign exchange gains and losses, net | (436,704) | (2,413,095) |
| Gain from capital market transactions | 78,568 | 7,311 |
| **Total** | **(89,707)** | **(391,160)** |

## NOTE 27 - OPERATING EXPENSES

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Wages and salaries | 297,936 | 261,558 |
| Discretionary bonuses | 61,921 | 63,852 |
| Social security costs | 44,247 | 39,660 |
| Post-retirement health care costs | 13,576 | 13,647 |
| Pension costs | 12,143 | 228 |
| Other | 74,024 | 80,793 |
| **Personnel expenses** | **503,847** | **459,738** |
| Depreciation on property and equipment (Note 13) | 29,712 | 22,891 |
| Depreciation on finance lease (Note 13) | 32,143 | - |
| Amortisation of intangible assets (Note 12) | 26,237 | 21,287 |
| **Depreciation and amortisation** | **88,092** | **44,178** |
| Operational Lease Expenses | 16,632 | 72,652 |
| Maintenance Licensing Expenses | 49,946 | 46,180 |
| Maintenance Expenses | 24,818 | 24,092 |
| Communication Expenses | 14,764 | 17,439 |
| Advertisement Expenses | 44,775 | 20,485 |
| Loss on Sales of Assets | 6,986 | 8,712 |
| Tax, Duties, Charges and Funds Expenses | 92,040 | 54,731 |
| Saving Deposit Insurance Fund Expenses | 42,164 | 32,075 |
| Audit & consultancy fees | 1,118 | 6,718 |
| Arbitration committee expenses | 892 | 18,524 |
| Other(*) | 339,646 | 268,302 |
| **Other operating expense** | **633,781** | **569,910** |
| **Total** | **1,225,720** | **1,073,826** |

(*) Amount of TL 339,646 (2018: 268,302) is closed under "Other", consists of audit fee amounting to TL 1.118 (2018: 6,718), arbitration committee expenses amounting to TL 892 (2018: 18,524) and remaining TL 337.636 (2018: 266,292) of other expenses

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 28 - NET IMPAIRMENT LOSSES

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Expected Credit Loan Losses | 123,182 | 403,295 |
| Stage 1 | (19,965) | 48,780 |
| Stage 2 | 101,426 | 374,777 |
| Stage 3 | 41,721 | (20,262) |
| Marketable Securities Impairment Expense | 2,286 | 197 |
| Financial Assets at Fair Value Through Profit or Loss | 2,178 | 153 |
| Financial Assets at Fair Value Through Other Comprehensive Income | 108 | 44 |
| **Total** | **125,468** | **403,492** |

## NOTE 29 - COMMITMENTS AND CONTINGENT LIABILITIES

In the normal course of its activities, the Group undertakes various commitments and incurs certain contingent liabilities. The following is a summary of significant commitments and contingent liabilities at 31 December 2019.

### Legal proceedings

Due to the nature of its business, the Group is involved in a number of claims and legal proceedings, which arose in the ordinary course of business. The Group recognises provisions for such matters when, based on the opinion of management and its professional advisors, it is probable that a payment will be made by the Group, and when the amount can be reasonably estimated. As of 31 December 2019, lawsuits filed against the Bank is amounting to TL 36,286 (31 December 2018: TL 35,687). A total provision of TL 35,716 (31 December 2018: TL 32,467) is booked for lawsuits with probability of resulting against the Group is higher than the probability of resulting in favour, where TL 570 (31 December 2018: TL 1,284) for refunds related to case document charges.

In respect to the further claims asserted against the Group, which according to the principles outlined above, have not been provided for, it is the opinion of management and its professional advisors that such claims are without merit, can be successfully defended or will not have a material adverse effect on the Group’s financial position.

### Credit related commitments

The primary purpose of these instruments is to ensure that funds are available to customers as, and if required. Guarantees and standby letters of credit, which represent irrevocable assurance that the Group will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans.

The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without having been funded.

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 29 - COMMITMENTS AND CONTINGENT LIABILITIES (Continued)

The outstanding credit related commitments of the Group are as follows

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Letter of guarantees | 2,867,210 | 1,843,634 |
| Letter of credits | 1,678,260 | 1,256,433 |
| Acceptance credits | 1,029 | 203,137 |
| Other commitments (*) | 218,927 | 354,958 |
| | **4,765,426** | **3,658,162** |
| Current | 4,597,314 | 3,004,580 |
| Non-current | 168,112 | 653,582 |

(*) Other commitments mainly consist of the guarantees given to the correspondent counterparties on behalf of customers.

As of 31 December 2019, commitments for unused credit limits for credit cards, overdrafts and cheques amounted to TL 3,805,695 (2018: TL 3,828,455) in total and were non-cancellable by the Group.

### Lease commitments

In accordance with the “TFRS 16 Lease” Standard effective as of January 1, 2019, the difference between operational lease and financial lease has disappeared, and lease transactions have started to be displayed under the “Liabilities from Leasing Transactions”.
.

Future minimum lease payments under non-cancellable operating leases are as follows:

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Commitments due within one year | 2,963 | 16,339 |
| Commitments due in period from 1 to 4 years | 75,872 | 7,169 |
| Commitments due after 4 years | 45,558 | 330 |
| | **124,393** | **23,838** |

### Offsetting financial assets and liabilities

| | Gross Carrying amount (before offsetting) | Gross Carrying amount in accordance with in the offsetting criteria | Net amount presented in statement of financial position | Effect of remaining rights of sett-off | | Net Exposure |
|---|---|---|---|---|---|---|
| | | | | Financial instruments | Fair value of financial collateral | |
| **Financial asset recognized at 31 December 2019** | | | | | | |
| Derivatives | 1,597,102 | - | 1,597,102 | 173,604 | 173,604 | 1,423,498 |
| **Total** | **1,597,102** | **-** | **1,597,102** | **173,604** | **173,604** | **1,423,498** |

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 29 - COMMITMENTS AND CONTINGENT LIABILITIES (Continued)

| | Gross Carrying amount (before offsetting) | Gross Carrying amount in accordance with in the offsetting criteria | Net amount presented in statement of financial position | Effect of remaining rights of sett-off | | Net Exposure |
|---|---|---|---|---|---|---|
| | | | | Financial instruments | Fair value of financial collateral | |
| **Financial liabilities recognized at 31 December 2019** | | | | | | |
| Derivatives | 1,440,432 | - | 1,440,432 | 53,634 | 53,634 | 1,386,798 |
| **Total** | **1,440,432** | **-** | **1,440,432** | **53,634** | **53,634** | **1,386,798** |

| | Gross Carrying amount (before offsetting) | Gross Carrying amount in accordance with in the offsetting criteria | Net amount presented in statement of financial position | Effect of remaining rights of sett-off | | Net Exposure |
|---|---|---|---|---|---|---|
| | | | | Financial instruments | Fair value of financial collateral | |
| **Financial asset recognized at 31 December 2018** | | | | | | |
| Derivatives | 1,001,127 | - | 1,001,127 | 339,159 | 339,159 | 661,968 |
| **Total** | **1,000,127** | **-** | **1,001,127** | **339,159** | **339,159** | **661,968** |

| | Gross Carrying amount (before offsetting) | Gross Carrying amount in accordance with in the offsetting criteria | Net amount presented in statement of financial position | Effect of remaining rights of sett-off | | Net Exposure |
|---|---|---|---|---|---|---|
| | | | | Financial instruments | Fair value of financial collateral | |
| **Financial liabilities recognized at 31 December 2019** | | | | | | |
| Derivatives | 941,094 | - | 941,094 | - | - | 941,094 |
| **Total** | **941,094** | **-** | **941,094** | **-** | **-** | **941,094** |

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 30 - SEGMENT ANALYSIS

Following management's approach of IFRS 8, operating segments are reported in accordance with the internal reporting provided to the Board of Directors of the Bank. The main segments are retail banking, wholesale banking, and treasury & capital markets.

In retail banking segment, the Bank provides debit cards, credit cards, deposits, consumer loans, payments and collection, premier customer services, custodian services, financial planning and insurance products services. In the wholesale banking segment, the Bank provides loans, commercial cards, foreign trade financing, structured trade financing, project and export financing, syndications, custodian services, and cash and risk management services. In treasury & capital markets banking segment, the Bank provides marketable securities transactions, gold and foreign exchange transactions, derivative transactions and money market transactions services to its customers. There were no changes in the basis of segmentation or in the basis of measurement of segment profit or loss.

The analysis is as follows:

| 31 December 2019 | Retail Banking | Wholesale Banking | Treasury & Capital Markets Banking | Other Operations | Total |
|---|---|---|---|---|---|
| Segment revenue | 498,407 | 935,783 | 547,062 | (18,789) | 1,962,463 |
| Segment expenses | (727,453) | (469,069) | (161,897) | 7,231 | (1,351,188) |
| **Profit/loss before tax** | **(229,046)** | **466,714** | **385,165** | **(11,558)** | **611,275** |
| Income tax expense | - | - | - | (142,249) | (142,249) |
| **Profit/loss for the year** | **(229,046)** | **466,714** | **385,165** | **(153,807)** | **469,026** |
| **Total segment assets** | **3,076,295** | **9,850,745** | **22,031,609** | **2** | **34,958,651** |
| Segment liabilities | 19,298,572 | 8,509,234 | 2,783,545 | 1,224,833 | 31,816,184 |
| Shareholder's Equity | - | - | - | 3,142,467 | 3,142,467 |
| **Total liabilities** | **19,298,572** | **8,509,234** | **2,783,545** | **4,367,300** | **34,958,651** |

| 31 December 2018 | Retail Banking | Wholesale Banking | Treasury & Capital Markets Banking | Other Operations | Total |
|---|---|---|---|---|---|
| Segment revenue | 585,178 | 675,455 | 353,066 | - | 1,613,699 |
| Segment expenses | (521,233) | (802,997) | (151,855) | (1,233) | (1,477,318) |
| **Profit before tax** | **63,945** | **(127,542)** | **201,211** | **(1,233)** | **136,381** |
| Income tax expense | - | - | - | (43,336) | (43,336) |
| **Profit for the year** | **63,945** | **(127,542)** | **201,211** | **(44,569)** | **93,045** |
| **Total segment assets** | **3,958,667** | **7,966,839** | **20,153,193** | **214** | **32,078,913** |
| Segment liabilities | 16,392,499 | 7,687,153 | 3,693,182 | 1,706,417 | 29,479,251 |
| Shareholder's Equity | - | - | - | 2,599,662 | 2,599,662 |
| **Total liabilities** | **16,392,499** | **7,687,153** | **3,693,182** | **4,306,079** | **32,078,913** |

(Amounts expressed in thousands of TL unless otherwise indicated.)

## NOTE 31 - RELATED PARTY TRANSACTIONS

During the course of the business, the Group has made placements with and granted loans to related parties and also received deposits from them at various terms. A number of transactions were entered into with related parties in the normal course of business.

(i) Balances with related parties:

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Loans and advances to banks | 6,679,006 | 8,303,545 |
| Derivative financial instruments | 589,502 | 219,266 |
| **Total assets** | **7,268,508** | **8,522,811** |
| Deposits from customers and banks | 153,983 | 168,321 |
| Other borrowed funds | 1,368,001 | 2,696,387 |
| Derivative financial instruments | 747,624 | 383,665 |
| **Total liabilities** | **2,269,608** | **3,248,373** |
| Derivative contracts (notional amounts) | 28,671,672 | 18,860,741 |
| Credit related commitments | 657,056 | 763,591 |
| **Total commitments and contingent liabilities** | **29,328,728** | **19,624,332** |

(ii) Transactions with related parties:

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Interest income | 125,451 | 74,048 |
| Interest expense on borrowings | (249,412) | (338,264) |
| **Net interest expense** | **(123,961)** | **(264,216)** |
| **Net trading gain/(loss)** | **71,800** | **1,871,160** |

(iii) Balances with directors and other key management personnel:

| | 31 December 2019 | 31 December 2018 |
|---|---|---|
| Deposits from customers | 24,029 | 13,244 |
| Interest expense on deposits from customers | 795 | 407 |

Salaries and other benefits paid to the Group's key management amount to TL 46,685 as of 31 December 2019 (2018: TL 28,971).

## NOTE 32 - ASSETS UNDER MANAGEMENT

At 31 December 2019, the Group manages 14 (2018: 13) mutual funds and 14 pension funds (2018: 34) which were established under Capital Markets Board Regulations. At 31 December 2019, the Funds' investment portfolio mainly includes government bonds, treasury bills and share certificates amounting to TL 10,018,192 (2018: TL 9,635,402). In accordance with the Funds' statute, the Group purchases and sells marketable securities for the Funds, markets their participation certificates and provides other services and charges yearly management fees ranging from 0.35% to 2.50%. At 31 December 2019, management fees earned by the Group amounted to TL 25,305 (2018: TL 18,553).

## NOTE 33 - SUBSEQUENT EVENTS

The recent outbreak of Coronavirus, a virus causing potentially deadly respiratory tract infections, may negatively affect economic conditions regionally as well as globally, disrupt operations situated in countries particularly exposed to the contagion. The ultimate severity of the Coronavirus outbreak is uncertain at this time and therefore the Group's key management have closely monitored the possible effect of this event on the financial statements.

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